

**The University of Hull**

**An Evaluation of the Effectiveness of Standard Form  
Contracts in Meeting the Expectations and Needs of Business  
Users**

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by

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## **Abstract**

It has long been recognised that business users pay limited attention to the content of the contracts they use and the process of forming and executing a contract. This is especially true of standard form contracts used across millions of business transactions daily.

Two particular topics that have been identified as potential areas of concern that have generated previous empirical studies are those of contract formation and use of contracts in resolving disputes.

The first of these is fundamental to achieving the framework for the transaction and agreement to the deliverable and the compensation, but is rarely seen to be a problem. The second of these should be one of the core reasons for entering a formal legal agreement, but business users prefer to use alternative means of resolving issues which they consider are more effective, quicker and more likely to retain business relationships. These issues are more relevant with standard form contracts, where there is no transaction specific detail and less effort exerted in concluding the formal legal requirements for either formation or resolution.

This work is intended to review these issues in relation to standard form contracts, in the UK building services industry in the current environment. To achieve this, new empirical work is undertaken in two areas. Firstly, a survey of the knowledge and views of a sample of contract users from different companies and different specialisms provides a picture of the opinions of business. Secondly a sample of standard form contracts from the same segment is reviewed to assess whether the contracts align with these views and how they deal with the key issues identified in the survey.

The results are evaluated against previous work on the subject and variances and consistencies identified with a view to understanding whether standard form contracts are effective and where not, what options are available. Ultimately, whether they satisfy a need for formal relationships and what is their relevance to business effectiveness.

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# 1. INTRODUCTION

## 1.1 Background

In 1963 Stewart Macaulay published a paper<sup>1</sup> which considered the way in which businesses used or didn't use contracts in their day to day trading. The first underlying message from the work was that "...*businessmen often fail to plan exchange relationships completely and seldom use legal sanctions to....settle disputes*"<sup>2</sup>. These are two key areas where the written contract should be aiding companies and the people within those companies, to manage their business and control their risks.

The first area, dealing with planning exchange relationships, concerns the communication and negotiation between the parties as they reach agreement on what is being purchased and for how much. This is the process of creating a formal (usually written) contract as a preliminary to any deal and should be completed prior to any work being carried out in order to control the sales process and ensure that the parties are clear of their obligations and the risks they are accepting.

[In this thesis, reference to contract will mean the written agreement between the parties, whereas the deal or transaction will be the broader aspects, from the sale to completion and payment.]

The second point covers the way in which any dispute is managed when matters do not go as planned. The conventional view is that the parties will revert to what the contract says and then the legal system when things go wrong and that the document will deal with most eventualities. However, the conclusion reached by Macaulay is that "*Transactions are planned and legal sanctions are used when the gains are thought to outweigh the costs*"<sup>3</sup>.

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<sup>1</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) Am Sociological Review 55

<sup>2</sup> Ibid, p55

<sup>3</sup> Ibid, p55

These points indicate that the business users sampled by Macaulay took a pragmatic commercial approach to the use of contracts rather than a dogmatic adherence to the legal principles. If this sample of engineering businesses in Wisconsin was representative of businesses elsewhere in the US and other geographic regions and of other business sectors, then it raises questions on the relevance of business contracts.

However, these conclusions also raise further questions about the use of contracts in an evolving and rapidly changing business environment and the aim of this thesis is to explore and test in more detail some of these issues. Recognising that any new work will most likely focus on a different sample in a different geographic area, potentially a different industry sector and at a different time, results are unlikely to be directly comparable, but in general it is hoped that conclusions can be reached on whether similar commercial approaches to the use of contracts are still prevalent.

Several years after the Macaulay study, similar research was carried out in the UK by Beale and Dugdale<sup>4</sup>. This work, whilst being geographically different to Macaulay and also investigating a slightly different industry sector, produced similar outline results in that it showed that “...*many of the general explanations of why contract law may or may not be used are the same as his*”<sup>5</sup>.

This second study also addressed the initial stages of the contract, by examining the degree of formal planning and the extent to which there was agreement on different aspects of the relationship. It identified a number of points which were considered important at this stage, including unwritten rules (from customs or trade), the cost of planning against risk, the need for trust in the relationship and the expectation of mutual fairness. However, it also

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<sup>4</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies', (1975), Brit. J.L. & Soc'y 45

<sup>5</sup> Ibid, p46

identified little concern over the clarity of the final agreement, noting that “...most firms seemed unconcerned about the failure to make a contract.”<sup>6</sup>

Although most companies used their own standard terms and made fitful efforts to protect this position, they recognised that it was most important to reach agreement on the significant issues if only the item and the price. In order to provide a more specific focus, this work will be directed predominantly at Standard Form Contracts (SFCs) and therefore at a more specific area and method of transacting.

Since these significant works much has changed over the intervening period and whilst it may be likely that the conclusions are still valid, it is of practical interest to understand how the approach to the use of contracts might have developed and whether there are any significant changes. In the 50 plus years since the Macaulay study, there have been political, technological, legal and industrial changes that have impacted on the way that businesses operate which could potentially affect how they use contracts.

For example, the progress of electronic communication means that the speed of information exchange has developed significantly and although this area will not be explored specifically, it may have had a knock on effect on traditional transactions. The expansion of financial services and the way that business deals with financial institutions has also grown noticeably which could possibly lead to the introduction of more sophisticated methods of managing risk.

Changes in the legal environment will routinely lead to changes to what might be included within standard terms and conditions as businesses react to case law or new statutes. For example Unfair Contract Terms Act 1977 (UCTA) limits the exclusions that may be incorporated. They may also wish to introduce new clauses driven by external factors like the concerns at the turn of the century and the impact of Y2K or more recently, the potential impact of the UK leaving the EU (Brexit) on costs of trading.

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<sup>6</sup> Ibid, p50

It is not possible to consider all of the factors that might be underlying causes of differences since the Macaulay study and therefore drawing any causal link would be inconclusive. However, if there are differences, then it will be of benefit to understand what they are and whether there are any fundamental changes that could improve the effectiveness of such contracts.

To explore these issues as they apply today it is intended to carry out new research in two distinct forms. Firstly, the views of a sample of business users will be collected using an anonymous survey, seeking their understanding and views on SFCs. Secondly, a review of a sample of SFCs will be conducted identifying common themes across the selection and assessing how they deal with key issues raised by the earlier studies and by the survey.

## **1.2 Standard Form Contracts in Business Transactions**

The two key studies both dealt with businesses and made no specific reference to dealing with consumers and this is a sensible starting point for further work. By directing the investigation at corporate bodies, there should be an expectation that they are efficient organisations and that they understand the various needs to be successful, including managing risks through the contract process.

The Consumer Rights Act 2015 (CRA) provides a suitable definition which can be used to define this underlying criterion:

*“Trader” means a person acting for purposes relating to that person’s trade, business, craft or profession, whether acting personally or through another person acting in the trader’s name or on the trader’s behalf.*

Using this definition ensures that the work does not consider consumers and hence that the parties are not subject to additional contractual protection provided by the CRA. The parties to the contract are however expected to have



read and understood the detail of the contract terms that they agree<sup>7</sup> and should therefore be considered to be intelligent and informed contract users.

Although limiting the area of interest to business users, this still leaves a large scope for different attitudes and approaches of differing commercial entities. The size of a business can vary from a small family firm providing local services up to a huge multinational corporation with diverse activities in geographically varied locations. Each of these will have its own objectives, culture and standards and these will be represented by the individuals which it employs and who carry out the daily business.

A number of factors will need to be considered when attempting to understand if there are any common aspects that dictate how businesses use contracts. These will include the size of the company (by turnover, number of employees, geographic coverage and range of products/services), the specific function of the business and the general industry in which it operates.

The size of the business will also be important in identifying the roles of individuals within it as larger organisations are likely to employ more specialists, possibly including in-house lawyers. As both Macaulay and Beale and Dugdale identified different views on contracts being held by differing organisational roles, this will be an area of interest.

The Macaulay study considered contracts in general when reaching its conclusions though frequently referred to SFCs and particularly *standardised planning* and *standard provisions*. This makes the distinction between the clauses that might be specific to any deal and the multiple other provisions that should apply regardless.

This study will be focussed on the use of SFCs as these contracts are used routinely to facilitate business and in most cases without any thought as to their effectiveness. Clarification is though necessary to define SFCs, as Lord

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<sup>7</sup> See *L'Estrange V. Graucob*, [1934] 2 K.B. 394, though subject to alternative defences of fraud, misrepresentation or *non est factum*, or subsequent breach of Unfair Contract Terms Act

Diplock pointed out<sup>8</sup>, they fall into two distinct categories which may be very different in their nature and fairness.

The first of these are those that have developed over many years and often within a specific industry to address the particular demands of that area of commerce. An example of this would be the Joint Contracts Tribunal (JCT) suite of contracts that are used frequently within the construction industry. These have been developed by different practitioners within the industry representing different roles and specialities and are therefore considered to be fair and reasonable to all parties.

Conversely, the other type of SFC are those that have been developed by one party and intended to provide a contract that is beneficial to that party. Although they may not be as one sided as Lord Diplock suggested they are likely to be prepared to ensure that the requirements of the drafting party are to the fore. It is these contracts that are of interest to this study as these are primarily the form of contracts that are subject to the UCTA (Section 3(1), being “...*the other’s written standard terms of business*”.

However, it should be noted that in some cases, the former type of SFC may be considered the latter, though what criteria need to be satisfied to reach this position is less clear. Longmore LJ provided some useful clarification on this point in *African Export-Import v Shebah*<sup>9</sup>. Starting with the requirement from *British Fermentation v Compair Reavell*<sup>10</sup>, the terms should be written, a term of business, part of the other party’s standard terms of business and the party is dealing on those written standard terms of business.

It is intended to assess what business users expect from their contracts and what they might need to ensure that they satisfy legal requirements. It will then evaluate how they work in practice for the two key areas of deviation identified by Macaulay, creating legal relations and resolving business disputes.

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<sup>8</sup> *Schroeder Music v Macaulay*, [1974] 1 W.L.R. 1316

<sup>9</sup> In *African Export-Import v Shebah*, [2017] EWCA Civ 845, Longmore LJ

<sup>10</sup> *British Fermentation Products Ltd v Compair Reavell Ltd*, [1999] All ER (D) 606

Although the main aim is to review whether the attitudes toward contracts revealed by the early empirical studies are still prevalent, an important part of this work will be to concentrate on the use of SFCs in business transactions. This requires further clarification to identify what is meant by SFCs, also often called 'boiler plate'. It also needs to be clear on limiting the area of interest to business transactions to avoid being drawn into consumer legislation<sup>11</sup> which presents a different set of challenges for the businesses using SFCs.

SFCs are commonplace across industry as they provide an essential tool in facilitating commerce, providing efficiency and speeding and smoothing the vagaries of business activity. The early part of the 19<sup>th</sup> century saw the industrial revolution introduce new economic theories<sup>12</sup> and established a need to avoid preparing a contract for each sale (see Chapter 2). SFCs provided a solution which fitted both with this and the increasing expectation that individuals were capable of making deals and committing to the terms agreed.

By focusing on SFCs, the study will introduce additional factors when considering the effectiveness of key clauses as a result of the UCTA<sup>13</sup>. Although, as will be described later, the general principle with business contracts derives from the age-old concept of "freedom of contract", under the Act the use of SFCs does introduce some level of protection and, in defined circumstances, the need for reasonableness (see chapter 5).

### **1.3 Business Expectations and Needs**

One of the key objectives of this thesis is to understand whether SFCs meet the needs and expectations of business users and to reach this end there are a number of steps to complete. Firstly it is important to define the terms "expectations" and "needs" so that they can be assimilated and assessed.

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<sup>11</sup> The Consumer Rights Act 2015 brought together a number of different areas of consumer protection, but specifically excludes business to business deals.

<sup>12</sup> See George Gluck, 'Standard Form Contracts: The Contract Theory Reconsidered', (1979), Int Comp Law Q, Vol28, 72-90 for a summary of how economic theory influenced contract.

<sup>13</sup> Unfair Contract Terms Act 1977 Section 3 (2)

Understanding what expectations business users may have of contracts introduces a wide range of variables, beginning with the definition of business users. The aim is to limit the area of interest to commercial organisations (variously referred to as *businesses*, *companies*, *organisations* and *commercial entities*) which use contracts, and particularly SFCs, as a fundamental part of their trading activity. Whether they are selling (or buying) goods or services, ultimately they are doing so to make profit for their owners, and their officers and owners are generally protected from financial risk by corporate limitation on liability.

Whether the individuals who routinely use contracts are familiar with and actually understand their contents, is an area to be explored. Organisations by their nature are made up of large numbers of individuals each bringing with them specific skills and knowledge and contributing to the combined strength of the entity. It is unlikely that they will all have the same interest in or enthusiasm for the content of the contract even if they are relying on the agreement routinely.

This variety of attitudes and views on contracts was highlighted by Macaulay<sup>14</sup> and will be a specific area to be investigated, primarily in respect of SFCs, in this study. Whether the results from the previous work are still maintained and different roles still have different perceptions on the use of contracts will need to be tested. This will review the views and knowledge of individuals fulfilling different functions within a business unit to assess whether it is the individual, the role or the business that is dominant in providing a common factor in attitudes to contract use.

As any research will be directed towards individuals and therefore soliciting their own views and ideas (using a suitable methodology), there is a recognition that the data will be based on perceptions of those in any sample. The limitations of this approach will be explained more in chapter 3, but any results

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<sup>14</sup> Further developed in his later work Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules', (2003), 66 Mod. L. Rev. 44

will generally be limited to subjective views of the users sampled. This should however be adequate to develop conclusions on the aggregated expectations of the group in general and sub-groups based on specified parameters.

This process to evaluate the expectations of the users might not necessarily identify what they need from contracts. There may not be a direct association between what they expect their will contracts provide to assist business and what they actually achieve through the words of the terms and conditions. The second part of this research therefore will be to assess how a sample of contracts might actually deal with some of the concerns of the users.

These concerns might be described as the “needs” of users, as derived from their broader objectives and expectations and general business objectives. It is expected therefore that the content of contracts will have been drafted based upon set business objectives which may be either strategic or operational in nature.

The first of these can be used to describe the clauses that provide protection against catastrophic failures (like limiting liability, force majeure etc.) which could cost a business millions of pounds. Although prudent companies will take out insurance policies to at least ensure that such events do not bankrupt the business, they may nevertheless have a severe financial implication. This can be through future insurance premiums, claims that are not covered by insurance or even the effect on the standing of the company in the business community and its reputation.

The second of these would include the key terms that ensure that the contract is both manageable and profitable and when referenced to SFCs, used for mass transactions, these need to be effective and efficient. The clauses that fall within this area will include for the seller, price and payment to ensure that the bargain is profitable and that payment is secured and timely. For the buyer, their requirements will be to ensure that the product or service satisfies their needs and that it is delivered in the right quantity, to the right place, at the right time and to the agreed quality.

By reviewing the actual content of contracts it should be possible to assess whether they address the concerns of the users and if so how they manage

this. From here it should also be possible to review whether there is a gap between the content of the contracts and the understanding of the users. Any inconsistency between the expectations and the reality may be because the individual users are misguided or that they are poorly informed. It may however be due to the need to deal with particular issues in a particular way to satisfy the constraints of the law or the higher level demands of the business and therefore outside the area of interest or knowledge of the daily users. If this is apparent, then it is unlikely the exact reason can be deduced and most likely will be a combination of several factors.

This review of the content of sample contracts will allow an assessment of how they deal with the specific requirements within the context of the legal system in which they operate. By identifying what the users see as important it is then intended to assess how they meet these needs.

This will be as part of a business process to make transactions simple and efficient, but also whether they provide an attractive proposition to potential customers (or suppliers). This latter aspect however will also be dependent on the opportunity for the customer to review, understand and then accept or negotiate the proposed terms. These factors will be examined as they are understood by the users and also as they may be subject to legislation<sup>15</sup>.

#### **1.4 Creating Exchange Relations and Resolving Disputes**

The Macaulay<sup>16</sup> work was the first obvious attempt to report on the way that contracts are used in practice as opposed to the theory of how they work under the law and was followed up in 1975 by a study in the UK by Beale and Dugdale.<sup>17</sup> This took a similar approach to the earlier work, but the research was in the UK and the industry sector was engineering manufacturing. From the title it is clear that it deals with the same basic areas as Macaulay, exploring

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<sup>15</sup> Unfair Contract Terms Act 1977

<sup>16</sup> Macaulay (n1)

<sup>17</sup> Beale and Dugdale, (n4)

the degree of planning during contract formation and then the issue of the contract to remedy any breach.

One of the features of the work of Macaulay is that, not only is it directed at the practical use of contracts, but it is written in a very practical style. Although published in a legal journal, it also approaches the subject from the perspective of management and business and this would make it more accessible for the business users it may be intended to inform. Although not intended to replicate this style, it is hoped that this thesis will provide practical and useful guidance for all with an interest.

The process of planning exchange relationships is the starting point for contractual relations and in addition to reaching a contractual agreement is the process of establishing this broader relationship that should become the foundation to a successful contract. Unfortunately, there are numerous challenges to reaching this position and most of the individuals actively involved in any contract relationship are likely to be from different technical disciplines and therefore may not be aware of the significance of the legal implications.

Although it may seem a minor point, Macaulay points out that these documents are commonly referred to as orders and not contracts. This demonstrates a mind-set whereby the sample he interrogated saw the document as a method of demonstrating a future financial benefit rather than a document detailing obligations and liabilities. An order is perceived as an instruction from one party to another, albeit with an associated price, whereas a contract is a two sided agreement.

If this is a common approach then it does indicate that individuals are more focussed on securing a written instruction that confirms a sale and profit than they are on ensuring that a contract is formed on mutually agreed terms. This is certainly likely to explain the position for the selling organisation and primarily sales professionals, but may be different for buying organisations. In most cases buyers can be more discriminating and may consider contract conditions as part of a broader purchasing evaluation.

Where both parties to a deal attempt to impose their own terms and conditions on the exchange then there is a possibility that there is no clarity of the final

agreement and this scenario is known as the *battle of the forms*. Where a seller is only intent on securing an order and pays no attention to the terms and conditions, then this battle of the forms may be seen as immaterial as the order received will commonly include the conditions of the buying party.

However, where both parties are engaged in the buying and selling process and the transaction is such that it is expected to be completed on standard terms and conditions, then there will often be uncertainty over the final agreement. This uncertainty is an area requiring clarification from the users on their aspirations and understanding of the concept and whether it is seen as a problem. Subsequently it can be reviewed in the context of how the contracts themselves deal with and try to prevent these issues as examined in chapter 5

The second major area of focus for the two studies (explored in chapter 6) was how the parties deal with disputes or failure by one party to meet its contractual obligations. Macaulay reviewed the topic of settling of disputes and concluded that many are settled without reference to the contract and additionally, that *“Law suits for breach of contract appear to be rare”*<sup>18</sup>.

Beale and Dugdale took this further and investigated four specific areas which were known to create issues under the agreement. Of these, one reviewed the issues that caused challenges to the selling party (payment and security) and two dealt with similar challenges to the buying party (delay in delivery and defects or failure to attain performance). The fourth dealt with issues of cancellation by either party. Acknowledging that these were dealt with to differing degrees, they concluded that there was generally inadequate provision even for common events in SFCs.

This therefore is a second area for more detailed investigation, again seeking the views and perceptions of contract users to understand if the use of contract for dispute resolution is still rare. It is also of interest to understand whether, if this is the case, it is because of the reluctance of the users to resort to the

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<sup>18</sup> Stewart Macaulay (n1), p61



contract and if so why. Alternatively is it because the contracts rarely address the breaches encountered.

Having solicited the views of users, these can then be evaluated against the contents of the sample of SFCs to understand whether the contracts are adequate and also whether they do in fact deal with the types of breach. Following on from this, a review of the options for resolving disputes will provide the context to assess whether the documents are adequate or whether they could be more effective in achieving the expectations of the users. This stage is not intended to develop into a detailed analysis of legal cases, but focus on resolution pre-litigation and various options from informal “give and take” at the front line to formal procedures under the pre action protocols.

Although not intended to be re-evaluation of the previous studies, by narrowing the focus to these two specific aspects, there will be the opportunity to assess any notable changes. Such changes however may not be a result of any specific factor and may be a natural evolution in the use of contracts. They should be able to be reviewed to reflect on whether SFCs do support the businesses and people that use them or whether there could be a more effective solution within or without standard contracts.

## **1.5 Objectives and Questions**

From the background discussed, it is apparent that contracts are not purely legal documents necessary to enable parties to work with each other as they also include important rules for the relationship. The process of reaching agreement can vary significantly and in many cases there is no clear recognition that reaching such agreement is necessary, hence the use of contracts may be largely peripheral to an exchange.

Contractual agreement can also in some cases be seen as an obstacle rather than a facilitator to effective business transactions. In many cases it is questionable whether the contracts create positive or negative impacts on dealing and relationships and how they are perceived by the users is therefore as significant as how effective they are in controlling risks.

Based on the issues raised in previous studies (outline above) the objectives of this work are:

1. Identify what business contract users understand about their contracts, including what they expect them to achieve, what is important and how they operate in practice.
2. Assess whether contracts actually meet these expectations through the way they are drafted and the provisions they include and whether they are able to deliver the outcome that the users hope within the constraints of the legal system in which they operate.
3. Examine whether user's expectations in relation to contract formation are justified and realistic and if and how contracts are formed in practice in the context of current case law.
4. Evaluate whether SFCs are able to meet the expectations of users in dealing with situations where things go wrong, whether the provisions agreed address the problems encountered and when they don't how such issues are resolved.
5. Review whether there are any clear differences from previous studies, albeit that they will have differing parameters including geography, industry and type of contract.

These objectives are intended to provide a broad assessment of whether SFCs are effective in business and whether they do facilitate the commercial transaction or whether they are a hindrance. This aspect is particularly important when considering the cost and effort required to establish a contractual relationship when compared to the benefit it may bring over the longer term (see chapter 3).

Focussing on SFCs limits the area for research as they are most often used for multiple, lower value transactions. However, these forms should represent a well-developed statement of a company's objectives and therefore a mature reflection of the optimum business position.

Although lower value contracts would seem to present lower expectations from business users and therefore less expectation from the contract, this can be misleading if the lower value of individual contracts are part of an important long term and multi contract relationship.

## **1.6 Summary**

This thesis has been prompted by almost 30 years of personal experience of contracts being used in commercial environments and seeing that their importance in routine commerce varies significantly. Having then encountered the work of Macaulay and subsequently Beale and Dugdale, it was clear that there is a subject worthy of further and more current examination. The general aim is to understand whether these previous works are still valid but also to find out whether there are specific areas which present specific points of interest and additional conclusions.

From the work of Macaulay, the two prime areas of focus were the creation of the contractual relationship and the subsequent settling of disputes and these two areas were explored further by Beale and Dugdale. It is therefore these two topics that will form the basis of this work.

From the starting point of these previous works which provide a high degree of correlation in spite of being separated by 10 years and across two continents, the first aim is to understand what they concluded and assess any further work relevant to the subject. This review is included in chapter 2.

These conclusions will form the basis of further new investigation into the views and perceptions of current users. Gathering new data for analysis will enable specific issues to be addressed based on the particular areas highlighted by the previous work.

The samples used in previous studies have necessarily been limited and subject to selection by prevailing circumstances. This will be the case for any new work and any selection of participants will be driven by availability thus indicating that there is unlikely to be a clear comparison with existing data. Whilst this may be seen as a limitation on any new work, the results are likely to provide useful information with relevance to a broader business environment.

The work will be directed at business users with a specific focus on standard terms and conditions of business. Whilst the first of these two criteria will align with previous studies and ensure that there are no direct issues raised by consumer protection legislation, the second introduces an additional factor. The previous work make reference to Standard Terms of business as part of a

broader review and focussing on this area will most likely limit the type of transactions that are included whilst allowing an additional level of focus. Chapters 3 and 4 will address the methodology used for gathering the empirical data and then the detailed analysis of the survey results collected.

In addition to this, by reviewing sample SFCs from the same broad business area of the users, it should be possible to compare the actual content to the perception of the users. This assessment with analysis of how the clauses deal with the key areas of concern identified by the users is included in chapter 5.

In order to complete the work, it was originally considered necessary to examine in more detail the two specific areas identified by Macaulay: '*Creating Exchange Relations and Resolving Disputes*'<sup>19</sup>. These two topics are assessed within chapters 3, 4 and 5 based on the empirical work from the sample of business users and the findings from the content of the contracts. As will be seen however, the issues around contract formation are not seen to be significant and as explained in chapter 4 do not merit further examination.

The issues around resolving disputes are however an important factor in the use and no-use of contracts and this area is therefore developed further in chapter 6. This will provide more information on what happens when things do not proceed as expected and whether the practical steps taken by the users are supported by the document and match the expectations of the legal system.

These steps should present a current appreciation of how individuals involved in business transactions manage their deals using SFCs at key points in the contracting cycle and whether the documents themselves actually facilitate the exchanges.

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<sup>19</sup> Stewart Macaulay (n1)

## **2. REVIEW OF THEORIES OF CONTRACT WHICH EXAMINE THE USE OF CONTRACTS IN PRACTICE**

### **2.1 Introduction**

*“Most legal scholarship produced today is either theoretical and normative in nature, or, to a lesser extent, doctrinal and descriptive. Both forms of scholarship, while very important to legal education and our legal culture, have contributed to the gap between the legal academy and the profession by failing to focus on the societal effect of particular legal mechanisms.”<sup>1</sup>*

This observation summarises much of the original motivation behind this thesis, though the view may be developed to identify a further gap, between the legal academy, the profession and society in general. Specifically in the field of contract law, the area of society under consideration would be the businesses that routinely use, and in some cases rely on, contracts.

The objective of this thesis is to understand how businesses transact routinely and it has been developed based initially and primarily on the work of Stuart Macaulay<sup>2</sup>. This most notable piece from 1963 initiated a new way of looking at how contracts work in practice and developed on a history of socio legal research dating back to the work of Weber<sup>3</sup> and Durkheim<sup>4</sup>. From these earliest theorists in sociology and development of the area of legal sociology, the interaction between the law and society has been a fertile area for theorising. This work is not intended to consider sociological theories in any detail other than to acknowledge that such works have formed the basis of developing

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<sup>1</sup> Craig Nard, Empirical Legal Scholarship – Re-establishing A Dialogue Between The Academy And Profession, 30 Wake Forest L. Rev. 347 1995, p349

<sup>2</sup> Stewart Macaulay, ' Non Contractual Relations in Business: A Preliminary Study', (1963), Am Sociological Review 55

<sup>3</sup> See: Hunt A, ' Max Weber's Sociology of Law. In: The Sociological Movement in Law', (Palgrave Macmillan, Ch 5, 1978) for a summary of his role in the movement.

<sup>4</sup> Roger Cotterrell, 'The Durkheimian Tradition in the Sociology of Law', (1991), Law & Society Review, Vol 25, No 4 provides a good introduction to the subject.

empirical research. In the context of this thesis, this considers how contracts are used in practice by most businesses many times daily.

The aim of this chapter is to review previous work that addresses the key aspects under investigation in this thesis. This starting point for this is the Macaulay study, followed by work inspired by Macaulay and focussing on the main areas of focus for this thesis.

Socio-legal studies places the law in the context of other dimensions of society<sup>5</sup>. Using this definition, is then a reasonable extension to this scope to recognise business as another social context. There are many different ways to approach the subject of standard form contracts in business even from a socio-legal perspective. Smith and King<sup>6</sup> wrote on the practical use of contracts in an attempt to consider contracts as features of organisations rather than as instruments in a mature legal system. Recognising the ultimate benefits to business and thence to society they claimed:

*“Among the expected benefits of studying contracts more closely is that we will have a better understanding of the context in which contracts are negotiated, maintained, adapted, and enforced.”*<sup>7</sup>

This provides a broad appreciation of economic, sociological and organisational theories of contract distinct from doctrinal legal studies and theoretical doctrinal analysis of legal rules<sup>8</sup>. They suggest that empirical studies into the use of contract are rare apart from those which developed from economic theory. They recognise a need for such studies and so they offer four fundamental

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<sup>5</sup> S. Wheeler and P.A. Thomas, 'Socio-Legal Studies' in D. Hayton (ed.) *Law's Futures*, Oxford, Hart Publishing, 2000, 271.

<sup>6</sup> D. Gordon Smith & Brayden G. King, 'Contracts as Organizations', (2009), *Arizona Law Review*, Vol. 51, No. 1

<sup>7</sup> *Ibid*, p3

<sup>8</sup> Paul Chynoweth, 'Legal Research' in Knight, A. and Ruddock, L., *Advanced Research Methods in the Built Environment*, Wiley-Blackwell, October 2008, p29

organisational theories to use as a basis for such work (resource theory, learning theory, identity theory, and institutional theory).

This is relevant as an introduction which attempts to understand key aspects of contracting behaviour through the life cycle of the contract from formation, to delivery and development (changes) and ultimately enforcement. One of the key points that is made is that there is little enthusiasm for research into “*spot contract(s), where the most important variables are quantity, quality, and price*”<sup>9</sup>. These were not considered to be subject to relational theory which explores the context of the transaction and by its nature the relationship between the parties, though as will be shown later, Macneil later considered even these to be relational in a broader context of society<sup>10</sup>.

This may be the case in many such deals but as a result of this approach there has equally been limited work in understanding standard form contracts and the content of such documents. As standard form contracts are often associated with low value, low risk and frequent transactions, they are also often linked to consumer sales. There is however a “*spectrum ranging from highly discrete to highly relational*”,<sup>11</sup> with most interest being focussed on the relational end as these offer more interesting information and more material for analysis.

To investigate how the ideas of Macaulay are relevant in the 21<sup>st</sup> century and in a different industry and location must start with a deeper analysis of the original core work<sup>12</sup>. This forms the basis of a volume of additional papers by Macaulay which refer back to this investigation and develop the ideas, most

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<sup>9</sup> D. Gordon Smith & Brayden G. King, 'Contracts as Organizations', (2009), Arizona Law Review, Vol. 51, No. 1, p3

<sup>10</sup> Ian R. Macneil, 'Relational Contract What We Do And Do Not Know', (1985), Wis. L. Rev. 526 1985

<sup>11</sup> Ian R. Macneil, 'Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos' (1987) Journal of Institutional and Theoretical Economics, Vol. 143, No. 2, p. 275

<sup>12</sup> Stewart Macaulay (n2)

notably in the area of disputes and dispute resolution without engaging in the legal systems.

The work of Macaulay formed the basis for other similar work, primarily in the US, but also in the UK with Beale and Dugdale developing similar conclusions from their work in a different country and a different industry. This therefore also bears more analysis to understand both how they derived their conclusions and the specific areas of the investigation. From these two pieces, the further work in the field has tended to become narrower as the need to understand contracts in practice has driven the need to derive more detail.

Various studies of interest have looked at these detailed areas including contract formation and tendering practices<sup>13</sup>. Additionally, the work of Lisa Bernstein <sup>14</sup>has brought more illumination to the issues around the relationships of the parties, albeit that these relate to specific industries and tend to be associated with deeper historical and cultural norms. They do however provide insight and evidence that non-contractual issues are generally more important when matters do not follow the desired route than legal sanctions and reference to the agreement. More recently two specific areas of work have developed with the theories of Richman<sup>15</sup> and the area of boiler plate.

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<sup>13</sup> Daniel Keating, 'Exploring the Battle of the Forms in Action' (2000) Michigan Law Review Vol. 98, No. 8 & R. Lewis, 'Contracts between businessmen: Reform of the law of firm offers and an empirical study of tendering practices in the building ' (1982) 9 Journal of Law and Society 153-73

<sup>14</sup> Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions' (2001) 99 Michigan L R 1724-1790.

<sup>15</sup> Barak D. Richman, ' Stateless Commerce: The Diamond Network and the Persistence of Relational Exchange', (Harvard University Press 2017) & Mitu Gulati & Robert E Scott, ' The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design', (The University of Chicago Press 2013)



These non-legal aspects of contracts form the basis for Ian Macneil and his relational theory of contract which, although accepted as lacking in empirical rigour<sup>16</sup>, do provide structure and explanation for the recorded phenomena.

To provide further context for an analysis of contracting in practice, it is helpful to view the subject from different areas of interest. As the contract is an integral part of business activity, and as this thesis is intended to evaluate effectiveness in a business context, then it is necessary to consider contract theory from these angles, including the purely economic perspective.

The importance of contracts to economics has been able demonstrated by the award of a Nobel Prize to Oliver Hart and Bengt Holmström “*for their contributions to contract theory*”<sup>17</sup>. This work on contracts incorporates a wide range of contract types which are not relevant to this thesis, including employment contracts and insurance contracts, though some of the principles of risk and incentives are generally applicable.

It is not intended that this analysis will include any significant reference to the economic theories of contract, but in view of the importance of such theories to the use of contracts and in order to appreciate any relevance as it may appear, a brief summary is essential. The development of economic theory of contract has taken a firm grip of empirical studies, primarily because of the natural expectations of the economics world to see data in support of theories.

This chapter therefore examines the work of Macaulay in more detail and then explores subsequent similar research into contracting behaviours which generally refer to the core findings. In order to provide the more theoretical assessment of the subject, it then considers the ideas of Macneil and how these developed in parallel, though without the benefit of supporting empirical research. To complete the background picture, it reviews other aspects of

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<sup>16</sup> D. Gordon Smith & Brayden G. King, 'Contracts as Organizations', (2009), Arizona Law Review, Vol. 51, No. 1, p11

<sup>17</sup> The Royal Swedish Academy of Sciences Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2016

research into contracts from different perspectives both practical and theoretical.

## **2.2 The Macaulay Study**

### **2.2.1 Overview**

The classic legal study into the use of contracts in business was conducted by Macaulay<sup>18</sup> in 1963 and in many respects this is still the most significant study still referred to 50 years later. Until the 1980s there was little work in the area<sup>19</sup> which is an interesting feature in itself. The opening statement of Macaulay's paper perhaps helps to explain this shortage by pointing out that to fully understand the topic would require investigation into "*...every type of transaction between individuals and organisations*"<sup>20</sup>.

Any research can only be carried out on a small sample and therefore application of any findings will be limited to a small segment of the overall population. In the case of Macaulay, he limited the field initially to businesses, thus excluding any consumer contract matters and then to a small market sector (manufacturing). The sample was further limited to a contained geographical area by drawing the boundary around Wisconsin.

In order to provide a broader cross section of views and approaches, the study did include a variety of individuals from different functional roles and levels within the organisations and it is this analysis that can provide useful illumination on the way organisations operate.

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<sup>18</sup> Stewart Macaulay, (n2)

<sup>19</sup> See Rex Ahdar, ' Contract Doctrine, Predictability and the Nebulous Exception', (2014), C.L.J., 73(1), 39-60, who bemoans a lack of empirical work to confirm whether businesses desire certainty in contractual outcomes and Craig Nard, ' Empirical Legal Scholarship – Re-establishing A Dialogue Between The Academy And Profession', (1995), 30 Wake Forest L. Rev. 347

<sup>20</sup> Stewart Macaulay, (n2)

The paper itself breaks the research into two by initially reviewing the '*creation of exchange relationships*'<sup>21</sup> and then assessing '*the adjustment of exchange relationships and the settling of disputes*'<sup>22</sup>. The output of the work has been analysed a number of times since with differing views on the key points, but they are concisely summarised by Scott<sup>23</sup>. He identified six key points, the first of which summarised that most firms try to plan carefully and focuses on the start of the contract process. The remaining five points all related to practical resolution of disputes and avoiding litigation and therefore fall into the second category.

### **2.2.2 Planning**

The findings in the first part of Macaulay's<sup>24</sup> paper suggest that little time and effort is exerted in developing these agreements and there is a common theme that at the top end of the scale in long term and/or high value contracts there is a higher level of planning, but that this tends to be around the product and deliverable aspects of the transaction to ensure that the customer gets what they want. The elements of planning identified by Macaulay<sup>25</sup> were:

- a) The obligations of the parties
- b) What factors might impact on those obligations
- c) The effect of one party failing to meet its obligations
- d) The legal consequences of such a failure to perform

The findings reached were that there was a high level of planning in the first of these matters which significantly reduced as they reached the latter. The level

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<sup>21</sup> Ibid 56

<sup>22</sup> Ibid p60

<sup>23</sup> Robert E Scott, The Promise and the Peril of Relational Contract Theory in Jean Braucher, John Kidwell & William Whitford, 'Revisiting the Contracts Scholarship of Stewart Macaulay', (Hart Publishing 2013)

<sup>24</sup> Stewart Macaulay, (n2)

<sup>25</sup> Ibid p57

of involvement of legal or commercial personnel generally reflected this approach with a tendency to avoid their involvement where possible.

The second group of contracts where the business was lower value and arguably therefore lower risk, tended to be carried out on an organisation's standard forms. In theory this should therefore present a clear and structured agreement understood by both parties. Unfortunately, the evidence indicates that there was rarely any certainty by the individual involved over what set of terms had been agreed (if any) and therefore if there was still any contractual risk. Whilst familiar with the concept of the 'battle of the forms', the individuals appeared to pay little interest on the effect this might have on their particular business.

### **2.2.3 Adjustment**

The second part of the Macaulay study<sup>26</sup> proceeded to investigate what happens in these business deals when one party fails to meet its obligations or there is some breakdown in relationship which results in a dispute. Having identified a shortage of legal involvement in the contract formation stage, it then seems that there is likely to be even less involvement in the resolution or development stage. The key issue here is that the contract and the relationship are fully interdependent and that they are not managed by lawyers.

The individual within the organisation who is responsible for the contract will be the person who deals regularly with the other party and hence will have the most interest in resolving the matter amicably (this point was addressed in more detail in later work by Macaulay<sup>27</sup>). The result is that they will only bring in legal support to help resolve any disputes when they have exhausted all other avenues and it is likely that the relationship has broken down at least partially if not irreconcilably. The paper supports this primary finding with more general contemporary data on litigation within the United States showing that there was

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<sup>26</sup> Ibid p60-62

<sup>27</sup> Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules', (2003), 66 Mod. L. Rev. 44

a surprisingly low level of civil cases handled by the courts which involved business contracts.

#### **2.2.4 Why Contracts**

Having demonstrated that the creation of contracts and their use in managing business transactions was limited, Macaulay then goes on to discuss why this might be the case and what greater features are there which dictate this finding. In assessing '*Why are relatively non-contractual practices so common*'<sup>28</sup>, he identifies two key features of business behaviour which militate against legal sanctions<sup>29</sup>.

- a) Commitments are to be honoured in almost all situations
- b) Companies are expected to produce a good product and stand behind it.

These both drive businesses down the route to a non-confrontational approach to business as they do not wish to be seen as poor producers and they need to be able to maintain strong and positive business relationships with their trading partners. Not only do they not wish to be reverting to 'the contract' at the slightest hint of a disagreement, but even at the planning and contract formation stage, they do not wish to be seen as a company that tries to nail down every eventuality in the legal agreement as this will be seen as a precursor to how they might operate later during the delivery of the contract.

This then leads to the reasonable question as to 'why such relatively contractual practices ever exist'. Macaulay identifies a number of possible justifications for using contracts, particularly in business where the complexities of the deal may automatically generate potential for failure or where the agreement itself may be used as a planning and management tool to assist delivery. Interestingly however, he indicates that the decision on the level of planning and contractual agreement necessary is often the decision of an individual and this decision

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<sup>28</sup> Stewart Macaulay (n2), p62

<sup>29</sup> Ibid p63

may depend on the person's role and responsibility in the organisation and also on the organisations themselves and how they perceive the use of contracts.

The study sheds light on some important principles in how and why organisations use contracts both as internal tools and more traditionally for sorting out problems, but has to limit its validity due to the narrow nature of the research sample. Although it may be that the findings do ring true in other business segments and in other geographic locations and at different times, the exact behaviour of any alternative sample may differ.

### **2.2.5 Subsequent Macaulay**

Macaulay was particularly prolific in the 1960s, but continued to develop his theories producing a number of relevant papers dealing with social interaction with the law and often the use of contracts in practice. These have tended to focus more on how contracts are used in disputes as he explored the inherent desire of people and organisations to “...*avoid, suppress and resolve disputes little influenced by academic contract law*”<sup>30</sup>. The continuing insistence that contracts are not at the heart of business and that the profession was possibly missing key features of the contracting process.

Macaulay's 2003 paper<sup>31</sup>, brought many of these ideas together and distinguishes between the literal interpretation of the words of the contract and the intentions of the parties in carrying out their business. In addition to advocating that the words of the contract will rarely encompass every understanding of the relationship between the parties, he also challenged the strict doctrinal view of law as independent and objective.

These themes are further illustrated in two subsequent papers, one dealing specifically with breach and what remedies the parties might actually expect<sup>32</sup>.

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<sup>30</sup> Stewart Macaulay, 'An Empirical View of Contract', (1985), 1985 Wis. L. Rev. 465

<sup>31</sup> Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules', (2003), 66 Mod. L. Rev. 44

<sup>32</sup> Stewart Macaulay, 'Renegotiations And Settlements: Dr. Pangloss's Notes On The Margins Of David Campbell's Papers', (2007), 29 Cardozo L. Rev. 261 2007-2008

The second again reverting to his preferred subject of the non-use of contracts when matters depart from the party's original expectations<sup>33</sup>. Far from being a negative, this is seen as positive as mature organisations take pragmatic views of relationships both with each other and their standing with third parties and at the same time save in expensive legal costs.

## **2.3 Post Macaulay**

### **2.3.1 Beale and Dugdale**

Whilst there may have been similar studies in the practical application of contract in business prior to Macaulay, it seems that this work in the early sixties had a resonance with the time and is therefore seen as a landmark work. In the UK, it was in the 70s that Beale and Dugdale<sup>34</sup> undertook similar research and provided support for the Macaulay theory.

Beale and Dugdale explicitly built on the work of Macaulay but with a specific focus on a limited number of issues. They were keen to look at the planning aspects of the contract and the resolution of disputes and derived this through concentrating on formation issues and then four further areas:

- a) Payment and Security (p51)
- b) Cancellation for reasons other than breach (p52)
- c) Delay (p53)
- d) Defects (p56)

This cross section of important functions of a contract was intended to provide a suitable summary of the effectiveness of the contracts as a whole. Taking a similar approach to Macaulay, they limited the sample to a specific industry (engineering) and a specific geographic area (Bristol) to try to generate a more concentrated and therefore representative sample, though this will necessarily limit the transferability of any findings.

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<sup>33</sup> Stewart Macaulay, 'Freedom From Contract: Solutions In Search Of A Problem?', (2004), 2004 Wis. L. Rev. 777

<sup>34</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y 45

The technique utilised was similar to Macaulay, employing interviews of a smaller sample, 33 individuals from 19 businesses and attempted to collect views from different sides of the contract with selling and purchasing represented as well as specialist legal and senior personnel within the organisations concerned. The paper produced makes frequent reference to Macaulay further establishing the earlier work as a landmark in its field.

The initial points made dealt with the apparent lack of formal planning and identified a couple of contributory factors. Firstly, it was felt that there was a high level of industry norm and implicit understanding which removed the necessity of incorporating such express terms in a formal document. Secondly, they confirmed the earlier view that there was a trade-off between the cost of preparing a comprehensive and detailed contract and the benefits to be gained where the risk of requiring more detailed provisions was seen a low<sup>35</sup>. This was further reduced by the recognition that litigation was extremely rare and all parties considered they were there to succeed and would work around difficulties in a spirit of partnership, a fact that was reinforced by the data relating to disputes requiring legal sanctions.

The matters governing the formation of the contract were shown to take a predicted form as the value and the risk assessed for any transaction defined the level of planning and hence whether standard forms contracts were employed. Even when they were, the deal specific information tended to be clearly defined even if there was less clarity about which set of standard terms the contract was actually formed under.

The four areas of further interest produced more useful information on the contracting behaviour of the businesses involved and demonstrated a number of points of interest on conduct within a defined market sector. It also highlighted the possible suspicion towards lesser known business partners, whether from a different industry or different geography. This came through notably in the analysis of the payments and security data though this may also have been influenced by the timing of the survey which was completed in the

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<sup>35</sup> Ibid p 47



mid 70s during a period of recession. There would have been a keener focus on cashflow and hence more emphasis on the liquidity of the customer (and the supplier) and more energy exerted to reduce the risk of bad debts.

This approach to contract development contributes to the general conclusion that contractual remedies were to be avoided as being inflexible and contrary to good business practice, the latter of these being seen as essential to success and developing ongoing and prosperous business relationships. By establishing clearer contractual terms dealing with the specific issue of concern (payment) then there is less need for contractual remedies for failure to comply. This is an example of how their work had taken Macaulay further in that it identified the ways in which lawyers could add value by refining the contract to cover areas of risk which would otherwise result in conflicts and disputes if they went wrong.

### **2.3.2 Subsequent Studies in Contract**

A later work was carried out by Weintraub<sup>36</sup> in the US into contracting practices in relation to a small number of specific issues. Again this is a useful piece as it provides plentiful detail on the methodology including a copy of the actual questionnaire sent out. The questionnaire was sent to 182 corporations and the paper includes the summary results from the various questions to allow the reader to interpret themselves. As with many of these studies, much reference is made to Macaulay, but this work includes a large element explaining the need for empirical data and also the difficulties and limitations of such techniques.

The research was directed largely at in house legal counsel and addressed a small menu of contract practices, looking at the use of contracts for long term business and mechanisms for dealing with changes in market prices in such transactions. It then explored how the businesses dealt with changes in market conditions that hadn't been covered and whether these were effective. These points were concluded with an assessment of the views of the parties on non-

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<sup>36</sup> Russell J. Weintraub, 'A Survey of Contract Practice and Policy' (1992) Wis. L. Rev. 1 1992

legal sanctions and whether the view of the legal community differed from that of other senior executives. The questions were fairly narrow and detailed in the explanation of what was wanted thus limiting the potential for misinterpretation though required a level of technical knowledge in order to respond.

The findings followed the usual route of shunning the formal options to litigation with a strong tendency for businesses to exercise non-legal resolution through '*accommodation and compromise*'. The requirement would be for simple and predictable contracts that allow merchants to '*...efficiently plan their transaction, price their goods and services and, when something goes awry, settle the dispute*'.<sup>37</sup>

Taking Macaulay to the next stage seems to have been a challenge due to the fragmented nature of the subject area and hence one option is to focus much more specifically on a limited market segment and a small window within this segment. This is the approach taken by Richard Lewis<sup>38</sup> as he concentrates his study purely on tendering practices in the building industry.

Lewis carried out his work in 1982 in order to provide input into a Law Commission Review into a fairly small and select area of law. The work was primarily targeted at the use of firm offers and the degree of commitment by the tenderer and expectation or reliance on that offer by the receiver. In sampling the activity of sub-contractors in the building industry, he investigated a number of businesses operating in the field in South Wales.

As part of a process where the Law Commission was intent on seeking inputs from outside its traditional sources and to "*evolve a standard procedure for harnessing social sciences to law reform*"<sup>39</sup>. It was hoped that it would be more representative of business views and therefore present a more comprehensive and workable system that would aid business. Ultimately he concluded that

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<sup>37</sup> Ibid p53

<sup>38</sup> R. Lewis, 'Contracts between businessmen: Reform of the law of firm offers and an empirical study of tendering practices in the building ' (1982) 9 Journal of Law and Society 153-73

<sup>39</sup> Ibid p158

formal solutions would not necessarily assist as informal systems were already applying a level of self-control<sup>40</sup>.

It was carried out by use of a detailed questionnaire sent to a selection of Main Contractors (20) and Sub Contractors (20) and resulted in a response of 50% reasonably well split between the two to provide a relatively good sample from which to deduce conclusions that could be applied to the whole of the population (albeit that the population was geographically limited).

The importance of the Macaulay<sup>41</sup> study continued to be emphasised into the 1990s, notably by an attempt to revisit the original work by Esser<sup>42</sup>. In order to assess how the world of contract had evolved during the 30 years since Macaulay questioned the businesses of Wisconsin, he looked to replicate the sample by questioning a similar size and cross section of business users in 1990s Wisconsin. The questions were necessarily slightly different but the prime objective was to try to confirm whether the same approach was prevalent. The two key principles being examined were “...*Rational planning of the transaction with careful provision for as many future contingencies as can be foreseen*” and “...*the existence or use of actual or potential legal sanctions*”<sup>43</sup>.

The indication from most of the respondents was that contracts were changing and particularly with a belief that they were tending towards longer term enabling contracts which reflected the changing business environment they were operating in. The paper then evaluates this concept within economic models but does not explore in any more depth, specific issues like contract formation or contractual remedies. The exploration of the use of long term contracts would indicate more detailed development of the terms and is unlikely therefore to routinely apply to the use of SFCs which would be expected to be

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<sup>40</sup> Ibid p170

<sup>41</sup> Stewart Macaulay, (n2)

<sup>42</sup> John P. Esser, Institutionalizing Industry: The Changing Forms of Contract, (1996) Vol 21 Law and Social Inquiry 593.

<sup>43</sup> Ibid, p594

used in lower value and more voluminous transactions. There would appear to be little that can be drawn to illuminate further the possible line of questioning or investigation for this study, apart from the area of the effectiveness in developing longer term business relationships.

This type of work would fit neatly into the matrix developed by Korobkin<sup>44</sup> as it uses data from actual contracting practices with an intention to use this for doctrinal changes to the law.

Another study which deals with a small and challenging topic was made by Keating<sup>45</sup> which reviewed the effect of the Uniform Commercial Code (UCC) on the Battle of the Forms in the US. This assessed the views and approach of industry to an old problem and whether the code was effective and utilised. It was founded on a comprehensive review of previous written works to develop a set of questions and helpfully provides significant detail on the methodology used. This describes a sample of 25 companies and 32 interviewees from different specialisms, though all companies were represented by their in house counsel which may itself indicate a bias in the conclusions.

Though it was recognised that the sample was small compared to the total number of businesses that might be dealing with the problem, there was nevertheless sufficient consistency in the results to draw reasonably supportable conclusions and hence recommendations. The conclusion again was that business found ways to deal with changing legislation and mostly wanted to avoid increasing regulation that get in the way of commerce<sup>46</sup>.

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<sup>44</sup> Korobkin, R, (2002), Empirical Scholarship in Contract Law: Possibilities and Pitfalls, University of Illinois Law Review, P1033.

<sup>45</sup> Daniel Keating, 'Exploring the Battle of the Forms in Action' (2000) Michigan Law Review Vol. 98, No. 8

<sup>46</sup> Ibid p56-57

### 2.3.3 Private Legal Systems

The concept of using non-contractual sanctions has been explored further by Bernstein<sup>47</sup> in her work on the US cotton industry. The research focussed on a specific industry in a specific country which has developed its own systems and culture of many years and appears to have shunned the use of the US Legal system as its primary control mechanism. Indeed, although the core of the research was directed at the US Cotton Industry, the implication is that these and similar tools are widespread internationally and account for 50% of all cotton trading. How this proportion relates to the relative involvement of the US in such trade is not clarified however.

The work of Bernstein was necessarily narrow and was intended to try to understand how such a non-formal system operates and ultimately to assess the effectiveness of such a system against the formal legal processes. The outcome suggests that it is effective in a number of ways though as a result of a lengthy period of development and integration into the culture of the particular business area. Specifically, it is reliant on reputation based non-legal sanctions which in turn depend on the broader Cotton Industry mechanisms to ensure that these sanctions are effective.

The research was structured to look at the sets of rules and procedures that are used and then takes a deeper look at the broader cotton industry systems and organisations to understand how they support the use of such a '*Private Legal System*' (PLS) and how the industry itself has tried to structure itself to facilitate such a system. The study then explores how these efforts by the industry have helped to nurture an environment that creates the conditions to allow a cooperative trading environment. In order to bring the study into a more general theatre, it then assesses whether and what lessons there are to be learned that may be applicable to other industries to improve business relationships and facilitate trade.

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<sup>47</sup> Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions' (2001) 99 Michigan L R 1724-1790.

Whilst all of these aspects are of interest, the central two areas which look at the system in the context of the specific industry are of limited value to other studies as they relate to a very specific business area with its own very unique and independent history and process of development (though note that other studies by Bernstein identified similar results<sup>48</sup>). The system in place developed over a lengthy period allowing the industry and the PLS to develop in tandem.

The examination into the system itself however may be of more general interest as it identifies different approaches and tools that could be applicable more broadly. This area of the research identified the procedural rules that are a core part of the system and are an equally important part of the business structures.

Although there are a number of different organisations which offer controls for different aspects of the trade, they mainly revert to a set of rules and a dispute resolution procedure developed by the industry itself. The substantive rules are effectively standard terms of business which have been developed and understood over many years to form a clear basis for transactions. The author makes the point that they differ in a number of respects from conditions that would be the norm under the Uniform Commercial Code<sup>49</sup>. The cotton industry rules have rejected this less formal guidance in favour of clearer and more robust rules that suit the industry. In addition to using industry specific terminology which would be inappropriate or inexplicable elsewhere, they also use industry specific remedies which make the resolution of disputes quicker and more relevant to the parties.

