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Contract Law and Inequality in the Global South

Brazil, Colombia, and South Africa

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2.1 INTRODUCTION

Economic inequality is one of the most pressing problems facing modern societies, but it remains an open question whether it is one that contract law has any role to play in addressing. The orthodox answer to this question is no – contract law should pursue autonomy, efficiency, or justice in exchange, but not distributive objectives. This orthodoxy is rooted in the idea that pursuit of distributive objectives through contract law is both illegitimate and ineffective, particularly when initiated by judges as opposed to legislators. Accordingly, distribution should be pursued principally through the fiscal system – taxes and public spending – rather than through courts' rulings in contractual disputes. Critiques of the prevailing orthodoxy struggle with an inconvenient fact: Existing literature suggests that legal systems around the world have converged on contract law doctrines that are insensitive to distributive considerations, part of a broader trend that leaves very few differences of economic significance among contract laws. The absence of concrete experiences with alternatives to contract law orthodoxy casts doubt on the appeal and viability of heterodoxy.

This chapter explores examples of contract law heterodoxy in the legal systems of the Global South. Although the potential uses of contract law to mitigate inequality have long been the subject of heated scholarly debate,[1] the comparative dimension of this controversy has been neglected, even though inequality in the Global South is an especially pressing concern.[2] Our analysis unveils how courts in select Global South jurisdictions have recently diverged from orthodoxy and begun to embrace

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[1] See Section 2.2.

[2] For exceptions, cf. A. Bagchi, The Political Economy of Regulating Contract (2014) 62 *The American Journal of Comparative Law* 687–738, 704 (examining how inequality ought to and

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heterodoxy: the use of contract law to reduce inequality. In particular, we document important instances in which courts in South Africa, Brazil, and Colombia have adopted distinctly heterodox approaches to contract law. The decisions cover an eclectic mix of topics, including general rules on the calculation of prejudgment interest as well as more specific doctrines governing the purchase and sale of real estate and the provision of health insurance, life insurance, and water.

We do not claim that legal heterodoxy prevails in all Global South jurisdictions or even that it is dominant in the Global South jurisdictions we focus on in our case studies; indeed, we believe that this is not the case. We also do not maintain that heterodox contract laws actually achieve their intended distributive objectives; they may well be ineffective or backfire. Nevertheless, the greater incidence of contract law heterodoxy in several large Global South jurisdictions is noteworthy and likely consequential from an economic standpoint.

The existence of contract law heterodoxy in Global South jurisdictions has both practical and scholarly implications. From an economic perspective, heterodox approaches to contract law have the potential to alter pricing schemes, contract design, the choice of contracting partners, and incentives for vertical integration. From a theoretical standpoint, the finding of greater contract law heterodoxy in Global South jurisdictions has important implications for scholarship on comparative contract law, law and development, and contract theory.

To begin, these findings contradict the frequent assumption that contract laws do not differ substantially around the world.[3] The consensus in the literature on comparative law has been that the traditional distinctions between contract law in civil and common law systems are either waning or have limited economic significance.[4] As for comparisons between Global North and Global South countries, the focus of the literature on the role of contract institutions in development has been on differences in contract enforcement. When institutional economists and

will influence contract law in the United States and Europe and arguing that greater "income inequality increases the cost of mandatory terms"); Helen Hershkoff has examined the closely related topic of the use of contract law to protect rights to education and healthcare services in selected Global South jurisdictions. H. Hershkoff, Transforming Legal Theory in the Light of Practice: The Judicial Application of Social and Economic Rights to Private Orderings, in V. Gauri and D. M. Brinks (eds.), *Courting Social Justice: Judicial Enforcement of Social and Economic Rights in the Developing World* (Cambridge: Cambridge University Press, 2008), pp. 268–302, 290–94.

[3] For such assumptions, see F. Jiménez, Against Parochialism in Contract Theory: A Response to Brian Bix (2019) 32 *Ratio Juris* 233–50, 236; J. Smits, *The Making of European Private Law: Toward a Ius Commune Europaeum as a Mixed Legal System* (Cambridge: Intersentia, 2002), p. 187.

[4] See, e.g., H. Spamann, Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law (2009) 2009 *BYU Law Review* 1813–78, 1814–75. But see generally M. Pargendler, The Role of the State in Contract Law: The Common–Civil Law Divide (2018) 43 *The Yale Journal of International Law* 143–90 (explaining the rationale behind the existing distinctions between the common and civil law of contracts).

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international agencies, such as the World Bank, have attempted to assess the quality of contract institutions across the globe, they have focused exclusively on measures of enforcement (such as the time and costs of legal proceedings and the competence and integrity of courts), completely neglecting potential variations in contract law doctrines.[5] Scholars who have commented on substantive divergences between private law in Global South and Global North jurisdictions have posited that jurisdictions in Latin America and Africa embody "the rule of political law," in which distribution is led by political actors who are susceptible to influence by wealthy as well as poor groups.[6] In contract law at least, the possibility of progressive judicially-led innovations in the Global South – a well-known phenomenon in constitutional law[7] – has been overlooked.

Contract law heterodoxy in the Global South also destabilizes the theoretical foundations of contract law orthodoxy, namely, arguments that distribution through contract law as opposed to the fiscal system is always illegitimate or ineffective. Our findings suggest that the practical appeal of these arguments is contingent rather than universal. Even if contract law orthodoxy is optimal for Global North jurisdictions, contract law heterodoxy may, in economic parlance, constitute an attractive second-best approach in the Global South, given the limitations of other institutional alternatives in tackling inequality.