Such disputes are also well regulated and follow clear guidelines which would not comply with Code principles, taking as they do a firm view of the rules and

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<sup>48</sup> See also: Lisa Bernstein, 'Opting Out Of The Legal System: Extralegal Contractual Relations In The Diamond Industry', (1992), *The Journal of Legal Studies*, Vol. 21, No. 1, pp. 115-157 and Lisa Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms ', (1996), 144 *Uni Pennsylvania L R* 1765-1822(1996) 144 *Uni Pennsylvania L R* 1765-1822

<sup>49</sup> Uniform Commercial Code – The American Law Institute and the National Conference of Commissioners on Uniform State Laws

not allowing external industry or relationship norms to influence the outcome. *“In general, cotton arbitrators decide cases in a highly formalistic manner, even when their sense of fairness suggests that additional considerations are relevant or that a contrary result should be reached.”*<sup>50</sup>

Whilst these decisions could in theory be enforced through the courts, the final aspect that makes the system effective is that this rarely happens as the remedies available are clear and well understood and generally accepted as being fair. Hence any failure to comply with such a decision would immediately identify the organisation as a difficult party to do business with. It is this implicit use of reputation based non-legal sanctions that provide the strongest argument for such a system, though this is dependent on the bounded nature of the industry and the closed nature of the system. The ultimate remedy available is expulsion from the relevant association, which effectively means that the business cannot trade and unless it has other business interests, will most likely end in insolvency.

This is one example from a number of similar investigations by Bernstein<sup>51</sup> which show that businesses operate within the law, but develop structures and dispute mechanisms to suit the culture and norms of the industry.

The lessons that can be taken from such specific research need to be carefully assessed if they are to be applied elsewhere. The striking feature highlighted in the report is contained in the assessment of the effectiveness of the system. The indication is that there are very few disputes that go to arbitration and those that do are quickly and effectively resolved using the systems in place.

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<sup>50</sup> Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions' (2001) 99 Michigan L R, p1737

<sup>51</sup> See also: Lisa Bernstein, 'Opting Out Of The Legal System: Extralegal Contractual Relations In The Diamond Industry', (1992), The Journal of Legal Studies, Vol. 21, No. 1, pp. 115-157 and Lisa Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms ', (1996), 144 Uni Pennsylvania L R 1765-1822(1996) 144 Uni Pennsylvania L R 1765-1822

This one measure is a barometer of the overall effectiveness of the trade systems in general as clarity of understanding and the cultural factors within the market segment all contribute to establishing an environment which promotes cooperation and facilitates business relationship. By creating these rules and managing the system, the industry has effectively reduced the overall transaction costs and produced an infrastructure which seems to help business.

This area of investigation by Bernstein into PLS provides a more formal structure but nevertheless supports the general thesis that business finds solutions to its own problems. It will generally avoid the classical legal remedies through the courts in favour of either PLS or less formal relationship solutions.

#### **2.3.4 The Diamond Model**

One of the most commonly quoted examples of the informal private legal systems explored by Bernstein was that of the Diamond business<sup>52</sup>. This is a prime example of an area of commerce which relies on existing cultural and historical systems to govern transactions. The system has developed over many centuries and relies on “...a variety of reputational bonds, customary business practices, and arbitration proceedings”, by which “...the diamond industry has developed a set of rules and institutions that its participants find clearly superior to the legal system.”<sup>53</sup>

This system evolved in parallel with the legal systems it provided an alternative to and offers a more defined mechanism to the extra-legal solutions that Macaulay identified<sup>54</sup>. The reliance on key values of trust and reputation reflects significantly on the culture of the core exponents, the Jewish community (and primarily the Hassidic Jews) that dominated the industry for many centuries.

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<sup>52</sup> Lisa Bernstein, 'Opting Out Of The Legal System: Extralegal Contractual Relations In The Diamond Industry', (1992), The Journal of Legal Studies, Vol. 21, No. 1, pp. 115-157

<sup>53</sup> Ibid p157.

<sup>54</sup> Stewart Macaulay (n2)



This concept of bounded trades implementing their own rules and systems of control which extend beyond legal or contractual elements has provided much justification for considering that organisations find ways to avoid the ever increasing cost of legal remedy. This suggestion demonstrates an immediate flaw in that the specific example of the diamond trade has developed over many centuries and probably before the issue of formal legal remedies would be considered extortionate. However, they do demonstrate that alternatives to such systems are feasible, manageable and provide demonstrable benefits.

The diamond industry as examined by Bernstein has subsequently provided useful material for further studies which in more recent times have indicated that there may need to be more depth applied to the studies and a broader understanding of the social context in which they exist<sup>55</sup>. Richman identifies a need to “...scrutinize enforcement costs more than administrative costs”<sup>56</sup>, in order to fully understand what they contribute to contract theory.

This analysis starts from a clearer definition of private legal systems as distinct from the mechanisms identified by Macaulay<sup>57</sup> which operate around the edges of the formal legal system and rely on the structure of those formal systems to guide any alternative processes. These private systems operate separately and have their own structures, principles and standards that may reflect existing formal systems but operate apart throughout and have no dependence upon them.

The desire to understand the difference between enforcement costs and administrative costs is seen as essential in analysing why and how they are effective. This attempt may have limited success as the two areas will have significant interdependencies and assessing the economic benefits achieved in

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<sup>55</sup> Barak D. Richman, 'Norms and Law: Putting the Horse Before the Cart' (2012), 62 Duke Law Journal 739-766

<sup>56</sup> Ibid, p766

<sup>57</sup> Stewart Macaulay (n2)

the administration of any system is likely to be dependent upon the costs and efficiency with the enforcement element to some extent.

However, the exercise carried out by Richman<sup>58</sup> does provide useful insight into the relationship with contract law and what lessons might be learnt to improve the effectiveness of formal systems and particularly mechanisms for enforcement. The conclusion reached is that the system used by the diamond merchants is very much driven by enforcement mechanisms although they do also demonstrate procedural efficiencies. The benefit of the enforcement economies is that they rely on a small segment of the population, all of which comply with the system as opposed to the general legal systems that have to apply a broad approach to parts of the population that don't wish to comply.

The importance of reputation, and its use as a tool in enforcement, as a feature in this system provides it with its strength in reducing costs and but also provides significant barriers to entry to the industry that itself maintains the controls over its members. New entrants are unable to demonstrate a reputation that can be used as a lever if they haven't a track record behind them. The bedrock of the system has been the inherent and integral trust that exists between dealers within a small and limited community and breaking in to this community to establish such long held reputations can take generations.

Interestingly, this factor itself is now seen as a potential problem for the industry which for centuries has been centred in a small number of traditional geographic locations with strong local cultures. As time and technology move forward, the strengths of these centres are becoming eroded and the barriers are being broken. The effect of globalisation and the development of new technology has allowed new centres to establish a foothold driven by whole world economics, the effect of the internet on international trade and erosion of the need for

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<sup>58</sup> Barak D. Richman, 'Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering,' (2004) 104 Columbia Law Review 2328-2367 (2004)

individual skills as technical solutions provide alternative, and in some cases more accurate, ways of processing diamonds<sup>59</sup>.

The main beneficiary of this change has been India with the development of the diamond trade in Mumbai, though the indication is that it is also driven by old established cultural groups which have adapted to, or with, the existing expectations of the industry. These changes will continue to be examined by those interested in contract theory and as international commerce strides forward further changes and examples will no doubt become apparent.

### **2.3.5 Boiler Plate**

This thesis, whilst exploring the general principles of contracts in practice, is focussing specifically on the use of standard form contracts. This aspect introduces a different view of contracts as the use of standard forms and standard conditions presents a new dichotomy. On the one hand, a standard form of contract will not be examined in any detail for any individual transaction and is unlikely to suffer any extensive amendments (if any). On the other hand, as a document used by business in large numbers of transactions and therefore potentially large overall value of business, then it would be expected that the terms and conditions would be subject to forensic examination and frequent development.

The first of these points is explored through the empirical data analysed in chapter 4 and the subsequent review of the content of standard form contracts included in chapter 5. This should show whether there is any expectation on the users on the content and effectiveness of the forms and also whether the content matches those expectations.

This second point however has been questioned by the work of Gulati and Scott<sup>60</sup>, where a single example has opened the door to much further research.

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<sup>59</sup> Barak D. Richman, *'Stateless Commerce: The Diamond Network and the Persistence of Relational Exchange'*, (Harvard University Press 2017) p115-132

<sup>60</sup> Mitu Gulati & Robert E Scott, *'The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design'*, (The University of Chicago Press 2013)

Although the original doubt was driven by an unusual form of contract used in sovereign debt and with associated anachronisms, it has uncovered a widespread issue where boilerplate is used even in high value and high risk contracts.

The '*3½ minutes*' of the title refer to a comment made by a lawyer in an interview explaining that contracts within his large law firm were produced by a computer programme, based on significant input over time by many legal brains, but which then allow an Associate to "...produce a contract for one of these deals in three and a half minutes"<sup>61</sup>.

Whilst the fact that the clause in the boiler plate from the original case (commonly referred to as the '*pari passu*' clause<sup>62</sup>), had been included in contracts for many years (possibly centuries) without challenge is a key issue, what then transpired becomes of more interest. The authors' investigations indicated that in spite of the sizeable cost of the decision and the high visibility of the case, the clause continued to be included in contracts.

This concept that boiler plate does not change easily has been described as "...stickiness in standardised boiler plate language"<sup>63</sup>, and led to further investigation. This phenomenon behind this accounts for the assessed situation where such boiler plate exists without challenge has then been the subject of more recent investigation by the original authors<sup>64</sup>.

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<sup>61</sup> Ibid, p 9

<sup>62</sup> Elliott Assocs., No 2000QR92 (Ct. App. Brussels, 8th Chamber, Sept. 26, 200)

<sup>63</sup> Mitu Gulati & Robert E Scott, '*The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design*', (The University of Chicago Press 2013), p33

<sup>64</sup> For example: Choi, Stephen J. ; Gulati, Mitu ; Scott, Robert E., 'The Black Hole Problem in Commercial Boilerplate' (2017) Duke Law Journal, Vol. 67, Issue 1 (October 2017), pp. 1-78 and

A number of hypotheses have been put forward in explanation of this theory, including the possibility that it is not actually prevalent but a specific exception to the rule, including<sup>65</sup>:

- Learning Externalities: States that through usage and experience the terms become familiar and understood and that this confidence in them deters change;
- Negative Signalling: Relies on the theory that changing boiler plate terms will be challenged by the other party or recognised as a change which may also send other unintended messages to the other party;
- Satisficing: This takes the principle that the cost of changing is more expensive than retaining the status quo, and therefore assumes that the associated risk of the existing draft being ineffective is also calculated;
- Contract Routines: This assumes that the contract is drafted to align with other aspects of the business and therefore it cannot easily be changed in isolation;
- Understanding: The reluctance to change may be a result of a lack of understanding of the clause and the specific interpretation that raised the issue.

The results from the extensive enquiries made in the specific case of the *pari passu* clause indicated that there were two dominant principles put forward as explanations by the senior lawyers questioned. The first of these is that there is an underlying resistance preventing lawyers from making such changes, either by the inertia created by the firms themselves or the ability of individual lawyers to effect such change. The second is more difficult to understand as it suggests that the lawyers fundamentally don't see a problem with the clause. This outcome suggests that the clause is actually effective and it is the interpretation in the relevant case that is the problem.

This idea that boiler plate terms are unlikely to be changed either in response to significant cases or even changes in external conditions is seen by Richman

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<sup>65</sup> Ibid, p34-43

as an organisational theory problem rather than one of cold economic theory<sup>66</sup>. Comparing contract preparation somewhat irreverently with manufacturing cars, he surmises that law firms are like any organisation which relies on establishing processes and systems that remove the need to think independently in order to become more efficient.

Subsequent to the *pari passu* case, a change in boiler plate was identified in 2014, a significant number of years after the original case and therefore potentially leaving more contracts at risk of a similar fate. Although there may be risk with the users of the clause, the original authors then questioned whether the courts could have done more to close the hole<sup>67</sup>.

There is still plenty of opportunity for further research to be carried out in this area to understand whether SCFs (and the ever present boiler plate terms) are efficient. The previous view that they evolve to support business is not necessarily being questioned, but other factors seem to be in play that resist the natural development and potentially create tension between business and the law. The development of efficient organisations and the use of technology have been of particular relevance in this resistance and will be of continuing interest.

## **2.4 Macneil's Relational Theory of Contract**

### **2.4.1 The Problem with Macneil**

Whilst it may not be appropriate to compare the works of Macaulay with those of Macneil, the latter does form a key foundation in any understanding of contracting behaviour. Where Macaulay did carry out detailed research using a defined sample, the Macneil theories (as explained later) relied on a more idealistic and conceptual approach in the expectation that his theories could form the basis for others to validate empirically.

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<sup>66</sup> Barak D. Richman, 'Contracts Meet Henry Ford' (2011) 40 Hofstra L. Rev. 77 (2011)

<sup>67</sup> Choi, Stephen J. ; Gulati, Mitu ; Scott, Robert E., 'The Black Hole Problem in Commercial Boilerplate' (2017) Duke Law Journal, Vol. 67, Issue 1 (October 2017), pp. 1-7

At first read, it is difficult to understand how the work of Ian Macneil relates to contract law, when it appears to be a much broader commentary on social interactions and relationships and is written in a style that explores the deeper evaluation of such relationships in a manner more becoming of a philosopher than a lawyer. This spurning of traditional legal academic language for a more esoteric prose has created its own mystique around the theories and in some ways may have deterred a large audience from discovering more.

There may however have been reason behind this approach as suggested by Whitford<sup>68</sup>, in that the traditional language of the legal profession was entrenched in the traditional understanding of contract theory and a novel dictionary was necessary to be able to distinguish the new concepts from established mores. He states that this difficulty to read his work is “...*not simply a matter of style. To a great extent it is an inevitable concomitant of Macneil's challenge to basic conceptions embedded in traditional contract theory.*”<sup>69</sup>

Although quite prodigious in the production of more theories behind the basic concept, the style of writing is nevertheless an obstacle to engaging the reader and hence to acceptance. The many papers seem to lack specific focus and structure and so do not lend themselves to usual analytical techniques or translation to a more practical interpretation.

Conventional contract theory is based on the principle that two parties agree the terms of a contract in order to carry out business and the terms of the contract deal with all aspects of the transaction. It works on the basis that the contract is an expression of the joint will of the parties which impose on the parties agreed obligations. It is formed at a point in time and within a framework of a regulatory system which supports the process and is available to enforce the obligations when necessary. From this starting point, Macneil takes a

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<sup>68</sup> Ian Macneil's Contribution to Contracts Scholarship, William C Whitford, Wis. L. Rev. 545 1985

<sup>69</sup> Ibid, p556

divergent angle, challenging this perfect view of the law when imposed in the real world.

From the first written exposition in 1969<sup>70</sup>, his ideas developed but as Macaulay points out<sup>71</sup>, he was more interested in the theoretical than the empirical, leaving these gaps that would potentially support his theories to be filled by others. The conviction with which his ideas were developed shows the depth of his belief in the need to understand these new dimensions to contract law but also a concern that he was competing on parallel lines with other scholars eager to be first to present the concepts.

Whitford divides the theories into two great ideas<sup>72</sup> and explains how the two have been received differently by the legal fraternity. Splitting the sizeable volume of literature by Macneil into two big ideas is at least a starting point and benefits from allowing structure for subsequent evaluation. The two ideas he identifies are effectively the two stages, firstly believing that here is a view that relational contracts exist and that these deserve to be treated in a different way for the purpose of judicial systems – this he concludes is widely supported by the additional literature in the field. The second and more challenging aspect is “...*how as opposed to whether, relational contracts lacking a great meeting of minds should be enforced.*” Unfortunately the conclusion is that this aspect has not been embraced by the legal community, probably as a result of the difficult challenges it presents.

#### **2.4.2 Whither Contracts**

A starting point for the journey can be considered the core question Macneil raised in December 1967 in a paper<sup>73</sup> delivered to the Association of American

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<sup>70</sup> Ian R. Macneil, 'Whither Contracts' (1969) 21 J. Legal Educ. 403

<sup>71</sup> Stewart Macaulay, 'Relational Contracts Floating On A Sea Of Custom? Thoughts About The Ideas Of Ian Macneil And Lisa Bernstein' (2000) 94 Nw. U. L. Rev. 775

<sup>72</sup> William C. Whitford, 'Ian Macneil's Contribution to Contracts Scholarship' (1985) Wis. L. Rev. 545

<sup>73</sup> Ian R. Macneil, 'Whither Contracts' (1969) 21 J. Legal Educ. 403



Law Schools (AALS) and documented in 1969, on the fundamental existence of contracts as a general entity rather than as discrete and specific instruments each with a specific objective (referring to such areas as distribution of goods and services, collective bargaining, corporate finance, credit transactions etc). By looking more broadly at the nature of contracting behaviours, he quickly concluded that there was enough in common across these separate areas to justify the existence of contracts in general. Specifically he identifies five common traits running through contracts<sup>74</sup>:

- Cooperation between the parties (and therefore dictating that there are '*parties*' to the contract.
- Economic exchange which is a much deeper concept requiring further exploration elsewhere, but requiring that both (all) parties gain some benefit from the contract.
- The third element is one which in many ways forms the basis of future theories, being the effect of planning for the future.
- The introduction of potential sanctions outside of the agreement itself, predominantly these are expected to be legal, but may frequently be imposed by cultural or business considerations.
- Finally, he suggests that contracts are subject to 'social control and social manipulation' which will not always be in the interests of the parties.
- The paper then seems to be uncertain whether there should be a sixth common element, by suggesting that most also include a degree of property and so a value in their own right.

Although diverse in nature, these are all common characteristics of contracts and are apparent to varying degrees. Some may be considered the counter of others, as co-operation and economic exchange may be considered at opposite ends of the bargaining spectrum, but nevertheless there will be elements of all, to some extent.

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<sup>74</sup> Ibid, p404

Having concluded that contracts exist, the follow on question asked is whether it is a substantial enough subject for study. In order to deal with this question, Macneil decides to use his common traits to provide insights into the way that a study of contracts in general might provide more useful understanding of individual specialist areas. This leads to an analysis of how these common elements might be addressed in delivering a contract in general course, which includes a hint at the key content of future work in the explanation around the need for an appreciation of non-legal aspects as espoused by Macaulay, noting in particular how problems are dealt with outside of the law.

The overriding message from the paper is that the law of contract exists as a separate entity, but is (and should therefore be studied as) more than just the arcane legal principles from precedent cases, statutes and the core concept of offer, acceptance, intent and consideration. It needs to be understood in the broader and much more challenging context of the environment in which it operates and the parties who use it.

### **2.4.3 Restatement (Second) of Contracts and Presentation**

The significant paper presented by Macneil to the AALS in December 1973<sup>75</sup> took the next step in expressing his developing ideas on the relational aspects of contracts. The key introduction to the paper addresses the term '*presentation*' and the distinction between this and the more common approach to contract drafting and life in general that considers how current actions can impact on the future.

Recognising that it is not possible to predict the future with any degree of confidence, the frequent solution is to plan based on the present. The act of planning therefore deals with trying to assess what may happen and prepare for those eventualities. Conversely, presentation is the act of taking that future and placing it in the present to define predictability.

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<sup>75</sup> Ian R. Macneil, 'Restatement Second of Contracts and Presentation', (1974), 60 Va. L. Rev. 589

The application of this to contracts is fundamental in view of the desire to define the future through the clauses of the contract such that all parties know what will happen. As Macneil states, “*Total presentation through 100% predictability was sought as of the time of something called the acceptance of the offer*”.

Campbell explores this theme when he assesses the possibility of knowing all the potential eventualities and then drafting a contract that provides contingencies for ‘...*every conceivable act of non-performance*<sup>76</sup>’. In this case he is considering remedies for breach, but the conclusion is that negotiation costs are driven by the ability to predict what might happen and agree the effect of those events.

To explain presentation further, Macneil introduces the ideas of discrete transactions as opposed to relational transactions and confesses that full presentation is only likely in discrete transactions, being ones which are quick in formation and execution with no continuing relationship and therefore no possibility of impact of future events.

The classic example used to illustrate the discrete transaction is of two strangers meeting and selling and buying a horse before going their separate ways<sup>77</sup>. This simple scenario though also seems to have limitations as the deal is struck and would appear to be concluded without debate, which is common to the majority of all transactions. Whether this is truly a discrete contract with no continuing obligations or relationships is subject to debate and it may be argued that there is no such thing as a truly discrete contract, but in principle the parties depart with what they have, never to deal again.

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<sup>76</sup> David Campbell, ' The Relational Constitution of Remedy - Co-Operation as the Implicit Second Principle of Remedies for Breach of Contract', (2005), 11 Tex. Wesleyan L. Rev. 455, p 464.

<sup>77</sup> Ian R. Macneil, ' Restatement Second of Contracts and Presentation', (1974), 60 Va. L. Rev. p595

In his 1978 work he developed this to the sale of fuel at a petrol station on the New Jersey Turnpike<sup>78</sup> bought with cash by someone who rarely travelled the road in a discrete transaction.

To Macneil this then raises the question of how the law should deal with these contracts when it is predicated on simple discrete contracts and in determining doctrinal rules for the situations that fall outside this central theme. The exploration of his four proposed responses to the conundrum, allow a level of application but fail to address the resonant problem. The first two options are to either not apply transactional law to relational contracts or to apply it rigidly, assuming total presentation.

The second two options are however the more pragmatic attempts at solutions and would look at modifying the details of contract law to accommodate relational contracts by adjusting the objectives away from full presentation. Finally, though not considered a sustainable option would be to totally redevelop the structure of contract law to accommodate both discrete and relational contracts. At the time of the paper, this was ruled out on the basis that the justification for such a root and branch approach was not evident and unlikely to be demonstrated as likely without huge and far reaching research.

#### **2.4.4 The Many Futures of Contracts**

Probably the most significant and oft quoted work by Macneil was published in the Southern Californian Law Review in 1974<sup>79</sup> and develops the ideas of relational contracts. The article starts by reconsidering a basic definition of contract as “...a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognises as a duty.”<sup>80</sup>

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<sup>78</sup> Ian R. Macneil, ' Contracts: Adjustment Of Long-Term Economic Relations Under Classical, Neoclassical, And Relational Contract Law', (1978), 72 Nw. U. L. Rev. p857

<sup>79</sup> The Many Futures of Contract, Ian R Macneil, 47 Southern California Law Review 691

<sup>80</sup> Ibid, p693

The challenge faced in reconciling this simple premise with the reality apparent from experience of the (then) current world of contracts leads naturally on to questioning the underlying presupposition that contracts are transactional. Whilst it is probably true that the innocent tradesman looks on them in this way, the changing environment suggests a move away from this norm towards broader agreements requiring consideration of factors beyond payment for goods. Examples from many contracting circumstances are provided but for the purpose of this piece it is business transactions that are the most relevant and also the most significant. Identifying the increasing trend towards a service economy, the use of business models like franchising, the increase in governmental intervention (outsourcing) and the financial attraction afforded by leasing arrangements rather than outright purchase he makes a strong case for the development of relational contracts and hence ongoing relationships more than discrete transactions.

In order to challenge these entrenched concepts of discrete transaction, Macneil feels it necessary to look to the past and dissect the way that transactional basis for exchange replaced the relational roots and thence formed the basis for the legal systems currently in place. Whilst of interest, this does not offer much in the way of appreciating the present situation or ways of resolving the challenge. The second part of the paper does however explore “promissory and non-promissory projections” in order to then produce a theoretical structure as a foundation for analysing the nature of transactions against a relational and discrete matrix.

The total scope of the work of Macneil extends into many additional areas of interest and it is hoped that these can be explored alongside the empirical work which they may underpin. Though as has been pointed out, they do not naturally flow from one work to the next and therefore need to be considered against any potential findings which may support or challenge his theories.

## **2.5 Alternative Perspectives**

### **2.5.1 Business Considerations**

As a starting point Macaulay has been the basis for numerous further studies taking the general findings that businesses do not use contracts in the

conventional and purist legal manner but see them almost as a necessary evil which is there in the background but should never be used in anger. In many ways this is the nuclear deterrent of business relationships, where both parties are aware that it is available, but neither would wish to be the one to press the button on legal action in the knowledge that the relationship will never be the same again.

One study that starts where Macaulay finishes is Roxenhall and Ghauri<sup>81</sup> which approaches the subject from a marketing perspective. Possibly as a result of this bias, it starts by quoting the Sales view of contracts as summarised by Macaulay: "...*the work of the devil; it is just one more thing to get in the way of closing a sale.*"<sup>82</sup>

The methodology for the study was more limited than many as it focussed on just three transactions involving 6 parties, whilst trying to cover a broad range of industries and types of contract. These deals were investigated by comparison to a conceptual model (figure 1<sup>83</sup>) which had been formed using data from previous studies. These dictated three key reasons why two parties might agree to a contract being:

- a) To transmit information between the parties;
- b) To reduce uncertainty, particularly in large and complex transactions;  
and
- c) Because they are customary and there is an expectation that one will be agreed.

This then leads into the three ways in which they are used:

- a) To define the agreements to what has been sold and any other details;

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<sup>81</sup> T. Roxenhall and P. Ghauri, 'Use of the Written Contract in Long-Lasting Business Relationships' (2004) 33 Industrial Marketing Management 261-268

<sup>82</sup> Stewart Macaulay, 'The Use and Nonuse of Contracts in the Manufacturing Industry' (1963) Practical Lawyer, 9, p15

<sup>83</sup> T. Roxenhall and P. Ghauri, 'Use of the Written Contract in Long-Lasting Business Relationships' (2004) 33 Industrial Marketing Management p262

- b) To control individuals within both organisations; and
- c) To clarify where there may be uncertainty or conflict.

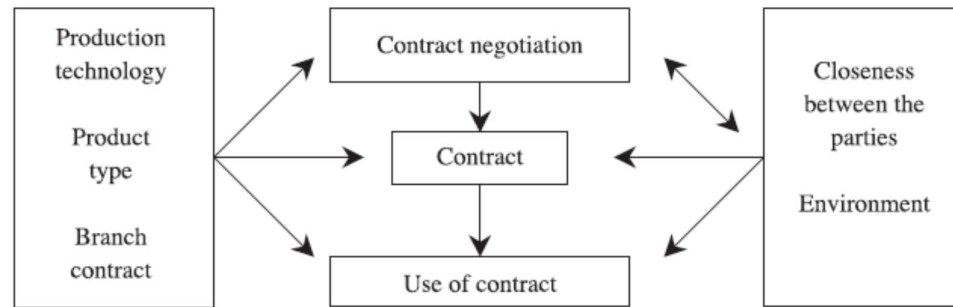


Fig. 1. Factors influencing the use of contracts.

The conclusions from the study are derived from an organisational theory perspective as they attempt to deal with the process of agreement and the subsequent process of delivering the contract requirements. The hypothesis suggested that the key business factors that influence the process are the technology, which may be directly associated with the industry, and the relationship between the parties. This was borne out by the conclusion which supported the theory that the contract itself is secondary to the transaction and the purpose of the formal document is more to do with communicating what has been agreed than as a basis for resolving disputes whether or not through the courts.

In addition to looking at different industries, alternative studies have been carried out to bring together different systems in different countries. One notable work was supported by the Economic and Social Research Council in an effort to bring together different academic disciplines in a consolidated review of transactions and the place of the contract in the economic market place. The result<sup>84</sup> is that the broader academic approach suggested that contract law does have an important role to play in 'underpinning long term

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<sup>84</sup> Alessandro Arrighetti, Reinhard Bachmann and Simon Deakin, 'Contract Law, Social Norms and Inter-Firm Cooperation' (1997) *Cambridge Journal of Economics*, 21, 171-195

relations based on cooperation and trust'. It assessed inputs from 62 companies from Germany, Britain and Italy, both suppliers and purchasers from two distinct and separate industries (mining machinery and kitchen furniture).

Whilst concentrating on similar concepts to the traditional studies (contract planning and dispute resolution) the work looked in greater depth at the use of contracts for establishing and developing relationships. The results pointed to the need for contracts as the basis for building trust and to closer working relationships enabling long term benefits, though this seems to be partly associated with the principles behind the arrangement in the first place. As with many of these studies, the conclusions may not be transferrable to SFCs, where the transactions are shorter and not obviously part of a longer terms business relationship.

The work of Deakin in this study is taken further in a number of pieces with similar objectives and involving similar breadth of expertise<sup>85</sup>. These are driven by a desire to understand the interaction between contract theory, competition and underlying economic principles to inform political policy.

### **2.5.2 Economics**

Contract has continued to be an area of interest to many academic disciplines beyond the pure legal scholars. Indeed, when first investigating how contracts work, it is likely that attention is drawn towards the economic theory of contract. This body of work established a leading position from the early days of the expansion of the use of contracts during the 18<sup>th</sup> Century. Although in 2000, Korobkin and Ulen suggested that the value of the insights provided by economic theory to legal scholarship were diminishing<sup>86</sup>, it has become particularly prevalent more recently with the work of Hart and Holmström being

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<sup>85</sup> See: Simon Deakin and Jonathan Michie (editors), 'Contract, Co-operation and Competition', (Oxford University Press 1997)

<sup>86</sup> Russell Korobkin & Thomas Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 Cal. L. Rev. 1051



awarded the Nobel Prize for Economics in 2016 “*for their contributions to contract theory*”<sup>87</sup>.

Whilst this interest in contracts is undoubtedly important and worthy of its position, it is not the only way to evaluate contracts and their importance and use in the 21<sup>st</sup> century. As Smith and King point out, “...*economic theories do not adequately explain many commonly observed features of contracts...*”<sup>88</sup>. They go on to explain that empirical studies into the use of contract are rare apart from those which developed from economic theory.

As most of the economic theories are driven by economic analysis of transaction costs, they are also largely relevant to negotiating contracts. This is still a fertile area of research, but not immediately relevant to SFCs and hence this thesis.

### **2.5.3 Standard Form Contracts**

In addition to works dealing generally with contracts in practice, there is some work which looks at the principles of how standard form contracts operate and whether they are fair and effective. In general, this thesis is focussing on those terms and conditions that are produced by one of the parties, usually the selling entity and not what may be described as industry standard form<sup>89</sup>.

Noting that these have developed since the industrial revolution in the 19<sup>th</sup> century, Yates explains<sup>90</sup> “*Once the usefulness of these contracts became apparent and perfected...their use spread into all other fields of large scale business enterprise...*” They have continued to evolve to keep up with

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<sup>87</sup> The Royal Swedish Academy of Sciences Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2016

<sup>88</sup> D. Gordon Smith & Brayden G. King, 'Contracts as Organizations', (2009), Arizona Law Review, Vol. 51, No. 1,

<sup>89</sup> See *Schroeder Music v Macaulay*, [1974] 1 W.L.R. 1308 for a view on how two types of contract may be referred to as Standard Form Contracts

<sup>90</sup> David Yates, 'Exclusion Clauses in Contracts', (Sweet and Maxwell 1982) p 2.

developments in the law but have also developed to increase the efficiency of the transaction.

The proposition supporting this increased use is that they facilitate business by making transactions more efficient and is further developed by Korobkin<sup>91</sup>:

*“Economic analysis suggests that in a perfectly functioning market with complete information contracts between buyers and sellers will contain only efficient terms, defined as those for which the differential between benefits and costs is greatest, regardless of how distributed between buyers and sellers.”*

As these contracts are dominant in most business transactions and are expected to be the most efficient means of conducting trade<sup>92</sup>, then it would be expected that they are commonly analysed and any unbalance in between the parties would be eroded.

Interestingly, Korobkin suggests that, counter-intuitively, standard form contracts will not necessarily be biased in favour of the drafter. The analysis assumes that decision makers are not infinitely capable of analysing the costs and benefits of different contractual offers and therefore make decisions based upon limited key factors.

Whilst any of these hypotheses on the efficiency of standard form contracts may be difficult to prove, there have been some detailed mathematical attempts to provide substantiation including designing models to illustrate the benefits, using an economic analysis. Chakravarty and MacLeod<sup>93</sup> concluded in an evaluation of construction contracts focussing on standard industry contracts that “...*contract can be viewed as part of the technology of exchange whose*

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<sup>91</sup> Russell Korobkin, 'Bounded Rationality, Standard Form Contracts, and Unconscionability' (2003) 70 U. Chi. L. Rev. 1203

<sup>92</sup> Russell Korobkin, ' Bounded Rationality, Standard Form Contracts, and Unconscionability', (2003), 70 U. Chi. L. Rev. 1203 summaries the view based on the earlier work of W. David Slawson, Standard Form Contracts and Democratic Control of Lawmaking Power, 84 Harv L Rev 529, 529 (1971).

<sup>93</sup> Surajeet Chakravarty and W. Bentley MacLeod, 'On the Efficiency of Standard Form Contracts: The Case of Construction' (2004) USC CLEO Research Paper No. C04-17

*efficiency has improved over time as the result of competition in the market for form construction contracts*". They went on to suggest that the particular form of contract they analysed could be "...viewed as an optimal solution to a contracting problem...". Although this refers specifically to the construction form of contract under investigation, they consider that the problems faced between buyer and seller are sufficiently common as to provide "...some useful insight for contract theory".

Others have tried to take a more purist theoretical approach to the application of economic theory to the law, most notably Posner<sup>94</sup>, this has not been received with universal acceptance. Although these ideas, that economics should be a driving factor in making decisions in law, have been subsequently challenged by a number of legal scholars<sup>95</sup>, there would nevertheless seem to be some element of justification. The specific concept expounding the efficient cost of negotiating contracts balanced against the unknown costs of dealing with the consequences of inappropriate or incomplete agreements would seem to be well founded.

This general appraisal of contract as a fundamental organ to business mechanics can be traced back to the development of transaction cost economics in the 1930s where Coase challenged the existing status quo of economic theory<sup>96</sup> and defined the economics of the firm as an efficient entity. In order for these entities to work together however they require a mechanism to optimise the relationship with other entities with which they need to trade to

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<sup>94</sup> See: Richard Posner, 'The Law and Economics of Contract Interpretation' (2005) 83 Tex L. Rev. 1581, for theory specific to contract; and Richard Posner, 'Utilitarianism, Economics and Legal Theory' (1979) 8 J. Legal Stud. 103, for broader application to judicial opinion in general.

<sup>95</sup> See for example: David Campbell, 'Ayres Versus Coase: An Attempt to Recover the Issue of Equality in Law and Economics' (1994) 21 J.L. & Soc'y 434 and Chazard Ameer, 'Between Scylla and Charybdis: Posner, Dworkin and the Theory of Efficient Breach' (1995) UCL Juris. Rev., 2, 194-214.

<sup>96</sup> Ronald Coase, 'The Nature of the Firm' (1937) *Economica* 4, pp 386-405

exist and so evolved the contract. Williamson<sup>97</sup> described this in more detail when he identified the different levels of governance required by six different forms of transaction defined by frequency (frequent or occasional) and specialisation (non-specific, mixed and idiosyncratic). For each of these possibilities there is a different governance requirement which can be met with different contract options.

Although it is reasonable to say that there are always going to be contractual disputes which generate tests for the content and effectiveness of the system in general, it may be assumed that through years of evolution these forms should be tending towards an efficient model which minimises costs and maximises business efficiency.

One of the prime drivers for standardised forms of contract has been to reduce transaction costs and this aspect has been the subject of various observations including Trebilcock<sup>98</sup>, who asserts on a number of occasions that it is this rather than the '*take it or leave it*' characteristics of one sided agreements that dictates the importance of standard form contracts. Patterson<sup>99</sup> also makes the argument and although his focus is more towards those forms agreed within industries and therefore accepted without negotiation, many of the arguments also support the company standard form contract.

That this form of contract is both effective and efficient should be a natural conclusion from the expectation that business will always strive to be competitive and therefore organisations that use ineffective systems to manage relationships will not compete and therefore either change and progress or fail – the business equivalent of the '*survival of the fittest*'. This "*quasi-Darwinian*"

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<sup>97</sup> Oliver E Williamson, 'The Economic Institutions of Capitalism', (The Free Press 1985)

<sup>98</sup> Michael J. Trebilcock, 'The Limits of Freedom of Contract', (Harvard University Press 1997), p119

<sup>99</sup> Mark R. Patterson, 'Standardization Of Standard-Form Contracts - Competition and Contract Implications' (2010) William & Mary Law Review; Volume 52, Issue 2

theory is one of the possible reasons identified as an explanation for the stickiness of contract terms<sup>100</sup>.

## **2.6 Empirical Research in Contracts**

### **2.6.1 Socio-Legal Research**

This research project has developed from a first-hand involvement in the use of standard form contracts and it is therefore principally from a socio-legal perspective that the project has evolved and therefore likely to be from a similar position that the research is conducted. To understand the alternatives available for further research, it is helpful to appreciate how this then falls within the broad spectrum of academic research a useful model is that created by Anthony Biglan in 1973<sup>101</sup>.

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<sup>100</sup> Mitu Gulati & Robert E Scott, 'The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design', (The University of Chicago Press 2013) p34

<sup>101</sup> A. Biglan, 'The Characteristics of Subject Matter In Different Academic Areas' (1973) *Journal of Applied Psychology*, 57(3), 195–203 and Paul Chynoweth, 'Legal Research' in Knight, A. and Ruddock, L., *Advanced Research Methods in the Built Environment*, Wiley-Blackwell, October 2008.

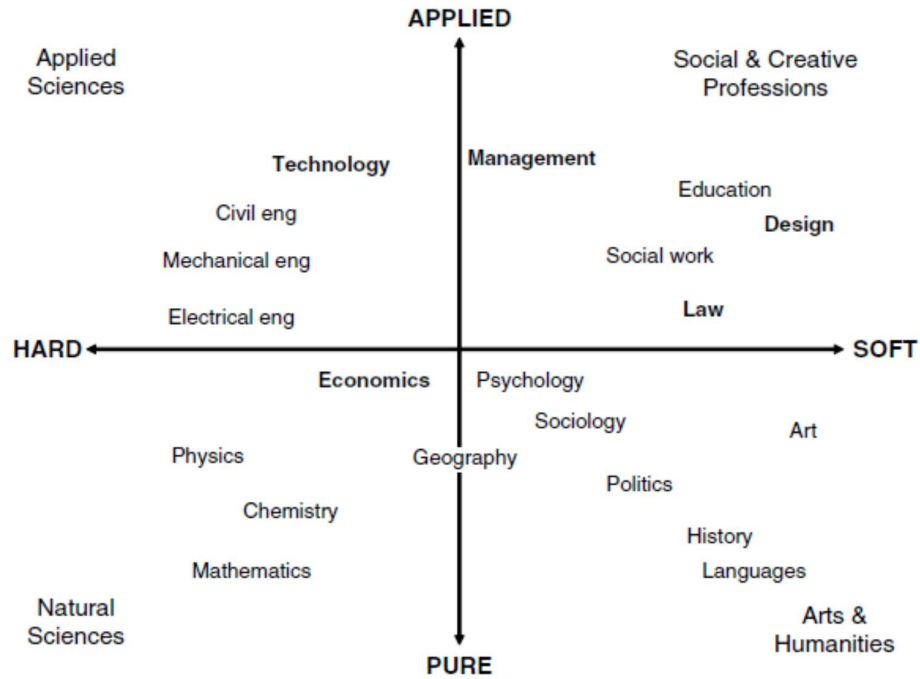
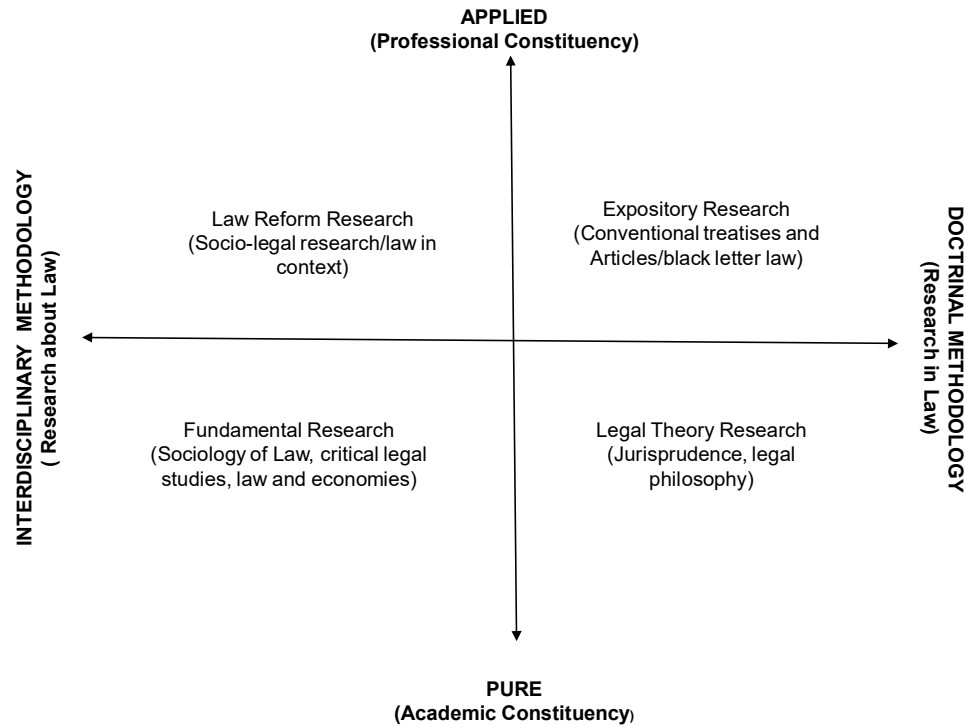


Figure 1: Evaluation of Academic Disciplines (Biglan 1973), developed by Chynoweth (2008)

Following his own research in two academic institutes, he developed a model characterised by two factors, whether the study was either pure or applied and whether it was a hard or soft discipline (see figure 1). This chart helps to explain how legal research has evolved principally through doctrinal research as compared to the sciences which have relied mainly on empirical research. This view that law is both pure and applied may explain why there is significantly less empirical research on law in practice.

This model was also the basis of work by Arthurs<sup>102</sup>, s who developed it in a slightly different direction and considered legal research in comparison to the broader area of Arts and Humanities and identified a two dimensional structure to help place any particular work.



**Figure 2 Legal Research Styles (Arthurs 1983)**

The first of these dimensions would assess where the work lies on the spectrum from academic to professional and therefore accepts that although the law is a working system needing to produce practical application, there is still a need for pure academic understanding of the theory behind such a system. Superimposed on this axis is the assessment of what the research relates to and whether it is about legal principles (doctrinal methodology) or presenting the subject in a broader social context.

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<sup>102</sup> Arthurs, H.W., 'Law and Learning: Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in Law, Information Division, Social Sciences and Humanities Research Council of Canada, Ottawa.' (1983)

However, throughout the history of law, doctrinal legal scholars (as they are more often described rather than legal researchers) have taken the view that they should investigate the interpretation of texts and their meanings rather than the practical application of judgements and their impact on society.

This approach to legal research dates back centuries and has always been doctrinal<sup>103</sup> in nature and focussed on understanding the nature of law and interpretation of decisions philosophically and not in the context of the effect on society. These ideas see law as a fundamental basis of society that reflects the moral and cultural norms of the society whilst remaining independent from them.

In the 19<sup>th</sup> Century when society began to undergo significant change through the development of labour and move from feudal agricultural based organisations to organised industry, a broader and more enlightened view emerged. Seeing it as important to consider all aspects of society it was not possible to consider any part of the fabric of the society in isolation and therefore law itself became subject to this sociological investigation<sup>104</sup>.

It took however some time for these theories to evolve into a recognised area of research and approach to legal scholarship. The approach taken in the study of contracting behaviours is fully embodied within this area as it is from a sociological perspective that the question has arisen in the first place. Wheeler and Thomas<sup>105</sup> describe a broad definition of socio-legal Studies as: “...*an interface with a context within which law exists, be that a sociological, historical, economic, geographical or other context.*”; In this subject study, the *other context* would be business or management studies.

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<sup>103</sup> Brian R. Cheffins, ' Using theory to study law: a company law perspective', (1999), C.L.J., 58(1), 197-221

<sup>104</sup> See Hunt A, ' Max Weber's Sociology of Law. In: The Sociological Movement in Law', (Palgrave Macmillan, Ch 5, 1978) for a summary of his role in the movement.

<sup>105</sup> S. Wheeler and P.A. Thomas, 'Socio-Legal Studies' in D. Hayton (ed.) *Law's Futures*, Oxford, Hart Publishing, 2000, 271.



## 2.6.2 Qualitative and Quantitative Methods

Unlike scientific experiments where results can be measured, recorded and subsequently analysed, any investigation into the use of standard form contracts will start with the views of the individuals who use them. Whilst some of the questions may provide measureable and recordable data (eg “How many contracts do you enter into each year?”; or “What is the maximum value of contracts these form of contracts are used for?”), they rely on the statements of the individuals who are unlikely to have captured such data in the requested form and are therefore likely to be making educated estimates. Additionally, many questions will only provide subjective responses (eg “How important do you think it is to enter contracts on your own company Standard Form contracts?”; and “In your experience, please rank in order the nature of any disputes by frequency”) and consequently, the source data can only be described as qualitative.

The intent however is to take these responses and evaluate them as a group by aggregating the data and then analysing it through using statistical (quantitative) techniques. This dictates that the test will most likely result in a quantitative analysis of qualitative data.

Much research in the field of law is traditionally based on case analysis and comparative studies of different legal systems. Apart from the well-recognised and recorded studies<sup>106</sup>, there appears to have been limited interest in exploring the more common empirical methods that have been well developed in other social science areas to provide a greater understanding of contracts. More recently Eigen<sup>107</sup> points out that a ‘*cottage industry*’ has grown as he identified 115 empirical studies in the subject area between 2005 and 2012 reviewing them to assess the present position and provide some possible direction for future work. In identifying eight core themes he has then put forward two

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<sup>106</sup> See Macaulay (n2) and Beale & Dugdale (n34)

<sup>107</sup> Zev J. Eigen (2012), Empirical Studies of Contract, Northwestern University School of Law Faculty Working Papers. Paper 204.

propositions which he considers underpin these eight categories of research questions:

- Contracts are a product of how drafters and signers interpret the law.
- Contracts are a product of factors exogenous to the law.

Nevertheless, there would still seem to be gap between what the Social Sciences might consider to be pure research often founded in rigorously testing conceptual ideas and the approach in the law where what is considered of interest is understanding, either the social basis of the law, or the way in which it is applied. This latter is thus frequently categorised by case analysis and comparison between similar cases or similar jurisdictions, though as Nard points out<sup>108</sup>, this gap is not unexpected. His simple research of 40 law professors indicated a clear recognition of the need for more empirical research and identified the main reason for the paucity as being the lack of training. Where empirical research forms a core element of many university courses, notably the statistical techniques apparent in the scientific disciplines, it is unlikely to feature on the syllabus for a law degree and the natural aptitudes of legal scholars are unlikely to include strengths (or interest) in mathematics.

### **2.6.3 Understanding Empirical Research in Law**

To try to understand the nature of legal research and hence what type of research might be used in evaluating the use of standard terms of business, it is useful to assess the view of Arthurs<sup>109</sup>, as described in 1983. The model shows how legal research can be characterised by using a matrix approach and by identifying the two defining criteria as Pure and Applied as then charted against the types of research, Interdisciplinary and Doctrinal. This approach was illustrated through a simple chart (figure 2) and assists in understanding

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<sup>108</sup> Empirical Legal Scholarship – Re-establishing A Dialogue Between The Academy And Profession, 30 Wake Forest L. Rev. 347 1995, Craig Nard

<sup>109</sup> Arthurs, H.W., 'Law and Learning: Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in Law, Information Division, Social Sciences and Humanities Research Council of Canada, Ottawa.' (1983)

the most appropriate methodology to employ by defining the practical nature of the work, and hence the potential applicability to real situations, and the underpinning principles being considered, which subsequently identifies the key source of information.

This model compares with the traditional Biglan Model<sup>110</sup> to understanding the academic disciplines and which places Law firmly within the soft end of the spectrum within the arts and humanities. The expectation from this is that, unlike the hard sciences, law progresses through asking questions and not testing hypotheses.

Using this model, the type of work being proposed for this study will fall solidly within the top left quadrant as it intends to evaluate practical applied law in a business (interdisciplinary) context. This should then have implications for the law itself or more likely the outcome will be of benefit to businesses trying to conduct transactions with standard form contracts. In summary, this work should be classed as research about law rather than research in law<sup>111</sup> and research with an objective in mind rather than for pure academic interest.

Korobkin<sup>112</sup>, whilst not carrying out such research directly, attempted to develop a framework in which to understand different types of empirical research into contract law. Korobkin's work is a very useful introduction to assist in any appreciation of empirical research in contract law providing a number of definitions and a broad structure for understanding different approaches. The purpose behind this was partially to understand why there was such a paucity of such research in the first place and how this reflected on legal practitioners but also to assist potential empiricists in developing their ideas and

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<sup>110</sup> Biglan, A (1973) The Characteristics of Subject Matters in Different Academic Areas, *Journal of Applied Psychology*, 57(3), 195-203

<sup>111</sup> Chynoweth, P (2008), *Advanced Research Methods in the Built Environment*, Blackwell Publishing, Chapter 3 Legal Research p30

<sup>112</sup> Korobkin, R, (2002), *Empirical Scholarship in Contract Law: Possibilities and Pitfalls*, *University of Illinois Law Review*. P1038

methodologies and then to help to identify the potential pitfalls of such empirical approaches.

The piece was produced in 2002 so still demonstrates a historical perspective but provides a number of significant concepts for current research. It starts with a useful definition of the two main terms '*contract law*' and '*empirical*' and builds on these to provide some ideas on why there is so little research which combines the two. Interestingly he takes a broad view of empiricism, beyond the general view that it is limited to mathematical and statistical analysis of collected data to include more qualitative evaluations of collected data, but does exclude unstructured analyses. This therefore allows inclusion of broad sampling of judicial decisions where there is a large population to be tested.

The reference to Contract Law is then specifically limited to legal research and does not extend to any other discipline which may have a view on aspects of contract law like business or psychology. This is a sensible and clear position which ensures subsequent analysis does not fall into the trap that he identifies for actual research as being sufficiently unlimited as to be non-transferrable. It was from these definitions that he was able to surmise that there was (and probably still is) limited academic research which satisfies these criteria.

When trying to categorise the types of research, the first split suggested is based on the source of the information to be analysed. By defining four distinct groups, Korobkin manages to cover most potential angles without reverting to a common trick of a group covering 'anything else we couldn't think of'. These groups offer a sound starting position for considering how information might be collected to challenge a particular hypothesis:

- a) Judicial Opinions; though limited to mass analysis rather than detail assessment of one or a small number of decisions.
- b) Actual Contracting Practices; collected and collated from a statistically significant sample.
- c) Negotiating Experiments; though the line between legal research and human factors research is liable to be unclear.
- d) No expert opinions about law; which is akin to the survey of contracting practices, but aimed at non-legal professionals.

The natural follow up from categorisation using the source of information is to consider how the information is to be used and to this end he identifies three broad classes:

- a) Positive doctrinal analysis; which necessarily only utilises information from judicial opinions, whether qualitative or quantitative.
- b) Effect of Doctrine; for practical purposes to inform and educate users of contract law in how they might become more effective.
- c) Normative Doctrinal Analysis; in support of possible reforms or improvements in the law itself.

This is more difficult to use as a number of studies appear to be carried out without such a clear motivation and although they may ultimately offer illumination to a particular cause this may have been incidental.

As an interesting development, he takes the necessary step of identifying the potential pitfalls of embarking on empirical research. In introducing this part he almost seems to be advocating against the use of such work as being an expensive and difficult methodology. The conclusions he draws are that there are three prime reasons that can limit the effectiveness of such research and he provides detailed explanations of all three, none of which would be considered radical and all of which should be recognised when completing similar projects.

The first is one that is identified by Macaulay<sup>113</sup> very early and is difficult to address with limited resources and is described by Korobkin as the problem of '*generalisability*'<sup>114</sup>. Although the law of contract within any jurisdiction will be common, a large number of studies focus on a specific business segment and even geographic area within the jurisdiction. As they are interested in the application of the law by practitioners, the findings are likely to reflect the practices within that business sector as they operate within the geographic

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<sup>113</sup> Stewart Macaulay (n2)

<sup>114</sup> Russell Korobkin, 'Empirical Scholarship in Contract Law: Possibilities and Pitfalls' (2002) U. Ill. L. Rev. 1033-1066

area. Similar reservations are made about alternative techniques (as defined previously) with similar concerns over the generalisability of the conclusions.

The second reason is more specific to the application of the findings in that there is often no clear linkage between the data and the hypothesis under consideration. The common lack of any definitive and incontrovertible link can lead to assumptions being made to derive relations between cause and effect when they are not obviously present and such assumptions are not always reasonable and sustainable.

Finally, there may be difficulties due to the lack of clarity of the data. Whenever carrying out these types of studies there is a hope that the data provides clear and statistically significant results that can be used to support (or reject) an initial theory. This is unlikely to be the case in a large and complex system, particularly where a big aspect of the data is formed by unstructured communication between two parties and hence interpretation may be an obstacle.

The work of Korobkin is a very detailed piece that can assist in constructing any methodology for empirical research into contract law as it provides guidance in both structure and process.

#### **2.6.4 Alternative Empirical Methodologies**

The first of these is the most common area for legal work, review of judicial decisions and statutes, though this can be approached from a subjective analysis or from a statistical analysis of a large number of decisions. However, the focus of this thesis is primarily on the behavioural aspects of contractual relations and non-legal sanctions, such that developing the analysis of decisions of the courts on contractual disputes will only deal with a small part of the sample. It is expected that the number of contracts that result in disputes is small and the number of those disputes that actually reach court is also small such that this area of study will encompass only ancillary part of the overall area of interest.

Whilst most research would suggest that case studies should be more properly defined within a literature review and therefore as secondary research, in legal research cases are the fundamental building blocks. Korobkin makes the point

by defining judicial opinions as the first source of empirical data and therefore would suggest that this brings it within a more objective and practical category than theoretical. The nature of legal reports that are published would indicate that there is much subjectivity associated with their content.