We argue that three key features of the countries we study favor the use of contract law to achieve distributive objectives and explain the emergence of heterodox approaches. First, widespread poverty and inequality make the distributions of income and wealth more salient. The fact that these inequalities are often traced to historical injustices such as slavery and colonial exploitation enhances the perceived legitimacy of distributive objectives. Second, the fiscal system has failed to meaningfully reduce persistent inequality. Third, consideration of inequality in contract disputes is often viewed as a constitutional imperative in view of legal commitments to equality. For all these reasons, arguments against consideration of distributive concerns in contract law have recently won less traction in Brazil, South Africa, and Colombia than in the Global North.

Finally, our examination of contract law heterodoxy in the Global South has a deeper methodological implication. Specifically, it illustrates the potential benefits of looking beyond the usual Global North suspects as sites for contract law

[5] World Bank Group, Doing Business 2020: Comparing Business Regulation in 190 Economies (2020), 19. For a discussion of the economic literature's exclusive focus on procedural criteria to measure contract institutions, see M. Pargendler, Comparative Contract Law and Development: The Missing Link? (2017) 85 *The George Washington Law Review* 1717–38, 1719.

[6] U. Mattei, Three Patterns of Law: Taxonomy and Change in the World's Legal Systems (1997) 45 *The American Journal of Comparative Law* 5–44, 28.

[7] See M. Versteeg, Can Rights Combat Economic Inequality? (2020) 133 *Harvard Law Review* 2017–61, 2020, 2059 (describing how courts in various Global South jurisdictions, as well as a few Global North jurisdictions, have employed constitutional law to tackle economic inequality).

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scholarship and comparative analysis. Explorations of how and why contract law varies from one environment to another can shed a great deal of light on empirical assumptions and prevailing normative and explanatory theories. At the very least, this kind of inquiry can help address the question of whether Global South jurisdictions are best served by rules of contract law that diverge from those which are suitable for the Global North. We show that analysis of innovations in the Global South can also illuminate how contract law might respond to problems that affect a broader range of countries.

As inequality becomes an increasingly pressing problem around the world, deviations from contract law orthodoxy in the Global North become more plausible. In fact, the highly explicit instances of heterodoxy in the developing world draw attention to the significant – if less salient and often downplayed – elements of heterodoxy in the contract laws of the United States and European jurisdictions. In the real-world operation of different legal systems, the distinction between contract law orthodoxy and heterodoxy is a continuum rather than a dichotomy. Orthodoxy is not, contrary to frequent assumptions, the inevitable or universal "end of history" for contract law. Mounting inequality raises the prospect of public policy interventions through contract law in all jurisdictions – regardless of whether one believes they constitute clever remedies or misguided populist responses.

Before proceeding, two caveats are in order regarding the scope of the analysis that follows. First, our analysis leaves out agreements governed by labor and employment law. In contrast to prevailing assumptions of similarities in general contract laws, scholars have documented significant cross-country variations in the law of employment agreements.[8] Excluding employment agreements from the scope of this chapter likely understates the degree of contract law heterodoxy in the Global South to a significant extent.

Second, contract law heterodoxy is not a unitary phenomenon. Just as we define contract law orthodoxy broadly enough to encompass distinct (and conflicting) normative goals, contract law heterodoxy is used as an expansive category that covers different strategies to address diverse and potentially conflicting conceptions of inequality. Heterodox approaches may be more or less tailored to the circumstances of the particular contract parties, or instead operate based on untailored (categorical) assumptions about the majority of similar cases.[9] Contract law heterodoxy may focus on factors such as income, wealth, ability, capabilities, opportunity, poverty, exclusion, race, gender, or historical injustice – and these are only a few of the possible

[8] See generally, e.g., B. Ahlering and S. Deakin, Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complementarity? (2007) 41 *Law & Society Review* 865–908; J. C. Botero et al., The Regulation of Labor (2004) 119 *The Quarterly Journal of Economics* 1339–82.

[9] I. Ayres and R. Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules (1989) 99 *Yale Law Journal* 87–130 (detailing the classical distinction between tailored and untailored default rules in contract law).

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dimensions. While we focus on how contract law heterodoxy in South Africa, Brazil, and Colombia differs from contract law orthodoxy in the Global North, the case studies reveal "varieties of heterodoxy," rather than a single monolithic approach.

2.2 CONTRACT LAW ORTHODOXY

2.2.1 *Defining Contract Law Orthodoxy*

Although there are profound disagreements about the aims and purposes of contract law, the orthodox view is that generally contract law is not and should not be concerned with the distribution of wealth in society.[10] Liberals and libertarians argue that contract law should instead be motivated by the value of individual autonomy, that is, the value of allowing individuals to make the momentous decision to bind themselves legally or, more broadly, by making it possible for them to pursue their own conceptions of the good in collaboration with others.[11] Law and economics scholars argue that contract law should be designed to promote efficiency, primarily by facilitating mutually beneficial (Pareto-efficient) exchanges.[12] Finally, scholars writing in the Aristotelian tradition focus on how contract law can help to preserve the existing distribution of wealth – which is presumed to be just – by promoting equality in exchange, which entails, among other things, ensuring that the terms of contracts are substantively fair.[13]

Although there is a fair amount of tension between these different intellectual traditions, they all view the pursuit of distributive objectives as beyond the domain of contract law, at least as that body of law is traditionally defined by teachers and scholars. Distributive considerations appear prominently in anti-discrimination law and bankruptcy law, which clearly bear upon the enforcement of contracts. But those bodies of law are traditionally understood to fall outside the bounds of contract law. Teachers and scholars also tend to define the domain of contract law in ways that exclude the statutory schemes that govern specific types of contracts, turning the field into a "law of leftovers."[14] Those statutory schemes may well contain

[10] See, e.g., H. Collins, Distributive Justice through Contracts (1992) 45 *Current Legal Problems* 49–67, 49; R. E. Scott, A Joint Maximization Theory of Contract and Regulation, in H. Dagan and B. C. Zipursky (eds.), *Research Handbook on Private Law Theory* (Northampton: Edward Elgar, 2020), pp. 22–38, p. 22. For a different, though now somewhat dated, assessment, see D. Kennedy, Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power (1982) 41 *Maryland Law Review* 563–658, 586–88.