This aspect reflects the previously identified phenomena of legal research in general in that most such work is focussed on understanding the existing body of knowledge and applying it to new scenarios. A simple review of any academic legal work will show that rather than understanding and applying the works of legal study, the larger part of any references are to primary sources which will include specific cases and legislation (Acts and Statutory Instruments). As such a review is considering interpretation and analysis of decisions albeit with every effort to be objective, it will be subjectively based on the individual's own perceptions and prejudices. Each stage of the translation from the judge's consideration through the reporter's application to paper and the review of the analyst introduces subjectivity and scope for qualitative assessment.

In addition to understanding the exact meaning of the words prepared by the judge, there is often a need to reconcile the different words written by a number of judges (in the case of the Court of Appeal and the Supreme Court). They may claim to agree with the other members, but when reading the judgements, it is not always clear that they do. One way of reconciling this might be to review secondary interpretations of the judgements, but this is then introducing another layer of subjectivity into the equation.

It is possible that this method would provide useful information on some aspects of the use of standard form contracts if it were to explore a number of key decisions or look to compare decisions in UK courts with similar cases in other jurisdictions. This would only provide results on the matters that reach the courts though when an important element of this thesis is to assess the way that contractual matters are handled by individuals and so this would only be relevant to final stage in a lengthy process.

A further option that should be more beneficial is to review sets of standard conditions in order to assess what is included and how certain matters are

covered. This can then be used to compare against other results to provide substantiation for particular comments like the importance of establishing limits on liability or clarity on payment terms.

The second source of data proposed by Korbokin is through actual contracting practices and may be by gathering information from current practitioners through a variety of methods including structured or semi structured interviews of without direct contact through questionnaires. The structured interview approach reflects the methods used in previous notable studies of similar phenomena in contracting behaviour by Macaulay<sup>115</sup> and by Beale and Dugdale<sup>116</sup>. The choice of method will depend on various factors including the accessibility of suitable sample and the time and resource available to carry out the work.

## **2.7 Summary**

From the initial work of Stuart Macaulay<sup>117</sup> in 1963 and a slow start to further exploration of how contracts work in practice, there has then been a steady expansion. This has developed in different areas as the focus has become necessarily narrower, with each piece of work contributing to an overall greater understanding of contracts.

The analysis of how contracts are used and how effective they are in managing business has been an area of interest for many different disciplines. Economics has attempted to take ownership of the subject but other management and business areas have also developed a body of work. It is important to consider these in order to recognise any relevance to the area of SFCs and hence to this thesis.

This thesis is driven by a desire to understand how contracts are established and used in practice and is therefore primarily focussed on empirical

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<sup>115</sup> Stewart Macaulay (n2)

<sup>116</sup> Beale and Dugdale (n34)

<sup>117</sup> Stewart Macaulay (n2)



approaches to contracts. This is based on the findings of Macaulay in identifying the non-contractual features that explain how contractual matters are actually dealt with in the many millions of contract transactions completed daily.

As the first to develop these ideas, Macaulay set the basis for the areas of examination, being initially the '*creation of exchange relationships*', which deals with forming the contract and establishing the agreement. The second aspect which became of more interest in his later work concerned the '*adjustment of exchange relationships and settling of disputes*'.

In both of these areas it was clear that the approach of the business users sampled was detached from the detail of the contract and focussed on the practical challenges of maintaining commercial relationships. These areas will therefore be an important feature of this thesis in testing whether these attitudes are still prevalent and whether there are any differences in the detail from previous studies.

The summary conclusion reached by Macaulay was that the legal aspects of contracts were generally secondary to the practicalities of running a business. The challenges of ensuring that each contract was a true reflection of the intention and expectation of the parties frequently proved too great and the impact of failing to reach clear agreement was sufficiently small to encourage users to pay minimal attention.

Subsequent studies reached similar conclusions in spite of taking different populations for their sampling, indicating that it may possible to apply the results more generally to business contracts in general. The further work of Macaulay identified broader conclusions in relation to dispute resolution confirming that commercial entities prefer not to litigate and reach agreement to maintain both the relationship between the parties and their reputation within their specific community.

This desire to find alternative solutions has been developed to a more systematic level in some controlled business environments as demonstrated by Bernstein. Founded in custom and practice and embedded in the culture of the specific industries, these models present a formal representation of the informal techniques that have been recorded in most studies. More recently these

models have been developed and challenged by Richman<sup>118</sup> as they try to adapt to technological, political and economic changes in the current environment.

The clear rules evident in these examples are at one extreme, which may include less recognised methods apparent in all samples, including the one subject to this thesis. This can be tested to a degree by checking for any common themes in different organisation's standard terms of business that might indicate a cultural alternative method to achieve a goal.

An underlying theme in the works reviewed is the desire to maintain business relationships and this is explained by one of the two relational concepts expounded by Macneil. Although standard form contracts are likely to be used for discrete transactions, the relational aspects will still prove to be important. The use of SFCs may be for individual transactions, but are potentially used routinely for the same product or service with the same trading partner.

To understand how best to further explore practical use of contracts requires some appreciation of alternative views and methodologies and this leads to considering whether alternative business or social assessments might add context. Other academic analysis of contracts has been led by economics with its desire to create complex models that fit in to the bigger economic models. This has led to some significant success but without visiting the everyday use, or potentially lack of use, of the formal agreement.

To achieve an appreciation of this requires assessing previous empirical studies which have provided a good source of knowledge and experience that will be used to develop a methodology in chapter 3.

This thesis is intended to explore the specific area of SFCs and identify the key features that support the hypothesis that earlier studies, and in particular Macaulay<sup>119</sup>, are still valid. It is also expected that it will identify some areas

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<sup>118</sup> Barak D. Richman, ' Stateless Commerce: The Diamond Network and the Persistence of Relational Exchange', (Harvard University Press 2017)

<sup>119</sup> Stewart Macaulay (n2)

which are specific to SFCs or potentially have developed in the period since the previous studies. Recognising that the world in which business operates is constantly changing, it would be unlikely that the contracts that govern transactions don't change to accommodate these changes.

### **3. DEVELOPMENT OF A METHODOLOGY FOR EMPIRICAL RESEARCH**

#### **3.1 Introduction**

Since Macaulay<sup>1</sup>, there have been a number of works developing the core principles his original study identified. These have, in general, provided similar results from different countries and different industries. Some, like Keating<sup>2</sup>, have investigated narrower aspects of the original work. The intent of this thesis is to examine the outcome from these previous works and test whether they are applicable using different parameters (location, time and industry) and narrowing the field to focus on standard form contracts (SFCs).

The outcome from this work will then be developed in relation to an analysis of the content of a set of SFCs from the same group. It will then examine in more detail the results of these two activities in the context of the two key features of Macaulay study (creation of exchange relationships and adjustment of exchange relationships and settling of disputes).

This aim of this chapter is to assess possible methodologies to carry out new empirical research to collect new data. Having identified the intended methodologies, it will then develop the detail, including the specific questions to be used in the survey.

A starting point for this will be to revisit the proposed research question to provide more detail on what it means and how it can be dissected and hence the context in which it must be evaluated. What appears on the surface to be a simple expression of an open and clear problem soon becomes grey as it is broken down and each element examined for increased clarity.

The next stage is to carry out a review of research methods used in law to understand what methodologies are effective for different legal topics and how they have been applied to shed more light on the differing legal areas. The

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<sup>1</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), *Am Sociological Review* 55

<sup>2</sup> Daniel Keating, 'Exploring the Battle of the Forms in Action', (2000), *Michigan Law Review* Vol. 98, No. 8

development process can then analyse the earlier studies of similar topics to test their applicability including whether replicating a previous study (if possible) would provide greater insight into the development of knowledge. If this is not possible, then the outputs from those studies will at least provide a framework within which to place any new findings and hence some of the key conclusions from those works may be assessed to form the basis of a new investigation. In this case, the two main works to be considered are by Macaulay<sup>3</sup> and by Beale and Dugdale<sup>4</sup>, and by exploring these in more detail it should be possible to generate a framework in which to carry out new research.

This comprehensive grounding in the empirical research environment will then allow the development of the proposed methodology using an on-line questionnaire and hence the key activity of designing the questionnaire structure and ultimately the specific questions. Closely aligned to this is the need to identify the target sample and the proposed analysis that will be carried out on the results and hence the need for general questions on the individual and their employer.

### **3.2 The Research Question**

The first stage in developing a methodology to capture new information on the subject of this project is to revisit the core hypothesis to ensure that it is clear and unambiguous. The question as stated is:

*“An Evaluation of the Effectiveness of Standard Form Contracts in Meeting the Expectations and Needs of Business Users”*

The concept throughout has been that the prime method of data capture would be through the use of a form of a questionnaire. This will then rely on the interpretation of the questions by the respondents and then the views of the individuals rather than any scientifically measurable criteria. As such, it is attempting to create a form of quantitative analysis of qualitative information but

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<sup>3</sup> Stewart Macaulay (n1)

<sup>4</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y 45

therefore requires a maximum degree of objectivity in the definition of the hypothesis and the subsequent questions.

### **3.2.1 Effectiveness**

The first part of the question then lies in the test of effectiveness of SFCs though recognising that effectiveness may be a subjective perspective and be a different quality to different individuals. It should be possible to test this property through a number of methods to provide an answer indicating that either they are or are not effective or, more realistically, how and to what degree they are effective or ineffective.

This can be considered from various perspectives. The initial concept was from a point of view of a commercial organisation wishing to balance the cost and benefit equation across its various functions with the ultimate goal of delivering an acceptable return for its shareholders. Consequently any assessment of effectiveness would be from this perspective and evaluated under some form of analysis of the costs and potential benefits of different approaches.

This would consider the cost of using this approach against the comparative costs of using no such forms or an alternative approach like negotiating each contract individually. However, the effectiveness may also be judged within a broader legal environment which would assess whether they provide benefit for business in general and support the higher principles of fairness and equality of bargaining power. It is hoped therefore that any interrogation might provide guidance in both of these areas without diluting the relevance of any results.

Taking the first position to the next level of definition requires an appreciation of how businesses might consider the effectiveness of such tools and what is important to them. This may be the desire to facilitate relationships with trading partners and not create conflict when entering each separate agreement or it may be the need to ensure that it manages its business risks effectively through limiting contractual exposure.

An important aspect of an interrogation therefore should be to elicit an understanding of how these documents are used beneficially by the different functions within a business. These may be:

- Sales: increase revenue by facilitating the selling process.
- Finance: reduce costs of agreeing contracts.
- Legal: reduce risks when the transaction fails in some way.
- Operations: Provide a standard approach to delivery.

Most likely, it is a combination of a number of factors, each competing with the other for primacy in the drafting of terms. Ultimately, effective terms will be those that contribute fully to the business objectives, most commonly dictated by the ultimate financial results driven by corporate strategy.

### **3.2.2 Standard Form Contracts**

The second element of the question is probably easier to define without being significantly controversial. Most organisations will have a set of standard terms and conditions established for different types of transaction and will try to use these routinely either as pre-printed forms, as part of an electronic document or also more recently included on the company web site and referred to on the order or offer document.

Additionally, it will be necessary to decide whether to include industry SFCs which are produced by an independent body in order to allocate risk in a reasonable manner and facilitate fair dealings.

Another area of uncertainty is in defining when standard forms are no longer standard forms following negotiations and subsequent amendments. This is the subject of debate and clarification through case law in response to matters arising out of the Unfair Contract Terms Act (UCTA) and its reference to “...*the other’s written standard terms of business*”<sup>5</sup>. Consequently, in view of the importance of this legislation to the area of study, it makes sense to use this as the starting point and its subsequent interpretation by the courts as the benchmark. In most cases it is clear if a deal is on standard terms of business although there may be uncertainty where there has been some negotiation between the parties and the effect of this on the status of the terms can only be assessed on the facts as can be seen in *Salvage Association v Cap Financial*

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<sup>5</sup> Unfair Contract Terms Act 1977, Section 3(1)

*Services*<sup>6</sup>. In the end, the most illuminative approach may be to let the respondents reach their own conclusion on what they consider to be Standard Terms and Conditions as this will be the way they deal with the subject in general business.

### **3.2.3 Expectations and Needs**

The desire to assess the use of contracts against defined criteria will require those criteria to be defined. In this case, the aim is to use expectations and needs and these two properties will be developed on separate principles. The expectations of the users will take the views of the sample to establish what the users believe their contracts are intended to achieve and their understanding of how they satisfy broader business objectives.

The needs of business users however will consider whether they actually achieve any objectives through their content and if they are effective in smoothing business transactions. This will be from a review of the content and the feedback on their use in resolving problems as they arise.

### **3.2.4 Business Users**

The final part of the question can be effectively covered by limiting any research data gathering to business entities and ensuring that the questions are specifically related to business relations and deals between companies. Whether the companies are 'commercially astute' may be subjective, but the intent is that they are currently trading and therefore have a degree of commercial maturity. In the end, the measure of this is the commercial success of the business and by limiting the work to business transactions and therefore excluding any issues which would be with consumers (covered by the Consumer Rights Act 2015<sup>7</sup>), then the sample is bounded.

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<sup>6</sup> *Salvage Association v CAP Financial Services Limited*, [1995] F.S.R.654, QBD

<sup>7</sup> Consumer Rights Act 2015



### 3.3 Research Methods Theory

#### 3.3.1 Empirical Research

To be able to answer the research question requires the researcher to assess information and that information needs to be relevant, consistent and reliable. Gathering that information or “...*data from the real world*”<sup>8</sup> requires using empirical methods and such data could be qualitative or quantitative. It has been argued that, assuming there is a common understanding of scientific research, such scientific techniques cannot be applied to the social sciences<sup>9</sup>. Indeed the relevant analysis goes on to question whether they are even justified in being used for scientific research. This thesis will assume that such empirical methods are valid for scientific research and in principle can be applied to the social sciences, albeit that there are limitations which will be discussed later.

Having crossed this hurdle, the next challenge is to identify what methods are available to provide new data and hence new information to assist in answering the question. As a starting point, the methods available may be divided “...*because the empirical evidence can be numerical (quantitative) or non-numerical (qualitative)*”<sup>10</sup>, though as Epstein and Martin go on to explain, this is a limited view of empirical research. The classic studies<sup>11</sup> forming the basis of this thesis would be categorised as qualitative under this principle, but by interviewing a large number of individuals, the works may start to generate a statistical basis.

Perceived wisdom is that the true sciences like physics, chemistry and biology can use quantitative techniques, but where the subject of the research was generally humans and human interactions, then this was less likely to be

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<sup>8</sup> Lee Epstein and Andrew D Martin, '*An Introduction to Empirical Legal Research*', (Oxford University Press 2014), p3

<sup>9</sup> Colin Robson and Kieran McCartan, '*Real World Research*', (John Wiley & Sons 2016) p 17

<sup>10</sup> Lee Epstein and Andrew D Martin (n8), p3

<sup>11</sup> The works Macaulay (n1) and of Beale and Dugdale (n4)

appropriate<sup>12</sup>. A number of factors were identified as making quantitative techniques using unsympathetic numerical analysis ineffective, including “...*human consciousness and language, the interactions between people in social situations, the fact that both researcher and researched are human...*”<sup>13</sup>.

In most cases however, the design of the research is driven by practical considerations like the availability of suitable data, whether people or documents or records. This was certainly true for Macaulay<sup>14</sup>, who used his own knowledge of the Wisconsin local industry and contacts to form the basic sample for his interviews. This approach, though not seen as a criticism of Macaulay at the time would be described as a convenience sample, by using “...*the nearest and most convenient persons to act as respondents*”<sup>15</sup>.

### **3.3.2 Interviews**

Taking the Macaulay<sup>16</sup> study as the model, the first option to collect new data for this work would be to duplicate the model. The paper does not provide much detail on how the interviews were carried out and whether they were clearly structured however it can be assumed that, from the analysis, they were at least partially structured. The alternatives would have been Fully Structured or Unstructured according to Robson and McCartan<sup>17</sup>. Whilst they allow “...*further investigation of more interesting points...*” and “...*the potential for providing rich and highly illuminating material*”, they also have disadvantages.

Amongst the disadvantages listed are<sup>18</sup>:

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<sup>12</sup> Lee Epstein and Andrew D Martin (n8), p18

<sup>13</sup> Ibid p18

<sup>14</sup> Macaulay (n1)

<sup>15</sup> Colin Robson and Kieran McCartan, (n9), p281

<sup>16</sup> Macaulay (n1)

<sup>17</sup> Colin Robson and Kieran McCartan (n9), p285

<sup>18</sup> Ibid, p 288

- Lack of standardisation that it implies inevitably raises questions about reliability. Biases are difficult to rule out.
- Interviewing is time consuming;
- All interviews require careful preparation; and
- Notes have to be written up and tapes if used need to be transcribed.

Face to face interviews, whilst allowing more depth and exploration of points of interest present an additional practical challenge in maintaining a standardised approach unaffected by the specific circumstances of the separate interviews. This may be affected by the location, the time or even the specific mood of the interviewee.

As interviews are considered an appropriate option to follow up on and collect more information on a quantitative study<sup>19</sup>, it was intended to utilise this option following the questionnaire. This plan however was discounted due to the time necessary and the limited resources available.

### **3.3.3 Questionnaires**

An alternative to such interviews and a solution that is recognised as growing in popularity<sup>20</sup> are surveys conducted via the internet. This removes some of these variables allowing the respondent to work in their own time as convenient to them is the use of a questionnaire, this is even more the case when the questionnaire is on-line and allows them to choose when to commence. These surveys however also have their limitations. Robson and McCartan identify five specific disadvantages of surveys<sup>21</sup>, being:

- The characteristics of the respondent (like memory, knowledge and motivation);
- A desire to provide socially acceptable answers rather than true feelings;
- Low response rate – which means that the sample is self-selecting;

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<sup>19</sup> Colin Robson and Kieran McCartan, (n9), p286

<sup>20</sup> Lee Epstein and Andrew D Martin (n8), p77

<sup>21</sup> Colin Robson and Kieran McCartan, (n9), p265

- Ambiguities in the questions which may lead to misinterpretation; and
- The seriousness of the responses.

The design of the questionnaire and the approach to addressing specific areas of interest will also affect the quality of the data. Getting a balance between the depth of the data and the volume of responses will present a challenge that can rarely be satisfactorily solved.

One way to improve the validity of empirical research is to employ more than one method and then assess whether the results provide a common substantiation for the proposed theory. This method of triangulation, from the geographic technique of fixing a position using three separate known points (triangulation stations) can counter the threats to validity<sup>22</sup>, particularly where the separate methods might have their own limitations.

Although there is more than one method of establishing this triangulation, the one that is most appropriate for this study is '*data triangulation*'<sup>23</sup>. This supports the process of gathering data using various methods which can then be used to cross reference specific aspects of the theory. In this study, the starting hypothesis is derived using grounded theory and this is then triangulated using data from a questionnaire and then a review of SFCs.

### **3.3.4 Empirical Research in Contract Law**

The next stage in deciding what data to use and how to collect that data is to consider what methods have been used before in legal research and then specifically in similar research into contracts.

As has been highlighted elsewhere, the use of empirical research in law has a mixed history and as Nard<sup>24</sup> pointed out, there was in the 90s considered to be

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<sup>22</sup> Ibid, p174

<sup>23</sup> Norman K. Denzin, '*The Research Act: A Theoretical Introduction to Sociological Methods*', (Routledge 2017), p297

<sup>24</sup> Craig Nard, 'Empirical Legal Scholarship - Reestablishing A Dialogue Between The Academy And Profession' (1995) 30 Wake Forest L. Rev. 347

a gap. Equally, Eisenberg raised the rhetorical question “*Why do Empirical Legal Scholarship*”<sup>25</sup>. Both then went on to explain that there is both a basis for such work as well as a genuine need for the results.

Perhaps the most useful reference when exploring potential empirical methodologies for gathering data on in any area of socio legal research and specifically in contract law is Korobkin<sup>26</sup>. As explored previously in chapter 2, he provides a number of possible frameworks for such work based on thorough analysis from a wide range of work over a 15 year period and focussing on the source of the data and the intended use of the results.

This thesis has always been based on practical use of contracts and intended to provide insight into how they can be used effectively and is therefore intended to be presented in a practical and useful report. Of the four possible sources of data, the one identified by Korobkin that fits this principle most closely is that of ‘*Actual Contracting Practices*’<sup>27</sup>.

This category is broken down further into three subsets, the first of which is categorised by Bernstein<sup>28</sup> using descriptive methods of explaining behaviours without any quantitative aspects. Another subset is to study actual contracts and complete analysis based upon the content and use of those written documents, a method that is also used in this thesis. The third subset identified by Korobkin however, is characterised by the work of Macaulay and uses the results from interviews with those individuals who are actual users of the contracts in question.

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<sup>25</sup> Theodore Eisenberg, 'Why Do Empirical Legal Scholarship?' (2004) 41 San Diego L. Rev. 1741

<sup>26</sup> Russell Korobkin, 'Empirical Scholarship in Contract Law: Possibilities and Pitfalls' (2002) U. Ill. L. Rev. 1033-1066

<sup>27</sup> Ibid p1040

<sup>28</sup> Lisa Bernstein, Opting out of the Legal System: Extralegal Contractual Relations In The Diamond Industry, The Journal of Legal Studies, Vol. 21, No. 1 (Jan., 1992), pp. 115-157 amongst others referenced elsewhere.

Ultimately, the decision to use data collected from real people who routinely use SFCs was initially prompted by reviewing previous studies like Macaulay and Beale and Dugdale<sup>29</sup>, though consideration of other empirical studies<sup>30</sup> also identified this as the most appropriate means of capturing useful data. These studies have formed the basis of numerous further studies which seek to both develop the findings and also to build upon them with new studies.<sup>31</sup> As Wheeler points out<sup>32</sup>, Macaulay used a snowball sample starting with personal contacts and ending up with a sample size of 68 from engineering firms in Wisconsin.

This well reviewed work was based on face to face interviews<sup>33</sup> lasting from a 30 minute superficial response to a set of open questions up to 6 hours long in-depth discussions and driven primarily by a basic question on how contracts were used in practice. The technique was effective in establishing a basis of a common approach, but was limited by the size and cross section of the sample. By using contacts and second order contacts, the individuals reached were potentially of a similar background and philosophy of business.

Beale and Dugdale<sup>34</sup> took a similar approach when they carried out their research in the Bristol area in the 1970s. They also interviewed the sample of 33 from engineering manufacturers in the Bristol area, though don't highlight how they defined the sample. This therefore also leaves questions over the representativeness of the sample and whether they are naturally a closed group.

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<sup>29</sup> Macaulay (n1) & Beale & Dugdale (n4)

<sup>30</sup> For example R. Lewis, 'Contracts between businessmen: Reform of the law of firm offers and an empirical study of tendering practices in the building '

<sup>31</sup> Sally Wheeler, Contracts and Corporations, in Peter Cane & Herbert M. Kritzer (eds), The Oxford Handbook of Empirical Research (Oxford University Press 2013)

<sup>32</sup> Ibid, p132

<sup>33</sup> Macaulay (n1)

<sup>34</sup> Beale and Dugdale (n4)

### 3.4 Empirical Methodologies for Testing Contractual Behaviours

From examining empirical research in law, it can be derived that there are a number of possible options for producing empirical data to inform this work<sup>35</sup>. These may include:

- a. Reviewing case law relevant to interpretation of contracts and in the context of developments in law, in order to understand whether the use of SFCs achieves one of the perceived objectives of reducing cost and simplifying the contracting process;
- b. Analysing the decisions of the courts either qualitatively or quantitatively by surveying a large number of outcomes, which would also provide illumination as to whether SFCs are subject to a lower ration of court claims than bespoke contracts, albeit that this may be a secondary effect of the value of the contracts;
- c. Analysing a selection of SFCs to assess what risks are covered and how they are covered and then considering whether the terms address the concerns of the organisations and individuals who use them;
- d. Interviewing a selection of individuals who are routinely involved in some aspect of contracting in practice (drafting, negotiating, delivering, managing) to understand their separate objectives and expectations of SFCs;
- e. Surveying a larger sample of practitioners with standard questions to allow a more quantitative analysis of the responses, though also testing the behaviours and aims of the organisations and individuals.

Many areas of the social sciences utilise techniques based on observation of target populations, often from an embedded perspective, whereby the observer integrates into the subject community. These observations are then recorded from inside and hopefully without adversely affecting the behaviour of the community itself. The recorded observations can then be evaluated for

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<sup>35</sup> Russell Korobkin, 'Empirical Scholarship in Contract Law: Possibilities and Pitfalls' (2002) U. Ill. L. Rev. 1033-1066

inconsistencies and reported as part of a broader study. It is from an equivalent starting point that this study has been born, by observing contracting practices from within the business community and recognising particular behaviours of different groups<sup>36</sup>. This can be divided into the functional groups within an organisation, like sales and finance or those organisational factors like selling or buying, large or small. This grounded experience has provided a canvass to which the academic theories have been added to create a base model for further exploration.

### **3.4.1 Grounded Theory**

The decision to pose, or at least develop, the specific question has already been made following extensive consideration based on personal experience from within the business environment which is the prime focus of this study. This has been expanded by anecdotal reports from other agents in the field and also from reports produced by Professional bodies<sup>37</sup>. Whilst the precise methodology may not have been defined in advance, it has been developed by observation of the activities of organisations and individuals operating what they hope and believe are competitive business models.

This perspective has been developed over a number of years but without a clear academic framework. By working within different types of organisations and with different types of customers and contracts, much personal and subjective assessment has been made of the business environment. This primary experience has been expanded through conversation and debate with other individuals from different backgrounds but who also have interesting and challenging opinions on the use of contracts. Whilst recognising that this is very personal and therefore influenced by multiple additional factors around education, training, employment background and even social activities, it is nevertheless valuable and important in developing the core question.

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<sup>36</sup> Macaulay (n4)

<sup>37</sup>For example: Nigel Blundell and Shy Jackson, ' Ask The Expert: A practical introduction to collaborative construction contracts', (IACCM Report Published May 2017)



The use of theories developed through first-hand experience has been recognised as an acceptable approach for empirical research since the 1960s<sup>38</sup>, but in this case will be used as a reference point for measuring against alternative techniques to produce a broader picture. The process has its limitations<sup>39</sup>, including the lack of clear pre-existing theoretical studies. However, in this study, it also has its benefits in providing additional soft data that enhances the quantitative data collected through other methods.

The next step is to put these issues into a form that can be used as any type of basis for analysis and to try to exclude as much of the subjectivity as possible. A sound starting place for this is through committing the existing experience to paper in order to organise and define the experiences. The act of writing requires application of structure and meaning to pure experience and this has led to a more objective understanding of the issues. One of a number of points that have become clear through this analysis is that sales personnel have a different view to the purpose of a contract to that of a commercial or legal individual; A point that substantiates some of the conclusions drawn by Macaulay<sup>40</sup>.

It has also demonstrated the different issues that arise out of contracts as matters of concern whether during the initial activity of negotiating and agreeing the terms or subsequently attempting to resolve disputes by referring back to the agreed terms. As identified by the previous studies of Macaulay<sup>41</sup> and Beale and Dugdale<sup>42</sup> however, the exact drafting of the terms seem to be of less importance than the intent and the relationship between the contracting parties. These initial observations are significant in aiding the direction of the research and the questions that need to be answered. Ideally, these would all be simple

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<sup>38</sup> Barney G. Glaser and Anselm L. Strauss , *'The Discovery of Grounded Theory: Strategies for Qualitative Research'* , (Chicago Aldine 1967)

<sup>39</sup> Colin Robson and Kieran McCartan, (n9), p 161

<sup>40</sup> Macaulay (n1),p. 13

<sup>41</sup> Ibid, p. 15

<sup>42</sup> Beale and Dugdale (n4), p.50

yes or no questions, but as the more interesting factors are behavioural, this is unlikely to provide as much useful data.

### **3.4.2 Options for Gathering Data on Views and Behaviours**

It is important to return to the specific research question in order to identify the best methodology for gathering useful data to provide answers. This summary of the issues from the previous dissection of the question can now be placed in the context of the background experiences described.

The question in this case is intended to test the hypothesis that SFCs have limited effectiveness as legal enforceable agreements as they are prepared on the basis that they satisfy certain legal criteria and fulfil a superficial role in establishing a relationship though it is almost a ceremonial role rather than a practical one. They are used where the cost of more complex or detailed contracts will be prohibitive compared to the value of the business they cover. This factor also militates against any potential disputes being extensive or justifying any large expense in time or money<sup>43</sup>. As an initial hypothesis, this has been derived from reviewing the studies already quoted and endorsed by observation and a desire to understand the approaches of a variety of practitioners but has subsequently been developed to consider other possible techniques.

However, the topic as defined is not a question but defines a process which itself needs to be broken down to facilitate analysis. The simple sentence can be broken down into a number of elements each raising its own points for clarification. The questions which arise immediately concern:

- What is 'effectiveness' and is this in reference to the context of contract law or to business;
- What nature of business is being considered to which the contracts relate;
- To what extent are contracts standard form.

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<sup>43</sup> Stewart Macaulay, 'Freedom from Contract: Solutions in Search of a Problem?' (2004) 2004 Wis. L. Rev. 777

An early stage of the project identified a number of earlier empirical studies in similar or related areas and a deeper look at these has provided a number of indicators on which techniques might be appropriate.

Previous studies<sup>44</sup> utilised methodologies based on interviews with a sample of individuals selected within a specific industry and geography as was determined by the availability of this resource. This approach may be considered a convenience sample as it uses the '*...nearest and most convenient persons...*'<sup>45</sup> to collect the data. Macaulay himself states that he was always aware of this, noting that the "*...sample consisted of friends of my father-in-law who would talk to me*"<sup>46</sup>.

More notably however is the use of interviews as the means of capturing the data and why and how these were used. This might also be described as a convenience method, as it was necessitated by the availability of subjects and ease of data collection. When collecting data from a sample of individuals, there are a number of methods available. These surveys can be carried out using a variety of methods<sup>47</sup>, from the original face to face interviews through telephone interviews (in increasing complexity) and more recently with internet surveys. Each of these will have benefits and limitations and the actual method chosen will be dependent upon the circumstances, not least the constraints affecting access to the sample and resources available to carry out the work.

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<sup>44</sup> Notably: Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), *Am Sociological Review* p. 13 & Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) *Brit. J.L. & Soc'y* p.50

<sup>45</sup> Colin Robson and Kieran McCartan, (n9), p291

<sup>46</sup> Stewart Macaulay, 'Contracts, New Legal Realism, and Improving the Navigation of The Yellow Submarine' (2006) *80 Tul. L. Rev.* p1182

<sup>47</sup> Mick P Couper, 'The Future of Modes of Data Collection' (2011) *Public Opinion Quarterly*, Vol. 75, No. 5, pp. 889–908

### 3.4.3 The Proposed Data Collection Method

The Macaulay method of selecting a sample<sup>48</sup> formed the basis of this study, though without the familial dimension. By then using the snowball method to increase the sample size introduces its own limitations<sup>49</sup>, as it relies on first order contacts to refer the survey onwards and they are likely to pass it on to colleagues of a like mind and hence with potentially similar views. However, this is countered to a degree by selecting the first order contacts with as broad a cross section as possible and therefore included different specialisations, organisations and experience.

This convenience sample<sup>50</sup> brings with it some limitations in respect of how representative it will be of the larger population, but is necessary to for two reasons. Firstly, the accessibility of the group ensures that optimum use is made of the limited resources available and secondly it controls the cross section of the group to try to collect data on a specific business market sector. There is however no opportunity to manage the distribution and hence the individual backgrounds of the group, as the sample should self-select a relatively representative cross section of the specific population.

Having identified the proposed sample the most important factors in selecting a methodology for this work were access and resources available. The sample was not as local as Macaulay as it was potentially spread across the country and potentially not as prepared to allocate significant time for an in depth interview.

Additionally, the resource available to carry out interviews was limited, although it was considered as an option early on to follow up on the questionnaire with interviews to explore some aspects in more detail. This was ultimately rejected based on the time taken following the questionnaire to complete the analysis to a position where further investigation would have been useful and hence the

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<sup>48</sup> Macaulay (n1), p. 13

<sup>49</sup> Colin Robson and Kieran McCartan, (n9), p291

<sup>50</sup> Martin Brett Davies, ' *Doing a Successful Research Project*', (Palgrave Macmillan 2007), p63

lack of continuity or availability of the original subjects. Additionally, the time needed to carry out such interviews was no available within the programme and as Epstein and Martin advise, “...researchers should collect as much data as resources and time allow”.<sup>51</sup>

The online questionnaire provided a compromise solution, though with recognised limitations. Some commentators have suggested that they may supply unreliable or inaccurate answers<sup>52</sup>, though it is hoped that a group of professionals would not fall within this set. Other problems identified are<sup>53</sup>:

- Difficulty in replicating them if needed – though this was intended to be a one off exercise;
- Ensuring the questions are clear and unambiguous – hopefully addressed through testing the questionnaire;

The original Research Question was framed to assess the views and opinions of a range of individuals within business and therefore the original expectation was that there should be some form of quantitative assessment of these differing views in order to provide statistical support for any particular position. By carrying out a questionnaire survey to a broad and representative sample then it should be possible to produce evidence to test the hypothesis that SFCs were merely a paperwork exercise that organisations felt they needed to employ as a matter of principle.

Unfortunately, this simplistic approach soon uncovered a number of limitations, most significantly the identification of the sample population and subsequently the availability of a suitable sample. The world of business is large and varied both in terms of the types of industries and the differing structures and attitudes associated with organisations. In order to avoid a survey on a mammoth scale

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<sup>51</sup> Lee Epstein and Andrew D Martin, 'Quantitative Approaches to Empirical Legal Research' ,in Peter Cane & Herbert M. Kritzer (eds), *The Oxford Handbook of Empirical Research* (Oxford University Press 2013)

<sup>52</sup> Lee Epstein and Andrew D Martin, (n8), p78

<sup>53</sup> *ibid*

and the data analysis complications, it would be necessary to revise the target sample. In either of these cases however, the approach, though fundamentally quantitative will need to recognise that the core questionnaire relies on qualitative information. Apart from some factual demographic data necessary to filter the responses and determine trends, the responses will be driven by the views and ideas of the respondents. These will therefore reflect many factors which are not specifically identifiable from questioning, like education and training, seniority, company culture, general views on business and knowledge of the law.

In attempting to resolve this limitation, a solution would be to attempt to use a variety of methods each providing a different perspective of the same theory, thus providing a triangulated indication of the probable answer, substantiated by different sets of data<sup>54</sup>. This would indicate evaluating differing approaches to supplement the raw quantitative measures that can provide more detail on a basic analysis and confirm (or otherwise) ideas derived from the initial survey.

An option to construct a second level of understanding of greater depth than the questionnaire survey brings with it challenges to objectivity. On the basis that a questionnaire process should not unduly influence the respondent, then any data collected should be due to the individual thoughts and understanding of the respondent. The design of the questionnaire is therefore crucial to avoid leading the respondent and thus encouraging them to answer in a particular way<sup>55</sup>.

The alternative, where the researcher is present for any activity, as the case with any form of direct interviews, the need for clarity and objectivity is more defined. Such interviews would need to take account of the sensitivities of the interviewee to ensure that they are comfortable with the manner and depth of questioning. Ideally, the questions should be made available to the subject in advance in order that they can consider the issues and not be required to formulate instant views. Although one of the benefits of semi structured

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<sup>54</sup> Bryman, A, ' *Quantity and Quality in Social Research*', (Allen and Unwin 1988,) p131

<sup>55</sup> Colin Robson and Kieran McCartan, (n9), p 258

interviews is that they allow flexibility to explore specific areas of interest as they arise, this can be a limitation as it provides the opportunity for the interviewer to direct the process whether intentionally or not.

Whilst it is probable and desirable that a research question will change over time it is important that this is recognised and that the methodology develops in support of this evolving process. By establishing a question or a set of questions, at the start there is at least an attempt to set constraints on what areas will be explored. The first challenge however arises from the first step of the quantitative process in defining the population for study.

Although the proposed area of study may seem clear, the reference to 'Business Users' raises further questions like "what is meant by commercial" and "customer of whom?". As the original concept would have been to carry out a broad research that would generate results that could be applied to a wide range of businesses, this would require taking a population of any business (within the UK) and any area within those businesses. Pragmatism dictates that the first stage of the project definition therefore will be to provide a degree of prescription to the area to be tested.

#### **3.4.4 Options for Gathering Additional Information**

Korobkin's<sup>56</sup> attempt to categorise the potential sources of empirical data widens the scope for techniques to be included within the field by embracing traditional legal sources including, amongst others, judicial opinion and actual contracting practices. Both of these areas will contribute to answering the research question, though at the present, only the latter is intended to be used for quantitative statistical analysis.

The use of judicial opinion in an analysis may be through understanding and interpreting a small number of significant decisions in the context of the area of study and then the applicability of those decisions to the wider cases. This approach is fundamentally a qualitative approach, unlike a large assessment of

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<sup>56</sup> Russell Korobkin, 'Empirical Scholarship in Contract Law: Possibilities and Pitfalls' (2002) U. Ill. L. Rev. 1033-1066

multiple decisions on a narrow issue, like a particular clause or statute that can be analysed statistically based on defined comparable criteria. These quantitative techniques attempt to apply a numerical mechanism to what is primarily written information and so will inevitably be subject to a level of variability. Generally, they will try to codify the cases on defined criteria that can then provide a numerical interpretation of the cases and the decisions. By accumulating a significant number of these it is possible that any variations can be smoothed, unless there is a systematic failure in interpreting a specific element.

An alternative approach to actual contracting behaviour is through analysis of a wide variety of standard forms of contract and approach used by Macaulay<sup>57</sup> to a degree. This also introduces a noticeable degree of subjectivity as it relies on the skills of the analyst in identifying the subtle drafting ploys of any particular organisation. It is also unlikely to be able to predict how the courts would ultimately assess the effect of such clauses so that any inferences could only be comparative without any definitive conclusions on effectiveness. This area could potentially be converted into a quantitative technique by collating data on different drafts for different terms, providing a statistical analysis of clauses like limitation of liabilities and what might be included or excluded, indicating key contractual requirements.

In this work, it is not intended to extend the research to a review of judicial opinion as the hypothesis is directed at contracting behaviours and, as Macaulay<sup>58</sup> pointed out, the disputes rarely go to court. In fact, one particular area of interest is specifically why disputes do not reach the courts and how and at what stage they are resolved.

An area of documentation that may be of more interest and one that Macaulay<sup>59</sup> utilised, is the actual SFCs themselves. By analysing a select sample for

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<sup>57</sup> Stewart Macaulay (n1), p57

<sup>58</sup> Ibid, p.11

<sup>59</sup> Ibid p.5



specific obligations it may be possible to derive an alternative conclusion on what is important and how key matters are addressed.

### **3.4.5 Preparation for the Questionnaire**

Having identified the main area for gathering data to try to answer the question central question on the effectiveness of SFCs, there are a couple of practical issues that then need to be addressed before issuing the survey. The first of these is to consider the ethical implications of the research<sup>60</sup>, particularly as it was intended to seek input from individuals from a variety of business organisations.

This raised issues both personal and professional as the data would be collected from some individuals who were personal contacts and also potentially from business organisations across a spectrum, including suppliers, customers and possible competitors. As it was always intended that the data collected would be anonymised, then there should be no problem with data protection, although the individuals were invited to include contact details should they be interested in further involvement.

The personal data did not include any names, addresses or contact information therefore unless the respondents were in agreement such that they would be able to offer clarification or further information at a later date (this option was subsequently excluded). The main issue therefore was related to business ethics and the use of any information that might be confidential. Although some information was requested about the size and industry of the respondent business, this was general and insufficient to be able to identify the specific company.

The next stage to improve the effectiveness of the questionnaire was to carry out a test sample with a limited group<sup>61</sup>. The aim of this was to ensure that the questions were understandable, the format logical and content reasonable. The test sample used individuals with a direct association and with a reasonable

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<sup>60</sup> Colin Robson and Kieran McCartan, (n9), p 209

<sup>61</sup> Colin Robson and Kieran McCartan, (n9), p 270

interest in the subject, though this automatically introduces some doubts as they would not necessarily be representative of the broader population.

Feedback from the test sample provided some queries about interpretation of specific questions which were then amended to try to clarify the intent. It also provided comments on the length of the questionnaire and resulted in some questions being removed, before the final survey was ready to use.

### 3.4.6 Recording and Analysing the Data

The final point to consider with the development of the questionnaire was how the data would be analysed when it was complete. The questions included fall into four broad types and each would need to be assessed in a different manner.

- Simple yes/no/don't know questions: These can be analysed by calculating the percentage of each response.

1	Does your Company use Standard Terms of business for buying or selling?	Yes	No
	Responses	52	1
	Percentage	98.1	1.9

- Identifying the band (eg turnover of the business or industry of the business): this can be analysed by calculating the percentage for each band.

<b><u>What is the main nature of your company business?</u></b>		
Construction	11	16.2%
Legal	2	2.9%
Property Services	10	14.7%
Specialist Sub Contractor	8	11.8%
Specialist Supplier	10	14.7%
Other	14	20.6%

Blank	13	19.1%
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- Ranking different items (eg most common disputes): This can be grouped to the first, second and third highest and then compared against the remainder.

<b><u>In your experience, please rank in order the nature of any disputes by frequency:</u></b>					
<b>Payment/ Billing</b>	<b>Poor Performance</b>	<b>Poor Quality</b>	<b>Early Termination</b>	<b>Relationship</b>	<b>Other</b>
23	9	2	5	0	0
3	13	8	8	7	0
8	9	12	3	4	3
59%	23%	5%	13%	0%	0%
8%	33%	21%	21%	18%	0%
21%	23%	31%	8%	10%	8%

- The final type is an open question asking for comments or more detail and usually following on from a narrower question (like what topics might have been included in any training): These are less quantitative, though can be if some responses are common, but provide more context to the responses. They can be used to provide more depth to the specific questions with an associated narrative.

With the limited volume of data it would be inappropriate to apply any more sophisticated statistical techniques to provide it with more validity. In practice, the data can be analysed to show the more prevalent responses and provide a quantitative assessment of qualitative data and hence allow comparisons with the pure qualitative research conducted by Macaulay<sup>62</sup>.

Analysing the sample of SFCs also provides a mix of quantitative and qualitative results. By identifying the key topics to be assessed then it is possible to record

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<sup>62</sup> Stewart Macaulay (n1)

those clauses in the sample to analyse the percentage of contracts that cover the risks. These clauses can then be reviewed in more detail to identify any common drafting or more subjectively by assessing how they deal with legal issues in the context of existing law.

### **3.5 Empirical Studies**

As identified on a number of occasions, any research into attitudes towards the use of contracts effectively starts with Macaulay<sup>63</sup> and his analysis of the non-contractual relations acting in parallel with formal contracts. This work was then explored further by Beale and Dugdale<sup>64</sup> in the 1970s with a study that looked in more detail at a number of specific aspects of contract, but with broadly similar conclusions. Subsequent studies<sup>65</sup> have taken these raw conclusions and examined specific aspects of them in more detail and provided further information.

In order to bring some context to any new research it is beneficial to refer to these earlier works as a starting point and to identify some of the key issues that can be assessed in the current environment. Assessing the methods used by these earlier studies can also provide pointers to what might be effective techniques for exploring the topic in the 21<sup>st</sup> Century, recognising that developments in technology might offer different options for the present day researcher.

#### **3.5.1 Key Factors Arising from the Macaulay Study**

Macaulay<sup>66</sup> points out early in his work that the study is limited to manufacturers in the Wisconsin area for very good reasons, one of which is the practicality of

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<sup>63</sup> Ibid

<sup>64</sup> Beale and Dugdale (n4)

<sup>65</sup> R. Lewis, 'Contracts between businessmen: Reform of the law of firm offers and an empirical study of tendering practices in the building ' (1982) 9 *Journal of Law and Society* 153-73; and, John P. Esser, 'Institutionalizing Industry: The Changing Forms of Contract' (1996) vol 21 *Law and Social Inquiry* 593

<sup>66</sup> Macaulay (n1), p.2 n.3

reaching and soliciting responses from the subjects. However, the analysis is directed at two specific aspects of contracts, the first of which, creating exchange relationships is an area where the subject businesses were identified as incorporating a significant element of transaction planning. The broader study was more comprehensive and included the examination of sample SFCs, reviews of reported court cases and letters of enquiry to a larger sample of business people. However it is the outcome from the interviews of 68 business users that forms the basis of the main findings.

The paper summarises the methodology and is then structured to address the two specific areas, creating exchange relationships and the use of (actual or potential) legal sanctions, where the findings are summarised before tentative explanations are offered.

The principle analysis of the contract creation aspect indicates four levels of detail and that these stretch from the essential attribute which defines the product or performance through to the rarely considered legal mechanisms for failure to perform. The depth and detail of any of these planning requirements would vary depending upon the size and complexity of the transaction, such that the more complex and higher the value, the larger the contract and the time taken to finalise. Routine transactions however are managed by using 'standardised planning' which includes the use of sets of standard terms and conditions backing up the necessary detail of the specific requirements.

How these standard terms and conditions are used provides some illumination on the importance they are afforded as exchanges of orders and acceptances appear to be handled routinely by non-lawyers who are interested primarily in the detail of what is being ordered. Although they will have been drafted originally by either in-house lawyers or adapted from industry standard forms, this level of expertise does not extend to the process of ensuring that the transaction is finally completed on the terms that are understood and agreed.

Further to this weakness in the process of reaching agreement, it was clear from the responses that there was recognition of the problem and an acceptance that this was part of the way business was conducted. The evidence indicated that there was a tiered approach, whether conscious or not,

such that the description was most closely planned and also such that more time and effort was expended in larger and more valuable transactions.

This part of the process, and particularly the use of SFCs, is therefore an area that may provide additional information in any new study and therefore collecting information on the processes, forms and approach to the use of such instruments should form a core element of the data gathering.

The second part of the Macaulay<sup>67</sup> study looked at how transactions might be adjusted and ultimately how any disputes might be handled. The outcome from this work points towards even less pure contractual effort than creating the deal in the first place. In almost all respondents, there was a similar message that there was a clear reluctance to even mention the contract terms as this would immediately establish a different relationship between the parties and make any future interactions more challenging.

The story was consistent, that, whether the contract terms covered the issue or not, then the first option would be to talk directly and try to reach a mutually acceptable position. The overarching yet unwritten rules that govern these businesses are summed up by Macaulay as “*Commitments are to be honoured in almost all situations*” and “*One ought to produce a good product and stand behind it*”<sup>68</sup>. These were seen as essential to continuing relationships, but also essential to maintaining the company’s standing within the specific business environment.

Although Macaulay’s conclusions<sup>69</sup> would suggest that there may be little need for contracts to exist, there are some good reasons why they are used, though much of this may be down to legally peripheral reasons like communication and formalising relationships. This attitude towards dealing with failures of the parties or processes and ultimately how disputes might be managed is, as Macaulay himself suggested, an area for further investigation.

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<sup>67</sup> Ibid p.9

<sup>68</sup> Ibid p13

<sup>69</sup> Ibid p.16

### **3.5.2 Additional Issues Identified by Beale and Dugdale**

If Macaulay<sup>70</sup> was the most significant study from the 1960s, then the most relevant work from the 1970s would be Beale and Dugdale reporting on contracts between business users<sup>71</sup>, where the second part of the title, '*Planning and the Use of Contractual Remedies*', expands to reflect the same areas that Macaulay had examined. In this case, the investigation was again directed at manufacturing organisations and specifically those in the Bristol area, introducing a degree of focus and inevitably a balance of representativeness against practicality.

Although the title identified planning as a key area of interest, the detail presented conclusions more related to the process of contract formation. The second aspect covered was contractual remedies and addressed four areas: payment and security, cancellation, delay and defects. These specific areas of failure were selected as it was expected that these would provide more information to develop the conclusions reached by Macaulay<sup>72</sup>.

In view of the case law illustrating the challenges around entering a legally enforceable contract which accurately reflects the intentions of the parties (see chapter 2), it is not surprising that this topic should be one for further examination. This subject area, along with the issues around ways in which specific failures might be resolved is therefore presenting challenging areas for further investigation.

### **3.5.3 Narrowing the Areas for Research**

To provide a distinctive structure for this research it will therefore be beneficial to return to the key areas of work examined by these previous studies. This will then provide a clearer focus for any questions and also allow some form of comparison with, what are now, historic positions.

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<sup>70</sup> Ibid

<sup>71</sup> Beale and Dugdale, (n4)

<sup>72</sup> Stewart Macaulay (n1)

In summary, these are:

- Whether establishing contract relations are important to the sample investigated and whether this reinforces the results from previous studies;
- Whether parties resolve disputes by reference to the contract and ultimately litigation;
- Whether parties have accurate knowledge of the contracts they enter;
- Whether the contracts the parties agree address what they see as important and they provide a sustainable position in law.

These will all be explored from a new perspective by using a different geographic and industry sample and in a modern environment. Additionally, it will focus specifically on SFCs thus excluding individually negotiated contracts.

### **3.6 Sample Definition and Relevant Analysis**

One of the reasons for the limited volume of empirical research in the field of contract law may be that it has limited applicability. By its nature, unless a huge industry wide study is attempted, any such research must focus on defined business areas and targeted questions. Such constraints automatically militate against drawing broad and sweeping conclusions without risking constant challenge. This leads to the question of what is an appropriate sample size and how the boundaries of that sample are defined.

The need to limit the sample in order to provide a manageable and achievable survey purely from the point of view of volume of data is then combined with a recognition that any proposed sample will also need to be accessible. This second factor then directs the survey towards an accessible and well understood market sector.

#### **3.6.1 The Size of the Sample**

A further look at previous the key empirical studies also provides some direction on what might be a workable sample size and how the business population as a whole might be segmented down to provide such a sample size. Of the two



earlier studies, the first was by Macaulay<sup>73</sup> who surveyed 43 businesses, most of which were in manufacturing, and 6 law firms in the Wisconsin area in 1963. This created a sample size of 68 individuals who were all interviewed for anything up to 6 hours.

Macaulay<sup>74</sup> makes further reference to additional data gathering including reviewing standard terms and condition from 850 firms and reviewing over 500 cases involving large manufacturing concerns over a 15 year period. This combination of sources and research techniques were brought together to provide some very interesting results. Although subsequent work (including Beale and Dugdale<sup>75</sup>) has identified similar type of behaviours, from a statistical view there has been no work that aggregates the findings in an effort to generate broader conclusions.

The sample can be used to suggest that a similar cross section of employees from similar firms in the Wisconsin area might provide similar results. However, whether this can be extrapolated to other regions or other groups of firms and employees is less certain. It is also worth noting that it is 50 years since the survey and much has changed in that time as the business environment is continually changing, for example:

- One area that may have changed to impact on the use of contract and therefore the possible responses could be an increase in litigious behaviour which may have prompted a more conservative and risk aware approach to contracting even within the same sample (should they still be working in the same businesses).
- Equally the broader business environment will have changed in the intervening years with the expansion of management and business theory, including more appreciation of Risk Management which could equally effect the commercial application of SFCs.

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<sup>73</sup> Ibid, p.2

<sup>74</sup> Ibid, p.2

<sup>75</sup> Beale and Dugdale (n4)

- A third significant change has been the development of information technology, and notably the use of the internet, encouraging wider business networks and increasing the speed of change within businesses.

Whether Macaulay's conclusions<sup>76</sup> can equally be applied outside of these very limited boundaries from a statistical analysis point of view therefore is questionable. Unfortunately, without carrying out such statistically verifiable tests it is impossible to validate this view.

Although from a purely statistical perspective, they may not be universal, from a behavioural perspective, it is likely that the same attitudes and understanding within his sample can be reflected in other jurisdictions and other test groups.

The second key study was the one carried out by Beale and Dugdale<sup>77</sup> in the Bristol area in 1975. The sample was smaller and more focussed as it took in nineteen engineering manufacturers in the Bristol area and interviewed 33 individuals from a mix of backgrounds including legal and senior managers. Part of the justification of the results from Beale and Dugdale<sup>78</sup> was based on the way the conclusions supported the earlier Macaulay<sup>79</sup> study. This second study appears to have been more limited in the nature of the study in that it concerns itself with interviews and does not make reference to additional evidence.

### **3.6.2 The Challenges of Using a Questionnaire for Statistical Analysis**

Both of these earlier studies have primarily used qualitative techniques relying on structured interviews and haven't demonstrated any obvious statistical analysis. The quantitative method to be used to answer the question in this study will be the use of questionnaires. The key to achieving representative

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<sup>76</sup> Macaulay (n1)p.12

<sup>77</sup> Beale and Dugdale (n4), p.46

<sup>78</sup> Ibid p.46

<sup>79</sup> Macaulay (n1)

and repeatable conclusions from such methods are through questionnaire design and appropriate analysis.

To achieve the first of these requires ensuring that the question design is clear, unambiguous and does not unduly lead the respondent<sup>80</sup>. In order to maximise the response rate, it will also need to address simple practical issues by ensuring it is not over complex or lengthy and encourages the respondent to engage and want to express their views. The number of questions will therefore need to be limited as there will need to be some demographic information required to allow comparison between roles, experience and business. Ease of use can be checked through a pilot study which can be run within a single organisation with known individuals before it is rolled out to the broader sample.