[11] For a survey of autonomy-based theories of contract law see, H. Dagan and M. Heller, *The Choice Theory of Contracts* (Cambridge: Cambridge University Press, 2017), pp. 19–47.

[12] M. J. Trebilcock, *The Limits of Freedom of Contract* (Cambridge, MA: Harvard University Press, 1993), pp. 15–17.

[13] See generally, J. Gordley, Equality in Exchange (1981) 69 *California Law Review* 1587–1656.

[14] The expression comes from L. M. Friedman, *Contract Law in America: A Social and Economic Case Study* (Madison: University of Wisconsin Press, 1965), p. 193. It relates to the frequent

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underappreciated amounts of heterodoxy. In any event, the dominant view, however accurate, is that distribution does not, and should not, influence the core contract law doctrines of general applicability concerning which promises are enforceable, how to determine when promises have not been performed and therefore need to be enforced, or the remedies available to the party seeking enforcement.[15]

Admittedly, there are points of contact between the orthodox and heterodox approaches when different objectives overlap. For instance, systemic disadvantage may be correlated with the presence of factors that undermine the promotion of autonomy, efficiency, or equality in exchange – factors such as coercion, imperfect information, or substantive unfairness. Within the orthodox position, examples of judicial solicitude for disadvantaged groups may be explained by concern about whether enforcement will promote autonomy or efficiency or equality in exchange, rather than about systemic disadvantage in its own right. It can often be difficult, in practice, to ascertain whether a certain exception to freedom of contract for the benefit of a disadvantaged party is attributable to orthodox or distributive considerations. Orthodox rhetoric may mask distributive objectives, and vice versa.

Moreover, it is important to recognize that the same tenets of contract law orthodoxy may lead to distinct patterns of adjudication owing to differences in factual circumstances. For instance, greater prevalence of inequality and market concentration in developing jurisdictions could prompt more frequent findings of unconscionability for the benefit of the weaker party, even under orthodox contract doctrines. The differences in dominant fact patterns are an important, though often overlooked, element in understanding the landscape of contract adjudication in the Global South. We argue, however, that there is more to the story: Beyond variations in the incidence of similar doctrines across jurisdictions due to distinct fact patterns, there are noticeable differences in contract law rules and doctrines as well.[16]

In practice, a legal system may embrace orthodoxy in relation to some types of transactions but not others, or place varying amounts of weight on distributive considerations. Therefore, the distinction between what we term orthodox and heterodox approaches to contract law constitutes a spectrum rather than a binary division. As is the case in comparative law more generally, our goal here is to

tendency in common law to characterize related fields of highly regulated contracts as something other than contract law. The effect of this artificial compartmentalization is to downplay the actual degree of heterodoxy in US law and beyond.

[15] For discussion of the historical emergence of this view in US law, see A. Fleming, The Rise and Fall of Unconscionability as the "Law of the Poor" (2014) 102 *The Georgetown Law Journal* 1383–442, 1436–37 (discussing how, by the 1970s, the concerns of the poor were addressed through antidiscrimination laws and statutory disclosure requirements while unconscionability was no longer characterized as part of the "law of the poor" and was reconceptualized as a response to defects in reasoning).

[16] It may also be that Global North jurisdictions offer greater regulation of specific types of contracts through dedicated regulatory schemes, thereby addressing certain fact patterns and relieving pressure on contract law (as it is conventionally defined) to tackle them. See discussion of functional equivalence in Section 2.4.3.1.

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examine differences in emphasis between the contract laws of certain Global North and Global South jurisdictions rather than to identify stark contrasts.

2.2.2 *Orthodoxy and Heterodoxy in the United States*

The common law of contracts in the United States is overwhelmingly orthodox.[17] While there are several doctrines consistent with contract law heterodoxy in that they may be used to protect weaker parties, an orthodox reading of those doctrines is that they are triggered when the potential beneficiary is less informed or is being coerced by the opposing party or when the transaction deviates significantly from prevailing notions of a fair bargain.[18] They do not key upon whether the person is disadvantaged relative to society as a whole nor do they explicitly refer to the role of contract law in promoting social justice more generally.

There are important exceptions to the prevailing orthodoxy in US contract law. As far as judicial decisions are concerned, the most famous example of heterodoxy is Judge Skelly Wright's opinion in *Williams v. Walker-Thomas Furniture*.[19] That opinion endorsed the use of the doctrine of unconscionability to avoid enforcement of a sweepingly broad security agreement by a furniture store against a woman who was identified as being on public assistance and responsible for seven children.[20] Although her race was not mentioned in the opinion, it is safe to assume that the court was aware that the customer was Black, as were most of the store's other customers. Judge Wright ruled that the unconscionability doctrine applies when the party seeking relief faces "an absence of meaningful choice ... together with terms which are unreasonably favorable to the other party."[21] This language could be interpreted to reflect purely orthodox concerns about asymmetric information, coercion, and unfair exchange, which is now the mainstream understanding of the unconscionability doctrine in the United States.[22] However, in extrajudicial

[17] See note 10 and accompanying text.

[18] M. A. Eisenberg, The Theory of Contracts, in P. Benson (ed.), *The Theory of Contract Law: New Essays* (Cambridge: Cambridge University Press, 2001), pp. 206–64, p. 257; see, e.g., The American Law Institute, Restatement of the Law of Consumer Contracts, 1 (Tentative Draft, 2019) (characterizing the fundamental challenge of consumer contract law – including the doctrine of unconscionability – as protection of consumers who lack information about the terms of agreements).

[19] *Williams v. Walker-Thomas Furniture Co.*, 350 F 2d 445, 449–50 (D.C. Cir. 1965).

[20] Ibid., 449–50.

[21] Ibid., 449.