To provide sufficient data to be of use will probably require a questionnaire divided into four or five sections each covering a specific area of research. Using the areas identified for investigation in previous studies, the two core areas should therefore be:

- Contract Formation, described by both Macaulay<sup>81</sup> as the '*...creation of exchange relationships...*' and Beale and Dugdale<sup>82</sup> as '*Formation*'. This will need to explore the understanding of the subjects to the principle of offer and acceptance (the battle if the forms) and the extent to which they expect to negotiate before reaching agreement.
- Contract Problems, covered by Macaulay<sup>83</sup> as the '*...adjustment of exchange relationships and settling of disputes*' and by Beale and Dugdale<sup>84</sup> as '*the use of contractual remedies*'. This should examine how failures of one party to meet contractual obligations are resolved between the parties or with the involvement of third parties.

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<sup>80</sup> Colin Robson and Kieran McCartan, (n9), p258

<sup>81</sup> Macaulay (n1), p.4

<sup>82</sup> Beale and Dugdale (n4), p. 48

<sup>83</sup> Macaulay (n1), p.9

<sup>84</sup> Beale and Dugdale (n4), p.46

In addition, in order to provide the necessary context for the second possible area of data collection (review of a selection of standard terms and conditions) it would be useful to expand the survey to include opinions on key contractual requirements. To achieve useful data in these three areas will require, either a yes/no methodology, or more likely a five point option for levels of agreement or disagreement with a specific statement.

As stated, previous comprehensive yet similar studies utilised samples of 68 and 33 for qualitative studies and a sample size necessary to provide enough data to draw statistical significance will require a similarly size sample. By limiting the definition of the population to organisations operating in the engineering and specialist maintenance services (lifts, security, doors, air conditioning etc), then the field of study is reduced as is the ability to read the results across to other sectors. Pragmatism suggests that a target sample from companies of differing sizes and focussing on 5 or 6 employees within each should provide a representative sample. The individuals should provide a cross section of ages, experience, background and functions, primarily sales, procurement, legal/commercial and senior manager.

Whilst this is likely to be classed as a convenience sample<sup>85</sup>, it should nevertheless provide data that can be used to draw conclusions, albeit limited. What conclusions can be drawn will depend on the consistency of the results from any cross section though it should be feasible to apply probabilities to any possible conclusion.

### **3.7 Questionnaire Design – Background Questions**

The question to date has been developed in three specific areas of application, the formation of the contract, the content of the contract and the method of dealing with failures of the contract or the relationship between the parties (disputes). It is logical therefore to take these three core aspects forward as the focus for the questioning in the research. However, one of the key areas of interest in examining this subject is to understand how the views of business

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<sup>85</sup> Martin Brett Davies, ' *Doing a Successful Research Project*', (Palgrave Macmillan 2007), p63

vary and what is important in driving any different considerations. This is intended to be evaluated by looking at the variations across different organisations and different practitioners. This data requirement therefore suggests that we will need to gather information about the individual and about the organisation in order to try to aggregate the various parameters.

### **3.7.1 Questionnaire Structure**

The outcome from this is a questionnaire structured in five parts, covering:

- the individual,
- the business
- understanding of contract formation
- understanding of contract content
- understanding of contract failures

In addition to these, it is considered useful to pose a small number of general questions on the personal thoughts of the individuals on the effectiveness and use of standard terms of business. This is intended to be a test of the personal opinions and not exploring the knowledge of the respondent.

### **3.7.2 Information about the Individual**

The first part of this investigation therefore is to gather factual data about the person and the organisation in which they are currently employed. The intention is to assess whether the responses correlate with any of a number of personal factors and therefore to understand whether such factors influence how such contracts are managed or negotiated.

The factors that are considered relevant to this exercise have been narrowed to four different criteria:

- The role of the individual: the expectation is that different functions within an organisation may view the use of contracts differently as they serve different purposes for those individuals.
- The experience of the individual: Here the hypothesis is that different levels of experience may influence the attitude to standard terms and conditions as a result of positive or negative specific experiences.

- The level of specific contracts training of the individual: Whilst providing extensive training on how such contracts operate and the benefits to the company may generate enhanced understanding, it may not affect the views of the recipient, though this should be tested.
- The active involvement of the individual in managing contracts: It is to be expected that those who are more actively involved in setting up and managing contracts should demonstrate a greater appreciation of the benefits of standard forms, though it may be that these individuals are more aware of the limitations of such forms and more comfortable in deviating from a standardised approach.

Having decided to use these categories, it is necessary to frame suitable questions to derive the data which will allow such analysis without providing sample cross sections which are too small and hence each division should allow four or five groups.

As the prime focus of the study is on the through life role of the contract, the functional responsibilities targeted should cover the different ages of the contract. Hence, the relevant functions should start with Sales and Contract Negotiators/Analysts, through operational activities and then to Legal and Management. The groupings which provided the best balance were:

- Legal/Commercial: this will cover the contracts professionals who will have greater in depth knowledge of the legal principles and also are likely to be more actively involved in contracts on a day to day basis.
- Management: It is important to gather the views of those who may not routinely deal with the detail of the contract, but are involved in managing functions that are involved to assess whether the views vary at different levels of the organisation.
- Operations/Technical: This grouping is intended to test the understanding of the individuals who are normally required to deliver the outputs from a contract. They may or may not be aware of the detail and the risks that they are managing, but will ultimately be aware if they fail to deliver.

- Sales: Sales is probably the grouping that will have the most relevant opinions as they are the set that has most impact from getting contracts agreed and hence possibly opposition to any structures that makes the job more difficult, like having to defend contractual policy positions in any challenges to standard terms.
- Other: Unfortunately there are a number of groups that have occasional and peripheral involvement with contracts but which do not in themselves justify a large sample or even facilitate sourcing a suitable sample size. It is however useful to get the input from these as they may have important ideas and contribute to the overall picture. This group will include functions like finance and purchasing.

The next two proposed criteria are driven purely by time, being the length of time in a particular role or function and the length of time since last trained on the principles of contracts and/or the specifics of the company policy. In order to provide suitable levels of analysis, the first of these has been broken down into three groups which can broadly be described as 'new to the role' (less than 1 year), 'getting established' (1-5 years) or 'well established' (more than 5 years). The second can then be divided into four groups with similar parameters 'current' (less than 1 year), 'fairly regular' (1-5 years), 'infrequent' (more than 5 years), but needs to include the additional option for those that may never have received any such training, though this may be because of the role that they are fulfilling.

The last individual factor that needs to be considered for its relevance to the individual opinion is the level of active and direct involvement in contracts. This has been structured to pick out the frequency with which the person reviews and/or agrees contract terms and therefore those that need to be more familiar with the content and importance of the contract. The specific question proposed to elicit this information is: "*Are you required to review and/or agree contract terms?*", with the options being Never, Rarely (Yearly), Occasionally (Monthly) or Regularly (Daily/Weekly). The last of these will be the contracts specialists and possibly a number of senior or experienced sales consultants.

This last point should provide additional insight into how contractual relationships are managed and how different roles are viewed within the

process. For example if contracts specialists are rarely involved, is this because there is little negotiation on standard terms and condition, or because the sales team are comfortable with such negotiation or even because the sales team wish to retain control of the customer relationship. There may be other reasons, but hopefully these may become apparent if this is the case.

### **3.7.3 Information about the Organisation**

The next stage is to assess what are the organisational factors that should be identified as being possible links to personal views. Again these have been broken down into four fundamental properties of a business which may be expected to have an influence on the core questions:

- **Size of the Company:** The size of a company can be measured in a number of ways, but the most common method for a business entity is by using the annual turnover.
- **Business Sector:** It is likely that different industries may operate in differing ways and with different types of contracts, thus engendering different views on the design and use of SFCs.
- **Level of Specialist Contractual Resource available within the Company:** In order to assess the level of interest in contracts and the desire to use such instruments to manage risk, it will be informative to understand the level of specialist expertise available to support contract negotiation and management.
- **Size and value of the contracts that are routinely entered into by the Company:** The size of the separate contracts which are routinely entered by an entity will provide an insight into the business activities and is likely to show that larger volume lower value contracts are more likely to be on standard terms due to the cost of use and the risk they present.

Two of these measures can be easily classified using a simple financial bracket. For the size of the business, a small company might be considered one with less than £1m annual turnover, whereas a medium sized business would be between £1m and £10m. Greater than £10m turnover may be described as medium to large whilst a large company will be one with a turnover greater than £100m. Although there may be a sizeable sample within this bracket, it is likely



that the factors that are at play will be the same as the size increases further. This method of segregation may present a different result to the use of number of employees, geographic coverage or some other measure, but should be adequate to allow initial analysis. By collecting additional data, further analysis may provide additional illumination subsequently.

When considering the value of contracts, the proposed limits are less than £10k, £10k - £100k, £100k - £1m and greater than £1m. Whether there is any material difference in the use of standard terms for the larger contracts will be of interest, as it would be expected that the principles would be similar albeit with greater risk exposure purely due to the value.

Grouping the organisations into business sectors needs to be structured to allow suitable sized groups whilst retaining adequate discrimination to be able to draw conclusion on a specific sector. As the target is principally construction and engineering services organisations, these are proposed as Construction, Legal, Property Services, Specialist Sub Contractor, Specialist Supplier and a broad group for others that may be involved.

The final category that may impact on the issue and the opinions of the sample is determined by the resources and skills available to support contract drafting and negotiation. Where there is a large resource available, it is likely that this will be employed in resolving contractual matters directly, whereas a smaller resource would indicate that the front end point of contact, most likely sales, between the two parties would retain more responsibility. This may be because of an expectation that there will be rare deviations from standard terms or because the risks that may arise are not considered significant.

### **3.8 Questionnaire Design – Core Questions**

Capturing the background information will allow the information provided by the respondents relating to the use of standard terms to be analysed from a variety of different perspectives. However, the actual questions to be asked need to be clear and unambiguous, whilst eliciting relevant and detailed information. The subject areas under focus have been established during the earlier chapters and are centred on three core topics:

- Contract Formation

- Contract Content
- Resolution of Disputes

In addition to these legal areas, it is desirable to collect some more general and personal views on the use of SFCs.

### **3.8.1 Contract Formation**

Taking the first of these, the specific area of interest relates to the 'battle of the forms' and the challenges presented by parties in ensuring that the deal they agree is on the terms that they believe they are trading under. The starting point therefore is to assess the specific understanding of the use of SFCs in the particular entity and also the understanding of the challenges faced when using them. By phrasing the question with the use of this terminology, there is a hope that the subject is not led into recognising a problem which they may have been vaguely aware of previously.

Subsequent questions are structured to get an understanding of the business' approach to entering contracts, or at least the person's understanding of such processes and controls. Clearly a company may have well defined policies and procedures, but if they are not communicated satisfactorily, then they will not be effective. This aspect will include controls and processes when not complying with the core objectives or when deviating on standard terms.

The final area being covered is more base data on the extent to which the company uses standard form against non-standard forms and if there is any correlation with the value or size of the contract. Here the hypothesis is that SFCs will be used for low value low risk contracts. Where the value and risk are greater, the contract is likely to be negotiated as both parties consider the investment in such a process more likely to be justified.

### **3.8.2 Terms and Conditions within Standard Form Contracts**

When investigating the second topic, the questions should hopefully offer two insights, being into the organisational approach to contractual risks and the knowledge and understanding of the content by the people involved. The main area of interest is directed towards the clauses within contracts which are seen as most important to the organisation, both in the way they are dealt with in

standard terms and conditions and the approach to negotiating or varying such terms when necessary for business purposes.

In order to provide data that is comparable, it is necessary to present options in this area to avoid different interpretations of the risks involved. The choice of the options in this case is based on personal experience of contracts within the operational area and also the analysis of the cases and statutes that have been discussed in earlier chapters. This has led to a number of key clauses or risks being defined, though as this may not always align with corporate assessments, there will need to be the option to add further items considered significant by different entities.

The second objective within this broad area is to gather data on processes in place to manage and monitor additional risks accepted through varying such terms. Although it is recognised that organisations cannot always rely on undertaking jobs on their own terms, it is not always clear that they recognise and assess the risks they are accepting when they deviate from such structured policies. The input on these matters should provide illumination on both the attitude to risk and the emphasis on the contract as a means of managing those risks.

### **3.8.3 Dealing with Failure to meet Contractual Obligations**

The final broad area for examination is the manner in which the contracts are managed once they have been agreed and particularly whether the contracts provide the theoretical degree of protection intended, when they are tested in actual challenged circumstances. The information which should illuminate this matter will be derived from questioning on the number and value of disputes and an understanding of the nature and means of settlement.

The quantity of matters that result in disputes needs to be evaluated in the context of the number of contracts within the specific sample and therefore those being considered by the individual to provide an indication on the percentage of problem contracts. This data can then be used as the survey explores both the nature of the disputes and the means of resolution. However, it is also expected that the financial value associated with these matters might also influence how and when they are resolved and hence this data also needs

to be captured. The aim of this particular area of research is to understand what causes disputes, how and when they are resolved and if there are any pertinent factors that significantly influence the latter two points.

#### **3.8.4 Subjective Opinions of the Sample**

The final area of interest in relation to the use of standard terms and conditions is directed at purely subjective opinions of the audience. Having collected what should be objective and unambiguous data on the application and interpretation of these forms, it is believed that there may be useful information to be assessed on the views of the users as this will open the door for individual views. Whilst all subjects should be able to respond on their understanding of contract formation or their experiences in resolving disputes, these should be objective responses and not distorted by personal opinions. This last section should provide the opportunity to express more subjective views which when consolidated may provide further insight into the field.

In order to present data that can then be analysed quantitatively, these questions need to offer specific statements which allow the respondent to agree or disagree with to varying degrees and are of the sort regularly seen in opinion surveys. As this may be seen as rather vague and unstructured questions, it is not intended to require excessive comments and to concentrate on four key criteria, being the views on the effectiveness of such documents in defining the transaction, fostering relationships, managing risks and developing business. As with all of the areas of the survey, however, there is also the option to add specific comments or additional points if these are seen as important or at variance with the structure of the question.

#### **3.9 Target Sample and Limitations of the Proposed Methodology**

The next stage of this initial exercise will be to consider the methodological limitations and to define the sample for examination and the process to be used.

The questions have been developed with a specific objective in mind but also based on an initial expectation of the target sample. As the proposed cross sectional analysis has indicated, the industries targeted will be different to those

used by Macaulay<sup>86</sup> (and hence Esser<sup>87</sup>), Beale and Dugdale<sup>88</sup>, and Lewis<sup>89</sup> for a number of reasons.

### 3.9.1 Differences from Previous Studies

Firstly, the intent is to delve more into the use of SFCs specifically as opposed to the general use of contracts. The previous samples were engineering companies and in the case of Lewis, building companies<sup>90</sup>. Although there is reference to SFCs in the reports, because they were employing a spread of contract types the responses specific to this area were limited (albeit that Macaulay specifically referred to *'Typically, these terms and conditions are lengthy and printed in small type on the back of the forms'*<sup>91</sup>).

Some were also dealing with a complete spread of values including higher value contracts and therefore were less likely to be utilising standard form. Conversely, it is helpful to evaluate the use of these forms of contracts, when they might or might not be used, and hence necessary to find a sample where both standard form and bespoke negotiated contracts might be an option.

In most cases, as Beale and Dugdale<sup>92</sup> identified, selling organisations are more likely to have more relevant standard terms and conditions than buying organisations as buyers are likely to be dealing with an array of products whereas sellers are usually dealing with a limited range. It is however helpful

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<sup>86</sup> Stewart Macaulay, (n1), p.2

<sup>87</sup> John P. Esser, 'Institutionalizing Industry: The Changing Forms of Contract' (1996) vol 21 Law and Social Inquiry 593.

<sup>88</sup> Beale and Dugdale (n4) p.46

<sup>89</sup> R. Lewis, 'Contracts between businessmen: Reform of the law of firm offers and an empirical study of tendering practices in the building ' (1982) 9 Journal of Law and Society 153-73

<sup>90</sup> Ibid

<sup>91</sup> Stewart Macaulay, (n1), p.5

<sup>92</sup> Beale and Dugdale (n4), p.49

to solicit the views of buyers and their tendency to accept or try to amend seller's terms.

### **3.9.2 Target Sample and Data Collection Technique**

The second main influence on the target sample is the practical availability of suitable respondents and the means of gathering the responses. Although there is clearly additional benefit to be gleaned through the use of semi structured interviews, they are by nature less objective as they are more likely to be influenced by conscious or unconscious leading by the interviewer. They are also more likely to be interpreted in a personal way as the reviewer reads the messages and translates these into meaningful data.

In order to simplify the data gathering process and hence increase the volume of data potentially gathered, the first avenue will be to exploit the improvements in technology since the earlier studies and employ an on-line survey tool. The one chosen is Survey Monkey as a simple system to use by both the researcher and the respondent and one that is commonly used by many organisations in the UK. This creates a level of familiarity and is therefore less likely to deter potential respondents from participating and completing the questions.

It should however be recognised that the use of such a tool may impact on the characteristics of the person responding as it may deter older individuals or those who are less comfortable with technology. Additionally, it may also inadvertently introduce other biases due to the language used in the drafting of the questions or the structure of the questionnaire overall.

By using an on line questionnaire, there is the benefit of simplicity for the respondent, but it is also possible that the extent of the information provided may be limited. The information provided is more likely to be comparable as the questions are standard and this should provide a higher degree of recognition that the information is robust.

In an interview then the interviewer can probe deeper those key responses that enables further soft information. An on line questionnaire is more likely to be completed unencumbered by personal feelings, but without any inclination to expand further by adding expressions within text boxes.

Ultimately, the practicality of an on-line system outweighs the potential benefits of one to one interviews.

### **3.10 Summary**

The aim of this chapter has been to identify what areas need to be explored to try to provide new information relating to the research question and to assess what options are available to gather the necessary empirical data. In order to start this process, the first step has been to fully understand the detail of the question.

What may have seemed a simple matter expressed in a short sentence has required further definition in three different areas to clarify the meaning. This detailed dissection of the question has then provided pointers to what information will be needed in order to assess the existing understanding of the use of contracts. There are a variety of techniques that have been used to provide insight into the law and a number of ideas on how useful these are and how they fit in to a theoretical structure.

The main focus of the new work however will be to take the key themes from the Macaulay study in the 1960s<sup>93</sup> and the subsequent work by Beale and Dugdale in the 1970s<sup>94</sup> and assess whether and how their conclusions are still relevant. This dictates a research directed at two core areas, contract formation and the processes and remedies used when things go wrong. These should be investigated by sampling the views and knowledge of individuals who use such tools on a regular basis. The key difference in this particular project however is that it is intended to focus primarily on the use of SFCs.

Empirical research in the social sciences has developed a number of methods in spite of suggestions that quantitative techniques are not valid in such subject areas. Qualitative techniques are more common and reflect the methodologies used in similar earlier studies<sup>95</sup>, where interviews were the main source of data.

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<sup>93</sup> Stewart Macaulay (n1)

<sup>94</sup> Beale and Dugdale, (n4)

<sup>95</sup> Ibid

Having narrowed the options down to the use of a quantitative analysis of the views of a selection of individuals who routinely use SFCs, the simplest and quickest method of capturing the data has been identified as an on-line survey. A difficulty with this approach is a lack of control over the respondents as maximum participation will be achieved by targeting as broad a sample as possible.

Taking the means of identifying a sample from the lead set be Macaulay<sup>96</sup>, the options are limited by the desire to focus on a small industry sector and the accessibility of any proposed group. A convenience sample defined by immediate business contacts and extended using a snowball effect presents limitations to its representativeness but ensures maximum availability with limited resources.

Additionally, there is a difficult balance to be achieved between a level of depth in the questions to provide useful information and maintaining simplicity to encourage participant completion. In the probable absence of the opportunity to delve deeper in interviews, it is necessary to ensure breadth of questions as well as detail as this will allow more analysis and hence a greater opportunity for variances to the norm.

Drafting the specific questions is driven by considering how the answers need to be presented and hence whether they are straightforward 'yes or no' questions, options on a subjective assessment scale or actual numbers classified within a bracket. The final survey has been designed to incorporate a variety of each type to provide different data.

The final design of the survey has been set across six sections to address the two core sets of factual information about individual and organisation and then the three target areas of interest, supplemented with a final section to test the broad opinion of the respondents to the effectiveness of the type of contract. Drafting the specific questions has been guided by the target information solicited and the simplest means to capture the data.

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<sup>96</sup> Stewart Macaulay, (n1)



A further limitation of this technique from a purely legal perspective is that the questions, and hence the data gathered, will be quite general in nature. In order to make the survey accessible and encourage participation, the questions need to be framed in a way that it understood by non-legal scholars and non-lawyers.

Although there are a number of ways in which to capture new information on the use of SFCs, there is no technique that is clearly superior nor any that is perfect. Hence it is necessary to consider the limitations of any method as these will impact on the information assessed and conclusions drawn. It is however expected that the methods used in this case will provide useful and informative data.

## **4. ASSESSMENT OF RESULTS FROM THE SURVEY**

### **4.1 Introduction**

One of the initial objectives of this thesis is to try to assess whether the findings of Macaulay in the 1960s and subsequently Beale and Dugdale in the 1970s are still true in respect of how contracts are managed in practice. The methodology to test this has been developed through the previous chapter and has resulted in a first stage of carrying out a survey testing the views of current individuals who use contracts, and specifically standard form contracts, on a regular and frequent basis.

The aim of this chapter is to document the results and provide analysis. The chapter is structured to follow the subject areas from the survey (see appendix A) and assess the results based upon the variances across the different individual and organisational characteristics. The results will be considered further in the next chapters in relation to the contract content, contract formation and disputes.

Having designed, tested and then circulated the survey there is a dead period when the main activity is checking regularly to monitor the responses and reviewing whether there is any additional initiative that might increase the number of responses. It is then necessary to decide when to close the survey to achieve an optimum balance between the volume of replies and the need to commence analysis regardless of the number.

Although the proposed methodology is to carry out statistical analysis of the results, the nature and extent of such analysis is dictated by both the quantity and quality of the responses. In this case, the quantity and quality are linked as there were a number of respondents who did not complete all of the questions, thus reducing the quantity of overall answers and the quality of the data for those questions with less than 100% completion. Although the questionnaire was tested, the test sample were selected and identified as individuals who were more likely to have a commitment to provide feedback and hence more likely to complete the full set of questions.

This position indicates that the depth of the statistical analysis is limited and the data can be reviewed as presenting a general picture. As there are intentionally a large number of detailed questions, this should nevertheless allow useful information to be derived.

The review will initially look at the overall sample and try to provide a summary of the information on the respondents, their roles and employers. It is hoped to assess the complete sample and hence identify what the average of the responses provide as well as the most common response to each question. This will provide a baseline to assess whether the different individual or organisational groups demonstrate any notable variances.

As there has also been a facility for additional comments to be added in some sections, these will be reviewed separately as it is hoped that these will provide more insight into the areas where the sample have particular concerns or interest. Although these comments are limited in volume, there is a significant amount of more qualitative data that should support the numerical analysis.

The detailed analysis will be carried out evaluating the different cross sectional groups against other groups and against the averages to see whether there are any groups with noticeably differing views. This should provide an indication on whether the hypothesis that attitudes to the use of contract will vary based on organisational constraints and on personal attributes like experience and role. The principle comparisons will be based on:

<b>Individual</b>	<b>Company</b>
Role in Business	Size by Annual Turnover
Experience in Role	Market Sector
Currency of Training	Availability of Contract Support
Involvement with Contracts	Value of Contracts

It is then intended to explore some of the most notable points arising from the analysis in more detail, referring specifically to the findings of the previous studies. Although there are inevitably inconsistencies across the surveys like the characteristics of the whole sample (industry and geography) and the

specifics of the questions, it is expected that the results should provide a broad picture of any changes that may be present.

## **4.2 The Questionnaire Response**

### **4.2.1 Survey Distribution and Response**

The questionnaire was issued using an e-mail link to an on-line survey system called Survey Monkey, which allowed individuals the opportunity to proceed at their own pace and without the need to complete the survey in one session. The target respondents were identified through business contacts and each direct contact was requested to forward the link to three further contacts in order to generate a larger sample.

Having sent the link to an initial direct contact list of 80, this should have then generated up to 320 possible respondents. The total number commencing the questionnaire was 68, which is a 21% response rate if the full 320 did receive the invitation. However, there is no way of checking that the maximum number did have the opportunity to respond as the initial 80 were only asked to forward the request and no feedback was requested in order not to apply undue pressure.

Sixty-eight people logged into the survey and started the questions; however a large number did not complete the full survey. Of the 68 that started and completed the background information on themselves and their employers, the average numbers of responses to the subsequent sections were:

- Contract Formation: 53 (78%)
- Contract Content: 48 (71%)
- Dispute Resolution: 40 (59%) – it should be noted that a number indicated that they did not have any experience of disputes and hence would not be expected to continue with this section.
- Opinions: 43 (63%)

It is accepted that the size and scope of the questionnaire was significant and therefore may have deterred some individuals after they had started, but this was necessary in order to be able to gather the depth of information required. The balance between an extensive and detailed survey and a simple and quick

one is a key decision. The former may deter respondents even after they have started whereas the latter will encourage completion and therefore potentially generate a larger sample from the same population but will not normally provide the same depth of information for analysis.

In this survey, the intent was to provide a bridge between the face to face interview technique whilst retaining the clear structure, and hence compatibility, of a statistical survey. The detailed and extensive questions should therefore provide more detailed and in depth information without the additional commitment and time necessary for face to face interviews.

#### **4.2.2 Analysis of Sample by Individual**

In general, the sample produced a reasonable cross section of respondents for both the individual analysis and the organisational analysis, though to allow practical reviews some of the groupings need to be aggregated. For the individual cross section, the majority identified themselves as Managers (47%) with the only other three groups of reasonable size being Sales (20%) Legal/Commercial (17%) and Operational/Technical (7.5%). Using these four groups and a residual group for those others not within these groups should provide sufficient discrimination to be able to draw conclusions.

The three additional questions about the individual were intended to assess their experience and involvement in contracts and in general provided a useful cross section though 80% had been with their current employer for more than 5 years, indicating a high degree of job stability. Although there is little UK data on the average length of time with a single employer, a US report<sup>1</sup> indicated that the median period was 4.6 years in 2014, though there were notable variations to this dependent upon industry and sector (Public or Private).

Additionally, at the other end of the experience spectrum, those who had been with their current employer or in their current job for less than one year was small, 1.5% and 7.5% respectively. This shows a high degree of experience of the respondents which may indicate that this is representative of the industry

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<sup>1</sup> Employee Tenure in 2014, Bureau of Labour Statistics, United States Department of Labour

sector or that those with more experience feel more inclined to respond to such surveys.

The data on experience also provides a useful insight to internal mobility with a common employer, as 39% were in at least their second job with the same employer.

The third area of interest relating to the individual and their experience is more specific to the work in contracts, exploring their involvement in contracts and the amount and currency of training on contracts. The amount of training delivered to those using contracts and the depth of such training provides an indication on the recognition of the importance of the documents within the organisation. Regular updates and refresher training to the operational users would suggest that the organisation acknowledges the significance of such contracts within the business structure. Additionally, the depth of such training would provide an indication on what is expected from the users when negotiating a sales contract or resolving a dispute.

Here there appears a slight anomaly, possibly resulting from the individual's interpretation of the question, where 57 acknowledged that they had received training in contractual matters from their current employer, whereas only 47 had a similarly positive response to ever having received such training. Unfortunately, this particular issue was not identified during the trial of the questionnaire and it is still not clear how the interpretation could be improved. In total, however a clear majority of between 70% and 80% had received some instruction though for up to 20% this was more than 5 years previously.

Finally, the sample produced a useful proportion of individuals who are involved to some degree in reviewing and/or negotiating contracts. Only 12% were never involved, whereas 75% were either regularly or occasionally involved. This should provide a reasonable sample for assessing the more detailed questions on interpretation and content of the documents.

In order to provide more information around the individuals there were a couple of additional open questions asked on the content of any training received, intended to assess how much detail this explored and whether it was specific training on contract law or broader training on the use and management of

contracts. These generated a large volume of comments which can be broken down into a number of areas.

Firstly, there were a large number of responses (19) which could be described as indicating that the training covered basic contract law, using terminology including: Terms and Conditions; Basic Contract Law; Contract Types; Basic Overview. In addition there were significant comments stating that they had been trained on different forms of contract, including Joint Contracts Tribunal (JCT) which was mentioned 4 times, New Engineering Contract (NEC) quoted 5 times and Model Form of General Conditions of Contract (MF/1) as well as a number of references to forms of contract relevant to the industry.

This suggests that the training was more in depth as it indicates a depth of knowledge to be able to discriminate between the main aspects of the different forms. It also demonstrates that these industry standard forms are in reasonable usage amongst the sample, sufficient to make it beneficial for such focussed training.

More specific training was provided on company's own standard form of contract (12 responses), which would be expected in order that Sales Representative were familiar with the terms in order that they could discuss and potentially negotiate any areas of concern with customers. Equally, those employees tasked with delivering the contract would need to know what obligations and liabilities were placed on them and should be in a position to be able to resolve any disputes should they arise.

Two further topics arose in a significant number of responses. Firstly, six individuals indicated that the training specifically included reference to the Housing Grants Construction and Regeneration Act (1996)<sup>2</sup> (as amended by the Local Democracy, Economic Development and Construction Act (2009)<sup>3</sup>). Although it was recognised that a large element of the sample would be active

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<sup>2</sup> Housing, Grants, Construction and Regeneration Act (1996),

<sup>3</sup> Local Democracy, Economic Development and Construction Act (2009),

within the construction market, the fact that 10% of the respondents identified this as a key aspect of training is of interest.

The Act provides a number of provisions which affect how construction contracts are managed with a particular focus on disputes and the use of adjudication as a more relevant and easier method of resolving disputes without using the courts. It also implies terms into construction contracts in relation to payment and the requirement for staged payments during extended programmes to assist small suppliers and sub contractor's to manage their cashflow.

It is notable that a few responses identified training in negotiation techniques and disputes. This recognises that these events are a routine aspect of managing and agreeing contracts and therefore tries to formalise the subject. Such training is usually structured to view disagreements as a common feature of business and provide techniques which concentrate on reaching positive and collaborative solutions<sup>4</sup>.

The question on training content also generated a number of additional comments which provide a greater insight into some of the more detailed areas associated with contracts and also into how some organisations integrate contract knowledge into the broader business environment.

- There are a few comments demonstrating that training provided included links with financial management: *variation pricing, credit mitigation, debt and financial control*.

These comments serve to emphasise the link between contracts and finance and point towards the broader business objectives. The need to understand the way in which the contract is intended to be interpreted financially becomes more important in larger and more complex contract

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<sup>4</sup> See: Robert B. Moberly, 'A Pedagogy for Negotiation' (1984) 34 J. Legal Education 315; and Robert J Condlin, 'Cases On Both Sides': Patterns Of Argument In Legal Dispute-Negotiation' (1985) 44 Md. L. Rev. 65; or Arlo Poletti, Dirk de Bievre and J. Tyson Chatagnier, 'Cooperation in the Shadow of WTO Law: Why Litigate When You Can Negotiate ' (2015) World T.R., 14(2) Supp (Economics Law International Institutions), s33-s58



as and, as illustrated by the comment on variation pricing, the particular relevance in construction contracts.

- Some show the relationship with risk management: *Insurance matters, insurance coverage v legislative compliance and risk identification.*

Whilst the importance of understanding insurance matters may be a topic in itself, the understanding of contracts as risk management tools is a theory which has been developed over many years<sup>5</sup>. The analysis of which risks are transferred and how forms the basis of more comprehensive contracts like Private Finance Initiative (PFI) and Public Private Partnerships (PPP) and these ideas are flowing through into other types of transactions.

- A number relate to specific requirements which will be routine aspects of contracts within certain business areas: *Extensions of time, Service Level Agreements (SLA) and Key Performance Indicators (KPI) and Bonds & Parent Company Guarantees.*

Extensions of time again relates primarily to construction contracts and other business where programmes and time of delivery are important, whereas SLAs and KPIs are more prevalent in contracts for the provision of services. All of these however may be considered to be methods through which risk is transferred between parties. Bonds and Guarantees are more likely to be a requirement where the risk of default is considered critical.

- Others are much more idiosyncratic in nature and probably are not representative of a general approach to contracts: *Asia Sourcing, Recruiting processes, terminating in-term contracts and corporate governance, Legal Entity of the signing party.*

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<sup>5</sup> See for example: Francis Meuret, 'Analysis and Management of the Risks in International Construction and Industrial Works Contracts' (1988) I.B.L.J., 6, 763-824 or F F. Peter Phillips, 'Drafting dispute management clauses: principles of risk management for commercial contracts' (2009) Const. L.J., 25(3), 199-205

These illustrate the wide range of training that may be provided but as they are limited in their application are not of interest for further investigation.

Whilst these comments related to the most recent contractual training, a few pieces of clarification addressed other training which the individuals had undertaken. A few topics were listed here which weren't included previously:

- *Terminology and Boiler Plate Terms*: These two descriptions suggest a more technical approach to the content of contracts. By examining specific terms and their meaning in the context of the specific contract, there is much more detail provided on the legal aspects of the relationship. The introduction of instruction on boiler plate terms is likely to be of assistance to those individuals who may be reviewing and negotiating contracts away from their own standard terms and conditions. This would require knowledge of what terms to expect and their relevance to the specific business. It may also be relevant to drafting, reviewing and updating of specific standard terms and conditions for particular usage by a company. Unfortunately, without data linking those who provided these comments on training with their specific views in other areas, it is not possible to draw further conclusions.
- *Aged Debt and Broad financial understandings*: These and some further references to financial aspects reinforce the point that contracts are instruments of business and as such need to support the overall commercial aims of the organisation. Aged Debt is a specific area where customers delay payment excessively for a variety of reasons.
- *Company Law, Anti Bribery legislation & Practise and company report analysis*: These are not specifically linked to contracts, but are important additional business legal functions. It is likely therefore that the individuals undergoing training in these areas are professionals who have a broader legal or commercial role within the business, possibly even to Company Secretarial.

The extent of the training provided gives a strong indication of the importance of the subject within the business and also points towards which particular areas

are considered significant. Where a large cross section of a business may be exposed to the use of contracts, it would seem normal that they are provided with appropriate training in order that they can read, understand and challenge where necessary such contracts. Where there is a shortage of this training, it would indicate that either the companies involved do not see this as important to the overall performance or that the level of knowledge expected is such a low level that most employees would be able to use their experience and common sense.

The assumption therefore might be that where a company uses standard terms and conditions, which would not or should not be subject to negotiation or changes, then all risks are controlled. There is no need for further knowledge to be imparted as there is no need for complete understanding – they are what they are. The only aspects of the contract which the majority will be required to understand are the key particulars, like the price, the product and the method of delivery and if something goes wrong, then the matter will be passed on to the relevant experts.

The final open question in this part of the survey asked for additional comments which might be thought to be relevant to the overall object of the investigation. This generated a number of comments, most of which were very personal to the respondent, like those that indicated specific roles or background (e.g. “9 years as solicitor in private practice specialising in commercial construction law and public procurement projects, 2 years as in-house legal counsel for major construction company”). Others provided more insight into how they dealt with contracts in their role, including:

- *Agree head terms with customers, contracts review the main body of terms*
- *I train the "contract negotiators" within the company, and am usually only involved in the process when new, or particularly difficult or complex contracts need to be addressed.*
- *I am usually guided by our in house procurement team and largely constrained by standing orders resulting out of audit reports.*

These comments show that in these companies, responsibility for understanding and assessing contracts is divided such that much can be dealt with by the first point of contact, which will normally be sales or purchasing. These organisations however, have additional resources with more specialist skills and knowledge that can provide more expert support. This principle is supported further by responses to questions about the organisation, where 78% confirmed that their organisation had a specialist team that provided commercial and contractual support.

- *... (I) am expected to manage various maintenance contracts on the basis of my engineering experience, previous experiences of contracting and basic common sense, but no formal contract training.*
- *we could do with having a best case vs worse case chart so we know what items are acceptable before the approval process, this would help speed things up*
- *It is expected that you know and are an expert on all forms and types of contract, customer and supplier policies as well as own company policies inclusive of parent company.*

These few comments show a degree of frustration that there is an expectation that everyone has knowledge and can deal with contracts regardless of their background and their training. Although businesses may have some level of additional contractual support, it is clear that there is an expectation that this is not used as the norm. Those individuals dealing directly with the other party, be they suppliers or customers, are expected to have at least a rudimentary level of knowledge and be able to understand the key aspects of the agreements they enter into.

- *Many large contractors lack a uniform approach, and responses vary from office to office.*

This final comment provides a more interesting insight into the way that larger organisations operate which may be indicative of poor controls in larger organisations or a more diversified approach to business allowing levels of delegated authority to smaller branches. This view is limited to one response,

but may be indicative of a broader approach common across larger organisation.

#### **4.2.3 Analysis of Sample by Organisation**

The questionnaire gathered data on the organisations in question by looking at four different attributes of the businesses. It reviewed the size of the business by reference to the annual turnover, the market sector, the degree of specialist legal support and the typical value of contracts it might enter. This provides several different ways of analysing the results to identify whether there were any strong tendencies to the approach to standard form contracts.

The different groups of respondents identified by the organisational factors didn't provide as much separation of factors as hoped. Of the total sample, there were insufficient responses to many questions from businesses with less than £10m to provide any useful information.

Of the 68 total respondents, the majority worked for large organisations with over 50% employed by companies with more the £100m annual turnover. This characteristic is replicated in the measure of employees with a similar proposition having more than 1000 employees.

The more useful splits, indeed those that demonstrated more clearly defined trends, were apparent when looking at the business sector. Here there was a reasonable spread of businesses between Construction (16%), Property Services (15%), Specialist Sub Contractor (12%) and Specialist Supplier (15%). Additionally, although the size of Company was routinely large, the size of separate contract produced a broader cross section, with 16.2% valued at less than £10k, 17.6% between £10k and £100k and 17.6% between £100k - £1m.

A number of responses indicated that the organisation did not fit within any of the defined sectors and offered alternative descriptions including:

- *Public Sector: Transport, NHS Trust, and Education*
- *Quantity Surveying/Commercial Consultant*
- *Property Developer, Investor and Owner*
- *Manufacture, Install and Service lifts and escalators*
- *Aerospace & telecommunications*

- *Car manufacture*

This additional information, although not useful for the specific sectors, indicates that the sample may provide a broader base for extrapolating the findings.

In asking for any additional factors that might affect the results, the following specific comments were forthcoming:

- *Company acts in the commercial aspects of the contracts and not project management:* This possibly indicates that the approach to project contracts would be different to these commercial aspects and that the organisation may be less familiar with the project risks.
- *As a company we have a particular focus on high end high value projects:* Responses from this area will most likely not include much reference to standard form contracts which are too generic for this narrow field business.
- *Company T&C stance too complex compared to competitors which restricts business with certain clients:* This is an interesting comment which suggests a personal view of the organisation's approach to contracts and its position in the market. The comment came from a large business (greater than £100m turnover) which is a specialist sub-contractor. The individual expressing the view had extensive experience and filled a sales role. A number of these factors would potentially contribute to the view, not least the fact that the individual was in sales. The results clearly show that larger companies have more extensive and structured approaches to contracts and managing risk through contracts and it is also evident that those involved in sales consider the reliance on contract more of a burden that limits their ability to be effective.
- *There is no typical NHS contract costs, they vary from new build to minor mechanical maintenance, to facilities management, managed print service, IT data storage. Too big a list to quantify:* This comment again provides support to indicate that the responses should provide broader results and a more representative cross section in total albeit that they

may not offer such insight into smaller sub groups due to the smaller size of these groups.

### **4.3 Contract Formation**

#### **4.3.1 Prevalence of Standard Form Contracts**

Having gathered general data on sample population, the survey then focussed on the specific areas of interest, the first being the approach to entering into contracts. These questions were intended to create a picture of the extent to which the businesses and individuals within those businesses were concerned about when a contract was formed and what degree of agreement there was on the content of that contract.

*“The majority of firms intended to make their contracts by the use of forms containing standard conditions of sale or purchase.”<sup>6</sup>*

This statement by Beale and Dugdale defines what might be considered a starting point for this investigation into how organisations enter into contracts. The fundamental principle identified by both Beale and Dugdale and Macaulay was that organisations have developed sets of contract terms that address their own concerns in the contracts they are likely to enter. This approach of working to standard terms and conditions is explored in more detail in chapter 2, and is seen to improve contract efficiency by reducing time in negotiations but has its limitations in that the standard form of contract will normally be biased towards the organisation that has drafted the terms.

In order for the type of contract to be effective in managing an organisation’s risks however, it needs to be controlled and it is this aspect that is of particular interest in this part of the survey. The key areas of interest covered by the survey were whether the companies utilising standard form contracts have the necessary processes, controls and tools in place to facilitate the process of

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<sup>6</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y, p.49

entering into contracts whilst ensuring that the contracts which are concluded are on the terms and conditions expected.

Macaulay makes a broader statement:

*“More routine transactions commonly are handled by what can be called standardized planning”<sup>7</sup>*

This is a broader statement indicating by the use of the word ‘planning’ that it is a process more than just a pre-printed set of terms and conditions. This process through to establishing a contract and the pitfalls that may be encountered leads to the problem of the battle of the forms as developed in chapter 6 and it is this issue that is the primary focus of the questions in this section of the survey.

The initial questions explored the general views on the use of standard form contracts and the challenges of achieving a clear understanding of the point the contract is formed. These were structured to lead the respondent into the broad area of contract formation and to generate a picture of the overarching expectations and use of the form of contract.

The complete data sample for contract formation provided the expected results based on Macaulay’s general conclusion that such forms of contract are widespread. Only one respondent claimed that their organisation did not use standard form contracts though what type of company and business is not immediately visible from the overall data analysis.

The survey posed a specific question on the *Battle of the Forms*, without providing any clarification to the respondents on what this meant. The exchange of standard form contracts in the shape of tenders, purchase orders and subsequent communications, which are effectively offers and counter offers in the eyes of the law, can create uncertainty over the final form contract in place, a situation commonly referred to as the *Battle of the Forms*. Although recognition of this phrase may indicate a level of understanding, this may be

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<sup>7</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) Am Sociological Review p 57



different to knowledge of the principle and therefore the phrasing of the question was specifically intended to provide this additional segregation and hence more depth to the information, requiring respondents to recognise the phrase and understand the principle.

In response to this question on the *Battle of the Forms*, there was an even split between those who were aware and those that were not. This provides two levels of information concerning the individuals and their level of knowledge and also the recognition of the phenomenon. The importance of standard form contracts was seen as mixed although all but one considered them to be important to some degree, with 21% indicating that they were essential.

When these responses were assessed against the individual criteria, the second question on knowledge of the Battle of the Forms provided a split that would be expected with those individuals in operational roles being less aware than those in management or contracts. However, there was a similar balance within those directly involved in sales, as 75% were not aware of the concept. This may be that they were potentially not familiar with the specific terminology, but may also suggest that the people, who in most cases would be closing deals, were not aware of the risks they might be facing.

The similar comparison applied to the company cross section did not provide any significant data, though knowledge of the problems and risks of contract formation were more prevalent in larger companies. This would most likely be through greater training and communication or more strict processes applied in larger organisations.

In all cases there was a broad spread of views on the importance of standard form contracts with larger companies showing a slightly higher recognition of their importance. The notable exception in the sample of individuals was that those involved in the front line operational parts of the business demonstrated a lower assessment of the relevance whilst sales had a belief that they were more important. The operational areas of the business are those that actually deliver the product or service and may be a factory in manufacturing or front line engineers, builders, cleaners or even teachers and doctors in the public sector.

Interestingly, the small sample of legal professionals demonstrated a lower level of belief in their importance; this is possibly because they were more familiar and more regularly involved with non-standard form contracts and the significance and relevance of negotiating and managing risk in these circumstances.

Of the division by business sector, the notable variances were related to the appreciation of the battle of the forms where both construction and specialist sub-contractors had a higher than average recognition compared to property services and the generic category of others. This division was partially replicated when assessing the importance of standard terms, where construction again indicated a high level of importance.

It is perhaps surprising that the construction industry demonstrates this profile as it is probable that contracts in this sector will be of a higher value and potentially more complex and with greater risk. However, this may be a view primarily from the procurement side of the main contractors and the supply from the respective specialist sub-contractors where there is a more natural tension. Large construction companies will wish to manage risks down to sub-contractors and may be referring to industry standard form contracts like JCT<sup>8</sup>, MF1<sup>9</sup> and NEC<sup>10</sup>, whereas specialist sub-contractors are likely to have standard terms and conditions which are more appropriate to their particular area.

With such a desire to retain their own contractual position, as expressed by standard form conditions, the parties will routinely exchange or negotiate from this without necessarily reaching agreement. Construction companies will have strong commercial teams and robust contract principles designed to manage the complex risks common in all aspects of such projects but potentially not designed for the challenges of the many different types of services and products

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<sup>8</sup> See Joint Contracts Tribunal

<sup>9</sup> Model Form of Contract produced by the Institution of Engineering and Technology

<sup>10</sup> New Engineering Contract produced by the Institution of Civil Engineers

procured. The supplier will however have developed their own terms and conditions to address the specific risks they expect to face.

#### **4.3.2 Control of Contracts**

The subsequent five questions related to the availability of specific policies on entering contracts with or without standard form contracts in an attempt to test the level of control organisations applied to the terms and conditions they trade under. In all five cases, there was a strong tendency towards a structured approach of these policies though there was also a high level of uncertainty with up to 17% not knowing if such policies were in place. This particular level of uncertainty may be aligned to the specific role of the individual and their proximity to the contracting process, though this factor will be reviewed in more detail later.

In spite of the extent of policies and procedures in place to control the contractual process, there was a high level of acceptance that business was routinely carried out with no certainty of the conditions in place. More than half of the respondents (55%) claimed experience of doing business without being clear on the terms of the transaction.

The final of these questions developed the level of control further still by eliciting information on the sophistication of the processes. Where organisations have policies and processes recording levels of risk and potential liabilities under contracts, then they will be able to manage those risks and be more proactive in avoiding breaches and disputes. There is an identifiable drop off in the extent of the different processes, with 91% having policies to control contracts, 79% have processes for agreeing changes to the contract terms and 72% having similar processes for monitoring contracts by risk and value.

The analysis across the different functional business roles provided what might be considered expected results with operational individuals having a lower level of knowledge on policies or processes intended to control the management of contract agreements than sales or management. This distinction was more pronounced when reviewing the data on amending contract terms, but interestingly, sales professionals indicated a lower than expected

acknowledgement of entering contracts without clarity on the terms and conditions or whether there was actually a contract in place.

There are a number of ways in which this might be interpreted, including a superficial approach by sales having achieved the key principles with the customer but lacking the incentive to follow through to completion. Alternatively it may be a lack of appreciation of the challenges faced having passed the project on to other parts of the business which then discover that the contract is not clear or has not been concluded with matters still outstanding to be resolved and incorporated.

There is an interesting result within the responses to the final question in this section, where the key deviation relates to the individual aspects and shows that 30% of commercial or legal specialists confirmed their company had no system for recording contracts by risk and value whereas the overall sample had a higher number who did not know. This demonstrates that the knowledge of such systems which are most likely owned by the commercial or legal experts was not communicated to the remainder of the organisation. In order to be effective in practical situations, it would seem that this is a fundamental shortcoming of what may be an important tool.

Considering the responses to these questions across the organisational breakdown provides a consistent picture for the presence of processes to control standard terms with no noticeable deviations from the averages. The prevalence of policies covering changes to standard terms and acceptability of different amendments does however show variances across business types. This is a stage of sophistication beyond merely controlling contracts and should allow more flexibility in negotiating contracts, whilst retaining a level of control over key risks through indicating acceptable alternative terms and conditions.

The two main deviations to the average response were where specialist sub-contractors all indicated that they had such policies and where organisations with contracts valued in the bracket of £10k up to £100k. The explanation for this factor is possibly the same as the two groupings may well be much the same sample (though there are more responses within the contract value group). The nature of the work would suggest that the business will not be very

high value but may well be working for large main contractors with significant bargaining power. In these circumstances, such companies will need to be able to respond to the demands of their powerful customers and be able to accept more onerous terms routinely. To achieve this and avoid lengthening the sales process, there will need to be clear guidance to the sales team as the value of the contracts will be unlikely to justify more extensive support from legal or commercial specialists.

Of particular interest following this information is that this same group of businesses (identified by the value of the contracts) did not declare such a high level of experience of not being clear on the final terms. The implication is that where there was clarity over the process to ensure that contracts are entered managing risks, then the control processes extend to provide clarity on the formation of the contract.

The availability of a policy and process to resolve differences in contract position would therefore seem to be effective in ensuring that there is agreement on the terms and probably that there is a process for finalising the agreement without ambiguity.

The higher level of development of contract control processes showed no real variations by company sector, but did illustrate a slight increase in importance as the company size and the contract values increased.

### **4.3.3 Extent of Use of Standard Form Contracts**

The final two questions were intended to assess the extent to which standard form contracts are used and to develop this by comparing the number of contracts and the value on the expectation from Macaulay that they are more likely to be used for lower value, less complex exchanges. The results support this, though not as clearly as might be expected with 58% of the value of business compared to 67% based on the number of contracts. It is perhaps surprising that the figure is only 67% for the number of contracts, indicating that a large volume of business is still carried out on negotiated terms. However, one possible explanation for this result would be that the question had been interpreted to consider company own form of contract such that the remainder may be on another form of standard terms.

When the results are analysed by cross referencing the organisational factors, there are a number of interesting deviations from the sample norms. The first point identified above concerns the organisation that claims not to use standard form contracts. The business operates within the construction industry and has a turnover in excess of £100m, but with no dedicated contractual team. Notably however, the indication is that the typical value of contracts is greater than £1m, where it would be unusual to trade on a set of standard terms and more likely that bespoke contracts would be negotiated to address the higher value risks.

The analysis carried out by organisation shows one further anomaly from the norm with the Specialist Sub Contractor showing a higher ratio of contracts not on standard terms for both number of contracts and value. This supports the previous finding that this particular sector frequently has to accept alternative arrangements due their position in the market. Being the smaller party to the relationship and competing for a share of a large main contract, they will often have to accept non-favourable terms in order to secure the business.

As specialists however, they may quite reasonable justify the use of standard form contracts which specifically address the peculiarities of the business, as Beale and Dugdale point out, a common reason why sellers terms are used more often than buyers is not down to the relative bargaining power of the parties, but “... *it may also be explained by the difficulty in drafting uniform purchase conditions to suit a wide variety of different purchases*”<sup>11</sup>.

The breakdown indicated by the different professionalisms provided no significant deviations from the norm, which would be expected as this should be a function of the business and not related to the part the individual plays in the transactions.

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<sup>11</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y p49

## 4.4 Contract Conditions

### 4.4.1 Prevalence and Policy on Contract Terms

The questions in this section of the survey were designed to gather data on what companies included in their standard terms and conditions and what principles were important in managing their risk. This is intended to provide information for use in analysing the actual contracts to identify whether the views of the sample are matched by the contracts they use. Primarily it will identify what is important to the users and therefore provide a basis for assessing whether the SFCs are actually effective in achieving these aims.