[22] On the modern scholarly understanding of unconscionability, see Fleming, The Rise and Fall of Unconscionability as the "Law of the Poor," 1386 (arguing that unconscionability "is rarely invoked to protect low-income borrowers" today) and The American Law Institute, Restatement of the Law of Consumer Contracts. Whether interpreted in orthodox or heterodox terms, the conventional view is that the actual application of the doctrine of unconscionability is exceedingly rare. There is emerging evidence, however, of a resurgence in the use of unconscionability by courts. See, e.g., J. H. Russell, Unconscionability's Greatly Exaggerated

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writings, Wright characterized the *Williams* decision as part of the "law of the poor," a decidedly heterodox label.[23]

The "law of the poor" has not featured prominently in judicial decisions for contract cases in the United States – with the important exception of the implied warranty of habitability in residential landlord–tenant law.[24] One of the leading decisions in that field is another opinion authored by Judge Skelly Wright, *Javins v. First National Realty*.[25] Judge Wright announced that the decision was motivated in part by a desire to give effect to the expectations of the typical tenant, and in part by concerns about inequality in bargaining power arising from the use of standardized contracts.[26] Attention to these factors is consistent with orthodox concerns about autonomy, efficiency, and justice in exchange. But Judge Wright said that another compelling reason to adopt the implied warranty was to address the inequality in bargaining power caused specifically by "racial and class discrimination."[27] He made it clear that the decision was motivated by systemic concerns, saying "that poor housing [was] detrimental to the whole society, not merely to the unlucky ones who must suffer the daily indignity of living in a slum."[28] And, in private correspondence, Judge Wright described the *Javins* decision as part of an effort "to ameliorate, if not eliminate, the injustice involved in the way many of the poor were required to live in the nation's capital."[29] Unlike *Williams v. Walker-Thomas Furniture*, the decision in *Javins* endorsed a form of heterodoxy that is now an established feature of US law. Most states have legislation that codifies implied warranties of repair and habitability in residential leases, typically motivated, at least in part, by concerns about poverty and inequality.[30]

There are also notable historical examples of legislative interventions enacted in times of economic crisis that have fairly obvious distributive motivations. For instance, there is a long history of US states passing laws that impose moratoria on

Death (2019) 53 *UC Davis Law Review* 965–1026, 967 (challenging the conventional view by documenting how "the doctrine has quietly flourished in courts in recent years").

[23] See Fleming, The Rise and Fall of Unconscionability as the "Law of the Poor," 1385, n. 1, citing Letter from Hon. J. Skelly Wright to William E. Shipley, The Lawyers Cooperative Publ'n Co. (July 12, 1967) (J. Skelly Wright Papers, 1962–1987, Box 77, Folder 1965 September term, Manuscript Division, Library of Congress).

[24] See ibid., 1386, 1389.

[25] See generally *Javins v. First Nat'l Realty Corp.*, 428 F 2d. 1071 (D.C. Cir. 1970) (holding that the warranty of habitability is implied by operation of law through the Housing Regulations for the District of Columbia).

[26] Ibid., 1075–77.

[27] Ibid., 1079.

[28] Ibid., 1079–80.

[29] Letter from Hon. J. S. Wright to Professor E. H. Rabin, U.C. Davis Sch. Law (October 14, 1982), in E. H. Rabin, The Revolution in Residential Landlord–Tenant Law: Causes and Consequences (1984) 69 *Cornell Law Review* 517–84, 549.

[30] See D. A. Super, The Rise and Fall of the Implied Warranty of Habitability (2011) 99 *California Law Review* 389–463, 402–4; M. A. Glendon, The Transformation of American Landlord–Tenant Law (1982) 23 *Boston College Law Review* 503–76, 523–24.

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enforcement of creditors' rights, especially during economic downturns and particularly for the benefit of farmers.[31] The US Supreme Court upheld the constitutionality of the moratoria by arguing that "the legislation was not for the mere advantage of particular individuals but for the protection of a basic interest of society."[32] The Court endorsed the Supreme Court of Minnesota's finding that "the economic emergency which threatened 'the loss of homes and lands which furnish those in possession the necessary shelter and means of subsistence' was a 'potent cause' for the enactment of the statute."[33] There are, of course, also more recent examples of US legislation pertaining to contracts that have had significant distributive effects, even if that was not their ostensible purpose.[34]

2.2.3 *Orthodoxy and Heterodoxy in Continental Europe*

We now turn to continental Europe, another setting in which contract law orthodoxy largely prevails. The well-known differences between consumer contract law in the European Union and in the United States can be interpreted as divergent responses to concerns about consumer behavioral biases or inequality of exchange. To that extent, both jurisdictions are merely pursuing different versions of contract law orthodoxy.[35]

The closest instance of a heterodox approach to contract law is the famous 1993 decision by the German Constitutional Court (*Bundesverfassungsgericht*) in the *Bürgschaft* case, which became the poster child for the consideration of fundamental rights in the interpretation and enforcement of private contracts.[36] The case involved the provision of a hefty personal guarantee (surety) by a 21-year-old daughter for the bank's extension of credit to her father. When she entered into the agreement, the daughter, who lacked either a professional education or a full-time job, earned 1,150 DM per month in a fish factory. By the time her father defaulted

[31] L. M. Friedman, *A History of American Law*, 4th ed. (New York: Oxford University Press, 2019), pp. 229–30; see generally L. J. Alston, Farm Foreclosure Moratorium Legislation: A Lesson from the Past (1984) 74 *The American Economic Review* 445–57 (discussing previous legislative attempts at mitigating farm foreclosures).

[32] *Home Building & Loan Association v. Blaisdell*, 290 US, 445.

[33] Ibid.

[34] See, e.g., S. Agarwal et al., Regulating Consumer Financial Products: Evidence from Credit Cards (2015) 130 *The Quarterly Journal of Economics* 111–64, 114 (arguing that the Credit Card Accountability Responsibility, and Disclosure Act of 2009 generated significant savings for consumers, especially those with low credit scores).

[35] For a critical appraisal of European contract law from a mainstream US law-and-economics perspective, see, for example, O. Bar-Gill and O. Ben-Shahar, Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law (2013) 50 *Common Market Law Review* 109–25, 109–10.

[36] The description of the case comes from Pargendler, The Role of the State in Contract Law, 179–80.

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and the bank sued her for 160,000 DM, she was a single mother on social security. Her appeal argued that "courts should deny recognition to contracts that so strongly reduce the freedom of action of one of the contracting parties that she can no longer live with dignity."[37]

The German Constitutional Court found that the enforcement of an agreement characterized by a significant imbalance in bargaining power and resulting in such harsh consequences for the weaker party violated the constitutional rights to human dignity and free development of personality, as well as the principle of the social State (*Sozialstaatsprinzip*).[38] While the court's reasoning in the *Bürgschaft* decision stands out for its appeal to the social State and for its concern about the weaker party, the same result of full discharge would occur in other jurisdictions through different doctrinal routes.[39]

A prominent 1996 decision by the French *Cour de cassation* invoked fundamental rights to adjudicate a landlord–tenant dispute.[40] The agreement in question between the tenant and the city of Paris provided for the exclusive use by the tenant and her two children. However, the tenant also accommodated her children's father as well as her sister, leading to a notice of termination by the city. The Court invalidated the termination as a violation of the right to private and family life recognized by Article 8 of the European Convention of Human Rights.[41] At any rate, while noteworthy and widely cited, these cases from the 1990s failed to spur a revolution in contract law toward greater attention to social justice and inequality.

Although we do not see significant deviation from contract law orthodoxy in either continental Europe or the United States, there is greater support for heterodoxy in the European discourse about contract law. On balance, continental European scholars appear to be more likely than their US or UK counterparts to defend the role of contract law in the pursuit of social justice. It is common in continental Europe to regard contract law as striking a balance between the fundamental values of autonomy and solidarity,[42] a framing that differs from US scholars' primary focus on efficiency, autonomy, and fairness in exchange.[43]

[37] B undesverfassungsgericht [BVerfG] [Federal Constitutional Court] October 19, 1993, 89 Entescheidungen des Bundesverfassungsgerichts [BVerfGE] 220 (1994) (Germany) (translated by authors).

[38] Ibid., 89, 232.

[39] Pargendler, The Role of the State in Contract Law, 180–1.

[40] Ibid., 154, citing Cour de cassation [Cass.] [Supreme Court for Judicial Matters] 3e civ., March 6, 1996, 93-11.113, Bull. 1996, Civ. III, No. 60, 41 (France).

[41] Ibid.

[42] See, e.g., M. Hesselink, The Horizontal Effects of Social Rights in European Contract Law (2003) 1 *Europa e Diritto Privato* 1–18, 11.

[43] See generally D. Caruso, The Baby and the Bath Water: The American Critique of European Contract Law (2013) 61 *American Journal of Comparative Law* 479–91, 487.

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2.2.4 *The Impact of the COVID-19 Pandemic*

The COVID-19 pandemic threatened to exacerbate inequality in most countries. The pandemic prompted not only moratoria on evictions of residential tenants in the United States, as discussed in Chapter 6 by Bianca Tavolari and Saylon Pereira, but also new manifestations of contract law heterodoxy in Europe. The German statute "to mitigate the consequences of the Coronavirus crisis" allowed consumers to refuse payment of essential continuing obligations if they would not be able to pay for the service without risking either their own subsistence or that of their dependents.[44] A temporary right to refuse performance was also extended to microbusinesses, provided that its exercise does not "endanger the creditor's [] subsistence[,] ... the reasonable subsistence of [the creditor's] dependents or the economic basis of [the] business" (in which case the debtor may seek to terminate the contract).[45] In linking contract rights to the particular economic situation of the parties – and not to the fairness of the exchange – this special German legislation reflects a new manifestation of contract law heterodoxy in a Global North jurisdiction, even if it was only a temporary response to a time of significant economic crisis and dislocation. We now turn to the description of contract law heterodoxy in the Global South, contexts where economic crisis, dislocation, and inequality are particularly commonplace.

2.3 CONTRACT LAW HETERODOXY IN THE GLOBAL SOUTH

In this section we describe instances in which contract law in three Global South jurisdictions – South Africa, Brazil, and Colombia – diverges from orthodoxy. Each example involves a doctrine formulated by one of the apex courts of the country which covers an economically important class of transactions. None of our examples involve the law of employment agreements because, as noted in the introduction, that is one of the few areas of contract law where scholars have already documented economically significant divergence.[46] Still, our collection of illustrations is eclectic. The contracts in dispute range from agreements for purchase and sale of residential real estate to insurance contracts to agreements for the provision of water. The different examples reveal that contract law heterodoxy, that is the endorsement of contract doctrines which embrace distributional goals, has made important inroads into the legal systems of these three countries. They are not, however, intended to suggest that contract law heterodoxy is dominant in any of these legal systems. In fact, even in the areas of law that we canvass, we document tension and conflict between proponents of orthodox and heterodox approaches.

[44] For a description of the German statute, see N. Brunotte and L. Elsaß, The German Bundestag Resolves Amendments to Contract Law to Mitigate the Consequences of the Coronavirus Crisis, DLA Piper, May 6, 2020.

[45] Ibid.

[46] See note 8.