Initially they attempt to collect summary data on the company policy and compare this with the terms covered in standard form contracts. Here there is a level of consistency with the most significant risks covered by policy being limitation or exclusion of liability, payment terms and liquidated damages as shown below:

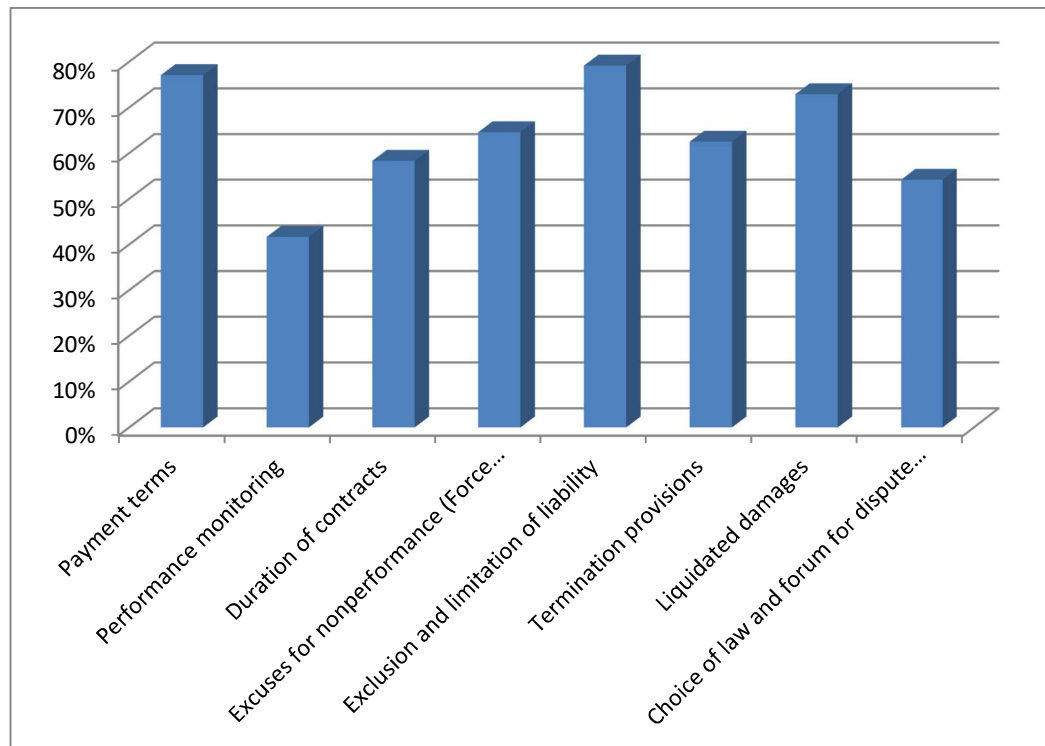


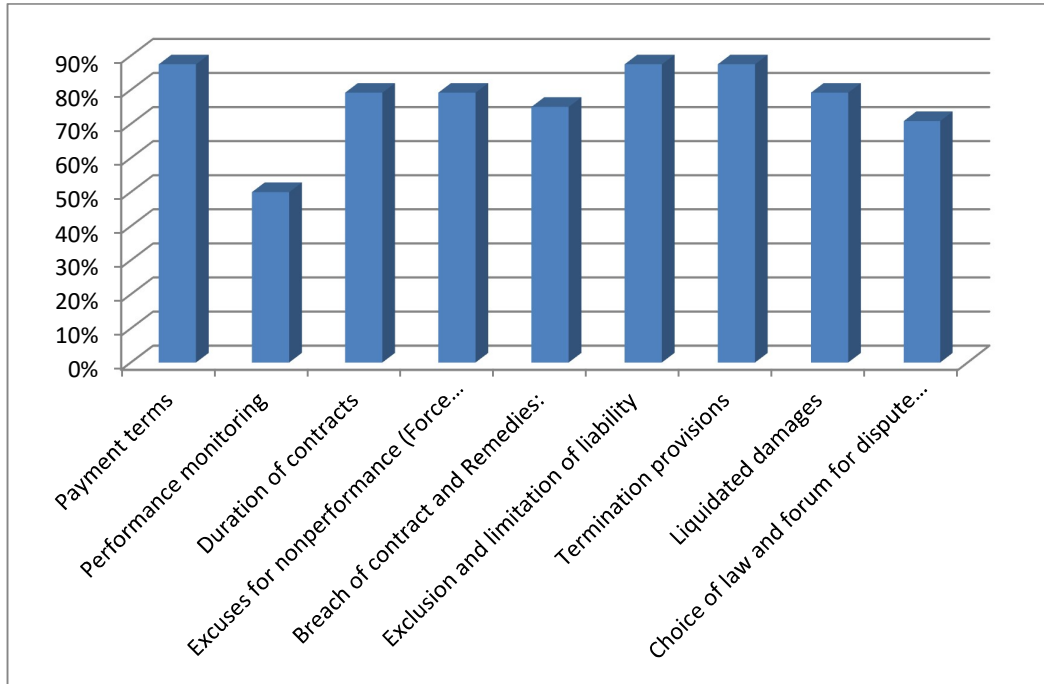
Figure 3: Which of the following are addressed in the Policy?

In order to provide a useable analysis, the data has been assessed as a factor of the average number of respondents to the complete section, though it is not possible to confirm whether all responded each specific question. Whilst this may not provide an accurate figure for the graph in all cases, it will nevertheless generate a true reflection of the relative importance of the different factors against other contractual requirements.

The items identified as important to the business in general therefore cover both the immediate and common risk of maintaining cashflow through appropriate payment terms and the significantly lower probability risk of limiting the impact of a significant breach through limiting total liability.

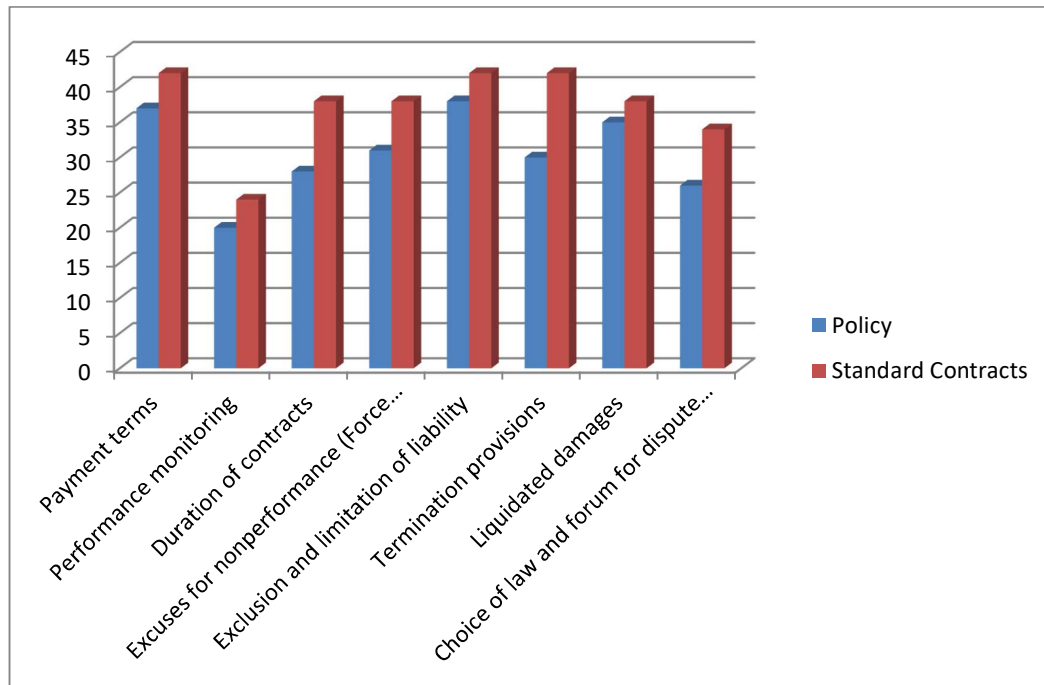
The inclusion of these requirements within a company's standard terms and conditions of business provides a slightly different profile as three items provide the same level of representation, though termination provisions are now more common than liquidated damages. This may be that the type of business has a different representation as term contracts like service are more prevalent than construction contracts where delay is a risk routinely covered. It may also be that it is not common for liquidated damages to be included in standard form contracts where the risks are different and it would be unlikely that the nature of possible losses could be assessed.





**Figure 4: Contents of Standard Form Contracts**

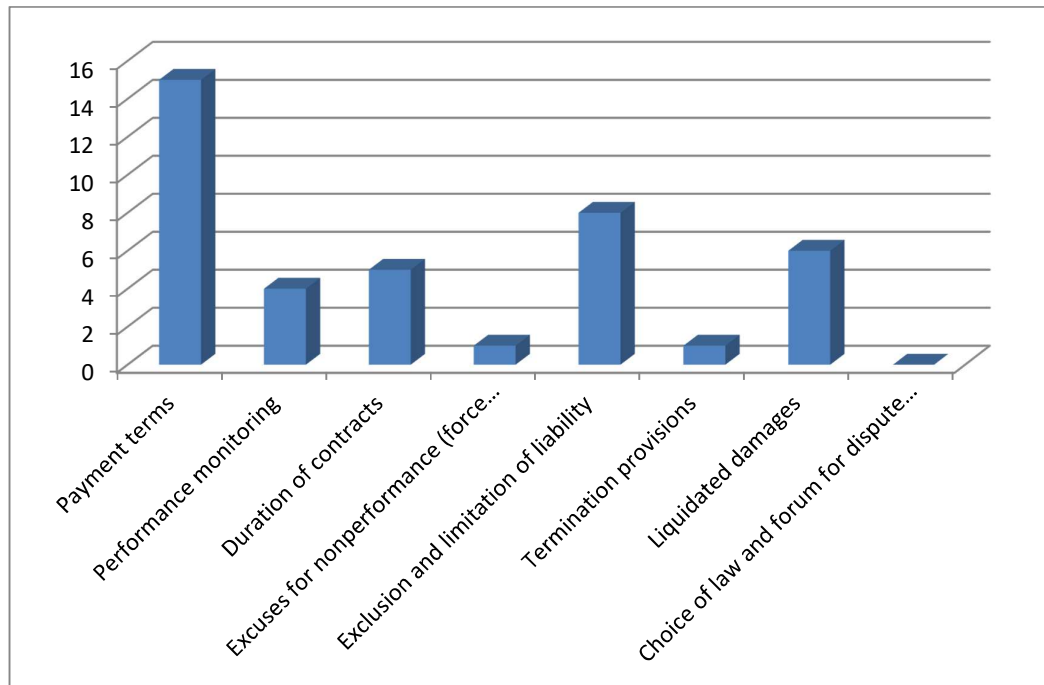
When taking this to the next stage it seems that there is a higher level of inclusion of these requirements within standard terms and conditions than there is within the broader company policy as shown by the previous questions on what is acceptable within its contracts. The chart below demonstrates this by showing the number of times items are included in standard terms is routinely higher than those terms are covered in corporate policy requirements.



**Figure 5: Comparison of Policy and Standard Form Contract Provisions**

This would indicate that standard terms and conditions are likely to be more robust in addressing issues than the broader organisational approach to contracts. It is not surprising that a company will try to include a higher level of control in standard form contracts that may not be challenged than it will routinely accept when negotiating contracts. If such terms are not accepted then there is an alternative position that can be reached within the established policy.

The follow up question move beyond what are effectively the facts of what is covered in policy and in standard terms, to elicit the views of the respondents on the relative importance of the different terms and conditions. It is probably reassuring for the companies involved that the data here provides similar results with the most important single factor seen as being payment, with almost twice the total of the second, exclusion or limitation of liability. This would suggest that the majority of the respondents were working on the supply side of the business and therefore dependent upon prompt and accurate payment for their business. Whilst there are aspects of payment terms that are important to purchasers, they are probably less important than ensuring time and quality of delivery.



**Figure 6: Question D.4 - Indicate the relative importance of the different terms within your company**

When these questions are assessed against the specific characteristics of the individual respondents, the most significant variances are across the different professionalisms. With the views on company policy, Legal and Commercial experts showed a noticeably lower appreciation for terms dealing with performance monitoring, duration of the contract and termination. These three areas may be considered to be very operational as they impact on the management of the contract and not on the impact on the broader business, hence it would be reasonable that they are not routinely addressed by the contracts specialists. These items were all rated more highly by Sales and other professionals.

A second notable variance is apparent with individuals recently trained showing a higher acknowledgement of the importance of such operational clauses as performance monitoring, duration, termination and liquidated damages. This may be a function of the cross section within the group if they are also mainly from the legal and commercial group, or it may be that they have been trained to recognise the significance of the other more strategic factors.

Analysing the response on content of standard terms, the responses were similar though there was an additional notable factor for individuals with less

than a year in post. This group showed a lower recognition of the importance of inclusion of termination clauses.

The corresponding analysis by organisational factors showed that it was primarily specialist sub-contractors that had the lower responses to the clauses on performance monitoring, duration and termination. This would be reasonable as such clauses would normally be important in term contracts for services and not for specialist services which are normally associated with construction projects. As would be expected, Property Services business showed the reverse of this trend.

The comparison of the views on importance demonstrated a notable difference for individuals within the specialist sub-contracting area as they indicated a clear preference for limiting liabilities and addressing liquidated damages above performance monitoring and payment. This would suggest that it is longer term objectives that they are interested in considering payment to be short term whilst liquidated damages and other claims would ultimately impact on profitability, not on cash flow.

#### **4.4.2 Deviation from Core Terms**

Having established that most organisations have both their own standard terms and conditions and a written policy on how they manage contracts, the next question tested how much they were prepared to deviate from their objectives in order to secure business. This again questioned whether there was a willingness to take this approach and also whether there were any controls to manage the process. In general the answer to both these questions was positive with only a handful indicating that there whilst they would deviate, there was no control of those deviations.

The subsequent open question asked whether there were any issues which would not be acceptable in any situation and generated a number of comments.

The most common terms that would prevent companies agreeing to contracts was the extent of the potential liabilities which was recorded as a factor by 12 respondents. This was phrased in a number of different ways and mostly identified unlimited (or uncapped) liabilities as the driver, though some were less clear using excessive liabilities or level of liabilities as the descriptor.

This requirement was followed by equal second place for different types of liabilities, both liquidated damages and consequential losses gaining five specific references. The reference to liquidated damages has been broadened to include two respondents who used the terms “*too onerous obligation clauses re speed of delivery of service*” and “*unreasonable KPIs*”.

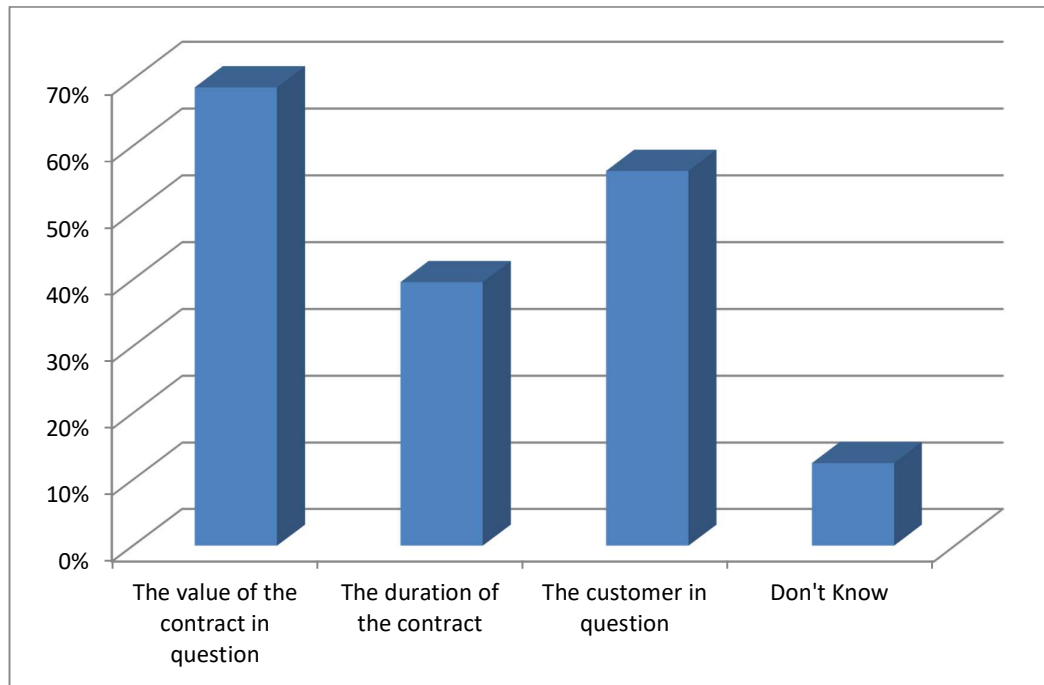
There were a number of references to matters directly related to payment, including the use of retention (which three individuals claimed would not be accepted) and other onerous payment terms. There were then a few solitary items which were identified:

- Guarantees: Provision of Parent Company Guarantees was specifically mentioned.
- Intellectual Property: though there was no indication on the specific concern.
- Risk: There were two respondents who indicated a general reluctance to engage in “*high risk*” or “*excessive or unusual shifting of risk or costs*”.
- Net Contribution: One individual stated that net contribution clauses were unacceptable, though didn’t provide any further elaboration.

As there was such clear majority confirming that there was flexibility and a similar majority confirming that policies were in place, there was little to assess from reviewing the smaller groups of individuals or organisations. It was also apparent that the free comments on unacceptable terms did not demonstrate any clear tendency across the groups.

#### **4.4.3 Factors Effecting Deviation**

The final question in this section tried to identify whether there were any general factors which played a significant part in influencing any decisions on what terms might be accepted. Based on the company policy in place, were decisions on what risks might be acceptable dependent on such specific criteria as the type of contract, the value of the business, the customer involved or other undefined reasons.



**Figure 7: Factors Affecting Agreement of Terms**

The most common consideration in negotiating terms was the value of the contract, though unfortunately whether this provided more latitude or less was not explored or explained further. Hence, this ambiguity could be interpreted either way, such that low value contracts might encourage the acceptance of deviations due to the likelihood that the risks are lower. Conversely, the prospect of a higher value contract might indicate that a company would agree to accept more changes to terms as they would have the benefit of increased management time. This latter position may also be driven by the need to agree to more variations on terms to secure the business and whether these are then standard from contracts or fully negotiated would be open to debate.

The other factor that showed a noticeable response was the specific customer, where repeat customers are likely to benefit from better terms through better relations and knowledge of their ways of doing business. Equally there may be some trading partners that would automatically revert to stricter terms on the same basis. This would be particularly true where there were a payment risk driving more onerous payment terms and possible requirements for guarantees.

Whilst all of those who responded to these questions assessed that the value of the contract would be a factor in deciding whether to deviate and therefore to what degree such increased risks would be accepted, the only significant functional factor that provides unusual results was that those involved in sales contracts. This group showed a higher tendency to consider that the length of the contract was a more significant factor than the other groups.

The third noticeable result was that there were a small number of sales professionals who did not know if there were any criteria established for deviating from standard form contracts. This is surprising as it is this group that should be aware when a contract or customer justifies a special consideration in order that they have more tools available to secure business, but substantiates the conclusions reached by Beale and Dugdale, that “...*salesmen trying to meet targets might enter informal contracts without bothering with their terms*”<sup>12</sup>.

The main organisational deviation from the average for this question was tendency for Property Services employees to identify the length of the contract as more important whilst specialist sub-contractors were unanimous in seeing the contract value as being most important. This would align with the expectation that property service contracts are likely to be for a fixed term for service delivery and hence an extended term allows for the development of relationships and dependencies and therefore a long term relationship.

## **4.5 Resolution of Disputes**

### **4.5.1 Reasons for Disputes**

As Macaulay identified as one of his prime areas of research, there is a strong desire by businesses to avoid reverting to the contract when things go wrong. Notably he identifies “.... *a hesitancy to speak of legal rights or to threaten to*

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<sup>12</sup>Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y p49

*sue in these negotiations.*"<sup>13</sup> Beale and Dugdale<sup>14</sup> took this further by looking at a number of specific types of dispute in order to compare whether there was a different approach to four specific issues:

- Issues of Payment and security
- Issues of Cancellation (non Breach)
- Issues of Delay on Delivery
- Issues of Defects and Failure to Attain Performance

It is perhaps optimistic to expect that all possible disputes might fall within these four categories; in order to provide a broader base for developing this area of interest a suitable start is to gather data on the nature of business contractual disputes. Unfortunately it would be too broad to allow free description of the issue and in order to produce data capable of analysis a number of options were provided. These reflect the areas noted above in slightly different definitions and include additional areas to provide more information:

- Payment/Billing, covering security but also including other reasons for non-payment that are not related to performance.
- Poor Performance, intended to include late delivery or non-compliance with definitions of scope.
- Poor Quality, distinct from above as this would lead to rework or problems after delivery.
- Early Termination, similar to cancellation above and therefore potentially a breach on the part of the customer.
- Relationship, which may be associated with other factors outside the scope of the specific contract in question.
- Other, which will sweep up a number of additional reasons, but which are expected to less frequent and more obscure.

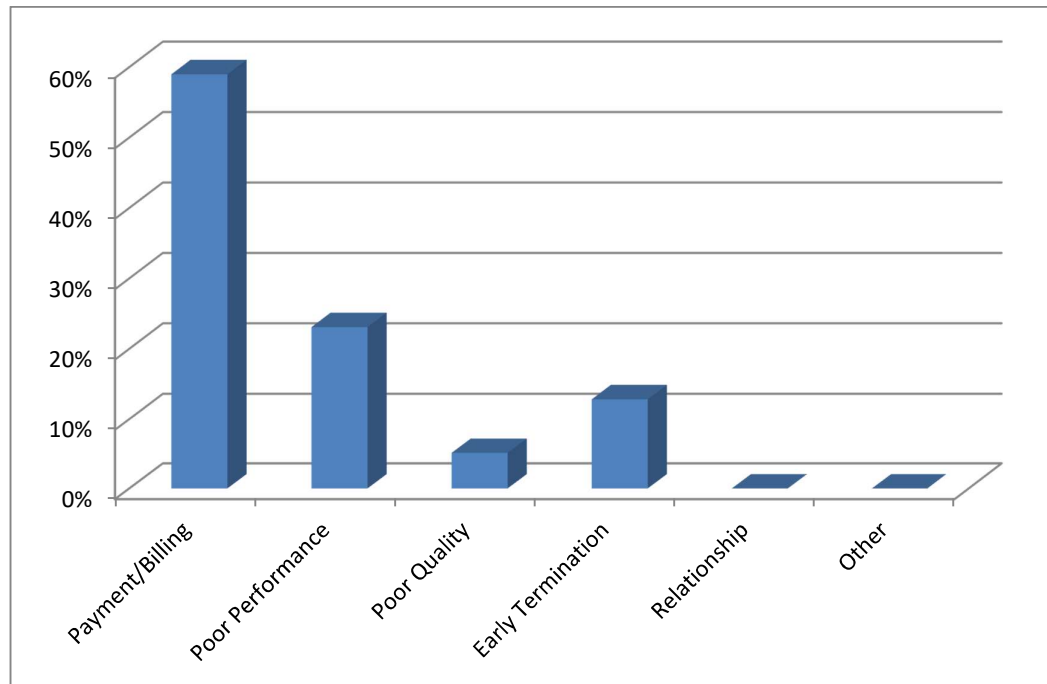
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<sup>13</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) *Am Sociological Review*, p61.

<sup>14</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) *Brit. J.L. & Soc'y* p51-59



The data from the complete survey shows that the last two of these possible options were not necessary as all identified disputes fall within the first four areas and with a significant majority being attributed to payment problems. This may be because many disputes will initially be identified through non-payment but when further investigation is completed there are other reasons for the non-payment, linked to performance.



**Figure 8: Causes of Disputes (by number)**

However, regardless of the true nature of the dispute, it is reasonable to deduce that in the view of the respondents, the most significant issues relate to the financial aspects. This should not be a surprise, as the sample is wholly comprised of respondents engaged in business activity where the ultimate commercial objective is to generate revenue and profit. The second largest category is identified as poor performance which also reflects the previous works of Macaulay and Beale and Dugdale. Whilst early termination or cancellation provide the next largest category, it may be identified that disputes arising from poor quality are more difficult to identify and may not be routinely associated with a specific product or service if they are not identified until some time after the delivery of the service or goods.

It is interesting that, although no respondents identified poor relationship as the leading cause of disputes, there was a sizeable group that indicated this as the second (18%) or third (10%) most likely. Additionally, poor performance was clearly the second most common cause with 56% classing it within the top two causes.

When the results are reviewed separately against the individual role or experience, there are no significant variances, though the item that has most variability is the identification of performance as a cause of disputes. The role of the individual created a split with Operational and Technical respondents indicating a higher level of disputes related to performance. This is not unexpected as these would be the roles where such issues would be most likely to be identified.

Additionally, the degree of involvement in contract documents generated some variance with those who rarely or never dealt directly with contract documents providing different assessments of the prevalence of disputes relating to both payment and performance. This might be assessed as being as a result of the lack of active involvement with contracts, but the group did demonstrate a distribution of contract involvement and exposure to disputes that matched the overall sample. The implication is that they are involved in the delivery of contracts, but are not involved in their negotiation or agreement. It is probable therefore that they have a less comprehensive knowledge of the terms and conditions and this may be an issue which may then be reflected in their assessment of the reason for the dispute.

The only noticeable variance from the expected results when the organisational factors were assessed was the view of the pure legal practitioners. Here, the opinion was that cancellation of the contract was more common than poor performance, though this may be a reflection of the nature of issues that were visible to lawyers, where poor performance issues are dealt with more commonly early in the dispute and don't therefore reach the stage of legal intervention.

When looking at the same question concerning the level of dispute, but assessed on the basis of the value of the dispute rather than the number of

disputes, the responses were similar. The one variation to this was that cancellation of contracts was seen as having a lower financial impact compared to quality issues. Additionally, disputes due to relationship problems were considered to be the most significant in some cases, most likely as these would have a long term impact and possibly spread to more than one contract.

These results were fairly consistent across all samples with the only area that created any variation being the views on the significance of payment issues. Here, there was a tendency for smaller companies to rank this higher than larger organisations, which would align with expectations that maintaining cashflow is more challenging for smaller businesses.

A number of additional items were identified as being significant causes of disputes. These were:

- *Price*: This is an interesting point as price is expected to be one of the items that would be most likely to be addressed and separately negotiated outside of the standard terms and conditions. For price to be a matter of dispute, it would suggest that the cost of the product or service is not a simple single figure but subject to more complex mechanisms, possibly aligned to performance, volume or even time for delivery.
- *Agreement of variations*: As a number of the organisation targeted were construction companies, it is to be expected that variations to contracts would be an area of concern. Even straightforward low value contracts in this field can be subject to outside factors which have an impact on the price and reaching agreement on the detail and price of these is a well recorded area of disputes<sup>15</sup>.
- *Automatic price variation*: Where contracts are for an extended period of time there is frequently a need to allow for annual increases in price to cover a variety of areas of price inflation. Whilst this may be covered in the contract with a detailed and often complex mechanism it is frequently dealt with under less rigorous terms allowing and encouraging flexibility.

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<sup>15</sup> Michael Sergeant, 'Variations on a Theme' (2014) 25 7 Cons.Law 14

Whilst this latitude may be beneficial in many cases, it can provide an opportunity for a customer to challenge an increased price.

- *Billing Errors*: Although linked to payment, more complex contracts (including Construction Contracts) can frequently lead to more complex billing requirements, including stage payments. If these are directly linked to work completed or goods delivered under a large contract and these are not agreed in advance, then there is scope for disagreement.
- *Customer not being able to pay due to business issues (administration etc), or not paying*: Even when the business environment is flourishing, there will always be some companies which struggle and even, if not actually insolvent, need to actively manage payments to suppliers and sub-contractors. They therefore withhold or delay payment in order to optimise their cashflow without any legitimate reason.
- *Site disputes as above, inevitably result in withheld payments or contra charges which affect the cash flow. Pressure is on Sub-Contractors at Final account stage to "do a deal" on these*: This also refers mainly to construction contracts, where there is a tendency on large contracts for the Main Contractor to request changes and acceleration without agreeing prices in the expectation that they can negotiate a better deal at the end of the contract.
- *Building demolished, Company goes into Liquidation*: This is similar to the previous comment on insolvency, but also includes those situations where a party attempts to exit a term maintenance contract when they move or even demolish the building. Whilst they clearly have no further need for the service, they have nevertheless entered into a contract establishing expectations on the other party for revenue for a set length of time.

These additional comments provide an interesting insight into the area of disputes, though may reflect individual opinions following a particular experience.

#### **4.5.2 Contractual Disputes**

The subsequent set of questions were intended to assess how relevant the terms and conditions of the contract were to the cause of the dispute and the resolution. Specifically, whether they assisted in dealing with the problem or were potentially the root cause of the problem.

The first question looked at the scope of the contract terms and whether the dispute was covered under the agreed terms. The average of the responses indicated that the subject wasn't specifically covered in only 16% of cases, though there was a significant variation around this figure. Some respondents believed that the disputes were not covered by the terms in 70% of cases whilst at the other end of the spectrum, there was a belief that disputes were always covered.

The results between individual roles produced noticeable differences, with those working in a pure commercial or legal capacity believing that far more disputes were not covered by the contractual terms. This may be due to a number of factors such as the type of dispute that they are exposed to or the more detailed understanding of the content of the contract and its application to the facts of the dispute. It may however be because these professionals have an expectation that if the matter were covered by the terms, then there would not be a dispute. Additionally, those with the least knowledge and experience of contracts shared similar views as the responses from the technical and operational areas and the those that acknowledged that they never reviewed contracts stated that a large element of disputes were not covered by the documented agreement.

The analysis of responses across the organisational divide produced much more consistent data, though the specialist sub contractor sector did indicate a similarly high element of views that the contract did not cover the matter.

The second question developed the theme by trying to establish whether the dispute could be resolved by reference to the contract terms. This question therefore only considered those issues that had been identified as being covered by the contract and then tried to establish whether the contract was useful in helping to produce a resolution. A high proportion of disputes (60%)

were considered to be sorted this way, though there was a significant variance to this figure experienced by operational and technical staff.

These individuals suggested that a smaller number were dealt with this way, indicating that this group who are closer to the customer at the stage when most disputes arise probably had more experience of dealing with them directly and did not wish to reach for the contract. This would substantiate the results from Macaulay and the oft quoted:

*"...if something comes up you get the other man on the telephone and deal with the problem. You don't read legalistic contract clauses at each other if you ever want to do business again. One doesn't run to lawyers if he wants to stay in business because one must behave decently".<sup>16</sup>*

The third question relating directly to agreed terms and conditions, addressed the interpretation of the terms and whether the dispute could be attributed to differing interpretation of the drafting between the two parties. In this case, a third of the disagreements were considered to fall within this category.

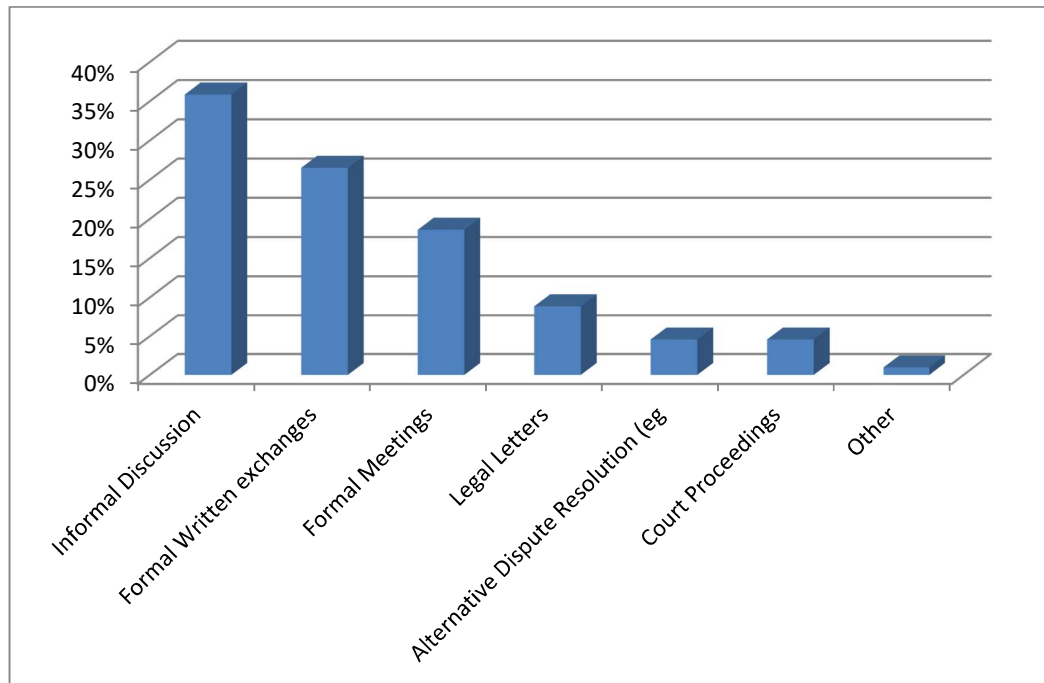
The variances across the individual classes showed that once again, operational and technical personnel were out of line with the majority of views elsewhere. In this case they considered that a larger than average number were due to difference of interpretation of the contract terms.

#### **4.5.3 Resolution of Disputes**

The final two questions in this area attempted to collect data on the final resolution of disputes, particularly the stage at which they are resolved and the factors that influence the resolution.

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<sup>16</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) Am Sociological Review, p61



**Figure 9: Stage of Resolution (%)**

The data is summarised above and shows that there is a clear tendency for disputes to be resolved at an early stage and without reference to the contract or intervention of legal experts. In total, the view was that over 80% of these issues that have been identified as disputes are resolved before any legal involvement and less than 5% actually reach the litigation stage.

Whilst this provides a good indication of the development of disputes, there may be a question over what constitutes a dispute (an issue that is explored in more detail in chapter 6). This would be the case where the relationship between the parties is such that what may be considered a serious disagreement in one situation is seen as a challenge to be overcome jointly where the parties are more aligned. A procession of e-mails forming a friendly negotiation over the price of a variation to a construction contract may be seen as a dispute or merely an important function necessary to achieving the desired contractual objectives.

The different personal groupings provided a degree of interesting differences, most notably the fact that those in operational and technical jobs considered that a majority of disputes (55%) were not resolved until the formal legal stage. As this segment is the one which is most closely involved in such disputes on

a daily basis, it may be seen that this is a more accurate reflection of the true position. However, it may also be that these individuals consider the first two stages (informal discussion and formal written exchanges) as a normal part of business and not specifically with a view to resolving disputes.

Additionally, those who had no involvement in reviewing contracts assessed that a larger proportion of disputes would be resolved at the early informal stage.

There were fewer deviations from the average when reviewing the organisational results, with the only point of interest being the indication that larger value contracts were again seen to have a higher incidence of resolution at the formal legal letter stage. It is likely that these larger contracts will have a higher degree of commercial involvement and therefore may reach this stage sooner, though with lower level issues being dealt with routinely at the operational level.

The final question about the nature of contract disputes was intended to gather data on the significant factors that affect how they are handled. The overall sample gave a clear indication that the main factor (48%) was the total value of the contract with the other factors (value of the dispute and relationship with the customer) presenting a fairly even second consideration. The type of contract (standard form, industry form or bespoke) was considered not to be relevant even though this may significantly influence the method of dispute resolution as well as indicating the robustness of any particular position.

The analysis of responses by the role of the respondent provided a similar outlier to other questions relating to disputes, as the group with the differing perceptions was mainly those involved in operational and technical jobs. Here there was no belief that the value of the contract was important, but the value of the dispute was significant. This factor would be more significant to the manager responsible for delivery as it would impact directly on the profitability of the specific job and therefore influence the way in which they may decide to resolve in order to maximise their performance. It implies therefore that they are more interested in the detail of their specific business and less in the larger



business of the effect of the contract on the business and the longer terms relationship with the customer.

This question also invited comments on additional factors that might be relevant in the resolution of disputes. This elicited the following comment:

*“Although Mediation / Adjudication accounts for a very low percentage of disputes resolved, the simple threat of such action accounts for a much higher percentage (10%?)”*

This points towards another possible area of future research in evaluating the tactics used in resolving disagreements and how the process might be managed.

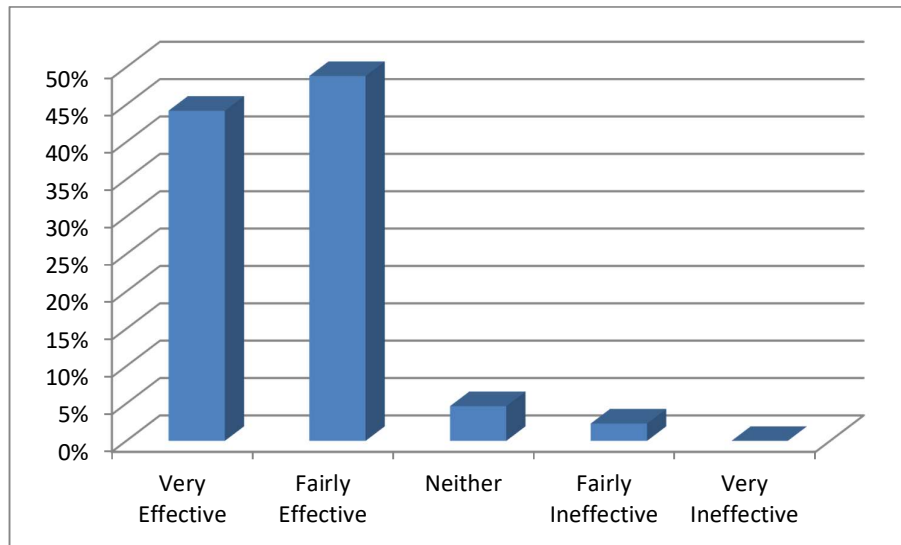
## **4.6 Additional Views**

### **4.6.1 Business**

The final set of questions was designed to gather broader information on the personal views of standard form contracts specific to the individual. These were exploring the opinions of current users on their effectiveness as business tools in achieving different company objectives. There was no intent to generate objective data and it was made clear that these should be the views of the individual developed from personal experience and not the policy of the employing organisation.

The four aspects tested were defining the transaction, fostering relationships, managing risks and developing business. Whilst these are intended to be individual perceptions, it is nevertheless informative to consider whether there are any patterns within the individual or organisations factors available.

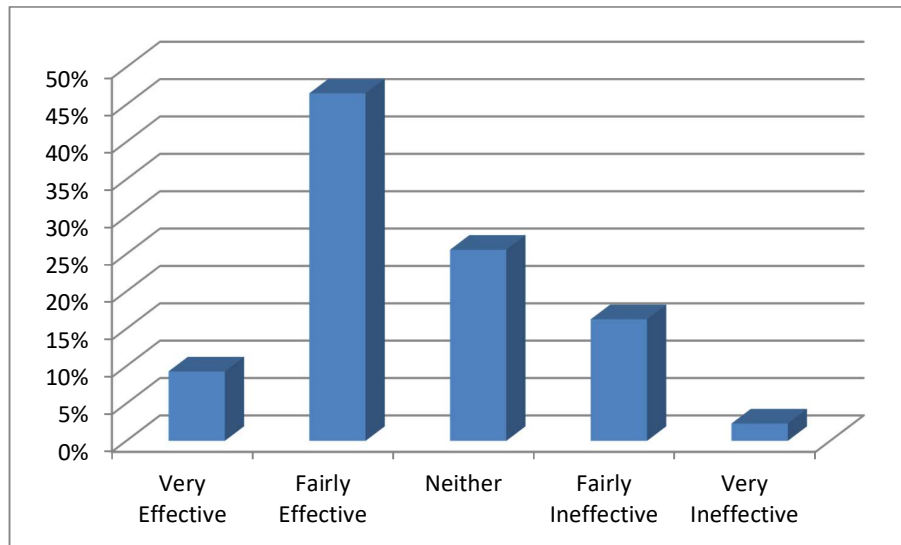
The first of these tests, defining the transaction and the obligations on the parties, produced a relatively positive response, with 93% assessing them as very or fairly effective. The notable variations to this trend were within the specialist supplier organisations, where the split between very and fairly effective was biased towards fairly and there were a number who doubted whether they were effective at all.



**Figure 10: Effectiveness at Establishing Obligations**

This may be a reflection of the nature of the business, where it may be rare to be able to agree contracts on the company's own terms and conditions and therefore necessary to negotiate starting from terms established by the other party and attempting to bring within an acceptable level of risk. The aim of the question however was to test the effectiveness at defining obligations and if this is not considered positively, then there should be concerns over how those obligations can be defined effectively to ensure compliance and complete delivery.

The second question looked at whether standard terms and conditions could help in developing the relationship between two contracting parties. The results were unexpectedly positive, with 56% supporting this view to differing degrees whereas only 19% indicated that they thought they were ineffective. As this question was intended to give the respondents the opportunity to criticise the use of standard form contract in the expectation that many parts of business may see them as creating obstacles to closing deals, it is interesting that the majority of responses indicated that they were to different degrees positive. On the basis that all business needs to be carried out under some form of contractual agreement, it seems that using standard form agreements may provide a simple and quick solution and reduce the possibility of confrontational negotiations.

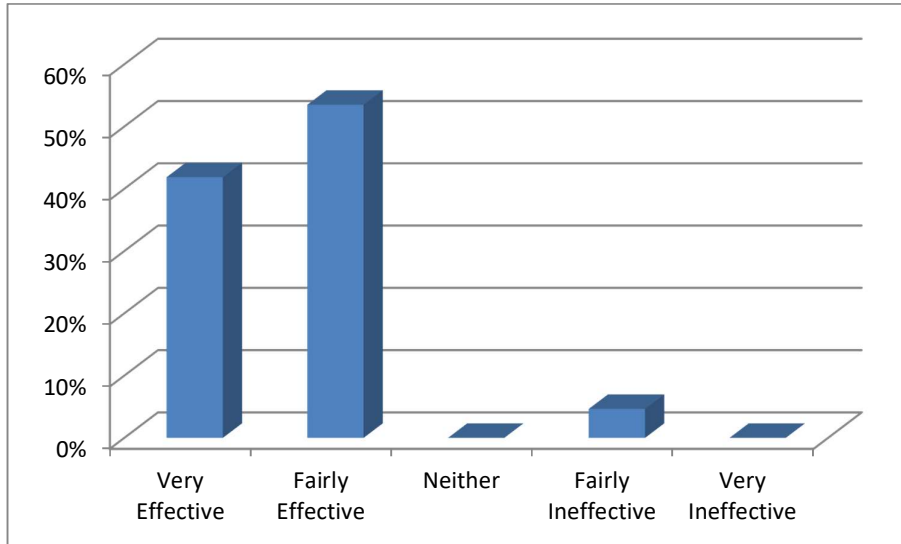


**Figure 11: Effectiveness at Developing Business Relationship**

The variations to this conclusion were less noticeable though the feelings from the specialist sub-contractor sector were stronger than elsewhere that such instruments are ineffective at promoting customer relations. Individual criteria analysis showed no noticeable trends.

#### **4.6.2 Company Objectives**

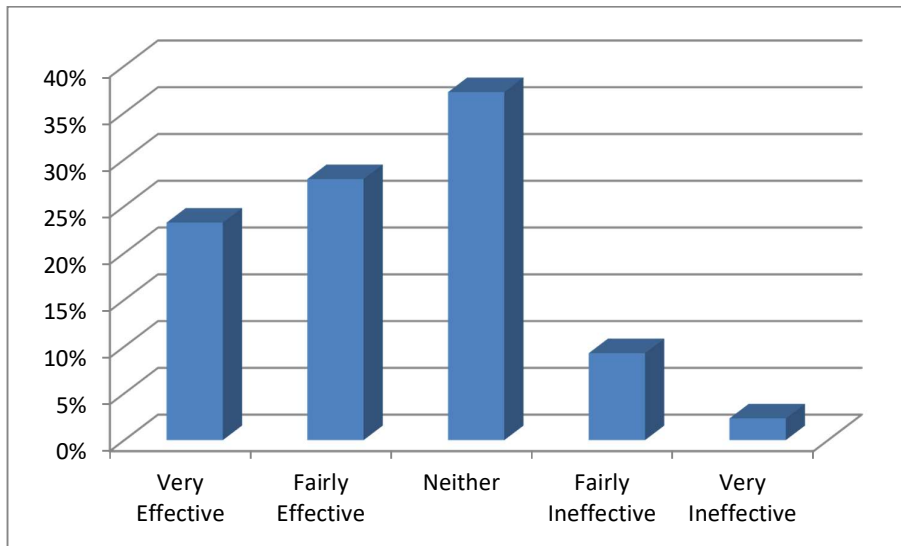
The third question tested views on the business objectives of managing risk by using standard form contracts and here again there was a general acceptance that these contracts were on the whole effective. Although there was a 5% element which responded negatively, 95% responded positively to different degrees. Managers were slightly less enthusiastic than the average and interestingly the only area which had any negative views on this was the described as legal or commercial. It is perhaps these specialists who are more aware of the limitations of such contracts or the extent of the risks which are not covered.



**Figure 12: Effectiveness at Managing Risks**

Yet again the specialist sub-contractors were the business area that had a lower level of respect for the effectiveness of these contracts, whereas property services were more positive in their assessment.

The final topic covered by these questions addressed the effectiveness at supporting the development of business opportunities. In general there was a significant section of responses which were indifferent to this hypothesis, with only 51% providing a positive response. The largest single answer was the neutral position with 12% indicating that they were detrimental to this objective.



**Figure 13: Effectiveness at Developing Business**

The main variances to the most common position were the opposite views of the Construction industry where there was a strong positive view on their effectiveness (44% indicating very effective) and Specialist Suppliers being much less positive (63% with either neutral or negative views). If the Construction businesses are the Main Contractors in general, then this would suggest that they are happy to use their T&Cs and impose them on suppliers or be able to amend the important aspects as a result of their strong bargaining position.

It is notable that the strongest advocates within the different roles were within the Sales professionals, where there may have been an expectation that they were an obstacle to developing business as they could provide a rigid and inflexible approach. However, it may be that this firm position allows the sales team to close sales quicker with less distraction in negotiating contracts once they have established the core principles.

## **4.7 Key Findings**

### **4.7.1 Interpretation of Results**

Whilst there is a large volume of data provided by the questionnaire, and hence many different ways of deriving relevant and specific inferences, there are a number of common features that flow through. Considering these themes in relation to the original core theories of Macaulay and Beale and Dugdale allows a number of further and new conclusions to be drawn. Some these are general features of the complete sample and some of these are associated with comparisons of the results based on the individual and organisational factors.

There are a number of general issues that are apparent from the responses across all cross sections, specifically:

- The relatively infrequent reference to the contract when there is a degree of disagreement between the parties.
- The lack of clear understanding on whether there is an agreement in place (has a contract been formed) and then what is in the final contract.

- A general lack of appreciation of what the contract says and how it should be used for any particular part of the agreement (delivery, payment, disputes).
- The general recognition that the most common area for disputes is that of price and payment; though this may ultimately be a symptom of other problems, it is the importance of the financial aspect of the transaction to both parties that causes a problem to be fully recognised.

These points are of interest as a general commentary on the use and misuse (or abuse) of standard terms and conditions and may be of relevance in developing more appropriate contracts. It may however be that a more likely outcome would be to ensure that standard form contracts are more closely aligned to the user's needs and established within a framework that allows them to support the business objectives as an integral tool.

The significant deviations from the expected norms of their use should be a concern to the organisations that use them and the systems within which they are used.

There are also some interesting points that demonstrate different approaches and attitudes between different groups of respondents:

- There is perhaps an understandable and definable difference in understanding and use of contracts between those who sell (and therefore agree the contracts) and those who deliver the requirements.
- The second notable area of variation across different individuals and organisations is shown in the level of enthusiasm to negotiate or deviate from standard terms and conditions.

These aspects are less surprising as they tend to support the conclusion reached in the earlier studies and demonstrate the normal tensions within business between sales and operations<sup>17</sup>.

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<sup>17</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) *Am Sociological Review*, p63

#### 4.7.2 Approach to Resolving Disputes

A significant point identified by previous studies was the lack of reference to the contract when the transaction does not go as expected. As Macaulay points out, *“Disputes are frequently settled without reference to the contract or potential or actual legal sanctions.”*<sup>18</sup> The survey tried to gather data on how such disputes are resolved and at what stage, but suffered to some extent by the difficulty in defining what is a dispute and hence when does it arise.

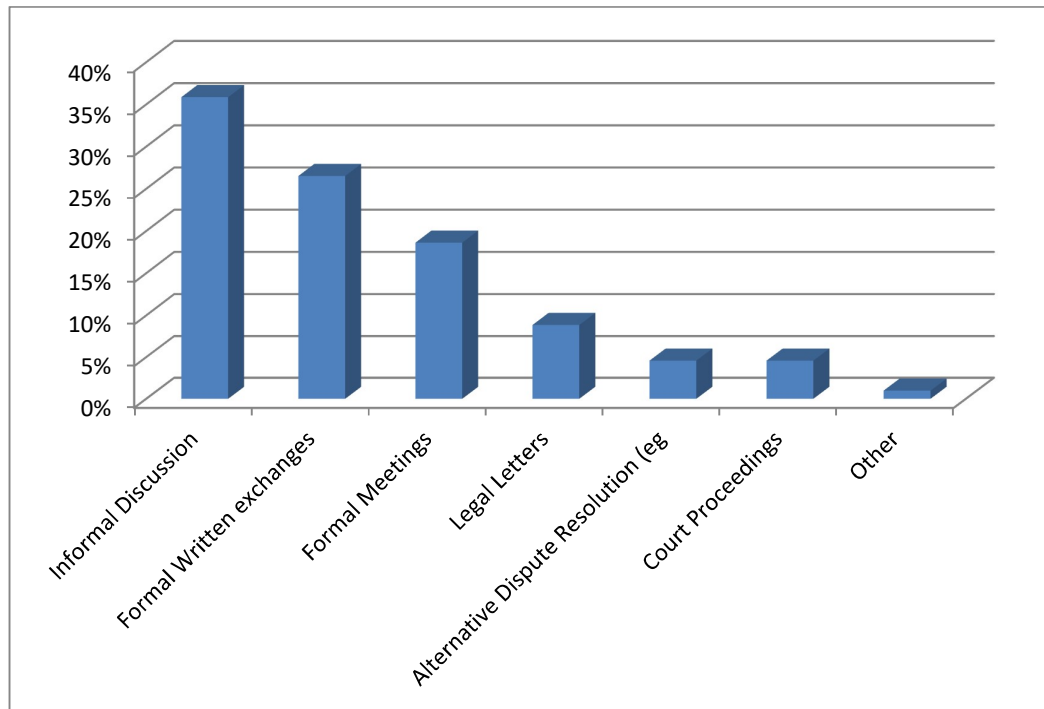
Interpretation of such a concept may range from a minor issue in daily activities which is sorted quickly by an open conversation all the way through to a failure by one party to deliver on its obligations which results in significant costs being incurred by the other party. Consequently, the identification of the resolution could be equally broad and poorly defined.

However, there is a common belief from the respondents that most disputes are settled without any reference to the contract terms and through informal discussions. Indeed, 60% of all issues identified as disputes were dealt with without the need for any formal communication. On the basis that those issues that progress further along the escalatory route will be better recorded and more obviously defined as disputes then this is likely to skew the results. It will be the classification of the minor issues that individuals may decide did not justify being classified as a dispute that will be lost to the analysis rather than those that become formal matters.

This large area of routine and commonplace adjustments to the relationship which may not even be considered to be governed by the contract may form a significant pool of disputes that would be worthy of further investigation. However, the fact that they are resolved routinely without any impact on the delivery of the contract or the effectiveness of the relationship may mean that they are not in fact worthy of comment or even relevant to the contract.

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<sup>18</sup> Ibid, p61



This acknowledgement that the contract has little part to play in such matters may derive from the desire of the individuals to work together to achieve mutually acceptable solutions or from a lack of understanding of the contents and functions of the contract. In reality, it is likely to be a combination of the two as individuals recognise that a discussion will be both quicker and more effective and that any reference to the contract documents will probably require involvement from others with more expert knowledge and most likely less personal interest in the final solution.

Where the contract is based on the standard terms and conditions of one of the parties, it is also likely that the need for generality to allow use across a range of requirements may mean that there are not specific terms relevant to any particular situation. If the individuals have not been successful in reverting to the contract previously, then they will lose confidence and routinely not bother to consult the terms for other disputes.

Whether there is a remedy defined within the contract for any type of breach will depend on a number of factors including whether the breach was reasonably foreseeable. Common breaches like failure to pay on time (or at all) will most likely be addressed as well as issues like time for delivery, but even the presence of an express remedy does not necessarily mean that the



contract will be the first option for these breaches. Beale and Dugdale commented that “...it was not surprising to find relatively little use of contractual remedies and almost none of formal dispute-settlement procedures such as a court hearing or an arbitration.”<sup>19</sup>

This comment picks up on a similar point about the use of alternative dispute resolution (ADR) clauses. The research in question was carried out in the 1970s and therefore preceded a number of initiatives to encourage a less litigious and more inclusive approach to disputes<sup>20</sup>. However, the chart above reinforces the point that even now there is limited appetite for ADR with a similar volume of disputes reaching ADR as reaching court.

#### **4.7.3 Prevalence of Uncertainty of Final Terms of Agreement**

It is also surprising that there seems to be an acceptance that not all transactions will be governed by a contract that is agreed, in writing and signed by both parties demonstrating such agreement. Macaulay recorded that “...frequently the provisions on the back of their purchase order and those on the back of a supplier's acknowledgment would differ or be inconsistent.”<sup>21</sup> Unless there is clear acceptance to one or the other through a signed acceptance or separate written acknowledgement, then there is no clear agreement and hence no contract.

However, he goes on to explain that in many cases both parties were content and “...they would assume that the purchase was complete”<sup>22</sup>. There is however little subsequent justification or explanation of the phenomenon,

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<sup>19</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies', (1975), Brit. J.L. & Soc'y p 48

<sup>20</sup> See The Right Honourable The Lord Woolf, Master of the Rolls, Access to Justice: The Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, (HMSO, London, 1996) and Lord Justice Jackson, Review of Civil Litigation Costs: Final Report, The Stationery Office, 2010

<sup>21</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), Am Sociological Review p59

<sup>22</sup> *ibid* p59

though some of those questioned indicated that they were keen to ensure agreement was clear. Beale and Dugdale concluded differently, that “...*there was considerable awareness of the fact that in many cases an exchange of conditions would not necessarily lead to an enforceable contract.*”<sup>23</sup>

Whilst there was a reasonable level of acceptance of the importance of standard form contracts to the companies involved, there was a general acknowledgement that not having a clear agreement was not infrequent. Over half of the sample questioned confirmed that they had experience of not being clear on the final contract in place or if there was any level of agreement. Unfortunately, the questioning did not examine this point further in testing whether the respondents considered that this was acceptable or whether the lack of agreement caused problems during the delivery of the contract.

Although the survey indicates this process of forming a clear and binding contract is recognised as an important and yet poorly executed activity, it did not provide any evidence to suggest that the lack of such clarity created subsequent problems. Although the questions did not explore this point specifically, there were no examples provided where recognition of the terms caused additional problems even where there was a dispute.

*“Legal enforceability seemed secondary to reaching a common understanding”*<sup>24</sup>

However, simple mathematics might indicate that if only a small number of contracts are subject to a dispute and of those only a small percentage are not resolved early and therefore result in reference to the contract then the number of contracts that are actually scrutinised in sufficient depth to identify problems with formation will be very small. The probability of reaching this stage and also having a problem with the contract is therefore smaller still.

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<sup>23</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y p50

<sup>24</sup> Ibid, p50

Even if the contract were not clearly established as legally binding, it is probable that this fact is unlikely to be challenged unless there is a substantial dispute that relies on the details within the contract. The most common reasons for such lack of clarity are either that the battle of forms is not resolved and hence there are two sets of conditions which may govern the contract or that negotiations are ongoing and final agreement is not conclusively reached.

*“...positive planning on particular issues even while using standard terms may have legal as well as commercial significance”<sup>25</sup>*

In the former case, then there will only be a problem if the point in dispute is addressed differently under the two sets of terms, otherwise both parties will have agreed and the point can be resolved. In the latter case then it is likely that most of the key points will have been agreed and only if the point is not covered will the dispute need to be resolved. In most cases, there are unlikely to be many points not agreed and as both parties will usually wish to reach resolution it will only be if the dispute is significant in value or importance and not covered in any form of agreement that the non-formation of contract might be a continuing issue.

#### **4.7.4 Understanding of the Content of the Contract and the Importance and Usefulness of Specific Terms**

One of the significant areas of agreement across all individual specialisations and organisational factors was recognition of the importance of controlling the contracts agreed using management processes which cover what can be agreed and when alternative terms can be accepted. Across the sample 81% confirmed that their company had a policy in place to manage what they agreed to within their contracts. Only 4% admitted that they did not have anything and a few confessed that they did not know whether or not there was a process in place, though these may have been employed in areas where they had little exposure to the contracting process.

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<sup>25</sup> Ibid p51

Additionally, a higher proportion stated that the business was prepared to negotiate their terms (94%), of which a similar proportion had a process to control these negotiated changes. There were however a couple where negotiation was permitted but with no stated process to control what was agreed.

The knowledge that these processes are in existence is the first step in managing contractual risks, but whether they are applied and controlled is more difficult to evaluate. Whilst Macaulay comments on the negotiation of some parts of the contract, he does not develop the concept but leaves it open as "*...the buyer's "fine print" will control. If the seller does object, differences can be settled by negotiation.*"<sup>26</sup> What may be amended and how such amendments might be controlled, is not explored further.

The need for such control processes would be important in large organisations to ensure that management is kept abreast of possible changes to risk profiles and more importantly to ensure that the individuals who deliver the contract are aware of the changes. In larger organisations, these personnel are likely to be different to the sales team who agree the contract.

In cases where the business expects to trade on its own standard terms and conditions, there may be little in place to support a negotiated process. This will be because the company does not wish to encourage its sales team to consider such an approach or it may be because the expectation is so strong that it does not even consider that its terms should be challenged.

The type of organisation then is more likely to dictate the approach to this dilemma than the individual and their role. Larger companies (which made up the bigger part of the sample) demonstrated 85% knowledge of control processes whilst smaller ones had a 50% positive response. Of those with processes to control negotiated terms, larger companies again demonstrated

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<sup>26</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), Am Sociological Review p58

more adherence to policies (97%) where medium sized companies permitted negotiation with no (or no knowledge of) control policies (only 67% agreed).

The most interesting result from this area of the survey was one that demonstrated a possible lack of consistency between the perceived policy on contract terms and the content of a company's standard form of contract. This acknowledgement that the robust and repeatable use of standard terms and conditions as a means to entering an agreement provides an opportunity to impose more rigorous terms and conditions than free negotiation is consistent across all areas.

Individuals are therefore able to establish a better position in their standard terms, which are more likely to deal with specific issues. If they are then required to negotiate, and potentially deviate from these standard terms, it is possible that there is not a company policy that provides guidance or clarity on what may be acceptable. This is most likely because the standard terms have evolved over many years and have been drafted and re-drafted by lawyers who will deal in detail with many points which are unlikely to be subject to challenge in most cases.

They are therefore comprehensive and refined on points that the users are not aware of or need to be familiar with. The results were not notably different for any individual or group criteria.

#### **4.7.5 The Extent of Disputes on Payment and Reference to Payment Issues in Contracts**

By far the most significant matter that caused problems with both reaching agreement to the contract and subsequently in completing the contract, were those described broadly as payment. Both Macaulay and Beale and Dugdale recognised that this was a significant area and the latter went so far as to use the issue as a focus for a specific area of research, namely in evaluating remedies for payment default and means of preventing such defaults.

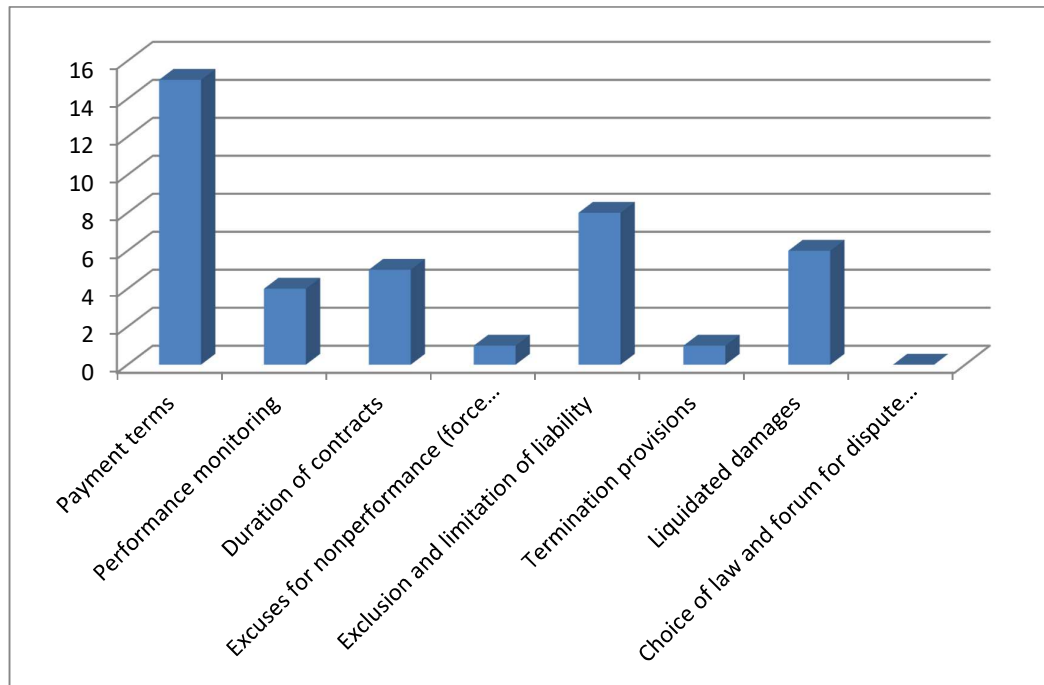


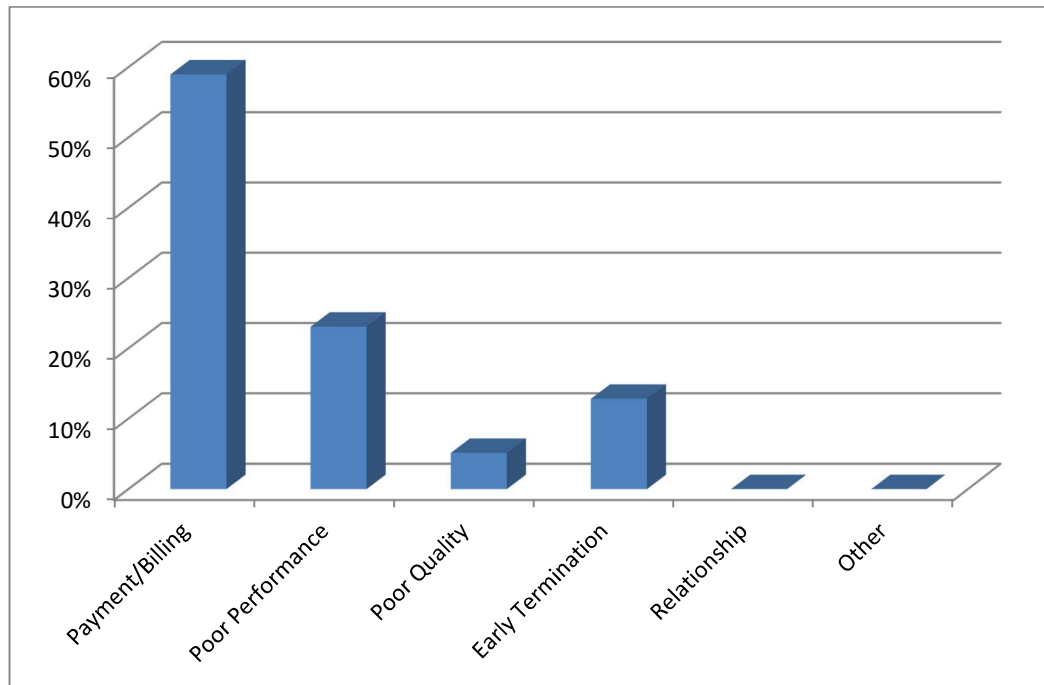
Figure 14: Q. D4 - Please indicate the relative importance of the different terms within your company

At the start of the contract however, matters of price and payment fall into area of deliverables which are normally a key point for negotiation and hence are planned and agreed. Of the two items, price is inevitably one of the key points to be agreed and hence is usually detailed formally and explicitly within the contract, sometimes with a detailed breakdown. Payment may be considered less of a problem in many cases and so may not be dealt with separately but will in most cases be included within standard terms and conditions.

Whilst the data from the responses illustrates that there is significant focus on these matters, it is also noted that an equally significant volume of disputes are also associated with payments. Beale and Dugdale observed that *“Payments were frequently made late...”*<sup>27</sup>, and subsequently become matters for dispute and potential legal action. Whether or not they reach this stage will depend on a number of factors both contractual and extra contractual.

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<sup>27</sup> Beale and Dugdale, 'Contracts Between Businessmen: Planning And The Use Of Contractual Remedies' (1975) Brit. J.L. & Soc'y p51



**Figure 15: E3 - In your experience, please rank in order the nature of any disputes by frequency**  
*“...the problem was also reduced by the various precautions, extra-contractual and contractual, taken by every one of the sellers.”<sup>28</sup>*

These extra contractual means would include such options as checking the credit rating of customers prior to agreeing either the contract or more particularly the payment terms. Should the credit status be less than positive, then the supplier may require payment in advance or at least largely in advance. Alliteratively it may be that a form of guarantee may be required by a bank or a parent company with more substantial standing. Whilst disputes about the price to be paid may be less common, they are more likely to be an issue in larger or higher value contracts. This may be a result of variations on what might be included or excluded or adjustments, particularly in construction contracts where the scope of what is required cannot be covered in the contract due to uncertainty in other areas.

It is however quite apparent that price and payment will be a significant matter within the contract and in spite of being dealt with in varying degrees of detail

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<sup>28</sup> Ibid, p52

at the contract formation point, still creates problems at later stages. As businesses inevitably are driven by financial measures, these will naturally be significant features.

The total amount due under the contract will be critical to the profitability of the individual contracts and any adjustments to the price have an immediate and direct effect on profit. Any delay in payment, whether justified or merely through poor processes will have a similar impact on another key business metric, cashflow. The phrase “*cash is king*”<sup>29</sup> is frequently stated underlining the importance of keeping cash as an asset and collecting what is due promptly on the basis that failing to have sufficient cash assets would not allow a company to pay its creditors, including salary bills and could quickly lead to it becoming insolvent even though it may be profitable.

#### **4.7.6 Difference in Understanding and Use between Sales and Operations**

One of the significant features of contracting behaviours identified by Macaulay was the different attitudes and opinions of different functions within organisations. Whilst, the comment “*People in a sales department oppose contract*”<sup>30</sup>, may be over simplistic, it is nevertheless a view expressed by many and, if not wholly true, often taken as indicative of the attitude of sales who are keen to remove any obstacles to reaching a deal. This distinction from the functional role of contracts seen by Finance and Operations where it is “*...an organizing tool to control operations in a large organization*”<sup>31</sup> is apparent within the results gathered for this study.

Additionally, Macaulay identified the differences between the different levels within organisations and specifically the relevance of the decision makers.

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<sup>29</sup> Believed to have been coined by Jack Welch, CEO of General Electric between 1981 and 2001.

<sup>30</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), *Am Sociological Review* p66

<sup>31</sup> *Ibid* p66



Recognising that different individuals hold power at different stages of the sales and delivery process, starting with sales where “...the sales manager may want to remove certain issues from future negotiation by his subordinates”<sup>32</sup>. Later, “...the power to decide that a more contractual method of creating relationships and settling disputes shall be used will be held by different people at different times”<sup>33</sup>, and this will be reflected in the extent to which the contract is used.

The results gathered in this study support these broad conclusions. The most notable output is apparent when looking at the opinions on the use of contracts. Here, the four questions produced results such that Operations/Technical based individuals did not consider such contracts to be very effective, whereas Sales personnel showed more confidence that they were effective in most areas:

<b><u>Question with Responses Indicating “Very Effective”</u></b>	<b><u>Sales</u></b>	<b><u>Ops</u></b>
Please indicate how effective you believe Standard Form Contracts are at establishing the obligations of a business transaction.	55%	50%
Please indicate how effective you believe Standard Form Contracts are at developing a business relationship.	18%	0%
Please indicate how effective you believe Standard Form Contracts are at managing company risks.	64%	0%
Please indicate how effective you believe Standard Form Contracts are at developing company business.	45%	0%

This shows a higher level of interest and confidence from the sales team where the use of standard form contracts is potentially more beneficial in reaching quick and profitable deals. This perception is not matched by those who deliver

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<sup>32</sup> Ibid p65

<sup>33</sup> Ibid p66

the contractual requirements, who may be frustrated by the lack of detail or flexibility which they would like. The management of the relationship between the parties then becomes more important in dealing with those areas which are not covered expressly by the agreement.

This point leads to the area of dealing with disputes, where it is the operational and technical teams that most commonly have to manage their resolution.

#### **4.7.7 Level of Enthusiasm to Negotiate or Deviate (Vary the terms)**

Where companies wish to transact on standard terms there is usually an expectation or at least an aspiration that these will be accepted and signed without negotiation or challenge. This is a comfortable starting position, but depending upon the other party is commonly not an acceptable position. The issues that might influence whether this is likely to occur will be:

1. The strength of the relevant parties: A large and dominant party to a contract is more likely to be able to establish its own terms and conditions as the prevalent arrangements for a deal as the smaller party will have less desire to challenge the terms;
2. The complexity of the contract and the requirements: It is unlikely that organisations will wish to expand time and effort in challenging or negotiating contracts for low value and simple transactions as the costs will outweigh any benefits;
3. The applicability of the terms to the particular transaction: the selling party will usually have terms that are more appropriate to the product or service as they are dealing with these as their primary activity, whereas the buyer will most likely be purchasing a range of products or services and therefore are likely to have more general contract terms.

Not surprisingly, those individuals employed in Sales and Legal or Commercial were more likely to be involved in negotiating changes to contract terms and therefore also had more knowledge of the latitude allowed and any corporate policy that may apply. There was however a reluctance within the operational and technical group to negotiate on any points.

This would indicate that they are less familiar with the contracts and hence less comfortable when deciding what may be negotiable or indeed what the

implications of such changes might be. As explained by Beale and Dugdale, “*The significance of what was being done was not always appreciated by the officer concerned...*”<sup>34</sup>.

Additionally, those involved in the initial stages of establishing a contract will know that there are always some items which are subject to agreements as these are the fundamental variables like price and product or service. It is common therefore for negotiation on these *primary obligations*<sup>35</sup> of the contract like price, delivery, quantity and description but less common to discuss obligations on how the contract would be varied or dealing with failure to perform.

Apart from a few common breaches like liquidated damages for delay and interest on late payments, it is rare for much time to be spent on dealing with other failures. There may be a standard clause dealing with Alternative Dispute Resolution, but unlikely to suggest that all matters should be explored fully at the operating level before any escalation is initiated. This is likely to indicate that operations personnel are unlikely to refer to the contract to address the type of problems they encounter.

#### **4.8 Summary**

This chapter dealing with the collation and analysis of the results from the original survey is intended to provide insights into the practical use of standard form contracts in actual business environments. The responses provided by the sample indicate that there is a significant proportion of those who use such instruments routinely who are sufficiently interested and challenged by their use to provide input.

With no previous experience of eliciting information using surveys, it was challenging to estimate what volume of response would be likely or what would be necessary to draw any effective conclusions. However, the full response

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<sup>34</sup> Beale and Dugdale, ' Contracts Between Businessmen: Planning And The Use Of Contractual Remedies', (1975), Brit. J.L. & Soc'y p49

<sup>35</sup> Ibid, p48

rate providing 68 inputs dropping down in some sections is both adequate for analysis and justifies the time taken.

Deciding on an initial approach to the evaluation was dictated by the number of responses and the analysis of the full sample is therefore more significant statistically than some of the subsequent findings where the sample in a particular cross section is limited.

Analysis of the results provides a number of notable findings supporting previous studies and some additional insights. The principle points identified are:

- The relatively infrequent reference to the contract when there is a degree of disagreement between the parties;
- The lack of clear understanding on whether there is an agreement in place (has a contract been formed) and then what is in the final contract;
- A lack of appreciation of what the contract says and how it should be used for any particular part of the agreement (delivery, payment, disputes);
- The recognition that the most common area for disputes is that of price and payment;
- Difference in understanding and use of contracts between those who sell (and therefore agree the contracts) and those who deliver the requirements.

The original intention of this thesis was to explore the two main areas of focus, being contract formation and the resolution of disputes. As an outcome of the results from the survey, it has become apparent that the first of these is not seen as a significant issue in commercial relationships and consequently it is not intended to explore this in more detail beyond substantiating the point when reviewing the sample of SFCs in chapter 5.

These results, as well as some of the detail recorded, will be used to establish the key areas for reviewing the sample of SFCs in chapter 5. They will also be considered in the context of the remaining main business areas of investigation, being contract disputes (chapter 6).

## **5. A REVIEW OF THE CONTENT OF A SAMPLE OF STANDARD FORM CONTRACTS**

### **5.1 Introduction**

*"It's impossible to unsign a contract, so do all your thinking before you sign"<sup>1</sup>.*

This quote by one of America's most successful traders demonstrates a recognition that, in the opinion of Warren Buffett, the contract is a fundamental part of business and it is critical that both parties are aware of what is included and to what they are committing. It is unlikely that the majority of the thousands of individuals committing to standard form contracts (SFCs) on a daily basis take such a singular view.

The aim of this chapter is to review a sample of SFCs from the same industry segment as the survey detailed in chapter 3 to identify what clauses they include and how they deal with specific issues. These issues are derived from those that were identified as important in the survey as they relate to either the company policy or the clauses the respondents believed to be included in SFCs. The objective is to test whether there is a correlation between the understanding of the individuals and the contents of the contracts they use.

The various areas covered by the contracts will be evaluated to identify the common themes and the different ways they deal with similar key issues and how they are framed in the context of the relevant law. This aspect is developed in more detail in relation to the UCTA, which is the most significant legislation concerning one of the most important requirements identified in the contracts.

Two outcomes from this evaluation should be to identify:

- How well do the users who responded to the survey understand what is included in their SFCs; and
- Do the contracts achieve what the respondents expect.

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<sup>1</sup> Warren Buffett. AZQuotes.com, Wind and Fly LTD, 2017. <http://www.azquotes.com/quote/880286>, accessed February 05, 2017

This should establish whether there is a gap in understanding and use between the SFCs (and the people who draft and maintain them) and the people who use them and whether this effects the way in which they are used in practice.

### Results from Survey

The starting point for this chapter is the results from the survey and in particular the responses in section 4 of the survey relating to the understanding of users on what businesses include in SFCs. The survey looked at the general approach to managing contracts by assessing the use of policies and controls on what businesses and business users might be prepared to accept within the contracts.

The results indicated that a significant majority of companies had a stated policy on their contracts (81%) and on whether and what they might be prepared to negotiate (94%). Additionally, where they are prepared to vary the terms, most had clear policy guidance on what they would negotiate and to what degree (89%).

From this base, the survey sought to establish the relative importance of different contract issues to the businesses from three different perspectives:

- Whether the company has a policy on different contractual requirements;
- Whether the issue was included in SFCs; and
- A personal assessment by the respondents of their view of the relative importance of the different issues (as the individuals using the contracts).

The first two of these should present factual information on the company priorities, but unless the respondent checked as they completed the survey, may be distorted by personal perceptions. The third of these will be a personal interpretation of the relative importance.

The perception of the respondents provides an important feature as this may be more relevant in many cases than the actual policies or contracts. Any disconnect between the drafters and the users may indicate a fundamental gap between policy and practice and demonstrate an internal communication problem. Any gap is likely to lead to inefficient practices as either users fail to

optimise the contract terms or the contract terms fail to support the business in practice.

Additional information is provided by the comments provided in response to the question about what is included in company policy on acceptable contract terms. These predominantly included excessive or unlimited liabilities, providing further basis for exploring this area and how they are managed in SFCs.

Review of Standard Form Contracts. The sample of contracts was reviewed from the basis of the survey results and generally followed the same order as the recorded order of importance apart from the limitations on liability. The analysis considered how the specific issue was dealt with in the standard terms against the expectations of the survey sample. There is also a review of the different approaches to the topics, notably the difference between Buyers and Sellers.

The main area for focus based on the survey will be price and payment terms, though recognising that the actual price for any transaction is unlikely to be included in standard terms as it will be unique to the specific agreement. In addition to the relative importance placed on payment by the survey results, a number of the supplementary comments (5) also highlighted payment as important policy items for businesses. Subsequent issues identified in the survey are then reviewed based on the relevant importance as derived from the survey.

Following these areas, the review looks in more detail at liability and indemnity clauses and how the contracts manage and control exposure to high level risks. This focus on liabilities and particularly limiting or excluding liabilities, was identified by respondents as a key requirement for many companies and is likely to be important to controlling their company level strategic risks.

The effect of the UCTA is of heightened importance when applied to SFCs due to the controls placed on the content of some standard terms under the

provisions of the Act<sup>2</sup>. Finally, a key feature of the act is how the test of reasonableness applies to SFCs and how it has been interpreted in a number of cases. It would be beneficial to assess whether the sample satisfies the test of reasonableness as defined by the UCTA<sup>3</sup>, but this is not possible as the test is dependent upon the specific circumstances of any case, including the resources available to the parties and availability of insurance.

## **5.2 Analysis of Sample Standard Form Contracts**

### **5.2.1 The Sample and Reference to the Questionnaire Responses**

In order to provide more substance to the Questionnaire responses dealing with what might be included in standard terms and conditions of business it is helpful to review a sample of such terms. This exercise is intended to refer back to the key terms as identified by the questionnaire sample and analyse whether the actual terms reflected the understanding of the users. It is also intended to assess how key terms are addressed with actual contracts.

The sample of standard terms and conditions was limited by two factors, firstly the time taken to review and catalogue the contents and secondly the availability of sample terms. The size of the sample was 25, providing a good cross section of businesses which can be tested by the degree of commonality across the documents and the issues identified within the sample covered consistently across the various sets of terms.

The analysis looked at the presentation and structure of the documents as well as reviewing the detail of some of the key clauses. To this end, the number of pages and the number of clauses was recorded to assess whether there is any common approach. As standard terms and conditions, there is often as perception that they are presented in any relationship as unchangeable and often not reviewed by the other party.

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<sup>2</sup> Unfair Contract Terms Act 1977, Section 3

<sup>3</sup> Unfair Contract Terms Act 1977, Section 11



The way the terms are presented and the degree of complexity as viewed by the size (number of pages/clauses) of the document may serve to perpetuate this view. Indeed, the expectation that they will be hidden away at the back and be printed in an unnecessarily small font may be a contributing factor to this perception. Whilst the size of the font and the availability of the terms adds to the overall picture, this is not explored in any greater detail in this chapter.

The other factor that was important was the position of the party in the transaction as there is likely to be a different approach depending on whether the party is the Buyer or the Seller. The sample contained more Buyer terms (18) but adequate Seller terms to be able to demonstrate a representative selection of different terms and conditions.

The sample was taken from organisations operating in building services as either Buyer or Seller. As most businesses may be involved in purchasing such services, the core business of the buyer was also noted, though the sellers were all from this market sector. This provided a small number of industries including retail (though specifically these were purchasing contracts for commercial services or products, not for retail goods), construction and building services and management.

There were a large number of Facilities Management (FM) or Building Services companies (10) with 8 Retail Businesses (including Hotels) and the remainder were providers of specialist services (5) or property companies (2). The sample from retail companies was for buying and the specialist services were for selling. The sample from FM and Property companies was a mix as they purchase specialist services and sell a complete FM package to their customers.

The most relevant information on SFCs from the survey were the responses to three questions. The first of these was intended to address the top level company approach to entering contracts by gathering data on corporate policy. This should demonstrate what is seen as important to the business at a corporate level. The results for this question were:

<b>Which of the following are addressed in Company Contracts Policy?</b>	
Exclusion and limitation of liability	79%

Payment terms	77%
Liquidated damages	73%
Excuses for non-performance (Force Majeure)	65%
Termination provisions	63%
Duration of contracts	58%
Choice of law and forum for dispute resolution	54%
Performance monitoring	42%

The second area to be considered was what was actually included in their standard terms and conditions in order to understand whether the policy principles are actually reflected in regular business contracts and also to see whether other issues are important at the working level of the business.

<b>Does your company include provision for the following in its Standard Form Contracts?</b>	
Payment terms	88%
Exclusion and limitation of liability	88%
Termination provisions	88%
Duration of contracts	79%
Excuses for non-performance (Force Majeure)	79%
Liquidated damages	79%
Breach of contract and Remedies:	75%
Choice of law and forum for dispute resolution	71%
Performance monitoring	50%

The final question was more subjective as it enquired about the individual understanding of what was important to the specific companies. This could be affected by a number of criteria, including of the relative role of the individual or the success of the business in communicating its principles on managing risk through contracts.

<b>Indicate the relative importance of the different terms within your company</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Weighted</b>
Payment terms	15	3	9	60
Exclusion and limitation of liability	8	6	5	41
Liquidated damages	6	9	4	40
Duration of contracts	5	4	5	28
Performance monitoring	4	4	9	29
Termination provisions	1	9	3	24
Relief for non-performance (force majeure)	1	3	5	14
Choice of law and forum for dispute resolution	0	2	0	4

[Note: The weighting is a simple approximation allocating a multiple of 3 to first choices, 2 to second choices and 1 to third choices]

From all three of these questions, the top two items were payment terms and exclusion or limitation on liability. In addition to these, termination was noticeable in view of the fact that the contracts were all for services usually provided over a fixed period, often agreed in advance.

These three are identified as the most important in all three questions, though the policy aspect suggests that limitation or exclusion of liabilities may be a strategic requirement as these clauses will only be relevant in disputes and claims. The use of such clauses will be important on very few occasions when there is a high value dispute which may impact on the financial performance of the business. The broader impact of these issues and hence the significance of limitation clauses suggests that they may have a strategic impact on the business.

Compared to this, payment terms are important in contracts as they impact each and every time a contract is agreed and impact at an operational level on performance. Collectively (across a combination of contracts) they will impact the company, but in isolation with low value contracts cannot create a financial risk greater than the value of the contract. Businesses are keen to ensure that the price for each transaction is optimal to maximise profit and that the payment terms are effective in smoothing cashflow.

### **5.2.2 How Payment Terms are Addressed in the Sample**

From the survey of users, the most common issue identified as the most important terms in their contracts were those dealing with price and payment. This was identified as most important twice as often as the next most important issue (limiting liability). It was also recognised as a key company policy issue and also as the main cause of disputes. It is of interest to review how the terms included within contracts deal with price and payment and assess whether they reflect the comments and views of the users.

One of the consistent features of the documents surveyed was that they all included clauses dealing with payment. From the sample of 25, all of them included a clause which described the main features of what would be required for the Seller to be paid. Most of them included additional more detailed explanation with up to 14 sub clauses addressing specific invoicing

arrangements intended to ensure compliance with financial controls and clarity to ensure payment and reduce disputes. Unfortunately many included differences in invoicing requirements and under a standard form of contract it is unlikely that each will be inspected in detail to ensure the invoicing process used by the Seller complies, thus introducing opportunities for disputes.

A number (6 from the sample) included reference to an on-line invoicing and payment process, requiring invoices to be entered electronically onto a separate system complete with purchase order numbers.

As standard terms, it is unlikely that the price will be included as this will be an item that is addressed separately and specific to each agreement. The extent of the detail provided on the method of payment however varies significantly. At the simplest level it will merely cover the fact that the amount, due defined elsewhere in the contract will be paid, usually explaining that sums included are exclusive of any local taxes like VAT. The timing and method of submission of invoices is routinely included and this therefore provides a level of organisation and planning for both parties. They then define the time allowed for payment and occasionally the way in which any disputes or delays in payment should be managed.

As the sample included contracts issued by the Seller as well as the Buyer, there is a clear difference in the emphasis of this clause. Sellers try to reduce the time for payment and ensure that any constraints are simplified whereas Buyers will routinely offer longer payment periods and will usually include more procedural hurdles in order to ensure they maintain financial controls. At its simplest, 5 Sellers set payment due dates at 28 days where two Buyers defined 60 days.

For the Buyer, this includes requirements to quote purchase order numbers, follow defined procedures and in some cases provide supporting information to back up the costs. The broadest example of such a term was:

*“All accounts for works... ..are to be fully detailed and contain such records or details and any purchase order number as may reasonably require including but not limited to time records, expenses incurred, invoices paid or any other documents...”*

There were also examples where Buyers included specific dates for receipt of invoices, advising that failure to meet these would result in payment being delayed until the following month.

For Sellers, the main objective is to ensure payment in full as early as possible and to avoid disputes. One mechanism to assist this aim was to offer discounts for prompt payment or for payment by standing orders, but this was only present in one sample. Apart from the option of charging interest for late payment, the remedies available for poor payment were limited and principally reverted to suspension of the services or ultimately termination of the contract.

The sample was principally comprised long terms (one to five years) term service contracts, so for terms of greater than one year there is also usually a mechanism for adjusting the price to reflect increases in costs. These price variation mechanisms can be important, particularly where prices are volatile due to exchange rates or inflation and can become very sophisticated and complex for long term contracts. Whilst two of the sample included reference to external industry indices (*British Electrotechnical and Allied Manufacturer's Association* and the *Office for National Statistics*), a simpler option taken by most was to agree the annual figures for the full term of the contract.

More comprehensive documents will also include possible mechanisms for dealing with breaches or non-performance. These often refer to key performance indicators and can allow the Buyer to reduce payments by pre-agreed amounts as remedy for failure to perform. The opposite position to this for Seller's contracts allow for interest to be claimed where the Buyer does not pay on time. This may be an agreed rate or may invoke the authority of the Late Payment of Commercial Debts (Interest) Act 1998.

Alternatively, where the goods or services are covered by the Housing, Grants, Construction and Regeneration Act 1996<sup>4</sup>, then the payment provisions will normally be defined by the Act unless there is express agreement to alternative

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<sup>4</sup> As amended by the Local Democracy, Economic Development and Construction Act (2009)

terms. This Act ensures clear payment periods and a mechanism for stage payments and will govern such contracts unless changes are agreed.

Although this piece of legislation was designed to protect small sub-contractors in the construction industry, there is a broad definition of what constitutes a construction contract. The definition includes construction operations, which in turn extends to include “...*construction, alteration, repair, maintenance, extension, demolition or dismantling of buildings.*”<sup>5</sup> Although it is possible that this may apply, there was no evidence to indicate it had been invoked.

In general the clauses governing payment are drafted to ensure that statutory obligations are met whilst also defining the payment process to minimise disputes. Although they are primarily practical they are also clauses that both parties need to understand. Due to the opposing expectations from the Buyer and the Seller, they are also potentially subject to disagreement where there is uncertainty over which terms govern the deal.

### **5.2.3 Contract Term and Termination Provisions**

A further area of interest from the survey lies with the duration of contracts and the ability to terminate before completion either for convenience or for breach. The survey data showed that of the individuals questioned, termination provisions were recognised as being included in SFCs an equal number of times as payment and limiting liability. These issues were recorded as less significant with reference to inclusion in policy and perceived importance.

The length and particularly the termination provisions are significant whether the contract is for goods or services though effects each in different ways. Under contracts for services, which are often for a fixed period and set termination date, the importance of certainty on the length of the contract may be significant in the price and risk assessment. With contracts for goods, termination by either party before the goods have been delivered is likely to lead to a serious loss to the other party.

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<sup>5</sup> Housing Grants, Construction and Regeneration Act 1996, Section 105

Most of the contracts reviewed (19) were for a fixed term and all were for the provision of services. The length varied from a single year up to 10 years and most also allowed for extensions though the method for extending was different. Where the terms were provided by the Seller, extensions were more desirable and in some cases would be automatic unless expressly terminated. Where they were the terms of the Buyer, then control was likely to be retained by the Buyer, allowing for termination unless expressly extended. In one case there was an obligation on the Seller to notify the Buyer 90 days prior to the end of the term in order for the termination to take effect.

All of the forms reviewed included termination provisions, an outcome which supports the questionnaire results that this is one of the most important aspects of both business policy (63%) and standard terms and conditions (88%). More significantly they all included a variety of different ways to terminate including termination for breach, termination for convenience and termination for specified events like insolvency. Some of the more comprehensive contracts also included some reference to the consequences of termination. This aspect extended from a simple indication of the financial implications:

*In no event shall Manager be obligated to pay any compensation, fee or penalty as a result of any termination under this Clause.*

To extensive details of ongoing responsibilities and obligations including assisting in the transfer to another party and where applicable, supporting the transfer of employees under Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).

Termination for Convenience. In most cases where the termination was not at the end of an agreed period there was a minimum notice period allowed which should be long enough to allow both parties to make any necessary arrangements. Additionally, in some cases there were financial remedies for early termination, partly as a deterrent and partly in order to provide suitable compensation for the foreshortening of the contract.

This ability to terminate the contract for convenience, early and without penalty may be an option desired by one of the parties and often referred to as termination for convenience. A Seller may wish to retain control over the

contract in order to be able to terminate if conflicting demands or reducing profitability create a challenge. Alternatively, a Buyer may wish to terminate if circumstances change, like termination of the main contract they are delivering, or where they wish to be able to look for alternative more competitive Sellers.

It is likely though that there will be some driving reason for the termination which will either be a change in circumstances outside their control or a desire for a more economical offer. Either of these general options could be defined explicitly within the terms, but to maintain simplicity and possibly to retain control the parties agree to an open option to terminate.

As this will often be one sided, generally in favour of the Buyer it will be conceded by the Seller based on the benefit of the contract and the relative bargaining strengths. If the contract is freely agreed between the parties on this basis then it is a commercial arrangement and both parties should have assessed the risk and benefits of the arrangement. Long term arrangements should suit both parties as they work together and develop relationships and understand the way the other operates. Unless the relationship breaks down or become uncommercial, then the agreement will persist.

Where contracts did include a financial settlement on termination (whether or not for breach), then the question to be addressed is how the cost of such termination is calculated and whether the figures are agreed in advance and included in the contract. The question in these situations is which losses might be allowed and the indication (see *Robophone Facilities Ltd. v Blank*<sup>6</sup>) is that more remote losses are allowable where they are agreed in liquidated damages clauses. However, where they are incurred purely as a result of the decision to terminate (which would not be a right under common law) then they may not be allowed (see Beale<sup>7</sup> for a more detailed analysis). Beale however concludes that:

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<sup>6</sup> *Robophone Facilities Ltd. v Blank*, [1966] 1 W.L.R. 1428

<sup>7</sup>Hugh Beale, 'Penalties in termination provisions', (1988), L.Q.R., 104(Jul), 355-359



*A clause which clearly states that in the event of certain breaches the contract may be terminated and various further sums, not exceeding the actual loss to the terminating party, must then be paid should be enforced unless there is good reason not to do so<sup>8</sup>.*

Termination for Specified Events. All of the contracts also included the ability to terminate for some specific events, most commonly these included a number of different forms of insolvency. The extent to which this event is described varies, but most included a number of different definitions, the simplest of which stated: “*in the event of the Contractor becoming bankrupt/insolvent etc*”. More common were much more comprehensive clauses listing a number of ways in which the party might become unable to satisfy its debts:

*...ceases to trade or is unable to pay debts as they fall due, has a petition presented, any distress or execution is levied on the Customer or an encumbrancer takes possession of or a receiver, liquidator or administrator, trustee or similar is appointed over any of the Customer assets or the Customer convenes a meeting of or proposes to make any arrangement with the Customer creditors or the Customer goes into liquidation or any other analogous event in any jurisdiction;*

This latter approach highlights another point that is explored in more detail later in this chapter concerning the way in which different organisations approach their contracts and the level of detail drafting included. The breadth of approaches to any particular issue is wide and may well reflect the organisational policies but also their approaches to reviewing and updating their SFCs.

An illustration of when an inadequate definition of insolvency led to an unplanned outcome is *William Hare Limited v Shepherd Construction Limited*<sup>9</sup>. In this case Shepherd (a construction company) expected to be protected from

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<sup>8</sup> Ibid, p359

<sup>9</sup> *William Hare Limited v Shepherd Construction Limited; C R Reynolds (Construction) Limited v Shepherd Construction Limited*, [2010] EWCA Civ 283, [2010] WL 889415

paying its sub-contractors should the Employer become insolvent and as a consequence of which, Shepherd were not paid. Unfortunately the clause as drafted in this case did not include the actual mechanism by which the Employer became insolvent and thus Shepherd was required to pay out even though they had not been paid.

Shepherd had taken the principle for its clause covering termination for insolvency from the Construction Act<sup>10</sup>, which itself referred to the Insolvency Act 1986 and hence methods covered by this act as the basis of financial failure. However, when the Enterprise Act 2002 was enacted, it introduced alternative methods of commencing the administration process which were therefore not included in the Insolvency Act and therefore not covered by the relevant clause in the Shepherd contract. By the time of the contract in question was entered, Shepherd would have had plenty of time to review and amend the clause, and were considered to have the resources and knowledge to be able to do so, but failed to make any changes. One aspect that could not be assessed with the sample was whether they had been recently updated as this has been identified as an area where companies demonstrated weak processes.<sup>11</sup>

As Stonebridge explains<sup>12</sup>, the decision may well be considered harsh in this case, but as Shepherd should have been aware of the introduction of the Enterprise Act, it had the opportunity to include it in the contract. This is also an example of the approach of the courts to limitation clauses and the application of *contra proferentem* rule<sup>13</sup>. Where there is any ambiguity in a limitation clause, then the courts have traditionally favoured the “...*interpretation which least favours the party who put forward the contract or*

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<sup>10</sup> Housing, Grants, Construction and Regeneration Act (1996) Section 113(2)

<sup>11</sup> Mitu Gulati & Robert E Scott, 'The Three and a Half Minute Transaction: Boiler Plate and the Limits of Contract Design', (University of Chicago Press 2013)

<sup>12</sup> James Stonebridge, 'Clarity crucial in insolvency clauses', (2010), 7 JIBFL 429

<sup>13</sup> See *Wallis, Son & Wells v Pratt & Haynes*, [1911] A.C. 394 for an initial application of this approach

*the clause.*” This approach has seen a change in recent cases<sup>14</sup>, particularly in respect of limitation clauses as the summarised by Peel<sup>15</sup>.

Termination for Breach. All of the contracts reviewed included termination provisions for breach of contract and it is this aspect that provides the most focus for businesses as it is the last resort should performance fail. The drafting usually includes for failures on both sides, such that the Seller can terminate where the Buyer fails to pay according to the agreed payment terms.

There is however a wide variety of ways in which these provisions are included and how they come into effect. Clearly termination for breach is a significant event and therefore needs to relate to a significant breach. Many contracts refer specifically to ‘material breach’, without providing much further clarity to the scope of this phrase.

In general, termination for breach would require a breach of a condition of the contract where these are expressly stated, however the case of *Rice v Great Yarmouth Borough Council*<sup>16</sup>, introduced some clarification of what might constitute sufficient grounds for termination for breach. This case is of particular relevance to the sample of contracts reviewed as it relates to a set length contract for services where the service provider has a number of obligations but also required a degree of investment based on an expectation of recovering that expenditure over the length of the contract.

In this case the Borough Council attempted to terminate the 4 year contract for breach, having identified a number of breaches and issuing default notice. The question decided by the Court of Appeal rested on whether they were breaches of conditions. Although the parties were entitled to agree that certain

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<sup>14</sup> *Transocean Drilling UK Ltd v Providence Resources plc.*, [2016] EWCA Civ 372

<sup>15</sup> Edwin Peel, 'Contra proferentem revisited', (2017), L.Q.R. 133(Jan), 6-11, though see also Julian Bailey, 'The limits of limitation clauses', (2017), Const. L.J., 33(3), 188-201

<sup>16</sup> *Rice (t/a Garden Guardian) v Great Yarmouth Borough Council*, (2001) 3 LGLR 4, CA

obligations might be significant enough to justify termination<sup>17</sup>, there was no evidence that this was the case. Hale LJ stated:

*“The problem with the council’s argument in this case is that clause 23.2.1 does not characterise any particular term as a condition or indicate which terms are to be considered so important that any breach will justify termination. It appears to visit the same draconian consequences upon any breach, however small, of any obligation, however small.”*<sup>18</sup>

Indeed, it was apparent that the proposed termination was for a number of smaller breaches rather than a single breach of a substantial requirement. The importance of the simple word ‘any’ and the view that *“...notwithstanding the literal wording of [the clause], on the facts of the Great Yarmouth case the Court of Appeal was unwilling to hold that any single breach gave rise to a right to terminate.”*<sup>19</sup>

From the sample, there were a small number of attempts to clarify which obligations might constitute significant breaches, including one which stated expressly that *“...any obligation to perform the Scope of Services shall be a warranty entitling the Customer to the exclusive remedy, subject to the provisions of this Condition, of claiming damages”*. Others identified some specific items of breach, most commonly failure to pay sums due, as being sufficiently material to justify termination, though there were fewer cases where the buyer detailed such items.

Persistent or multiple breaches is also covered in a number of the contracts surveyed (8 examples in the sample), with a common theme being introduced to allow the breach to be remedied. Where an opportunity to remedy is included, the ability to be clear and conclusive in the drafting is more challenging and it is possible that this may be deliberate, to allow the innocent

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<sup>17</sup> *Bunge Corporation, New York v Tradax Export S.A., Panama*, [1981] 1 W.L.R. 711

<sup>18</sup> *Rice (t/a Garden Guardian) v Great Yarmouth Borough Council*, (2001) 3 LGLR 4, CA, 22

<sup>19</sup> Jeremy Thomas, 'Some Recent Commercial Cases on Termination for Breach of Contract', (2001), I.C.C.L.R., 12(1), p27

party some discretion in any decision. Where there is discretion however, there is potentially also an expectation that the parties will wish to see the contract completed and therefore that they will exercise such a sensible approach. Indeed there is an increasing understanding that parties to a contract will act in good faith and not take severe course of action over trivial issues<sup>20</sup>, though such an approach will relate back to the underlying relationship between the parties.

The wording varies from a general “...*the Supplier consistently breaches this Contract, and despite written warnings...*” to clauses requiring written notification and allowing a specified period of time to remedy the breach or allowing a specified number of breaches in a defined period. This will usually be a number of days and may be different between the parties, allowing the Seller to terminate sooner and so avoid continuing to perform even though it is not being paid. These clauses become much more subjective as the degree of the breach, the ability to remedy and the extent of the remedy may all introduce imprecision for interpretation.

As termination is the ultimate sanction, it may be linked to other mechanisms in the contract dealing with performance failures including financial deductions, which will be dealt with later. Whilst more sophisticated contracts will be detailed and clear on the methodology for increasing sanctions as breaches become more severe, up to termination, the SFCs sampled were much more general. The need for clear drafting of such clauses is important if they are to be enforced and it is equally important that if they are enforced then the action complies with the term.

From the sample of drafts, and the broad range of attempts to cover termination for breach, there is little commonality, suggesting that there may be a recognition that in most cases these issues will be resolved before they become significant by organisations acting commercially. Alternatively, it may be that the drafters expect that the courts will assess other commercial factors and take

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<sup>20</sup> Lorna Richardson, 'Exercising A Contractual Right To Terminate: What's Good Faith Got To Do With It?', (2017), Edin. L.R., 21(1), 88-93

a “*commercial common sense*” approach to any such situations as suggested by Neil Andrews<sup>21</sup>.

Repudiation. Whilst the sample demonstrated little clarity on the ability to terminate for breach, there is always a common law option to repudiate the contract for non-performance should the breach be significant enough. Whether any particular contract is terminated in line with a defined termination provision or as acceptance of a repudiatory breach may initially seem to be unimportant, but on deeper investigation, may have significant implications.

In *Dalkia Utilities Services plc v Celtech International Ltd*<sup>22</sup> the termination clause included a fee which was payable should the termination result from application of the specific term. This clause (albeit there required clarification following an incorrectly drafted amendment) relied on by Dalkia was where Celtech were in material breach of its obligations to pay the charges giving Dalkia the right to terminate immediately. Subsequent clauses also allowed for charges to be applied under such a termination.

Celtech attempted various defences including a position where they alleged Dalkia had repudiated the contract, where a repudiatory breach would mean that no sum was due.

In this case, Clarke J decided that the contract was terminated for breach of a term and therefore the fee was due. He also explained that on termination there was no need to define which term was breached. Scott comments on the case<sup>23</sup>, indicating that the option rests with the innocent party to decide which is the most favourable route to follow.

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<sup>21</sup> Neil Andrews, 'Interpretation of Contracts and "Commercial Common Sense": Do Not Overplay This Useful Criterion', (2017), *Camb. Law J.*, 76, pp 36-62

<sup>22</sup> *Dalkia Utilities Services plc v Celtech International Ltd*, EWHC 63 (Comm), [2006] All ER (D) 203

<sup>23</sup> Nicholas Scott, 'Terminate with extreme prejudice', (2006), 156 *NLJ*, 872

There is no support for parties anticipating breaches and terminating contracts early<sup>24</sup> and neither is there support for parties failing to communicate adequately or in accordance with the contract<sup>25</sup>. Whilst the use of such clauses is widespread and attractive in order to provide a message when issuing the contract, they can be difficult to implement and often less effective than remedies available at common law<sup>26</sup>.

Effect of Termination. The more comprehensive contract will then also include details on the effect of termination depending on the actual cause of the termination. These focus particularly on issues around payment and continuing liabilities. Under longer term contracts, there may be an expectation that loss of future profit may be an entitlement but this will not always be the case.

In *Fujitsu Services Ltd v IBM United Kingdom Ltd*<sup>27</sup>, Fujitsu claimed that it had not received the work that had been agreed and therefore was entitled to damages on termination. Although this was a lengthy and negotiated contract and not standard form, the clauses and principle could equally apply to all contracts and highlights the need for clear and consistent drafting<sup>28</sup> and understanding of the complete contract. The contract included an express clause stating “...Neither Party shall be liable to the other under this Sub-Contract for loss of profits, revenue, business, goodwill, indirect or consequential loss or damage...”.

The court found that this was unambiguous and clear and applied to any claims, including termination. An additional obligation required that the parties act in good faith and reasonably under these circumstances and whether this

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<sup>24</sup> See *Western Bulk Carriers K/S v Li Hai Maritime Inc (The Li Hai)*, [2005] EWHC 735 (Comm)

<sup>25</sup> See *South Oxfordshire District Council v Sita UK Ltd*, [2006] EWHC 2459 (Comm)

<sup>26</sup> John Randall, 'Express Termination Clauses in Contracts', (2014), *The Cambridge Law Journal*, 73, pp 113-141, explores the difficulties and current position in a number of areas.

<sup>27</sup> *Fujitsu Services Ltd v IBM United Kingdom Ltd*, [2014] EWHC 752 (TCC)

<sup>28</sup> Chris Nillesen, 'Game over', (2015), 165 *NLJ* 7649, p19

introduces additional constraints beyond what may have been intended in constructing the contract may be difficult to assess<sup>29</sup>.

Although there is a large and varied selection of approaches to termination in the sample, the two key themes running through them reflect the fact that the sample primarily covers standard form service contracts expected to run for a fixed period of time. The desire to have some clear mechanism which assists termination should there be a failure by one or both parties cannot always be balanced with the expectation that the parties will work together towards a mutually beneficial outcome. Add to this the nature of the services being delivered means that it is not easy to include specific breaches that would merit automatic termination or accumulation of breaches that should justify the same result. This may also provide some explanation on the reluctance of the respondents to refer to the contract to resolve such issues.

#### **5.2.4 Breach of Contract and Remedies**

It is not surprising that in SFCs there are few examples of contracts that include specific clauses addressing breach of contract and potential remedies. Where they are present they are in the Seller's terms which by their nature will be more relevant to the particular product or service. As the main obligation owed to the Seller under these contracts is to pay the amount due within a specified period, any defined remedies usually relate to payment. In Buyer's terms the breadth of goods and services they might be used to purchase normally limits the ability to include a prediction of how the contract might be breached.

A brief review of text books on contract demonstrates that the primary area of interest for this topic is on legal remedies and not on more practical contractual remedies. The standard approach<sup>30</sup> considers the performance of the contract and then directs attention to breach and then to remedies where they then

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<sup>29</sup> Richard Hooley, 'Controlling Contractual Discretion', (2013), *The Cambridge Law Journal*, 72, pp 65-90

<sup>30</sup> See for example: Ewan McKendrick, 'Contract Law', (Palgrave Macmillan, 2005) ch. 21 or Richard Stone, 'The Modern Law of Contract', (9th Edition, Routledge, 2011) ch. 15.



become very theoretical in nature. They examine the principles and various aspects of damages and as they are books on theory, they don't consider the practical objectives of the parties.

Consequently, and as apparent from the review of standard terms, contracts tend not to include practical remedies like liquidated damages or similar deductions for failure to achieve performance indicators and focus more on how the law might view various breaches. The use of such practical and immediate remedies is not consistent with the use of SFCs as they need to be specific failures for the goods or service, where the contracts are general in nature.

Historically, liquidated damages were covered in detail by looking at the issues around penalties, though these are unlikely to be a realistic option in SFCs where the ability to satisfy the requirement for a genuine pre-estimate will be unlikely. However, more recent case law suggests that this penalty rule is not always relevant. In *El Makdessi v Cavendish Square Holdings BV*<sup>31</sup> (and the parallel case of *Parking Eye Ltd v Beavis*<sup>32</sup>) the Court of Appeal indicated that there may be commercial reasons why agreed damages are not penalties in spite of the fact that they are demonstrably not pre-estimates of loss. Whilst this has been praised by many it has also been questioned by others.

On one side there is a feeling of relief as “...the law relating to penalties has always been something of an anathema for the commercial lawyer since it interferes with a party's right to contract freely.”<sup>33</sup> Conversely there is a concern that “...in refashioning the test to fit these cases, the Supreme Court may have thrown the baby out with the bathwater, opening up a massive loophole in the

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<sup>31</sup> *El Makdessi v Cavendish Square Holdings BV and another*, [2013] EWCA Civ 1539

<sup>32</sup> *Cavendish Square Holding BV v Makdessi*, UKSC 67; [2015] 3 W.L.R. 1373 (SC)

<sup>33</sup> Mark Stamp, 'The penalties rule in corporate contracts - is it offside?', (2016), *Comp. Law.*, 37(7), p219

*law...*<sup>34</sup>, by allowing organisations the ability to introduce all sorts of extraneous factors that justify heavy damages.

It is paradoxical that the Seller would be the party best placed to develop and define possible liquidated damages for failure to deliver or perform but is unlikely to unilaterally include such mechanisms which would be of benefit to the Buyer. Seller's terms will be fairly specific to the product/service or range of products/services which they sell and therefore will be more relevant to the specific transaction. For example, a company selling security services will have standard terms that deal specifically with those services and therefore could include remedies for missed patrols or late response to calls. A company buying such services is likely to have standard terms that need to cover a wide spectrum of likely service requirements and are therefore more general in nature.

The Buyer on the other hand, which it is more likely would benefit from such mechanisms for poor performance, will have standard terms and conditions which will be necessarily general in nature as they will be used to purchase a wide range of goods and service. This issue was supported by the review of the terms and conditions, albeit that the majority were Buyer's terms.

When evaluating the content of the sample contracts for how they dealt with breach (apart from the option to terminate covered above), the review identified two specific elements. Firstly it looked at whether there was any active mechanism for monitoring performance and subsequently any agreed remedies for poor performance. Secondly it looked at more general clauses which provided ways for breaches to be remedied or otherwise resolved if they arose.

The first part of this found that 60% (15 out of 25) included some form of proactive monitoring, from a rudimentary requirement that the Customer "*...may at all reasonable times monitor the performance of the Services*", to the ability to apply deduction and off-sets for non-performance. As they are SFCs which could be used for different products or services these provisions are

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<sup>34</sup> Mathias Cheung, 'Shylock's construction law: the brave new life of liquidated damages?', (2017), Const. L.J., 33(3), p183

necessarily general in nature, but provide some methodology for monitoring how the contract is delivered.

At the most prescriptive end of this spectrum, the terms allow for the Buyer to enter the site (on Service Contracts) for monitoring and for the Seller to provide reports and other information as may be requested. Some also provide for routine meetings where these reports on performance are reviewed and any failings can be discussed and any remedial actions agreed.

A selection of the contracts (11) expressly allow for the Buyer to demand that incomplete works or works not up to the agreed standard should be re-performed. The next stage in the escalation process in a number of examples was to permit the Buyer to procure the goods or services from an alternative Supplier and to offset the cost of the alternative provision against the amount due to the Seller.

A smaller selection of contracts (5) introduced a more inclusive means of dealing with failures to perform, and example requiring the Seller to submit an improvement plan “...utilising an agreed evaluation process to ensure that the quality of the Services is improved.” This approach appears to be intended to offer a partnering relationship where the two parties work together to ensure that they both benefit from the agreement. This is more likely to be included in longer term service agreements, where the cost of changing Supplier may be more expensive and disruptive.