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2.3.1 *South Africa*

South Africa is perhaps the leading example of a jurisdiction which has recently taken a heterodox approach to the relationship between contract law and inequality.[47] Much of the change has been driven by the incorporation of constitutional principles into contract law. This kind of horizontal application of constitutional principles is expressly required by the South African Constitution which states: "[W]hen developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights."[48]

In a prominent series of decisions, the Constitutional Court of South Africa has taken the position that both principles of contract law and decisions about whether to enforce specific contractual terms must conform to constitutional values,[49] which might entail departing from "colonial legal tradition represented by English law, Roman law and Roman Dutch law."[50] Among those constitutional values is "*ubuntu*," an African concept which "emphasises the communal nature of society and 'carries in it the ideas of humaneness, social justice and fairness' and envelopes 'the key values of group solidarity, compassion, respect, human dignity, conformity to basic norms and collective unity.'"[51]

2.3.1.1 Prejudgment Interest

In *Paulsen v. Slip Knot Investments 777 Ltd.*, the Constitutional Court explicitly stated that limits on the principle of freedom of contract must be fashioned in light of socio-economic realities that include substantial amounts of economic inequality and poverty.[52] The appeal concerned the scope of the ancient *in duplum* doctrine, a rule which limits the interest that a creditor can recover on debts in arrears to an amount equal to the principal of the debt. At issue in *Paulsen* was whether the rule

[47] This is a recent development. As late as 2010, progressive commentators criticized the South African courts for their unduly orthodox approach to contract law. See D. M. Davis and K. Klare, Transformative Constitutionalism and the Common and Customary Law (2010) 26 *South African Journal on Human Rights* 403–509, 468–81, criticizing "the freedom-of-contract cases."

[48] Constitution of the Republic of South Africa, 1996 § 39(2).

[49] See *Barkhuizen* v. *Napier* (5) SA 323 (CC) (2007), para. 30 (South Africa); *Everfresh Market Virginia* v. *Shoprite Checkers* (1) SA 256 (CC) (2012), para. 48 (South Africa).

[50] *Everfresh Market Virginia* v. *Shoprite Checkers*, para. 23; see ibid., para. 71 (Moseneke, J., concurring).

[51] Ibid., para. 71 (footnote omitted).

[52] See *Paulsen v. Slip Knot Investments 777 Ltd.* (3) SA 479 (CC) (2015), para. 66 (South Africa) ("We need to look at South Africa's socio-economic realities. A large percentage of the providers of credit are large, established and well-resourced corporates. On the other hand, although there may be what the dissenting judgment refers to as 'stout-boned' credit consumers, it would be ignoring our country's economic reality to suggest that there is any comparison between these corporates and most credit consumers").

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applied to interest that accrued after the institution of legal proceedings but before the date of judgment (there was no dispute that interest could accrue after judgment).[53] In a 1997 decision called *Oneanate*, South Africa's Supreme Court of Appeal decided that the *in duplum* rule should be suspended during the pendency of litigation.[54]

The debtors in *Paulsen* were sureties for a property developer which had defaulted on a debt of R12 million.[55] The loan agreement specified that interest was to accrue at the rate of 3 percent per month. Under the traditional *in duplum* rule, the creditor could not have a judgment for more than R24 million. Under the narrower version of the rule favored in *Oneanate*, the creditor was entitled to a judgment for R72 million.[56]

In a split decision, the Constitutional Court in *Paulsen* decided to reinstate the traditional *in duplum* rule. In the main opinion, Justice Madlanga wrote that the court in *Oneanate* misread the relevant authorities and ignored relevant public policy considerations. The overlooked considerations were the risks that modification of the rule would prejudice debtors and inhibit their constitutional right of access to the courts. Justice Madlanga reasoned that "debtors, despite a genuinely held belief that they have a valid defence, may sooner opt to settle a claim than face the potentially financially ruinous interest that would again commence to pile up once court process was served."[57]

Justice Madlanga acknowledged that there were competing policy considerations. In particular, the traditional rule would encourage debtors to prolong litigation by raising frivolous defenses or employing other delaying tactics. This might in turn raise a constitutional concern if it caused creditors to abandon claims against defaulting debtors because the value was eroded by inflation.[58] Pulling in the other direction, though, was the fact that creditors could protect themselves by charging relatively high rates of interest, avoiding lending to debtors who were bad risks, and litigating swiftly.[59] He also noted that debtors' delaying tactics could be addressed by means of summary judgment and punitive costs awards.[60] More importantly, he believed that bearing the costs of prolonged litigation would prejudice debtors more than creditors because, although the Paulsens appeared to be "stout-boned commercial parties," debtors generally were more likely to be financially vulnerable.[61]

[53] Ibid., para. 96 ("It is settled law that the in duplum rule permits interest to run anew from the date that the judgment debt is due and payable").

[54] See *Standard Bank of South Africa Ltd. v. Oneanate Investments Ltd.* (1) SA 811 (SCA) (1998), para. 50 (South Africa) ("[T]he in duplum rule is suspended pendente lite ..." (emphasis added)).

[55] *Paulsen v. Slip Knot Investments*, para. 2.

[56] Ibid., para. 63.

[57] Ibid.

[58] Ibid., para. 65.

[59] Ibid., paras. 81–85.

[60] Ibid., para. 84.

[61] See ibid., para. 135 (Cameron, J., dissenting); Ibid., para. 69 (Madlanga, J., majority opinion).

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> We need to look at South Africa's socio-economic realities. A large percentage of the providers of credit are large, established and well-resourced corporates. On the other hand, although there may be what the dissenting judgment refers to as "stout-boned" credit consumers, it would be ignoring our country's economic reality to suggest that there is any comparison between these corporates and most credit consumers. To many credit consumers, who fall on the wrong side of this country's vast capital disparities, astronomical interest may mean the difference between economic survival and complete financial ruin. While in some cases creditors may lose money to inflation during litigation, this is very unlikely to have the same catastrophic effect on the creditor compared to what the accumulation of run-away interest will have on the debtor. If I were to be forced to make a choice between the two, it would be an easy one for me.[62]

Justice Madlanga went on to make it clear that he was particularly concerned about debtors who had been affected by apartheid and either remained financially vulnerable or were just emerging from the ranks of the financially vulnerable.