More sophisticated contracts, whilst still using the standard terms and conditions, included Key Performance Indicators (KPIs) detailed within the particulars. These KPIs were contract specific and included alongside the detail of the goods or services to be delivered and the price and provided the Buyer and the Seller clearer information on the expectations of the parties.

This detail would then be used to monitor the delivery and in some cases also included target levels of performance below which financial deductions could be made. By including these mechanisms expressly in the agreement with a clear process for recording and reviewing performance, there is an express and open position for both parties to work to.

Where some form of liquidated damages were apparent, there was also some evidence that the Seller was able to control the impact by including a limit to the amount of damages that could be deducted, either for any single failure or cumulative over a period of time. As these were contracts in constant use, then this position would have been included from previous contract experience or from a mature Buyer keen to establish a fair and equitable agreement.

### 5.2.5 Boiler Plate Clauses in the Sample of Standard Contracts

All of the contracts reviewed included a number of clauses that would be categorised as 'boiler plate'. These types of clauses are those "*...which are common to commercial contracts of a particular type and which usually deal with the operation of the contract.*"<sup>35</sup> They will generally be found towards the back end of the contract as they are seen to be of less importance than the business specific terms.

The inclusion of these terms is often established over years of experience and in many cases they are not regularly reviewed to ensure that they are still relevant and effective. More significantly, they are probably not reviewed by the other party and in cases where there are conflicting sets of terms (the Battle of the Forms), no consideration of how they will be interpreted<sup>36</sup>.

Clauses included in the sample were:

Clause	Frequency
Assignment	24
Severability	21
Third Party Rights	21
Governing Law	20
Notices/Variations	19
Confidentiality	18
Force Majeure	16

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<sup>35</sup> Mick Woodley (editor), 'Osborn's Concise Law Dictionary', (Sweet and Maxwell 2009)

<sup>36</sup> Steven Craig Hofer, 'U.C.C. 2-207: Boiler Plates and Arbitration Clauses', (1978), 30 *Baylor L. Rev.* 143

A number of additional clauses appeared on a few occasions which will be covered later. From this initial list, there is a distinction between those clauses which are required to ensure that the contract operates effectively and those which impact directly upon the specific risks of the two parties. The former are general risks that relate to all contracts and contracting activity, whereas the latter address what might arise to affect the specific contract.

Taking the first of these, most of the contracts (21) specifically prevent the ability of the other party to transfer their obligations. This usually covers either assignment or sub-contracting and allows the Buyer to apply some control over the transaction. This is more relevant with service (or term) contracts where the service provider may be required to attend or be present on the Buyer's premises and therefore visible to the Buyer and possibly their customers.

Whilst the contract will pass the risk of performance onto the Seller whether or not it delivers itself, the Buyer will wish to retain control. There may also be the ability to request permission from the other party to exercise the right.

There are also a number of instances (13) where there is a clause dealing with severability of the terms. The intent of this is to ensure that any clause included within the contract that it deemed to be illegal does not then cause the whole contract to be deemed illegal. Although the courts have managed to separate the legal and illegal clauses<sup>37</sup>, this seems like an area where the lawyers feel the need to be clear.

In order to provide specific clarification, and particularly where limitations on liability are concerned<sup>38</sup>, they will include an express statement that the illegality of part of the contract does not automatically preclude the enforcement of other clauses or the contract as a whole. This may be expanded to include any

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<sup>37</sup> *Ailion v Spiekermann and another*, [1976] 1 All ER 497

<sup>38</sup> John Warchus, 'The rise and rise of limitation clauses', (2008), *Construction Law*, 1910 *Cons.Law* 17

contract which is found to be invalid, unenforceable or unlawful and allows for such clauses to be severed from the remainder of the contract.

This is often included alongside clauses which ensure that a party not enforcing any clause is not automatically waiving its rights to enforcing other clauses. Although the courts have generally taken a pragmatic approach to situations where a party has waived a right under the contract, where this has been to the benefit of both parties<sup>39</sup>, they have recognised that this should not necessarily be an absolute waiver.

It is not unreasonable for one party not to enforce damages or terminate a contract immediately if they can still reach a mutually beneficial solution by waiving a right, but this should not mean that they cannot then enforce the right or alternative remedies should the breach continue<sup>40</sup>. Although the courts have been sympathetic to this principle, it seems that companies still wish to include express terms to provide clearer protection.

Another practical clause appears in 19 of the 25 sampled and covers how the contract can be amended. In general, these may be linked to entire agreement clauses and an example is:

*This Contract constitutes the entire understanding of the parties and any representations, statements and/or quotations, whenever made, not contained herein shall be of no effect unless they comply with the conditions stated below.*

*Any modification or additional conditions, which may be proposed by either party to the Contract, are not binding unless they are set out in writing, which shall be signed by both parties.*

Although this is intended to provide a clear and unambiguous method to ensure that any change to any part of the contract is controlled and expressly agreed by both parties, it has become more difficult to enforce with the advent of electronic communications. In *C&S Associates UK v Enterprise Insurance*

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<sup>39</sup> *Hartley v Hymans*, [1920] 3 KB 475

<sup>40</sup> *Charles Rickards Limited v Oppenheim*, [1950] 1 KB 616

Co<sup>41</sup>, the court found that variations agreed by e-mail satisfied the requirements of the contract.

Although the broader aspects of the case related to a repudiation, the trial of the preliminary issues considered whether an e-mail communication was effective as a variation to the contract. The variation clause in the contract stated “*Any variation of this Agreement shall not be effective unless made in writing and signed by or on behalf of each of the parties*”. A subsequent e-mail purported to change the terms and the court decided that the clause drafting was broad enough that the signature blocks on the e-mail met the requirement for signing.

On the surface, this would seem a pragmatic approach, though with the ever increasing use of e-mail for business communication, it may lead to undesirable consequences. None of the contracts surveyed included any specific reference to the use of e-mails for variations, either including or excluding their validity.

More recently, the Supreme Court overturned a Court of Appeal decision on the validity of a clause limiting modifications to contracts to written agreement<sup>42</sup>.

### Third Party Rights

The Contracts (Rights of Third Parties) Act 1999 was introduced in order to clarify that entities which were not a party to a contract will still have some rights. This would be the case where the third party is expressly noted in the contract or where they are deemed to have some form of benefit, but have not provided consideration and therefore have no rights under the contract.

Without the Act the doctrine of privity of contract has established, through *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*<sup>43</sup> that third parties cannot benefit from contracts to which they are not a party. The Act was introduced to resolve what had been claimed to be “...one of the most universally disliked

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<sup>41</sup> *C&S Associates UK v Enterprise Insurance Co*, [2016] EWHC 67 (Comm)

<sup>42</sup> *MWB Business Exchange Centres Ltd v Rock Advertising Ltd*, [2018] UKSC 24

<sup>43</sup> *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*, [1915] AC 847

*and criticised blots on the legal landscape*<sup>44</sup>. However, most of the contracts reviewed (21 out of 25) included clauses which expressly prevented any third party making any claims. Whilst this seems to dilute the effect of Act, it at least indicates that the parties have considered the matter and reached a reasonable and mutually acceptable agreement.

#### Choice of Law

It is perhaps strange that 80% of the samples included a provision defining the jurisdiction under which the contract is formed (in all cases the choice was English Courts). All of the companies being considered were companies registered in the UK and in most cases, were buying or selling services, which by their nature are static geographically. It is questionable which is a more interesting conclusion, whether there are 80% of the examples that feel the need to define this, where in most transactions there will be little doubt, or that 20% do not feel the need.

#### Confidentiality and Intellectual Property Rights (IPR)

A number of the more detailed contracts also included provisions which dealt with confidentiality and with intellectual property. These terms provide for a very generic protection and in SFCs, there is probably little need for additional protection as there is unlikely to be any new and valuable IP developed or confidential information provided. In more bespoke and higher value contracts this may be different.

#### Force Majeure

The final topic identified in more than 50% of the sample (16 out of 25) is of more interest as it addresses the risks which are considered acceptable to the two parties. Although the doctrine of frustration has long been established to allow contracts to “...*be discharged if, after its formation, events occur making its performance impossible illegal or radically different from that which was*

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<sup>44</sup> Meryll Dean, 'Removing a blot on the landscape - the reform of the doctrine of privity', (2001), J.B.L. 143



*contemplated...*"<sup>45</sup>, this does not always cover all possible eventualities that the parties may view as necessary.

More importantly from the commercial perspective where businesses crave clarity, it may not provide the necessary certainty that the parties would wish as any outcome will be dependent upon facts as they are at the time which by their nature will be unpredictable. Finally, it may not provide the desired outcome as it will lead to the contract being terminated<sup>46</sup>, when there may be a common desire to continue the agreement in some alternative form.

Indeed the courts have been keen to limit the scope of frustration to avoid "...[relieving] contracting parties of the normal consequences of imprudent bargains"<sup>47</sup>. In this significant case *Davis Contractors Ltd v Fareham Urban District Council* from 1956, the cost of delivering the contract for the builder (Davis Contractors Limited) increased significantly as a result of the shortage of the necessary skilled labour. Davis was contracted to build a number of houses for Fareham UDC at a fixed price but had not predicted the shortage of skilled labour that significantly increased its costs.

Faced with these increased costs to deliver the contract and the implications of the alternative which would be failing and hence being liable for sizeable liquidated damages, they looked for an alternative way out of the agreement. The claim that the contract had become frustrated was however unsuccessful as the court was clear that, although the events which led to the increase in costs were outside the control of either party, they only served to make the contract more onerous. This was therefore a business risk which Davis Contractors should have considered and had by entering the contract, accepted.

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<sup>45</sup> Mick Woodley (editor), 'Osborn's Concise Law Dictionary', (Sweet and Maxwell, 2009)

<sup>46</sup> See however the Law Reform (Frustrated Contracts) Act 1948

<sup>47</sup> Lord Roskill in his summing up of *Davis Contractors Ltd v Fareham Urban District Council*, [1956] AC 696

The idea that a company can avoid its obligations due to increased costs is clearly not one that most organisations would consider, but there may be circumstances that are broadly foreseeable but which would make the deal unacceptable or undeliverable. The sample provided a variety of approaches to drafting these clauses though they generally fall into one of two categories as suggested by Parker and McKendrick<sup>48</sup>.

The simplest provide a very general approach but little help in identifying what might be included:

*“Force Majeure” means government actions, acts of God, war, civil disorder and or other unavoidable causes beyond the reasonable control of the non-performing party and which cannot reasonably be forecasted or provided against.*

Whereas the more comprehensive definitions included lists of possible events:

- a. acts of God, flood, drought, earthquake or other natural disaster;*
- b. epidemic or pandemic;*
- c. terrorist attack, civil war, civil commotion or riots, war, threat of or preparation for war, armed conflict, imposition of sanctions, embargo, or breaking off of diplomatic relations;*
- d. nuclear, chemical or biological contamination or sonic boom;*
- e. any law or any action taken by a government or public authority, including without limitation imposing an export or import restriction, quota or prohibition;*
- f. collapse of buildings, fire, explosion or accident; and*
- g. interruption or failure of utility service.*

Some even go further including industrial disputes whereas one example introduced the concept of express exclusions from the Force Majeure

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<sup>48</sup> Matthew Parker & Ewan McKendrick, 'Drafting Force Majeure Clauses: Some Practical Considerations', (2000), I.C.C.L.R., 11(4), 132-138

protection. When included in SFCs, these are unlikely to be reviewed and challenged. It is not therefore until there is an event that causes one party to fail to fulfil its obligations that any specific inclusion or exclusion would become an issue and at this point any challenge may lead to dispute on the reasonableness of the clause.

Additional Clauses Apparent. Other clauses that were found relatively frequently in the sample (at least 40% of the sample) though not in all versions included:

- Entire Agreement: This is an important issue which ensures that unless included within the contract, any pre contract agreements or other extraneous documents are not a part of the agreement.
- Dispute Resolution: This subject is dealt with in more detail in chapter 7, but of interest is the fact that only 12 (less than half the sample) included specific provisions to deal with disputes. When they did they were generally related to construction contracts and therefore introduced the option of the Adjudication<sup>49</sup> process.
- Records/Audit: A number of the forms reviewed (14) included requirements for the other party to retain records for potential audit at a future date. These were inevitably fairly general in nature and in contracts provided by Buyers placing obligations on Sellers:

*The Supplier shall make its premises, books, records and other documentation relevant to the Contract available to Buyer at any reasonable time during the life, or subsequent to the termination of this Contract.*

- Ethics/Compliance: The area of Ethics and Compliance seems to be a growing area for inclusion in contract T&Cs following the introduction of various statutory requirements. The Bribery Act has pushed businesses into attempting to become more proactive in dealing with corruption and

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<sup>49</sup> Housing, Grants, Construction and Regeneration Act (1996)

therefore seeking commitments within contracts that the other party meet their obligations<sup>50</sup>.

One subject that was noted a small number of times (3) introduced Data Protection obligations on the parties and it is likely that the General Data Protection Regulations introduced in 2018 will see an increase in these provisions.

In general, these standard clauses which an organisation will routinely include in its contracts (probably both standard form and negotiated and for sale and for purchase) are rarely challenged and often not even considered. What is of particular interest is that there is a wide variety of inclusions. The question that isn't answered is why some organisations do not include some of these clauses that are routinely found. This may be because they are consciously trying to simplify their contracts, that they have decided the specific risk is not relevant or sufficiently significant or that they have merely failed to assess the need.

### **5.2.6 Indemnities and Liabilities**

From the survey of contract users (see chapter 4), exclusion or limitation of liability was seen as the second most important aspect for inclusion in contracts following payment provisions. Although this is a significant legal issue within contracts, the responses were similar across all cross sections of individual respondents and of company profile. This indicates a high level of prominence of the subject across businesses derived from direct experience or indirect knowledge. It also suggests that organisations see this as an important requirement as the message is clearly communicated to all parts of the business.

From the sample of 25 SFCs, they all included some clause or clauses which dealt with indemnities, liabilities or insurances, though there were a number of different approaches. There may be a number of factors that drive these

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<sup>50</sup> The Bribery Act 2010, but see also the Modern Slavery Act 2015 which places obligations on commercial organisation in respect of transparency of their supply chains, the Competition Act 1998 and the Enterprise Act 2002

differences, though the most likely will be dependent upon whether the terms are those of a Seller or a Buyer. A Buyer is likely to require significant indemnities from the Seller for a number of possible breaches whether they are buying goods or services.

Against this, a Seller will wish to include protection against problems with the delivery or use of the product or service and hence attempt to include limitations or exclusions. This will generally not include any broad indemnities, will try to exclude liability for indirect or consequential losses and will also include a limitation on the total liability for either any single claim or series of claims.

Fourteen of the examples included a specific requirement for the Seller to indemnify the Buyer in certain circumstances. The most onerous of these was a general indemnification for any claims relating to the goods or service, including the cost of any defence. This broad approach passes all the risk to the indemnifying party, often requires that the indemnified party is 'held harmless' and can apply even if the indemnified party has been negligent<sup>51</sup>.

Others were more reasonable in that they only provided indemnities where the Seller was in breach or negligent and some even limited the ability to claim to direct losses. In the narrowest examples, the indemnity was limited to breach of certain defined obligations, commonly relating to IPR, Confidentiality and TUPE (Transfer of Undertaking Protection of Employment).

Indirect or Consequential Losses. Whether specific indemnities were included or not, most of the contracts made reference to liabilities with a frequent approach addressing the issue of indirect or consequential losses. Some examples highlighted these as being within the scope of any claims whereas others attempted to exclude them. Where this was the case, there were a variety of different means to ensure that the drafting was clear and unambiguous. Some clauses provided a long list of head of claim that it identified as indirect losses. Others provided a more general and broader

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<sup>51</sup> *Canada Steamship Lines LD. Appellants v The King Respondent.*, [1952] A.C. 192

approach, merely using the terms “indirect” or “consequential” and therefore leaving the debate on whether any particular claim was excluded open.

The principle of indirect losses dates back to *Hadley v Baxendale*<sup>52</sup>, and there are two aspects that need to be considered:

- The loss should be fairly and reasonably considered as arising “...according to the usual course of things, from such breach of contract itself”, or,
- “...such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it.”

The first of these should ensure that that any damages are attributable to the breach, but the second opens up a potential chain of events that leads to losses more remote and less directly linked to the event. It is then necessary to consider what was in the contemplation of the parties, when the two parties may well have different expectations and hence claim different contemplations.

After a century and a half, there are still cases where the application of this principle is still evolving<sup>53</sup> and hence there may still be a need to continue to develop the clauses which try to deal with these claims, though whether this happens in practice is less clear.

The challenge for the companies therefore seems to be in trying to firstly identify those losses which are not direct, but may have been within the contemplation of the parties, and therefore should be classified as indirect (or consequential), without invalidating any clause by being too robust. Then needing to clarify those losses which they believe are too remote and therefore outside the contemplation of the parties.

Typical examples from the sample ranged from a simple:

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<sup>52</sup> *Hadley v Baxendale*, (1849), 156 ER 145.

<sup>53</sup> *Transfield Shipping Inc v Mercator Shipping Inc*; House of Lords; 9 July 2008; [2008] UKHL 48; [2009] 1 A.C. 61

*Neither party shall have any liability to the other party under the Contract for any indirect or consequential loss.*

To the other extreme which tries to cover all avenues:

*...shall be liable to the Customer by way of indemnity or otherwise for breach of contract or statutory duty or in tort (including negligence) in respect of defects in the provision of or failure to perform the Services or otherwise in connection with the Contract for any: (a) loss of rent; (b) loss of profits; (c) loss of revenue; (d) loss of business opportunity; (e) damages representing or calculated by reference to rent; (f) damages represented or calculated by reference to diminution in the value of the Building or of any property or accommodation; (g) payment or imbursement for payments to third parties; (h) indirect or consequential loss; or (i) economic or pecuniary loss or damage whatsoever or howsoever occurring.*

Whilst this analysis may appear clear, there are alternative views that the courts use this avenue as a way to allocate risks which have not been identified by the parties within the contract<sup>54</sup>. With SFCs however, it is likely that few identifiable risks are covered due to the general nature of the requirements.

The third aspect of these clauses is the subject that brings them closer to the test of whether they are reasonable. The desire to provide protection by limiting liability for claims to a financial figure brings the drafting to the attention of the courts considering the applicability of the UCTA. Most businesses will wish to ensure that they have a level of protection against the low probability yet high value claims that could severely damage the viability of the organisation. In many cases they will try to place a total liability cap that prevents situations where a claim could drive the company out of business.

Where this is the case, the question, which will be developed later in reference to the Act, becomes 'what is reasonable?'. This becomes particularly important

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<sup>54</sup> Andrew Robertson, 'The basis of the remoteness rule in contract', (2008), Legal Studies, Vol. 28 No. 2, June, pp. 172-196

as this review is addressing standard terms of business which introduces additional requirements under the Act.

The final element included in a number of the sample provided additional clarification by defining the types and level of insurance required by the Seller. This inclusion raises two separate points which should be addressed in the transaction. Firstly, there is not necessarily any relationship between the level of insurance required and the possible liability under the contract. Requiring a level of cover does not imply that liability is limited to that level and a separate, lower level would provide additional protection. Secondly, the requirement for defined insurance cover is intended to ensure that the Seller can meet its liabilities should there be a high value claim, but where the alternative is becoming insolvent, the onus on checking the presence of the necessary policies lies with the Buyer.

Requiring insurances therefore makes good business sense in reducing future risks should there be any significant claim, but it is only helpful if the relationship to the liabilities under the contract are understood and if the organisational processes ensure compliance. Taking out insurances and the availability of insurances also becomes an important point when considering application of UCTA.

### **5.3 The Unfair Contract Terms Act**

#### **5.3.1 Significance and Relevance of the Unfair Contract Terms Act**

From the review of the contract terms and the views of the respondents to the survey, it is apparent that the important issues addressed within contracts can be divided into two categories. The first of these would include matters like price and payment as important to the seller, and deliverables and quality from the position of the buyer. The second however includes items which provide protection for serious breaches which are designed to ensure that when the contract goes badly wrong that the impact on the business as a whole is controlled and are therefore strategically significant to the company.



The clauses which provide this latter protection are usually terms limiting or excluding liabilities in order to ensure that the company exposure to such events can be controlled. These clauses have been the subject of many decisions by the courts over the years and since 1977 have been subject to the UCTA. As pointed out by Elizabeth MacDonald<sup>55</sup>, this is one of “...*the two single most significant pieces of legislation in the field of contract law in the UK*”. As the second was the Unfair Terms in Consumer Contracts Regulations<sup>56</sup>, which has subsequently been replaced by the Consumer Rights Act 2015 (CRA), the one relevant to this work dealing primarily with business transactions, is UCTA.

For the purpose of this analysis, there are three key factors that impact on the application to contracts:

- The first of these factors is whether the parties fall within the scope and aren't covered by alternative legislation like the Consumer Rights Act<sup>57</sup>;
- Secondly, whether the terms are considered to be standard terms of business<sup>58</sup>, which in this study would normally be the case; and
- Finally whether the term in question is reasonable under the definition in the Act<sup>59</sup>.

Although the first of these would not seem to be relevant in this analysis which is directed towards business to business contracts, there is an aspect that may catch out unwary trading organisations.

Unless a company has clear processes to identify the customers it deals with, then it is possible that a business may use its SFCs unwittingly in sales to the public (consumers). This is unlikely to be the case where a business is the buyer as it will be buying from a trading organisation. However, where it is selling a service like maintenance of security or fire protection, then this could

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<sup>55</sup> Elizabeth MacDonald, 'Unifying Unfair Terms Legislation', (2004), 67(1) MLR p69

<sup>56</sup> Unfair Terms in Consumer Contracts Regulations 1994

<sup>57</sup> Consumer Rights Act 2015 Section 2(3)

<sup>58</sup> Unfair Contract Terms Act 1977, Section 3(1)

<sup>59</sup> Unfair Contract Terms Act 1977, Section 3(2)(b)

be supplied to businesses or consumers. As this may be a small and limited segment of its customer base, unless the selling organisation has clear processes to identify the status of the buyer then it may routinely use standard forms of contract not designed for consumer transaction.

It may not become apparent that the transaction is in fact with a consumer and therefore covered by the CRA until a dispute arises. The test now falls to the CRA, being “...an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession”<sup>60</sup>.

The other two points need to be considered in the context of the large number of cases that have informed interpretation of the Act.

### **5.3.2 Application of UCTA to Standard Form Contracts**

Section 3 of the Act, dealing with limiting or excluding liabilities in relation to breach of contract addresses situations where one party deals on the other’s “*written standard terms of business*”, a requirement which introduces an additional test for any company entering a contract. Again, whilst many such transactions will clearly be on a standard form of contract, there are many where a standard form is merely the starting point for negotiations. Whether a contract has been negotiated has been tested and is summarised later in this chapter.

From the survey sample, many respondents confirmed that their organisation was prepared to negotiate some aspect of the terms. Specifically:

- Is your company prepared to negotiate and amend its standard terms and conditions = 94%
- If yes, are these controlled by a formal process = 88%
- Are there any matters which are not acceptable to your company in contract = 63%

Further, when identifying which matters were not acceptable to negotiate, 15 out of 26 comments related to limits of liability and/or exclusion of consequential losses, indicating that these were unlikely to be amended from the standard

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<sup>60</sup> Consumer Rights Act 2015 Part 1, Ch. 1, 2(3),

terms position. This confirms that even if SFCs are negotiated to some degree some key clauses, including limits on liability, will not be changed and will therefore be subject to a higher level of scrutiny under the UCTA.

It is interesting then to understand how much negotiation is required to satisfy the requirement that they are no longer standard form of contract. One case which develops this principle is *The Salvage Association (SA) v Cap Financial Services Limited (CAP)*<sup>61</sup>.

This case revolves around a pair of contracts between the two parties under which CAP were to design, develop and deliver a bespoke software package to The Salvage Association. Following delays and unsatisfactory performance, the Salvage Association terminated the second of these and then issued a claim for repayment of the contract price and damages for wasted expenditure. Apart from denying any liability for the claim, the defendant referred to a limitation of liability clause which would have limited any claim to £25,000 under each of the contracts.

Whilst there was a defence to the actual breach, much of the case related to the validity of the limitation clause and how and to what extent it fell foul of the UCTA. The issues were summarised by the Judge as in four steps:

1. Whether the Act had any application to the case.
2. Whether there was any express or implied term that Cap should take reasonable skill and care in the performance of the contract.
3. Whether the contracts were formed on Cap's standard Terms
4. If they were subject to the Act, did the limitations satisfy the requirement for reasonableness?

Of relevance to this thesis is the third point, which concerned whether the contracts were on standard forms of contract and hence controlled under Section 3. Specifically, whether “...*the contract term satisfies the requirement of reasonableness*”<sup>62</sup>. In this aspect, the two contracts were considered

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<sup>61</sup> *The Salvage Association v Cap Financial Services Limited*, [1995] F.S.R. 654

<sup>62</sup> Unfair Contract Terms Act 1977, Section 3(2)(b)

separately as they had been discussed and entered into under differing business conditions. In the case of the first contract it was clear that even CAP had referred to the contract as being on their standard terms of business and although there was some reference to some amendments, it was clear that these were not material. As such, any exclusions would need to be subject to the test of reasonableness under Section 3(2) of the Act.

The second contract presented a different position as there was clear evidence that both parties entered into meaningful negotiation over the terms. The judge found that SA took legal advice and sought numerous changes to the terms which in most parts were received and agreed by CAP. As such it was decided that the contract was not on CAP's standard terms and therefore concluded that Section 3 of the Act did not apply.

The final part of the assessment required that the exclusion clauses be subjected to the test of reasonableness under Section 2(2) for both Contracts and under Section 3 for the first contract. In order to assist this assessment, the judge referred to the guidance provided (Schedule 2) whilst noting that it was not provided to assist evaluating reasonableness against Section 3, but recognising the decision in *Flamar v Denmac*<sup>63</sup>, that it would be sensible to do so. The argument put forward by CAP referred to *Photo Production v Securicor*<sup>64</sup> and the core principle “*not to interfere with freely bargained commercial contracts*”. However, the Judge identified a specific clarification within that judgement which proved to be a key factor. The matter was explained as being “*when the parties are not of unequal bargaining power, and when risks are normally borne by insurance... there is every thing to be said... for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.*”<sup>65</sup> and suggested that SA had demonstrated that the risks under debate were not normally borne by the purchaser. SA has

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<sup>63</sup> *Flamar Interocean Ltd. V. Denmac Ltd (Formerly Denholm Maclay Co. Ltd)*, (1990) 1 Lloyd's Rep. 434

<sup>64</sup> *Photo Production Ltd v Securicor Transport Ltd*, [1980] UKHL 2

<sup>65</sup> *The Salvage Association v Cap Financial Services Limited*, [1995] F.S.R. 675

considered insurance and had investigated the availability and the price of such insurance but had rejected the proposal on the basis that it was disproportionately expensive compared to the risk.

The judge went on to make a number of points which seemed all to focus on a recent decision of CAP's board to amend their standard form of contract and introduce increased levels of limitation on similar claims. He used this to demonstrate that the contract level of £25,000 was inadequate and in that it bore no relationship to the risks involved or level of insurance (CAP confirmed that it had £5m of cover) and described it as an arbitrary figure. As the onus under the Act is on the party relying on the limitation to prove that it is reasonable, this change in policy implied that CAP no longer considered it a reasonable amount.

This case presents a useful description of the different steps to be taken in assessing the effect of the Act and deals with each in turn. The different assessment of the degree to which the two contracts were considered of standard form is helpful as it shows a distinct comparison, though it is always going to prove difficult to assess the extent and effectiveness of any negotiating process. This contrasts with the view in *St Albans District Council v International Computers Ltd*<sup>66</sup>, where the terms remained largely untouched in spite of some degree of negotiation and similarly in *McCrone v Boots Farm Sales Ltd*<sup>67</sup> where Lord Dunpark commented that it included conditions "*which the proposer applies, without material variation*".

Any negotiation of SFCs can therefore result in the contract being considered a negotiated contract and therefore treated differently under the Act, but care needs to be taken to understand when this is the case. Where such contracts are used in large numbers it is unlikely that such close control is exercised as this would incur costs and defeat the objective and benefits of using SFCs for efficient transactions.

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<sup>66</sup> *St Albans District Council v International Computers Ltd* [1996] 4 All ER 481

<sup>67</sup> *McCrone v Boots Farm Sales Ltd*, 1981 S.L.T. 103

### 5.3.3 The Test of Reasonableness

Under Section 2(2) (other loss or damage resulting from negligence) or Section 3 (liability arising in contract), the Act introduces the concept of reasonableness. The party cannot exclude or limit its liability "*...except in so far as the term or notice satisfies the requirement of reasonableness*". This area of the Act is of particular relevance here as it addresses in Section 3(1) the use of "*...written standard terms of business*". Section 11(1) describes the criteria as "*...fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.*"

This test therefore is therefore considered when the court has decided that the claim results from negligence or there is a breach which purports to be limited under a standard form of contract. A significant case which demonstrates an application of the reasonableness test, but not from an assessment of the size of the limit, is *Stewart Gill Ltd v Horatio Myer & Co Ltd*<sup>68</sup>.

Stewart Gill Ltd installed a conveyor system for Horatio Myer & Co Ltd under a contract which was their standard form of contract and included a clause excluding the right to set off amounts due by counter claim.

*'12.4 The Customer shall not be entitled to withhold payment of any amount due to the Company under the Contract by reason of any payment credit set off counterclaim allegation of incorrect or defective Goods or for any other reason whatsoever which the Customer may allege excuses him from performing his obligations hereunder.'*

When the conveyor was finally installed there was a counter claim and Horatio Myer withheld the final 10% of payment which caused Gill to apply for summary judgement for payment of the amount. There appears to be little challenge to the fact that the counter claim was valid and therefore would justify a payment from Gill to Myer, though this would have needed to be considered by a different court. The decision on whether Myer could withhold its payment rested on

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<sup>68</sup> *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] 1 QB 600

whether the clause was reasonable under the Act and the unanimous decision was that it was not.

This was based on the fact that the general nature of the clause was far too broad and although the part being relied on may be reasonable, it is not possible to ignore the rest of the clause and consider this part in isolation. As the complete clause would effectively allow Gill to force payment under any circumstances, including, as pointed out by Stuart-Smith LJ, a defence based on fraud, it failed this test of reasonableness for the purpose of the claim.

A similarly important decision was in *St Albans District Council v International Computers Ltd*<sup>69</sup> where a number of tests arose including whether the terms were negotiated or standard terms and, having decided that they were (under Section 3(1)), whether they were reasonable.

The case resulted from a claim by St Albans District Council for damages for breach of contract, in that the computer system supplied by ICL failed to provide the correct figures for calculating the Community Charge and as a result the Charge was calculated incorrectly and the Council suffered a loss of £1.17m (made up of lost revenue and increased precept payments). The case went to appeal and following analysis it was decided that the Council was entitled to damages for breach and so the level of damages was then to be assessed in the context of a standard exclusion clause in the defendants' terms and conditions. The clause stated:

*'In all other cases ICL's liability will not exceed the price or charge payable for the item of Equipment, Program or Service in respect of which the liability arises or £100,000 (whichever is the lesser). Provided that in no event will ICL be liable for: (i) loss resulting from any defect or deficiency which ICL shall have physically remedied at its own expense within a reasonable time; or (ii) any indirect or consequential loss or loss of business or profits sustained by the Customer; or (iii) loss which could have been avoided by the Customer following ICL's reasonable advice and instructions.'*

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<sup>69</sup> *St Albans District Council v International Computers Ltd* [1996] 4 All ER 481

This clause would therefore limit any liability to £100,000.

In reaching his decision, Nourse LJ, considered the submission that the terms had been negotiated as some of the terms had been amended to reflect negotiations, but concluded that the terms '*remained effectively untouched*' and so were standard terms. This comment leaves doubt over how negotiation can be demonstrated to have left the terms unchanged, or indeed if it is enough to negotiate. If there is much negotiation and a particular term is ultimately left unamended, then is that considered not to have been negotiated for the purpose of the Act?

Therefore the essential requirement was that the clause should be reasonable under the Act. At appeal, the court reverted to the general principle from *George Mitchell (Chesterhall) Ltd v Finney L*<sup>70</sup>, that there will be different interpretations of what is reasonable, but unless there is clearly an erroneous principle or was clearly wrong, the subsequent judgements should not vary the decision, so supported the original decision that the clause was not reasonable.

At the original hearing, having ruled out the possibility that the Council was dealing as a Consumer Scott Baker J<sup>71</sup>, had decided that the terms were a set of standard terms. This was in spite of the fact that there had been negotiation of some points and making the point that there is always likely to be some negotiations on "*...for example, quality or price but none as to the crucial exempting terms*"<sup>72</sup>. To inform this point he referred to *The Flamar Pride*<sup>73</sup>.

The consequence was that the clause needed to be assessed for reasonableness and this analysis was based on a number of criteria available within the Act. The key factors considered were the availability of insurance to cover such losses and the bargaining power of the parties. ICL had extensive

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<sup>70</sup> *George Mitchell (Chesterhall) Ltd v Finney L*, [1983] 2 AC 803

<sup>71</sup> *St Albans District Council v International Computers Ltd* [1995] FSR 686

<sup>72</sup> *St Alban's City and District Council v International Computers Limited*, [1995] F.S.R. 706

<sup>73</sup> "*Flamar Interocean Ltd v Denmac Ltd (formerly Denholm Maclay Co Ltd), The Flamar Pride and Flamar Progress*, [1990] 1 Lloyd's Rep 434"



insurance which would pay out for such claims and the premium could easily be passed on to the customers. Additionally, as had been demonstrated, the contract terms were presented as standard terms, leaving the Council apparently little opportunity to object to their content. Taking a strong interventionist approach, he assessed that these two factors which were heavily in favour of the term being unreasonable were sufficient to outweigh the fact that councils and computer companies should be allowed the freedom to reach their own bargains without being subject to external controls.

This interventionist approach was maintained in *Britvic Soft Drinks v Messer UK Ltd*<sup>74</sup>, where the examination was directed more at risk allocation and where the risk for the breach should naturally fall.

Messer supplied Carbon Dioxide to manufacturers of soft drinks and therefore accepted that it was to be used in consumable products. The product contained traces of Benzene which although not to a harmful level were enough to create a health scare and impact upon the company image. As a result, the claimant had to remove stocks from shelves and suffered significant losses. A large part of the judgement covered the matter of whether the product complied with the British Standard, though ultimately the decision came down to whether it was reasonable for the defendant to exclude liability for a risk that the court decided was not a risk that the claimant could have predicted. An additional point was made that the parties were of equal bargaining power and that the purchaser could easily have placed the order elsewhere. This did not change the fact that the term as incorporated was not reasonable.

The Court of Appeal supported the decision finding that it was not reasonable to expect the purchaser to test for contaminants which had been supplied in compliance with the British Standard. It also argued that, had the matter of risk of contamination during the manufacture and supply process been discussed at the time of contract then it would certainly have been agreed that the risk would lie with the supplier (or the manufacturer).

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<sup>74</sup> *Britvic Soft Drinks and others v Messer UK Ltd and another*, [2002] EWCA Civ. 548

The defendant argued that this view had the benefit of hindsight and there does seem to be an element of this where the nature of risk allocation in contracts is made on known and unknown risks on the basis that unknown risks are theoretically less likely. Taking contractual agreements to be an agreed mechanism for allocating risks between parties as an essential element of negotiating a deal, it would seem odd that the court reversed this view, particularly as the party to the contract was a large international organisation well capable of managing its own risks.

Further evidence that the Act and its application may be providing inequitable solutions is provided by *Regus v Epcot Solutions*<sup>75</sup>. This case demonstrates the ineffectiveness of the system such that a dispute about poor air-conditioning (and some peripheral issues) and the subsequent claim for withholding of payments, which should have been resolved early led to a counter claim for £626m and a trial at the Court of Appeal with all the associated costs. Unfortunately, the judge in the first instance decided that the limitation clause in Regus standard terms of business was not reasonable under Section 11(2) of the Act as he considered it did not offer any remedy for the current dispute. He had no problem with the limitation on liability but considered that the parties had relatively uneven bargaining powers, a point challenged by the Court of Appeal due to the ready availability of alternative suppliers of office space in the area. He then considered that, as a part of the relevant clause was ineffective, then he deemed the whole clause to be ineffective. Unfortunately he then went on to propose that the damages due (in preparing to deal with the excessive counter claim) should be some percentage deduction on the rental fees, which seemed to be at odds with the contention that there was no remedy available. The Court of Appeal considered the different parts of the relevant exclusion clause and discussed the effect of each in turn and consequently decided that the clause was not unreasonable.

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<sup>75</sup> *Regus (UK) Ltd v Epcot Solutions Ltd*, [2008] EWCA Civ 361

He finally addressed the matter of the reasonableness of the limitation and had no difficulty concluding that a maximum of 125% of fees paid or £50,000 was both generous and reasonable.

This demonstrates a swing back to the non-interventionist approach advocated by much of industry and which encouraged Warchus J<sup>76</sup> to propose five key points when considering exclusion or limitation clauses. These are derived from the Act and from subsequent cases:

1. The relative bargaining power of the parties is becoming less important;
2. The use of similar terms by the Claimant and inclusion in any negotiations;
3. Remedies remaining if all options are excluded;
4. Availability of insurance as a contingency to either party;
5. Severability of the specific exclusion or limitation that may be unreasonable from the one being relied upon.

Specifically, he highlights the tendency of the courts to pay less attention to any inequality in the bargaining power of the parties and also suggests that this case increases the need to separate different limitation terms where possible covering direct or indirect losses.

A further point to consider when assessing the applicability of the Act relates to the requirement for the party relying on the limitation to prove that it is reasonable as summarised in *Sheffield v Pickfords*<sup>77</sup>.

A party which relies on SFCs is required to plead the matters on which it relies (See also *Lacey's Footwear v Bowler*<sup>78</sup>). Sheffield issued a claim for loss and damage to property left unprotected at a location by Pickfords. The court found that there was no obligation on the defendant to present the case for

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<sup>76</sup> John Warchus, 'The rise and rise of limitation clauses' (2008) *Construction Law*, 19 10 *Cons.Law* 17

<sup>77</sup> *Sheffield v Pickfords Ltd and Another*, [1997] CLC 648

<sup>78</sup> *Laceys (Wholesale) Footwear Ltd v Bowler International Freight Ltd*, [1997] 2 *Lloyd's Rep.* 369

reasonableness as the plaintiff had not identified this as the reason for the claim.

At appeal, Lord Woolf MR decided that as the Act places the onus on the party relying on the clause, in this case Pickfords, to prove that it satisfies the reasonableness test (S11(5)), then there is a responsibility on that party to demonstrate it is reasonable. Pickfords had notified the court that it would be relying on the limitation clause and hence should have prepared its defence by demonstrating that the limitation was reasonable. The obligation is therefore on the “...defendant setting out squarely and clearly that they contend that the contract provisions are reasonable.”<sup>79</sup>

There are many years since the Act was introduced and many cases which have demonstrated how it is interpreted, particularly in respect of SFCs. The additional expectations placed on SFCs should result in more care being taken in their use, but this principle is counter to the underlying efficiency reason for using them in the first place. On balance the results indicate that businesses take a view that their terms are reasonable and therefore won't fall foul of application of the Act.

#### **5.4 Summary**

The review of the sample of SFCs has produced a high level of correlation with the outcome from the survey as there is consistency between the views and expectations demonstrated in the survey and the actual content of the contracts. The survey identified two key topics as being most important to business and these two topics are strongly covered in the contracts.

The sample examined provided a large variation in approach with different degrees of depth demonstrated by the detail and extent of specific provisions. There was also a large breadth across the sample with the simplest covering just 14 clauses up to one example which included 39 different subjects.

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<sup>79</sup> *Sheffield v Pickfords Ltd and Another*, [1997] CLC 648

### Content of Standard Form Contracts.

In general, the content of the sample provided support for the assessments made by the survey sample. The items identified in the questionnaire as included in SFCs were represented in the contracts reviewed. All of the examples included clauses dealing with payment (though not specifically price) and all also covered limitations on liability, indemnities or insurances in some way.

The approach to payment was noticeably different between Buyers and Sellers demonstrating the different business objectives of the roles and desire to manage their financial obligations. Buyer's terms included specific processes as well as documentation requirements and processing deadlines to control their expenditure. Sellers attempted to ensure that any processing was simple with minimal obstacles to being paid quickly.

Other requirements considered to be of less importance by the survey participants were covered to varying degrees including a section of boiler plate clauses to ensure that the contract would operate in practice.

The approach to liabilities demonstrated a similar variation between Buyers and Sellers. Buyers requiring broad indemnities from the Seller where the Sellers attempted to limit their liabilities as much as reasonable. This included introducing a limit to their liabilities under the contract and wherever possible excluding liability for indirect or consequential losses. This was identified specifically by respondents to the survey as often being a company policy objective.

### Indemnities and UCTA.

Whether such limitation or exclusion of liability clauses are effective in SFCs will depend on a number of factors, starting with the assessment of whether the transaction is with a Consumer as it is defined under the Consumer Rights Act and then whether the contract is indeed on one party's standard form of contract. As this thesis is directed at SFCs in business transaction, both of these should be clear but need to be assessed to define the boundaries of the project.

Additionally, although standard forms of contract are unlikely to be subject to any changes, there are cases where some discussion or negotiation has taken place. This then leads to an amended standard form of contract and the extent of the changes and the clauses that are changed will then need to be assessed against previous case law to verify whether they fall within the specific compass of the Act.

Where they are fully exposed to the scope of the Act, then the final question is whether the specific limitations or exclusions are reasonable under the definitions included within the Act and the subsequent interpretations.

### Conclusion.

The review of the sample of contracts has provided a high degree of support for the understanding of the respondents to the survey. This indicates that the users are aware of and familiar with the contracts and what is relevant to their role, even if they do not ultimately refer to them on a regular basis.

The matters included in the contracts is quite consistent across the sample, though there is variety in the detail and the scope of the content. There is particular variance between Buyers and Sellers in some of the key topic areas identified as they all try to establish the optimum position on payment and risk.

There is a high degree of commonality across the sample indicating that many clauses have been tested and accepted as suitable for most situations. There are however also a large number of clauses with a variety of approaches. Some of these variations may be attributed to the specific role of the party (Buyer or Seller) but others may be due to different commercial objectives.

## **6. COMMERCIAL APPROACHES TO RESOLVING DISPUTES WITH STANDARD FORM CONTRACTS**

### **6.1 Introduction**

One of the most significant findings from the earlier studies and subsequently from the results of this work relates to how contracting parties deal with matters when they do not develop as had been envisaged when the contract was formed. As Macneil<sup>80</sup> described, the contract is intended to provide a written statement of a defined outcome or process and as such it is limited by both the ability of those drafting the documents to predict the future and their ability to put into words the possible outcomes. This he described as bringing the future into the present, or presentiation.

Macaulay<sup>81</sup> referred to the adjustment of exchange relationships, when the confirmed agreement failed to deal with a situation. When the contract is formed using a standard form of contract which needs to be simpler and more general in nature the ability to cover such a breadth of possible situations is reduced.

Firstly, the document is likely to be more concise in order to encourage the parties to accept the terms whether they wish to review and challenge or just sign the document without a second thought<sup>82</sup>. The review of SFCs in chapter 5 illustrates the size of the sample measured by number of clauses and by number of pages. Attempts to keep the document small will present fewer opportunities to include detailed provisions for the possible situations that may conceivably arise needing solutions.

Secondly, the fact that the terms are intended to be used across a large range of business with multiple different customers will mean that there is an increase

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<sup>80</sup> Ian R. Macneil, 'Restatement Second of Contracts and Presentiation' (1974) 60 Va. L. Rev. 589

<sup>81</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), Am Sociological Review 55

<sup>82</sup> Mark R. Patterson, 'Standardization Of Standard-Form Contracts - Competition and Contract Implications' (2010) William & Mary Law Review; Volume 52, Issue 2

in the possible issues that could arise. The business environment provides an infinite number of factors that might impact upon a transaction and cause a problem in the way a contract is delivered and hence an increased number of futures that would need to be addressed.

The extent to which these matters are covered is attributable to the company drafting the terms and the consideration of which possible outcomes are important and need to be addressed. What companies decide to include and to what degree these matters are dealt with is covered in more detail in chapter 5.

The aim of this chapter is to assess what options are available for businesses and the individuals within those businesses that manage delivery of the contract, when there is a dispute under the contract. It will review the two broad stages which apply when there is a failure of some sort in performance of the contract prior to formal legal proceedings:

- Informal solutions including negotiations and collaborative working to achieve a satisfactory outcome, including reference to the contract terms and conditions to seek clear guidance on what has been agreed.
- Formal dispute resolution using agreed processes or reverting to the legal protocols.

From the result in the previous chapters, informal methods are used to resolve a clear majority of the incidents where there is a dispute over the contract. In many cases it is likely that the parties may not even consider that there is a breach of the contract or that one party has failed to meet its obligations. The approach of most individuals and propounded by Macaulay<sup>83</sup>, is to '*avoid, suppress, and resolve disputes little influenced by academic contract law*'.

The results from the study (95% of the sample expected the contract to address risks) indicate a level of confidence in the ability of the contract to deal explicitly with what should happen when the requirements are delivered and more

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<sup>83</sup> Stewart Macaulay, 'An Empirical View of Contract' (1985) 1985 Wis. L. Rev. 465



importantly what happens when they are not delivered at all or not to the expectations of the other party.

This confidence, particularly when demonstrated by the operational teams that either deliver or receive delivery of the requirements, leads to an expectation that if and when matters don't follow the expected course then the contract will provide the answers. From the results however, this does not appear to be the first option and is only called upon when more practical solutions fail (36% of disputes are resolved informally).

Once these informal methods fail, or in some cases are not attempted, then there are further options advocated by the courts prior to taking form legal action. This is an area where the legislature has attempted to introduce reform in efforts to both reduce the costs to the parties and also to reduce the burden on the courts. In addition to alternative dispute resolution that may be a requirement of the contract, the Woolf<sup>84</sup> reforms established protocols to assist in reaching negotiated settlements.

This chapter will assess how the normal business practices of attempting to work through problems operationally as identified by the survey, has been developed through the implementation of the Woolf Reforms and whether they have improved business practices. The data collected<sup>85</sup> to inform the report was sizeable and provides additional information for assessing one of the core areas of this thesis. This will be used with the results from the survey and the content of sample contracts to understand how organisations, or more specifically individuals, deal with issues and whether the reforms have impacted on the process.

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<sup>84</sup> The Right Honourable The Lord Woolf, Master of the Rolls, Access to Justice: The Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, (HMSO, London, 1996)

<sup>85</sup> Hazel Genn, Research Conducted for the Final Report to the Lord Chancellor, July 1996, Lord Woolf's Enquiry: Access to Justice

## 6.2 Informal Solutions

### 6.2.1 Identification of Disputes

The results from the survey identified a number of issues associated with how contractual disputes are managed and particularly how difficult it is to identify and categorise such issues. Fundamentally, what is considered to be a dispute will be different to different individuals and as such will be managed differently.

A dictionary definition of dispute might be simply "*The act of disputing or arguing against; active verbal contention, controversy, debate*"<sup>86</sup>. This does not define any degree of activity and may therefore range from a single conversation where there is a disagreement which may never be resolved and does not create any lasting effect, up to full scale litigation.

A legal dictionary will then develop this simple definition to: "*A conflict or controversy; a conflict of claims or rights; an assertion of a right, claim, or demand on one side, met by contrary claims or allegations on the other.*"<sup>87</sup> This introduces the concept of rights and more broadly the concept that there is a disagreement or "contrary claims". It expands the meaning to reflect a fact that there are at least two parties and they have differing views on the matter.

In the 1924 case *Mavrommatis Palestine Concessions*<sup>88</sup> ("Mavrommatis"), the Permanent Court of International Justice ("PCIJ") famously defined a "dispute" as a "*disagreement on a point of law or fact, a conflict of legal views or of interests between two persons.*" Whilst this was in relation to an international disagreement and whether it could be referred to International Law for resolution, the definition is nevertheless a useful and concise one for more common business problems.

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<sup>86</sup> Oxford English Dictionary, (2016) Oxford University Press

<sup>87</sup> Blacks Law Dictionary (2016)

<sup>88</sup> *Mavrommatis Palestine Concessions* (Greece v. U.K.), 1924 P.C.I.J. (ser. A) No. 2, at 11 (Aug. 30)

More simplistically, the Housing, Grants, Construction and Regeneration Act 1996<sup>89</sup>, when referring a dispute to adjudication, simply describes the requirements as: *“For this purpose “dispute” includes any difference”*. This unusually broad and open definition allows a wide range of interpretations and hence in theory a large number of possible issues that might be brought to adjudication.

It is from this rather vague or varied position that an understanding of how organisations deal with contractual disputes must start. The lack of definition of what constitutes a dispute should not dilute the significance of any disagreement in a business relationship. When things go wrong then there is a potential for damaging business relationships and impacting upon future corporate performance.

Whether these disagreements become defined disputes and ultimately require reference to the courts to resolve, will depend on many and varying factors, which will also change over time. For example, as organisations become more familiar with each other, they are likely to become more tolerant of each other’s shortcomings in the knowledge that they are capable of resolving many minor challenges. New business partners will not have such well-established confidence.

Equally, two similar disputes between the same organisations might be dealt with differently by the different individuals as a result of different personal experience or different circumstances including having different financial targets. Although there is unlikely to be any conscious engagement in a process of negotiation, this is probably happening on a regular daily basis in most business relationships. Most individuals will develop their own ways of dealing with disagreements and there will usually be a natural tendency to avoid conflict.

Although negotiation as a principle is researched and analysed widely, how this is applied to everyday situations is not commonly understood by those actively

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<sup>89</sup> Housing, Grants, Construction and Regeneration Act 1996, Section 108.

involved. The data collected in the survey which addressed training received by respondents did not include any reference to negotiation training and only very limited reference to resolving disputes. Negotiation it seems is a skill which everybody has to varying degrees, and use routinely without needing to understand why or how.

At a higher level, there is more focus on this topic, though primarily this relates to the importance of understanding and being able to negotiate as lawyers or to pre contract situations.<sup>90</sup> It may however, be considered as a normal social interaction between two individuals or parties and can occur at any stage during the relationship from contract negotiation (demonstrably recognised as such) through to agreeing changes and accounts.

Once there is a level of disagreement, reaching a mutually acceptable position can happen at any stage right up to the steps of the court. This last stage before submitting to a decision that is outside the obvious control of either party generally creates additional pressure, combined with the step increase in potential cost, that forces many agreements<sup>91</sup>.

As a dispute is escalated within an organisation there will then become different factors at play. These will include factors relating to the parties and their relative position in the transaction which will be important in identifying how and when the dispute is resolved.

As Macaulay identified in his 1977 article, "*Larger organisations seldom need legal rights against weaker parties because they get what they want by command*"<sup>92</sup>. This would apply equally well to smaller organisations which have market dominance and the ability to control future deals should they suffer a significant reversal in any dispute. Many disputes that might therefore be

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<sup>90</sup> Robert B. Moberly, 'A Pedagogy for Negotiation' (1984) 34 J. Legal Education 315

<sup>91</sup> Simon Roberts, 'Listing Concentrates the Mind': the English Civil Court as an Arena for Structured Negotiation' (2009) Oxford J Legal Studies 29 (3): 457

<sup>92</sup> Stewart Macaulay, 'Elegant Models, Empirical Pictures And The Complexities Of Contract' (1977) 11 LAW & Soc'y Rev. p513

pushed upwards to formal legal action are resolved early as the weaker party attempts to maintain its relationship. The threat, whether explicit or merely perceived by the weaker party, is enough to ensure that a solution is reached albeit that closure may be achieved at what may be considered an unfair position.

The data from the survey supports these explanations on the early reconciliation of disputes. Where a dispute is considered to have arisen, more than 36% were resolved by informal means and, although 16% may involve legal escalation, less than half of these then resulted in litigation.

Other factors that have been identified by scholars as limiting the number that reach the lawyers include those that are of a technical nature. Where the dispute centres on a technical interpretation of what was delivered or the performance of the product or service, assessment of compliance with contractual obligations becomes more difficult. These may therefore require independent specialists to investigate and report. The Woolf report addressed this by advocating the use of single experts jointly instructed and whilst this is intended to reduce costs, it hasn't (and probably won't) been universally successful<sup>93</sup>.

When a matter requires the intervention of such experts, there is likely to be a level of uncertainty on the outcome and hence a risk that the decision may go either way. Whether the use of experts is pre-formal action (as part of alternative dispute resolution) or in the courts, this level of doubt will mean that business organisations will carry out a risk and return analysis and assess the likely outcomes against the cost of proceeding to such an assessment.

Although ultimately one party may have the best case and would win the decision, they take a pragmatic approach and optimise the position by reaching a negotiated solution. This brings back into play the economic factor in deciding whether to contend any position taken by the other party. Macaulay<sup>94</sup>

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<sup>93</sup> Brian Thompson, 'The problem with single joint experts' (2004) 154 NLJ 1134

<sup>94</sup> Stewart Macaulay, 'Elegant Models, Empirical Pictures And The Complexities Of Contract' (1977) 11 LAW & Soc'y Rev. p509 on David Trubeck, 'Notes on the Comparative Study of

summarised Trubeck's assessment that "...*economic actors will employ litigation process to settle disputes only to the extent that (1) the present value of continuing relationships is low, and (2) the anticipated return from the litigation process is relatively high.*" This view results in introducing an arbitrary financial threshold for most organisations, dictating whether the cost of the action and the probability of success provide sufficient justification to proceed.

The early stages of a dispute can be quickly elevated to a more formal level, if only to demonstrate the intent of one party and without any real effort, this may provide the desired result. This may be through employing a solicitor to produce a formal legal letter and hence showing that the party is prepared to expend cost to force a solution. By being prepared to spend early, a message is sent to the other party that they are confident that such expense is made at a low risk as they believe they have a strong position to exploit. Macaulay made this point in his 1977 work, stating that "...*filing a complaint, or even merely writing a letter on an attorney's letterhead, may be enough to provoke serious negotiations.*"<sup>95</sup>

Ultimately, the parties to a business contract will have different levels of appetites for disputes and the risk and cost of resolution. As competitive organisations operating in a broad market place, they are constantly making decisions based on costs, risk and potential returns and this same approach will be manifest in decisions on disputes.

Some businesses may have a greater appetite for the formal legal approach through previous success or through a better understanding of the process and the costs. Others may engage in such actions rarely and therefore be more nervous and reluctant to risk losing and the associated costs. These 'one-

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Processes of Handling Disputes between Economic Enterprises' (1975) Paper presented at the United States-Hungarian Conference on Contract Law and the Problems of Large Scale Economic Enterprise, New York

<sup>95</sup> Stewart Macaulay, 'Elegant Models, Empirical Pictures And The Complexities Of Contract', (1977), 11 Law & Soc'y Rev. p515

shotters' as Galanter described them are more interested in the single result and less interested in the long term changes to the rules than Repeat Players.<sup>96</sup>

### **6.2.2 Business Relationships and the Contract**

Since Macaulay in the early sixties, there have been further commentators offering their theories on how effective contracts are in regulating business transactions and suggesting what might be the role of the contract in these activities<sup>97</sup>. It might be thought that the result of these works would be a noticeable transformation in the overarching principles governing contracts to reflect what was actually happening in the real business world.

Whilst there have been some interesting proposals such as Hugh Collins<sup>98</sup>, there is usually an equally notable counter argument which advocates the status quo or at most reliance on market forces to apply regulation and allow the law to evolve. Of particular relevance is Collins' assessment of the parallel importance of three factors, the business relationship, the economic deal and the contract, provides a sound basis for understanding the results from such empirical research including this piece.

By identifying the first of these as the prime factor in any deal, the work helps to explain the results from this survey, which show that disputes are not infrequent (88% of respondents saw at least one dispute per year and 45% experienced more than ten) but are usually resolved at the coal face (62% before the need for a formal meeting and 94% without the need for issuing proceedings) and not escalated unnecessarily.

This outcome could be adequately explained by the desire to maintain an effective business relationship, though it is doubtful that this is a measured and calculated approach in most cases. Human nature will try to avoid conflict and

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<sup>96</sup> Marc Galanter, 'Why The "Haves" Come Out Ahead: Speculations On The Limits Of Legal Change' (1974) 9 Law & Soc'y Rev. 95

<sup>97</sup> See numerous references elsewhere including Beale and Dugdale, Mitchell, Galanter and Collins.

<sup>98</sup> Hugh Collins, 'Regulating Contracts', (Oxford University Press 1999)

therefore encourage individuals managing contracts to find compromise solutions that realistically support the business relationship at the operational working level.

This unstated objective will usually manifest itself through two individuals working together on a personal level to achieve the most effective solution to common everyday problems. This working level relationship may not even explicitly recognise the higher level strategic aims of the two businesses but be responding to ongoing relationships or embedded cultural features of the organisations.

The second factor (the economic deal<sup>99</sup>) then comes in to play to ensure that the solution provides the necessary economic outcome to satisfy the separate demands of the players, both individual and business. Again, the first of these will be the narrow aims of the operational participants who will know that there will be additional costs associated with problems like delays or rework.

Getting the job finished as quickly and completely as possible will naturally be seen as a personal objective whilst also in most cases providing the most cost effective route. This subconscious business analysis may also be driven by cultural factors though may be more personal as it also supports the individuals' personal objectives to reduce conflict and make the job easier.

Collins' suggestion that this practical use, or more accurately non-use, of contracts should be recognised and be embraced in developing a more business friendly contract law has however subsequently been robustly challenged<sup>100</sup>. The results from this survey would support this counter view as users accept the need for contracts regulated by the law even if they don't understand the detail. They also recognise that market forces are involved which allow the system to self-regulate.

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<sup>99</sup> Hugh Collins, 'Regulating Contracts', (Oxford University Press 1999)

<sup>100</sup> John Gava & Janey Greene, 'Do We Need A Hybrid Law Of Contract Why Hugh Collins Is Wrong and Why It Matters' (2004) *The Cambridge Law Journal*, 63, pp 605-631



From the data gathered it can be concluded that when the transaction does not proceed to meet the expectations of the individuals directly involved then there is not routinely a desire to consult the contract. The data indicates that almost half of cases where there is reference to the agreement, the contract fails to provide an answer or does not even address the subject of the dispute. This is likely to influence the individuals in future matters where they lose confidence in the contract itself.

There may also be concerns that the contract itself may not define the actual requirements as clearly as the parties may wish. Where there has been little involvement in agreeing the contract by the specific individuals who are responsible for the delivery, then the deliverable and the price and payment obligations may not reflect what would routinely happen in practice. Particularly where there are repeat transactions with the same parties, custom and practice may develop a more effective solution for delivery of the requirements than the contract specifies.

Alternatively, the individuals may make assumptions on what the obligations are without accurate knowledge of the documents or any desire to refer to the documents. Consequently when a problem arises and reference is made to the contract, the true nature of the transaction is understood and the parties have to reconsider the extent of the problem. Although the data gathered did not ask this question specifically, there were a significant number of respondents who admitted that they did not know what was included within their contracts (15%).

The significance of a legal agreement between two parties as the basis of a transaction is a prime question of this research and inevitably unlikely to provide a concise answer. The evidence from this research supports Macaulay's work<sup>101</sup> as, although users do recognise the importance of the contract, they still don't routinely use contracts to assist solving problems.

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<sup>101</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study', (1963), *Am Sociological Review* 55 and Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules', (2003), 66 *Mod. L. Rev.* 44

There are several further pieces which take the subject matter and provide contrasting analyses notably identifying the need for a contextual interpretation<sup>102</sup> which will rely on the individual characteristics of any particular deal.

The counter to this objective towards a flexible system that can accommodate and foster the differing aspirations of the parties, which may well be aligned through a common understanding of what has been agreed, is the orthodox view that decisions on contracts must be consistent and predictable<sup>103</sup>. This expectation of the law is based in an understanding that the law is fair and therefore treats all parties equally. Whilst no two cases will be the same, where they are sufficiently similar, it cannot therefore sustain decisions that are different depending upon the circumstances.

### **6.2.3 Non Contractual Remedies**

There are a large number of reasons why businesses do not routinely either engage in litigation or find some alternative mechanism for escalating the resolution process when things go wrong. Lisa Bernstein has carried out extensive research in the area of legal systems and dispute resolution outside of the courts by investigating different industries. This has confirmed that those industries (Diamond Merchants<sup>104</sup>, Cotton Industry<sup>105</sup> and Grain Industry<sup>106</sup>)

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<sup>102</sup> Catherine Mitchell, 'Contracts and contract law: challenging the distinction between the "real" and "paper" deal' (2009) *Oxford Journal of Legal Studies*

<sup>103</sup> Iain MacNeil, 'Uncertainty in commercial law', (2009), *Edin. L.R.*, 13(1), 68-99 and Rex Ahdar, 'Contract Doctrine, Predictability and the Nebulous Exception', (2014), *C.L.J.*, 73(1), 39-60

<sup>104</sup> Lisa Bernstein, *Opting Out Of The Legal System: Extralegal Contractual Relations In The Diamond Industry*, *The Journal of Legal Studies*, Vol. 21, No. 1 (Jan., 1992), pp. 115-157

<sup>105</sup> Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, (2001) 99 *Michigan L R* 1724-1790

<sup>106</sup> Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, (1996) 144 *Uni Pennsylvania L R* 1765-1822(1996) 144 *Uni Pennsylvania L R* 1765-1822

have developed their own private legal systems which are both more suitable to the operation of the industry and better understood by the players.

The most recent of these from 2015<sup>107</sup> evaluated the way in which equipment manufacturers in the Mid West of the United States created agreements with their suppliers. These Master Supply Agreements were stated not to be contracts, but rather frameworks for how the parties would act and include the expectations for various events. The aim for all parties is a long term relationship that benefits all without becoming confrontational. To achieve this, they include mechanisms for escalating disputes up the management chain alongside regular and structured review meetings.

By using these type of agreements, the industry has managed to develop a structure that's both self-governing to a degree (if all else fails, then litigation would still be the last resort) but also improves long term business goals. Selecting new business partners would also use reference to the record of the possible partners, though this would potentially have a down side where new entrants to the industry would face an additional barrier to entry.

The benefits of these systems are that they are tailored to the unique constraints of the reference industry where a general national legal system may not be. They have developed in response to the industry demands and therefore have been sanctioned and supported by the very parties that would wish to rely on them. They may also deal with lower level disputes in a cost effective manner without the need to instruct expensive lawyers and risk higher sums in litigation.

In the UK, attempts have been made to replicate these approaches more formally through such instruments as the Construction Act<sup>108</sup>, addressing the unique challenges within the construction industry. This provides the

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<sup>107</sup> Lisa Bernstein, Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts, *Journal of Legal Analysis* (2015) 7(2): 561-621

<sup>108</sup> Housing, Grants, Construction and Regeneration Act 1996 as amended by the Local Democracy, Economic Development and Construction Act 2009

intermediate option of adjudication as a cheaper and quicker means of reaching a decision than full blown litigation.

#### **6.2.4 The Contract**

When businesses enter contracts they do so on the basis that both parties enter the contract in good faith and expect to gain some benefit from the transaction. In the majority of these transactions the parties carry out their obligations and complete the transaction as agreed and then the parties, happy with the result, continue with their business. In many business arrangements, this will be one transaction of many where the parties frequently require different goods or services and in a beneficial arrangement they will rely on the other parties that they have developed successful business relationships with over time.

With larger and more complex contracts and those that are intended to be long term contracts with continuing obligations the possibility of events occurring that were not predicted or that cause problems is increased. However, the challenges faced by shorter and more immediate arrangements can be equally demanding as the effort exerted and costs incurred in reaching an agreement needs to be controlled if the deal is to be economically viable. It is in these situations that standard form contracts (SFCs) are the first option and by their very nature these will be general in form and short on specific detail relevant to a particular situation.

As described previously, and as evidenced by the data, there are many options and sociological factors that encourage parties to resolve disagreements at an early stage and in an amicable manner. Unfortunately however this is not always possible and if the parties have exhausted all local and informal methods at conflict resolution then one will decide to revert to the contract. The reason behind one the parties initiating this approach will be either frustration at the lack of progress or a secure knowledge that the words of the agreement will provide support to their position. It is unlikely that somebody would invoke

the power of the contract unless they were confident it would be to their benefit as they reach (as Macaulay described<sup>109</sup>) the endgame.

One of the main findings from the survey is that there is a general lack of understanding or appreciation of what the contract says about any particular matter or how it might be used to assist in resolving disputes. Unfortunately, this isn't necessarily because the parties are ignorant of the content but more likely that they put off referring to it as they do not expect it to assist.

There is a broad assessment of the likelihood of the contract not addressing the specific issue at dispute, up to a high of 70%, though with a mean of 16% (in 84% of cases the matter is covered in some way by the contract). This drops slightly when considering whether reference to the terms actually assists in resolving the problem with a mean of 62%, but suggests that only in 20% of cases does the contract not assist in resolving the problem even though it does cover the matter in some way (see Chapter 5 for more detail on what is actually included).

As a significant sample of the disputes is related to price and payment (59%), it is not surprising that the contract can be used in these matters. As this area is acknowledged as a key source of problems and as it is seen as a fundamental aspect of the contract, it is likely that it is covered with the necessary detail to assist managing most problems.

In principle, the contract is agreed in advance of any transaction and is intended to define a number of factors relevant to that deal. In many cases, this may be limited by the perceived risk of the transaction or by lack of expectation from the participants. It should however be intended to include, as a minimum, the basics of the product or service and the price to ensure that there is at least agreement on these aspects. Additionally, it may include provisions dealing with many other aspects of the arrangement and details of the parties but inevitably it is unlikely to be able to deal with every possible aspect of the deal.

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<sup>109</sup> Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules', (2003), 66 Mod. L. Rev. p53

As Macneil<sup>110</sup> indicates, the perfect contract can't exist as it should take all potential future events and place them in the context of the current circumstances thus ensuring that all of these possible eventualities are covered. Unfortunately, this is necessarily a futile exercise in view of the vast array of external environmental factors that can impact on the delivery of contractual obligations. Consequently, most contracts are incomplete<sup>111</sup>, a condition that has long since been recognised and therefore take a pragmatic approach and try to deal with those risks that have been assessed as important by the parties themselves.

Taking a risk based approach to contracts, it may be possible to identify the high probability or high impact risks to ensure that the contract provides adequate protection or mitigation and therefore ensure that these are managed. In most cases such an analytical approach is not practical and standard contracts develop in response to experience of previous difficulties or changes in law (statute and case precedents).

A simple view might consider that there are two key obligations in most contracts, being the provision of a service or product by one party and payment in return by the other party. In these cases, then an initial focus should be on the failure of either party to fulfil these obligations. There are however broader environmental factors that may impact on the ability of the parties to complete these simple tasks and in many cases, there have evolved standard approaches to deal with these.

- Acts outside the control of both parties: Whether an event that impacts on the performance of the contract is truly outside the control of the parties becomes a matter of the facts of the case, but there is a well-developed concept covering such 'Acts of God(s)'. Whilst the courts

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<sup>110</sup> Ian R. Macneil, 'Restatement Second of Contracts and Presentation', (1974), 60 Va. L. Rev. 589

<sup>111</sup> Oliver Hart and John Moore, 'Incomplete Contracts and Renegotiation' (1988) *Econometrica*, Vol. 56, No. 4, pp. 755-785

have taken a robust view of this<sup>112</sup> to prevent parties escaping their obligations, there are still some occasions which can genuinely be attributed to such circumstances. In an effort to control this, contracts may include Force Majeure clauses attempting to define what may be an allowable event and the drafting of these provisions can be the subject of keen negotiations.

- A second event that is frequently covered in contract drafting in order to limit the obligations is to address situations where one party becomes insolvent. Clearly in such circumstances it is likely that the contract will not be fulfilled and so most contracts will include a clause which will automatically give the other party the right to terminate.

A problem with drafting contracts however is that there needs to be an appropriate amount of effort exerted commensurate with the potential return expected and the possibility of negative occurrences increasing the risk of achieving the returns. It would be ideal to be able to achieve the level of legal certainty and environmental certainty (predictability and consistency)<sup>113</sup> that the users expect but this will usually demand much more analysis of the circumstances and extended discussion between parties to reach agreement.

There are a number of theories which develop the idea that businesses require certainty for decision making<sup>114</sup> or at least a known level of predictability from contracts, albeit balanced against the need in many cases for flexibility<sup>115</sup>. These demands usually conflict directly with the desire to keep contracts simple and reduce the cost of developing and negotiating for each transaction.

There may be a number of ways of assessing the variety of tools that are available for dealing with poor performance on behalf of one of the parties and

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<sup>112</sup> See: *Davis Contractors Ltd v Fareham UDC* [1956] AC 696

<sup>113</sup> Iain MacNeil, 'Uncertainty in Commercial Law', (2009), *Edin. L.R.*, 13(1), 68-99

<sup>114</sup> Rex Ahdar, 'Contract Doctrine, Predictability and the Nebulous Exception', (2014), *C.L.J.*, 73(1), 39-60 and *Chartbrook Ltd. v Persimmon Homes Ltd*, [2009] UKHL 38 at [37]

<sup>115</sup> Hugh Beale, *Remedies for Breach of Contract*, Sweet and Maxwell (1980) p10

these will start with deciding whether to break them down by the type of breach or by the type of remedy. The first of these approaches will then identify the different types of breach by either party and consider the possible remedies for each of those breaches.

The second technique was viewed by Beale<sup>116</sup>, and looked at all possible remedies including those expressed in the contract and those that might be effective even though strictly not legitimate. The available remedies run from one extreme of contract termination through to more inclusive processes like financial incentives.

Whilst the scope of available remedies is broad, the method to ensure that the most effective is used is less comprehensive and will normally depend upon a large number of factors. Ideally, as Beale explains<sup>117</sup>, there should be an economic solution that maximises return for the parties whether in a short term approach or the longer term relationship of the parties.

As contracting behaviour evolves and becomes more mature then so do contractual mechanisms become more sophisticated, facilitated by increasing levels of automation and analysis enabled by technology. This is particularly true of the progress in developing more responsive and appropriate mechanisms which fundamentally deal with risk management but effectively react to levels of non-performance or breach. Such payment mechanisms have become commonplace in large private finance contracts as the parties try to ensure the necessary mechanisms to reward good performance and penalise poor performance.

The actual pricing mechanism itself is also used to apportion risk. A fixed price contract passes all risk across to the contractor requiring that they are wholly familiar with the potential issues that will impact on their ability to deliver. However, for it to be effective, it needs to be clear in what is being delivered as any ambiguity will lead to grey areas and potential disputes.

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<sup>116</sup> Ibid

<sup>117</sup> Ibid, p11



In general however contracts are not so detailed and well developed and certainly with SFCs there is little sophistication in the mechanisms employed to address future failures. As these are used for constantly to cover low value and low risk transactions, they need to be cheap and easy to use and general in nature.

It is likely therefore that they will only include provisions for those risks that the drafter considers are either common or significant. The former of these will be identified through business experience and frequently such provisions are included following a failure that resulted in a dispute and subsequent financial loss. The latter may be broader in nature as they will attempt to cover situations that could result in significant impact on the organisations.

More detail of the risks companies try to cover through contract terms are included in Chapter 5.

### **6.3 Formal Pre Litigation Escalation**

#### **6.3.1 Pre Legal Options**

The data reviewed indicates that 65% of those responding experienced five or more disputes in any year showing that there are many opportunities for parties to reach a position where they disagree on some aspect of the relationship. This will normally be due to a failure of one of the parties to meet a contractual obligation and then a dispute over either the cause of the failure or the most appropriate remedy. Where a solution cannot be reached through practical means either negotiation or compromise, or referring to the terms and conditions, then the next option is to look for an alternative means of dispute resolution.

From the sample (Chapter 5) almost 50% included specific terms detailing a dispute resolution process detailing what form of dispute resolution the next step should be. These clauses will routinely start off with a requirement that the dispute should be escalated internally within the two organisations to a senior (possibly Board) level executive and such individuals from each side should meet to provide a more objective, detached and possibly commercial perspective to the problem.

This should remove the emotions which may have developed in the operational level discussions and also allow the matter to be considered within a broader business picture, which may indicate the necessity for continuing business relations between the two companies. This more senior review will allow the organisations to introduce more factors into the equation including the value of the business between the parties, the length and strength of any relationship and any previous similar disputes that may not be known by the local teams.

If no resolution can be achieved or is ineffective for any reason then there may then be defined a form of alternative dispute resolution which may be mediation, arbitration or in the case of construction contracts (as defined by the Construction Act<sup>118</sup>) adjudication. However, whether this is the most sensible next step or whether it actually occurs in practice, will depend on a number of factors.

The state of the relationship between the parties following the development of the dispute and broader aspects of the contract performance may dictate that a meeting between senior executives is impractical or might actually weaken the chances of resolution. This is likely to be the case where there are a large number of disputes between the parties across a number of contracts or where the executives have been intimately involved in the matter already and hence have already developed entrenched positions.

The technical complexity of a dispute may also dictate that the resolution will not be achieved by the prescribed methods. Where there is a level of complexity which needs to be understood and assessed by experts, then it is unlikely that many of the options available would be able to evaluate the merits of either party's position.

Another factor that may well drive one of the parties down a different route may be the urgency of reaching a resolution. This is likely to be the case where

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<sup>118</sup> Housing, Grants, Construction and Regeneration Act 1996 and amended by The Local Democracy, Economic Development and Construction Act 2009

there is a significant sum of money outstanding and a small sub-contractor is at risk financially if the cash is not released expeditiously.

The Construction Act 1996<sup>119</sup> was introduced primarily for this purpose to protect small sub-contractors from being bullied by large main contractors into accepting unfavourable settlements when under pressure financially to maintain cashflow. A significant feature of the Act promotes stage payments and ensures clarity of any amounts due as well the date on which payment should be made. Additionally, it provides for the use of adjudication to resolve disputes, which is intended to be a quick and cheap alternative to litigation.

There is also a strong possibility that even with an agreed dispute resolution clause incorporated into the contract, the chief protagonists may not be aware of it or may carry on along a different route regardless. If they are dealing with many contracts with differing requirements, they may have a set escalation process which they take without checking what may be a SFCs.

This is most likely to be the case where the disagreement manifests itself as a debt and the matter is therefore managed internally by the finance team and not by the operational or legal team. If the withholding of a payment is the first indication that there is a dispute, then the conclusion might be that the relationship has already broken down irreparably; there is clearly limited and ineffective communication between the active individuals to identify the problems and seek solutions.

Having either exhausted the contractual options for dispute resolution or not having referred to them in the first place, the common and often ultimate resort is to turn to the courts. However, this will not automatically result in issuing a claim and waiting for a formal response before proceeding to present the case before a judge. The courts have a number of ways of encouraging resolution of disputes to control the actual disputes reaching formal proceedings and also

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<sup>119</sup> Ibid

to try to reduce costs all round. These pre action requirements were implemented initially as a result of the Woolf Report<sup>120</sup> in the early 1990s.

The survey data indicates that 5% of disputes are resolved through alternative dispute resolution and 5% reach the court. Unfortunately the structure of the questions did not provide information on whether any were resolved under the pre-action protocols implemented as a result of the Report. This lack of clarity might mean that they have been classed into any of five categories (Formal Letters, Formal Meetings, Legal Letters, ADR or the courts) and that the survey fails to assess the benefits of the reforms. There is however other data which has been collected which focusses on the effect of these changes.

### **6.3.2 Civil Justice Reform**

Civil Justice in UK has long been recognised as imperfect and in need of reform, a subject that has been addressed on a number of occasions.

*“From Woolf to Jackson to Briggs, to Briggs again, and then once more to Jackson. Civil justice reform is a subject that never rests.”<sup>121</sup>*

The first of these provides useful background for this thesis as the remit was to speed up the process and make the whole system simpler and more accessible. The outcome from the report were proposals which should support the system as described by the sample in the survey whereby disputes are resolved before formal litigation.

Initiated by the Lord Chancellor (Lord MacKay), the remit was to speed up the process and make the whole system simpler and more accessible. Lord Woolf identified a number of failings with the existing system, as being too expensive, too slow, too unequal and too uncertain, but as stated in the overview“...*above all it is too fragmented in the way it is organised*”. This fragmentation was seen as the cause of many of the other limitations and therefore addressing this

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<sup>120</sup> The Right Honourable The Lord Woolf, Master of the Rolls, Access to Justice: The Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, (HMSO, London, 1996)

<sup>121</sup> Sir Terence Etherton, Master of the Rolls, Lord Slynn Memorial Lecture, 14 June 2017

aspect would provide some degree of improvement to the other problems. The tendency for disputes to become adversarial in nature was in part attributed to this lack of control as the parties were in a three way dispute with the courts being the third party.

The Civil Procedure Rules proposed included clear incentives on parties to follow a structured and participative approach in the early stages of a dispute linked to the level of costs which they might be able to recover should they ultimately be successful. These rules were then implemented through the Civil Procedure Act 1997<sup>122</sup> which created a power to make Civil Procedure Rules, which were themselves made on 10 December 1998<sup>123</sup> and came into force on 26 April 1999. There were two main areas of change, firstly the structure of the courts and secondly the introduction of new protocols for the management of cases.

The first part of the proposal was to establish the role of the courts in managing the cases and therefore to ensure that claims progress with clear time frames to avoid one party delaying and causing ever increasing costs for the other party. The aim of the revision was to move responsibility for the control of the process from the litigants to the court.

The second part was to establish Protocols including the Pre-Action Protocol for Construction and Engineering Disputes<sup>124</sup> which explains the principles behind the process and the potential sanctions of the courts should the process not be followed. The aim of the protocol is threefold:

- To encourage a full and early exchange of relevant information,
- To encourage parties to avoid litigation through sensible and early settlements,
- To smooth the process should litigation become the only option.

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<sup>122</sup> Civil Procedure Act 1997

<sup>123</sup> The Civil Procedure Rules 1998 (SI 1998/3132)

<sup>124</sup> Pre-Action Protocol for Construction and Engineering Disputes, MoJ Website: Updated: Tuesday, 28 July 2015

Since the implementation of the reforms, there have been a number of investigations attempting to assess the effect of the reforms and identify whether there are further changes that would benefit the system. In 2005, a study into the effect of the Woolf Report<sup>125</sup> indicated that in general the initiatives were effective and resulted in quicker processing of cases in general, though the costs had not necessarily reduced. In 2008, Genn even questioned the way the process was diverting cases from court and whether this was actually hampering justice<sup>126</sup>.

Subsequently, in 2009 a further study was carried out<sup>127</sup> with a desire to split the data collected into the comparison of both pre and post action, to try to understand whether the pre-action protocols, which were fundamental to the reforms, had a positive impact on the costs and time at both stages. Whilst this work was conducted in relation to personal injury claims (a topic covered specifically by the Reforms, but with approaches common to other areas) the results suggested that the intended aims were not achieved, though accepts that there may be other factors that impact outside the scope of the study.

The hypothesis being that more work prior to issuing a claim would potentially reduce the number of cases becoming claims and when they did, the work carried out earlier would reduce the costs later<sup>128</sup>. The counter to this is that more work carried out pre-action may not be necessary in many cases but because of the constraints of the protocols, parties were engaging in order to manage their future risks. With the presence of the protocols, a party will feel

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<sup>125</sup> John Peysner & Mary Seneviratne, *The Management of Civil Cases: The Courts and post Woolf Landscape*, DCA Research Series 9/05, see also Tony Allen & Karl Mackie, 'Higher resolution' (2010) 160 NLJ 1143, for an assessment of an increase in settlements.

<sup>126</sup> Hazel Genn, *Judging Civil Justice*, Hamlyn Lecture, 2008 and considered by Toby Fisher, 'Resolution of Judicial Review Claims without a Hearing: A Review of Two Papers from the Public Law Project' (2009) 14 *Jud. Rev.* 380

<sup>127</sup> Paul Fenn, Neil Rickman, Dev Vencappa, 'The impact of the Woolf Reforms on Costs and Delay', CRIS Discussion Paper Series – 2009.I

<sup>128</sup> Neil Rose, 'Civil Procedure Rules: Rules of law' (2009) *LS Gaz*, 10, May 2009

obliged to proceed in order to comply and incur unnecessary cost, whereas there may be simpler and more effective means that would reach a quicker conclusion but with a higher risk of ending up in litigation.

The rules have been in place for enough time to assess how effective they are and there have been a number of commentators who have done so with differing areas of focus. One concern associated with encouraging early and hence un-litigated settlements, is the shortage of cases that may be important in establishing new precedents<sup>129</sup>. The suggestion is that with claims being settled based on business efficiency, then there are fewer cases reaching the courts that might be important in testing the law. There may be important cases that neither party is prepared to risk at court and therefore which are settled through mediation, arbitration or other early forms of resolution, thus limiting the ability of the court to set precedents.

The next stage from Woolf was Jackson whose objective was summed up in the forward: *“In some areas of civil litigation costs are disproportionate and impede access to justice. I therefore propose a coherent package of interlocking reforms, designed to control costs and promote access to justice.”*<sup>130</sup>

As this statement indicates, the focus was much more on the cost of the system than further efforts to encourage early settlement. This attempts to control ‘Conditional Fee Agreements’, ‘After the Event Insurance’ and ‘Success Fees’ and impacts more on the growing area of personal injury claims than business disputes. Whilst the effectiveness of the reforms may be open to opinion<sup>131</sup>, it at least demonstrates a desire to continue to evolve the systems.

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<sup>129</sup> Linda Mulcahy, 'The Collective Interest in Private Dispute Resolution' (2013) Oxford J Legal Studies (2013) 33 (1): 59

<sup>130</sup> Lord Justice Jackson, Review of Civil Litigation Costs: Final Report, The Stationery Office, 2010

<sup>131</sup> See Tony Allen & Dr Karl Mackie, 'A Missed Opportunity?' (2010) 160 NLJ 215, for a challenge to whether the reforms achieve what was set out.

The most recent development, specifically as it relates to civil claims, is the Briggs Review of the Civil Court Structure<sup>132</sup>. This review has made a number of recommendations which are still being considered, all intended to streamline the system and make it more responsive to the needs of the public. Notable proposals are for an on-line court, for more cases to be resolved in the regional courts, for additional support to mediation and other forms of ADR and for a single point for enforcement of decisions.

All of these reviews and reforms are intended to promote swift, economic and fair resolution of disputes preferably prior to any formal litigation and hence are consistent with the results from the survey which indicated that disputes rarely go to court. Whether the respondents to the survey were consciously adhering to these protocols and principles or merely taking a commercial position was not explored. However, the legal advisors will be aware of the protocols and therefore should issues reach that stage there will be a reminder of the need to attempt resolution prior to initiating proceedings.

#### **6.4 Summary**

One of the main areas of focus for this project has been to assess how businesses deal with matters when one or both of the parties fail (or are perceived to fail) in meeting their obligations. This was identified as any area where there were notable comments from both Macaulay and Beale and Dugdale indicating that in many cases there was little reference to the contract document.

In broad terms, the resolution of disputes can be divided into two stages. The initial stage covers any solution that is reached between the parties through normal dialogue and business relationships, including using the contract terms informally as leverage towards resolution. The final stage, prior to formal litigation will introduce a form of alternative dispute resolution, whether mandated in the contract (for example Adjudication) or required by the Civil Procedure Rules.

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<sup>132</sup> Lord Justice Briggs, Civil Courts Structure Review - Final Report, Copyright Judiciary 2016



### **6.4.1 Early Resolution**

There are many reasons why reaching a quick and simple agreement over any disagreement is of benefit, not least the time and effort that may be consumed in extended analysis and discussion. In many cases there will be little or no assessment and structured negotiation of a mutually agreeable solution, but the parties will quickly vary their relative positions to re-align in achieving joint aims. The negotiation is not recognised as such as it is just part of day to day management activity.

In addition to the approach and objectives of the individuals who are dealing directly with the matter, there will be other possible explanations for disputes being resolved before reaching for the contract. The relative strength of the parties and any ability to apply commercial pressure will influence the relationship at an early stage where one party is aware that pursuing further will result in tacit threats to future business.

There is a common, though not universal, misconception within business managers that the contract is the ultimate source for solutions to issues that arise in their transactions (as confirmed by the survey). The use of a contract to define the obligations on the parties has evolved over many years but there is still a limitation to how well to can deal with the infinite number of scenarios that can arise.

This limitation is further reduced where the parties do not wish to expend time and money to clarify the requirements due to the low value and hence low expectations of the particular job. The use of SFCs therefore further reduces the desire of business to deal with a large range of possible situations.

The mechanisms included within contracts is addressed in detail in Chapter 5, but in SFCs is limited, frequently with only reference to late payment and occasionally delays in delivery. There is however more frequent reference to alternative dispute resolution to at least provide some agreement on what the next steps should be before reverting to litigation. These alternative dispute resolution clauses will require an internal escalation to senior executives within the respective businesses and then include a requirement for a defined method

usually involving external parties before the court (Mediation, Arbitration or Adjudication).

#### **6.4.2 Formal Dispute Resolution before Litigation**

One of the main obstacles to resorting to the courts for resolution has always been the time it takes to reach a conclusion and then the cost. However, a clear problem with reaching early resolution is the ability to identify a dispute and initiate actions to attempt resolution. Under the Construction Act<sup>133</sup>, which applies to construction contracts as defined within the Act, there is support for managing payments and clear requirements for financial withholding to be justified. When a dispute is identified then the Act provides for Adjudication as a means to prevent further legal escalation.

Outside of these options, the Woolf Reforms reviewed significant volumes of data and verified a reluctance to litigate identified by Macaulay. Based on this evidence it recommended a more formal process to be followed to try to encourage parties to enter discussions and pin point the cause of disputes prior to issuing proceedings.

The Woolf Report<sup>134</sup> was intended to address the problems of the efficiency of the existing process which drove higher costs and encouraged parties to become entrenched in their position as they sought to recover their ever increasing costs. The objectives of the proposals were to embrace the principles of *'equality, economy, proportionality and expedition'*.

The recommendations included introducing Civil Procedure Rules to assist potential litigants and guide them down a route whereby they benefited from engaging with each other earlier and exchanged information to support their position. One of the principle changes to facilitate this was a change to the role

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<sup>133</sup> Housing, Grants, Construction and Regeneration Act 1996 and amended by The Local Democracy, Economic Development and Construction Act 2009

<sup>134</sup> The Right Honourable The Lord Woolf, Master of the Rolls, Access to Justice: The Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, (HMSO, London, 1996)

of the courts from independent arbiters to active managers. The aim was to take control of cases and therefore ensure that they progress at an acceptable pace and avoid ever increasing costs. This latter was seen as a problem where lawyers were effectively incentivised to drag out the whole process when they are paid by the hour.

Subsequent evaluation of the effectiveness of the reforms has produced mixed views. Whilst there is some evidence to confirm that they have contributed to reducing time and cost<sup>135</sup>, other commentators have suggested that the desire to avoid legal resolution was having a detrimental effect on the legal system in general<sup>136</sup>. Additionally the requirement that much effort is exerted early in the process regardless may actually be increasing the overall costs.

These reforms may however be seen as the latest step in the continuous process of evolving the legal system and have subsequently been followed by the Jackson reforms. The legal system exists within a larger ever changing environment and therefore will always need to change to reflect that environment. This is illustrated by the rapid changes in information technology, which present both new challenges and also new opportunities like on-line dispute resolution.

### **6.4.3 Conclusion**

The data collected in general shows that the earlier works in assessing how contracts work is still an accurate representation of the current state. Disputes are commonplace in contractual relationships, but they are not routinely solved by reference to the written words of the contract and rarely by resorting to the court.

Lack of understanding or knowledge of the contents of the contract and desire to maintain relationships and deliver what is agreed will usually be more

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<sup>135</sup> Neil Rose, 'Civil Procedure Rules: Rules of law' (2009) LS Gaz, 10, May 2009

<sup>136</sup> Hazel Genn, Judging Civil Justice, Hamlyn Lecture, 2008 and considered by Toby Fisher, 'Resolution of Judicial Review Claims without a Hearing: A Review of Two Papers from the Public Law Project' (2009) 14 Jud. Rev. 380

important than the content of a document few have seen and fewer still have detailed knowledge of what the content means. Where circumstances demand and the contract is used to try to sort out problems, then there are unlikely to be wholesale answers as they can only address a limited number of events. As price and payment are seen as the most frequent cause of disputes, it is positive that the agreement will usually provide more detailed guidance on how these matters are managed, though a dispute may well be a symptom of some other failure like delivery of the product.

When all else fails then the post contract options will involve some form of external arbiter and even if this isn't mandated within the contract, the English Legal system now requires a structured pre-action process in order to drive resolution before the courts. The Woolf reforms (and subsequently Jackson) are all intended to encourage early and bilateral agreement, reduce expensive legal costs and avoid using the courts, and so aligns with what has been custom and practice for many years.

## **7. SUMMARY AND CONCLUSIONS**

### **7.1 Introduction**

This thesis started from a personal assessment that much time and effort was spent in preparing and agreeing contracts which were then not used routinely as a practical document for the subsequent transaction. The first stage of investigation commenced through reviewing existing literature on the subject and provided reassurance that it was a recognised issue that had been researched previously. From 1963 there has been a steady flow of work in various specialised areas, mostly concluding that businesses use contracts, but the individuals prefer to find alternative solutions to issues with the transaction.

The main part of this work therefore was to test these ideas with specific reference to standard form contracts (SFCs) and by seeking feedback from a sample of business professionals using a survey. The output from this and a detailed review of a sample of SFCs could then be assessed in respect of two specific issues identified by previous studies, contract formation and contract disputes.

From this work, the final chapter will be in four parts, starting with a review of the research and the research process, it then summarises the most significant features from the research. For completeness it will then revisit the core questions set at the start of the process and finally consider the conclusions from the overall thesis and continuing questions that may be unanswered.

### **7.2 Review of the Research Process**

#### **7.2.1 Previous Research in Contracting Behaviour.**

From a starting point of the 1963 work of Stuart Macaulay<sup>1</sup>, this thesis has intended to assess whether the views and expectations of business users as they relate to the use of contracts and specifically SFCs, have changed. Is

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<sup>1</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) *Am Sociological Review* 55

there still a tendency to manage the practicalities of transactions separately to the written contracts that are and have been agreed? The survey has been employed to evaluate the attitudes and understanding of a sample of business users to establish the base positions of a limited defined population.

A review of a number of pieces of research from different cross sections of industry, geography and time established a common theme that business users acknowledged the presence of formal written contracts without embracing their role in controlling transactions. More specifically, this thesis has narrowed the focus by limiting the research to standard form contracts. Although the survey posed questions specific to this type of contract, some questions were intentionally broader, dealing with more general contractual principles.

### **7.2.2 The Survey.**

The survey was the first part of the exercise which produced a reasonable volume of data, though not enough to provide any complete statistical analysis that would allow extrapolation to a broader sample. There was however sufficient to allow conclusions to be drawn and also some assessment of key features from the views of different subsets (both individual and company). The survey was intentionally extensive in both the breadth of topics and the depth of questioning on those topics, providing the necessary detailed responses to develop conclusions.

Specifically, the aggregated responses demonstrated a high level of consistency across the sample to deduce that the views would be applicable to a broader population within the market sector. Additionally, in some areas the variations between sub-groups was sufficient to conclude that this was symptomatic of the general views of that sub-group in the wider population.

The response was overall satisfactory, though the approach taken to attempt a detailed and lengthy questionnaire may have deterred some participants and some failed to complete the questions. Nevertheless, by using this method, the depth of the data derived from a small group provided more detailed information and hence allowed analysis of a broader range of subjects.

### **7.2.3 Analysis of Standard Form Contracts.**

Using the information from the survey as the basis, the review of the content of a sample of SFCs also provided a good degree of consistency to suggest that it was a representative sample of a larger set. The review was carried out by identifying the key provisions of a sample of 25 standard form contracts from the same business sector as the survey.

The contract requirements identified as important by the questionnaire provided the main subjects for deeper analysis from the contracts. A broad sample from 25 different companies provided good examples of how these organisations dealt with the important issues. It also demonstrated the difference between standard terms and conditions drafted by Buyers and those prepared by Sellers.

### **7.2.4 Summary of the Research Process.**

This thesis has been largely driven by the desire to gather new data and therefore much of the output is dependent upon the quality and quantity of the data to enable sufficient analysis. In the survey, the quantity of data was limited but the quality of the responses to the questionnaire ensured that the conclusions derived are valid for the sample. For the review of contracts, the quality of the examples was strong as many were from large established companies with reputable legal support organisations and so would be expected to have well developed SFCs.

An important assessment for such work is whether the results are representative and whether they can be extrapolated to a wider sample. As with similar previous works, there has been no attempt to carry out more technical statistical analysis to verify this, but to interpret the results in the context of the sample tested.

## **7.3 Key Findings from the Research**

### **7.3.1 Contract Formation.**

The survey provided strong evidence that the sample continues to follow the previously identified traits where there is little confidence or even expectation

of clarity on the formation of a contract. Whilst there was a recordable understanding of the issues around contract formation and recognition of the problems where there isn't clarity, it was not seen to be a major problem.

This point was further substantiated by the responses to the questions about disputes. Firstly, there is only a very small proportion of contracts that cause a situation which would be described as a dispute and, for those that don't, there is no need to clarify the terms and conditions governing the transaction. It doesn't matter if there is no contract in place because the parties know the fundamental requirements of the contract, what is required and how much is being paid.

Where there is a failure (or a perceived failure), then, as most disputes are managed and resolved without reference to the contract terms, there will still not be any requirement to identify agreed contract terms. The parties will agree what has gone wrong and reach a solution that they are both happy with, again without any need to be concerned with whether a contract is in place.

The second aspect of this question indicates that there is an appetite for amending SFCs and most companies have policies to control this activity. Unfortunately the questions did not explore in more detail to what extent contracts were negotiated away from the standard terms or what issues might be subject to such changes. This could be of relevance where the application of the UCTA becomes a factor.

### **7.3.2 Dealing with Disputes.**

As Macaulay identified particularly in his later work<sup>2</sup>, a more significant area of interest concerns dealing with changes that had not been anticipated when the contract was agreed. This process of adjustment to the agreement, is most obvious when the contract is not delivered as expected by one or both parties.

In these circumstances the data indicates that there is little enthusiasm for consulting the contract and that most issues are dealt with before any

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<sup>2</sup> Stewart Macaulay, 'Freedom from Contract: Solutions In Search Of a Problem?' (2004) 2004 Wis. L. Rev. 777 is probably the best example



consideration of the legal or contractual position. This substantiates the precedent studies albeit that they were not specifically in relation to SFCs.

The later work of Macaulay provided more focus on this area and introduced a number of aspects concerning the cost of litigation<sup>3</sup>, the need to maintain a good business reputation and the ability to work effectively with business partners for long term relationships. The data identified this aspect of maintaining key relationships as a significant factor in resolving disputes amicably.

In the UK, the authorities recognised the increasing reluctance of companies to litigate and associated this with the ever increasing costs and complexity of the process. The Woolf Report<sup>4</sup>, based on extensive specific data gathering, provided a comprehensive statement of the position as it was in the 1990s and proposed that the courts should support this desire not to litigate. It therefore introduced protocols to follow to support reaching solutions negotiated by the parties. To further reinforce this it also allowed for financial sanctions where parties failed to take adequate steps to avoid formal legal action. Subsequent research has reported positive outcomes from these reforms, though their effectiveness was not a question covered by this survey.

A further factor contributing to a reluctance to use the contract in such circumstances was identified as the limited knowledge of the terms by the users. The practitioners delivering the contract were not generally involved in preparing the terms and conditions and therefore had limited knowledge of what the remedies might be in any situation. As SFCs it is also likely that they were not sufficiently detailed to deal with many of these situations and hence not seen as necessary for the users.

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<sup>3</sup> Stewart Macaulay, 'Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 Mod. L. Rev. 44

<sup>4</sup> The Right Honourable The Lord Woolf, Master of the Rolls, Access to Justice: The Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, (HMSO, London, 1996)

### **7.3.3 Significant Contractual Issues.**

One of the most notable outcomes from the survey which was then supported by the contract review was the clear importance of two areas: payment and liabilities. Whilst this may be an expected result, it helps to understand the priorities of the people engaging in business transactions at all levels.

The first of these, payment, was identified as important in all three questions, covering policy requirements, inclusion in SFCs and also the perception of importance by the sample. Additionally, payment was noted as being the most common cause of disputes and the cause creating the most significant impact. Whilst this may also be expected, it is of interest when considered with the previous point about the reluctance to refer to the contract.

This suggests that the contract does not provide a simple solution to the problem and is therefore either inadequate or incomplete. As the review of the sample of SFCs demonstrated that all those reviewed included terms dealing with price and payment, then the implication is that they are not effective in achieving the aim.

The price (which will be contract specific) and payment of that price will be a fundamental obligation on the Buyer under the contract and therefore it should be expected that this would be covered in detail under the express terms of the agreement. However, a limitation of using SFCs is that the terms are by nature general and may not be flexible enough to support all situations.

An additional reason reference to the terms may not be the preferred first option may be down to the lack of clarity on whether the deliverable has been provided as required under the contract. Finally, as identified in a number of studies, the relationship and potential future business will be a factor. Although financial reward for services or goods is the prime objective of business entering transactions, the parties will be sensitive to the broader issues surrounding the exchange.

### **7.3.4 Different Views and Approaches of Different Groups.**

The survey results supported a further conclusion reached by previous work by demonstrating that different functional roles had different views on contracts.

This is true of for a number of areas including what may be included in SFCs, what is important and how the contract is used.

Whilst there were differences in their views on what was included in contracts and which risks were important, the clearest difference appeared when assessing their perceptions. Here sales personnel were significantly more confident in the effectiveness of SFCs in all respects.

### **7.3.5 Content of the Contracts**

There were two clear results from the review of the sample SFCs, being the degree of standardisation across the sample and the evident differences between those prepared by the Seller and those issued by the Buyer. Additionally, the sample reinforced the views from the questionnaire on which clauses are considered important to the businesses.

Although the sample was drawn from 25 companies from different market sectors, they were all in use for similar services. There was however a high degree of similarity in both the terms included and the approach to how those terms were drafted. All of the sample included clauses covering the two prime areas of interest expressed by the survey, being payment and indemnities.

The main distinguishing factor across the sample was the difference between Buyers and Seller, and this was also particularly evident for the clauses dealing with payment and indemnities. Sellers generally simplified the method of payment and introduced limitation on liabilities and exclusions for consequential losses. Buyers introduced controls on payment and sought general indemnities with any limitation only included in respect of to their own liability.

The focus on these two aspects highlights the difference between two reported objectives of contracts. The first of these, part of the role identified by Macaulay<sup>5</sup> as the planning tool, includes payment, where this is a key feature of the daily use of the contract. The second, which includes controlling liabilities, provides a more strategic role for contracts in managing any high level risks

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<sup>5</sup> Stewart Macaulay, 'Non Contractual Relations in Business: A Preliminary Study' (1963) *Am Sociological Review* 55

that could impact more widely on the company and outside the bounds of the specific transaction.

#### **7.4 Assessing the Core Questions**

Relating these findings to the original questions allows an assessment of whether the research followed the planned course and succeeded in achieving the original objectives.

- Identify what business contract users understand about their contracts.

It is reassuring that the users indicated a reasonably complete understanding of the content of their contracts. The results from the survey were supported by the assessment of the content of SFCs and showed that this was fairly consistent across different groups and subsets of individuals and businesses.

The sample demonstrated a good appreciation of the key issues with the two main items identified being consistently payment and liabilities. Although there was a variance in the recognition of the effectiveness of SFCs, there was generally agreement that they were effective in most cases.

- Assess whether contracts actually meet these expectations.

This question can be reviewed in two parts, firstly whether users consider that they are effective in managing transactions. Here the view message is mixed, as the general response on their effectiveness indicates that they do achieve the aims of the users, whereas the message from the comments on resolving disputes indicates that they are not the first option to assist. Evaluating these points together would imply that expectations of the use of contracts does not include an expectation that they can provide solutions to routine business problems.

The second part relates to whether the representative content provides the necessary tools to achieve the objectives. As they all include clauses to deal with the two key issues, then they do at least attempt to address these expectations. The level of disputes in these areas, particularly with payment, however indicates that they may not be wholly effective in this area.

- User's expectations in relation to contract formation.

The outcome from this is less conclusive and based on the results is not significant as the issue of contract formation is rarely a problem. The results do not provide any clear evidence that contracts are normally clear and fully agreed and actually there is doubt expressed that this is usually achieved. As it is not a problem unless there are other issues, then the significance of unclear contract agreement is limited and was not indicated as being an important problem.

- Whether standard form contracts are able to meet the expectations of users in dealing with situations where things go wrong.

The conclusion from the survey and from other studies is that the contract is not fundamental to dealing with changes to the transaction. However, the question in this case concerns meeting expectations and from the survey, the expectations for SFCs are minimal. The users do not routinely use the contracts to resolve issues and therefore do not have high expectation of their effectiveness in such circumstances.

The apparent high volume of disputes recorded suggests that the course of commerce is not smooth, however the small element that are referred to the contract indicates that the contract may not be helpful in their resolution. With SFCs, then the general nature of the terms and conditions is unlikely to provide sufficient detail in most cases and therefore the users will firstly look for other ways to sort out problems and maintain a working relationship between the parties.

- Differences from previous studies.

From the starting point in 1963 there have been many studies, even described as a cottage industry<sup>6</sup>, and most of these have drawn similar conclusions to the Macaulay study. Although examining different aspects, different samples and different locations, they are all principally testing how commercial contracts are used to manage and govern business transactions.

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<sup>6</sup> Zev J. Eigen (2012), Empirical Studies of Contract, Northwestern University School of Law Faculty Working Papers. Paper 204

This study has focussed on SFCs with their own limitations both in the ability to deal with a wide range of possible issues, the difficulty in managing the volume of transactions and the controls imposed on them by external statutes. They do however demonstrate similar properties to the previous comments on SFCs and also the broader results from other empirical studies.

There has therefore been plenty of research and theory, but little change. The papers produced by academics have identified the way contracts are used and this has changed little in either the way they are used or most likely (though not tested in this thesis) the way they are drafted.

## **7.5 Main Conclusions**

The empirical research conducted for this thesis generated a significant amount of data and allowed an equally significant amount of analysis. Many of the conclusions drawn throughout have been similar to previous works and often substantiating previous theories. There are however some key aspects that are significant by the way that they are highlighted across different research elements or by the clarity of the evidence for the conclusion.

### **7.5.1 Difference in SFCs between Buyers and Sellers**

In addition to an apparent level of standardisation across the sample of SFCs, the review of the sample of contracts identified some clear differences between SFCs prepared by Buyers and those issued by Sellers. These were as might be expected as the contracts are used to assist in managing risks and therefore to limit exposure to potential losses.

The two areas that were most clearly different represented the same two topics identified as most important on the survey, payment and liabilities. There were differences in the structure of the clauses and the detail, but these two effectively highlighted the difference between the objectives of the parties. They would also indicate the importance of ensuring a party's own terms prevailed in the battle of the forms. However the analysis on disputes from the survey suggests that this did not affect how the parties dealt with the issue in practice. The parties stuck to their own processes and expectations whether or not they were agreed in the contract.

### **7.5.2 Importance of Price and Payment**

The one area that produced a consistently strong area of concern from all respondents was that of price and payment. In spite of the fact that this is identified by all roles and all companies as a key provision and it was always included in the sample of SFCs, it was still the main cause of disputes. There are a number of possible reasons for this.

- Firstly the appreciation of the problem is perceived differently between the different parties and particularly those involved in preparing contracts, such that they do not revise the terms to provide the support necessary to avoid such issues.
- Secondly, this subject is always going to be a cause of disputes as it strikes at the heart of business practices where cash is critical to success and hence the users will always try to push the contract and the relationship to their extremes to improve financial performance.
- Thirdly, as such a key feature of business, the expectations of the two parties (Buyer and Seller) are always different and therefore the users will try to ensure they work towards these expectations rather than consider their contractual obligations.

### **7.5.3 Difference in views between different businesses and roles**

The survey results supported previous studies in that the views of different functional roles within a business varied consistently. The main roles reviewed were Sales and Operations and these demonstrated the most notable variances. Other roles were assessed but the results from these were less conclusive. There was a similar, though less clear, correlation across the business groups.

### **7.5.4 Lack of reference to the contract when issues arise**

Most previous work in this area identified that the contract document itself is rarely used as a solution to business problems. Business users either fail to appreciate that the contract might include the necessary words that would help to prevent or resolve such problems or more likely do not wish to demonstrate a 'contractual' approach.

Where the contract is formed by SFCs this is more likely to be the case as the terms, being general in nature, are less likely to be able to cover the likely challenges of day to day transactions. This position is recognised and has been supported by the courts in trying to formalise what is already happening in practice through the Woolf Reforms.

#### **7.5.5 No changes since the early work of Macaulay**

Perhaps the most significant conclusion to be reached from the results of the survey and the approach to the separate issues is that there has been little change since 1963. All of the studies since then reach similar conclusions in spite of investigating different groups in different locations. In spite of the fact that Macaulay prepared a paper that was accessible to business and considered issues that would be recognisable to business users, there has been a failure to engage between the different professions.

The business environment has changed markedly during this period and the advance of technology has introduced new opportunities and new challenges, but no development has impacted on how contracts are managed in practice. The academic papers have identified the gap between the theory and practice and the lawyers have continued to draft contracts with similar clauses and, it might be argued, failed to adapt contracts to assist the practical challenges of managing a business transaction.

Craig Nard identified a gap between “...*the legal academy and the profession*”<sup>7</sup>, but it may be more appropriate to describe a triangle of gaps between the legal academy, the profession and the business users when it comes to contract.

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<sup>7</sup> Craig Nard, Empirical Legal Scholarship – Re-establishing A Dialogue Between The Academy And Profession, 30 Wake Forest L. Rev. 347 1995



## **7.6 Open Questions and Possible Further Research**

The world of business and business transactions is continuously changing and the use of contracts within that world should also be changing to meet the changing demands. What is clear however is that the contracts which are in constant use do not always support the individuals that work in this arena. These contracts are not used to help in resolving the many and varied issues that arise in day to day business and they are not the first option when matters take a turn for the worse.

As a final point, it is worth considering a few key points that would form the basis of continuing research in an effort to assist business:

- Is this unavoidable as lawyers and business professionals must work to their own distinct objectives, or is there an opportunity to bring the two closer and develop SFCs that practically assist commerce?
- A gap has been identified between the academics and the profession, but is the gap equally apparent between the profession and the businesses that rely on the contracts?
- In view of the different and conflicting approaches of Buyers and Sellers, should legislation provide structure for such key issues as payment?

However, it might be argued that business users will always find a way to conduct business in spite of contract and not because of them.

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## Appendix A – Example of the Questionnaire