> It cannot be plausibly gainsaid that for our democracy to be meaningful, it is only fitting that those previously denigrated by racism and apartheid, confined to the fringes of society and stripped of dignity and self-worth must also enter the terrain of meaningful, substantial economic activity. Surely, our hard-fought democracy could not have been only about the change of the political face of our country and such upliftment of the lot of the downtrodden as the public purse and government policies permit. Entrepreneurship and the economic advancement of those with no history of being financially resourced must be given room to take root and thrive. This can hardly happen without finance. The sort of interest to which *Oneanate* exposes our legal system is deleterious to this necessary economic advancement.[63]

Accordingly, Justice Madlanga and the majority of the Constitutional Court decided to limit the creditor's judgment to R24 million.[64]

2.3.1.2 Installment Purchases of Land

South African jurisprudence also prescribes that constitutional principles inform the interpretation of statutory provisions regulating specific contractual provisions. A prominent example of this sort of application of constitutional principles is

[62] Ibid., para. 66 (citation omitted).
[63] Ibid., para. 75 (citations omitted).
[64] Ibid., para. 102. Justice Madlanga's judgment, which was joined by two other judges, characterized the decision as a reinstatement of a common law rule that had been abandoned in error. Ibid., paras. 89–90. He held that development of the common law in this area should be left to the Legislature. Ibid., para. 91. In a concurring opinion, Moseneke DCJ, joined by four other judges, preferred to say that the common law had been adapted to conform to public policy considerations and constitutional values and that this was a legitimate exercise of judicial power. Ibid., para. 109–10 (Moseneke, J., concurring).

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Botha v Rich N.O., which concerned the statutory rights of purchasers of land who agree to pay in installments.[65] The Alienation of Land Act 1981 authorized a purchaser who paid more than 50 percent of the purchase price to demand that title be registered in their name, subject to the purchaser providing a mortgage in favor of the vendor to secure the purchaser's remaining obligations.[66] The central issue in *Botha* was what happens when a vendor fails to comply with a demand for a transfer. Was a purchaser who defaulted on her payments after paying more than 50 percent of the purchase price only entitled to cancel the contract and recover the amount she paid, or could she, in the alternative, demand specific performance of the obligation to register a transfer? The statute mentioned the possibility of cancellation and restitution but said nothing about specific performance.[67]

In *Botha*, the Court held that the purchaser was entitled to specific performance of the right to a transfer, conditional upon payment of arrears and amounts owed to the local municipality.[68] The Court could probably have reached this result based solely on ordinary principles of statutory interpretation. However, the Court went out of its way to say that the case raised a constitutional issue and that its decision was motivated by the constitutional duty to "promote the spirit, purport and objects of the Bill of Rights."[69] It pointed out that the statute was enacted to protect installment purchasers and was prompted by the collapse of several township development companies in the 1970s.[70] It could have, but did not, note that there was good reason to believe that, in the South African context, people who purchased real estate by installment were likely to be relatively poor.[71]

2.3.1.3 Equality Rights and the Enforcement of Contractual Terms

Concerns about inequality have also influenced the South African Constitutional Court's approach to the enforcement of contractual terms, but less profoundly than in cases concerned with the development of principles of contract law. Technically speaking, the Court does not evaluate contractual terms directly against constitutional norms. Instead, contractual terms are evaluated in light of public policy, which is in turn shaped by constitutional values along with more traditional

[65] *Botha v. Rich* N.O. 2014 (4) SA 124 (CC) (2014), para. 2 (South Africa).
[66] Alienation of Land Act 68 of 1981 § 27(1) (South Africa).
[67] Ibid., §§ 27(3), 28(1).
[68] *Botha v. Rich* N.O, paras. 37, 49.
[69] Ibid., para. 28.
[70] Ibid., paras. 30–31.
[71] *Sarrahwitz v. Maritz* N.O. (4) SA 491 (CC) (2015), para. 82 (South Africa) (Cameron and Froneman, JJ., concurring) ("[P]urchasers who have access to enough money to pay off a property purchase immediately, or within a year, are better-off than those who have to pay in instalments over a period of one year or more. Hence, they need less protection than those whose financial circumstances oblige them to pay off their property debt more arduously, over a longer period").

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requirements of reasonableness and fairness. Significantly, the Constitutional Court has decreed that the relative bargaining power of the parties to the contract in question ought to be considered in determining whether contractual terms contravene public policy, stating, "[t]his is an important principle in a society as unequal as ours."[72] This contrasts with the approach taken in cases like *Paulsen*, in which the court ignored the fact that the parties seeking relief were "stout-boned" commercial actors.[73] It is not entirely clear, though, what counts as evidence of inequality of bargaining power. For instance, the seminal decision in *Napier v. Barkhuisen* was about whether a limitation of time for bringing claims under an automobile insurance policy was consistent with public policy. The majority in the Constitutional Court decided that there was insufficient evidence that enforcement of the clause was unreasonable.[74] However, the court noted below that the insured drove an expensive automobile (a BMW).[75]

The South African Constitutional Court continues to grapple with the challenges of using contract law to promote equality. Although most of the Court's members appear to be convinced of the legitimacy of the exercise, there remain serious questions about how far they are willing to depart from orthodoxy, as well as ongoing concerns about how to accurately identify disadvantaged parties and how to ensure that the potential benefits of decisions are not erased by changes in contracting practices.

All of these issues were raised, but not necessarily resolved, in *Beadica 231 CC v. Trustees for the time being of the Oregon Trust*.[76] In that case the trial judge allowed a set of franchisees to exercise options to renew their leases even though they failed to comply with a requirement that they give notice of intention to exercise the option more than six months prior to the initial termination date. The franchisees were black-owned enterprises and acquired their businesses as part "of a black economic empowerment [transaction]" funded by the National Empowerment Fund,[77] a public agency legislatively charged with "facilitat[ing] the redressing of economic inequality which resulted from the past unfair discrimination against historically disadvantaged persons."[78]

[72] *Barkhuizen* v. *Napier*, para. 59. Cf. Ibid., para. 97 (Moseneke, J., dissenting) ("When one weighs whether a contractual term is at variance with public policy, it matters little, or perhaps matters not, what the personal attributes of the party seeking to escape the results of the time bar are. It is not inconceivable that the personal and social station of the claimant may have some bearing on the public policy evaluation, but ordinarily it is not decisive. It is the likely impact of the impugned stipulation that should be determinative of what public notions of fairness may tolerate").

[73] *Paulsen v. Slip Knot Investments*, para. 73.

[74] Ibid., para. 84.

[75] *Napier v. Barkhuizen* (4) SA 1 (SCA) (2006), para. 15 (South Africa).

[76] See generally *Beadica 231 CC v. Trustees* for the time being of the Oregon Trust (5) SA 247 (CC) (2020) (South Africa) (discussing when a court may refuse to enforce a contractual term on public policy grounds).

[77] Ibid., para. 2.

[78] National Empowerment Fund Act 105 of 1998, § 3 (South Africa).

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The trial judge noted that the statutory initiative would be dealt a blow if the lease were cancelled.[79] He found that cancellation would be a disproportionate sanction.[80] He also referred to the competing policy considerations of, on the one hand, legal certainty and, on the other hand, the importance of infusing contract law with good faith and fairness and constitutional values such as *ubuntu*.

The trial decision in *Beadica* was overturned on appeal,[81] and that result was upheld by a divided Constitutional Court. The seven judges in the majority found that the renewal terms were written "in simple, uncomplicated language, which an ordinary person could reasonably be expected to understand" and so the franchisees failed to satisfy their onus of showing that enforcement would be unreasonable.[82] The majority were also unsympathetic to the franchisees' claim that strict enforcement of the renewal provision would violate public policy because it would be inconsistent with the constitutional right to equality.

In her majority opinion, Theron J. strongly rejected the proposition that enforcement of a contractual term would violate the constitutional right to equality merely because it would prejudice a member of a historically disadvantaged group. In fact, she suggested that refusing to enforce the contract would hurt rather than help the cause of equality, worrying that contracting parties would respond to such a legal rule by adjusting other terms of their contracts with members of disadvantaged groups, or refusing to contract with them altogether.[83] Her concern echoes a recurring theme in legal academics' defenses of contract law orthodoxy.[84]

The two dissenting judgments both argued that there was sufficient evidence to conclude that the franchisees were relatively unsophisticated and in a position of unequal bargaining power compared to the franchisors.[85] The dissenting judges would have found that enforcement in these circumstances was contrary to good

[79] *Beadica 231 CC v. Trustees*, Oregon Unit Trust (1) SA 549 (WCC) (2018), para 39 (South Africa).

[80] Ibid., para. 42.

[81] *Beadica 231 CC (5) SA*, para. 12.

[82] Ibid., paras. 93–95.

[83] The passage merits quoting in full: "To hold that the failure of a black economic empowerment initiative financed by the Fund renders the enforcement of the renewal clauses deleterious to the constitutional value of equality would have the undesirable result of defeating the Funds own objects. This is because the effect of this finding would increase the risk of contracting with historically disadvantaged persons who benefit from the Fund. If the applicants were to succeed, it would establish the legal principle that enforcement of a contractual term would be inimical to the constitutional value of equality, and therefore contrary to public policy, where enforcement would result in the failure of a black economic empowerment initiative. This could, in turn, deter other parties from electing to contract with beneficiaries of the Fund, or force beneficiaries to offset the increased risk by making concessions on other contractual aspects during contract negotiations". Ibid., para. 101 (footnote omitted).

[84] See the discussion of avoidance in Section 2.4.3.

[85] *Beadica 231 CC (5) SA*, paras. 196–98, 202 (Froneman, J., dissenting); ibid., paras. 224–26 (Victor, A. J., dissenting).

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faith, public policy, and *ubuntu*.[86] The majority's opinion, however, draws very important boundaries around heterodoxy in South African contract law.

2.3.2 *Brazil*

Brazil's contract law is heterodox, both in form and substance. Courts habitually note the "change in paradigm" in private law from a merely "liberal, individualistic, and patrimonial" view of private relations to one which emphasizes "good faith, the social function of contract and property and the valuing of the existential minimum."[87] The effect is that "the right to liberty and party autonomy needs to be weighed against the duty of social solidarity, in the sense that citizens must mutually help each other to preserve humanity and build a free, just, and solidary society that belongs to everyone indistinctly."[88] In this view, "solidarity is a guideline, an interpretative value, a guide to distributive justice," while "good faith is the translation of the respect to human dignity" and "represents the functionalization of private relations based on solidarity."[89] The scholarly push for the "constitutionalization of civil law" through horizontal effects of fundamental rights has been highly influential, even if the phenomenon is resented by doctrinal and law-and-economics scholars.[90]

Judicial and scholarly rhetoric on the role of human dignity, the social function of contract, and social solidarity in contract law disputes is pervasive. A search of abstracts (*ementas*) of contract opinions by Brazil's Superior Court of Justice (*Superior Tribunal de Justiça* ("STJ"))[91] alone returned over 1,700 results for "human dignity," over 13,000 results for "social function," and over 780 results for "social justice."[92] However, not all heterodox rhetoric translates into heterodox results, and not all heterodox results are based on heterodox rhetoric. While noting that heterodox rhetoric is widespread, this section will focus primarily on the distinct contours of the Brazilian contract law regime (heterodox results) that appear to set it apart from the international norm in the Global North.

[86] Ibid., paras. 201–2 (Froneman, J., dissenting); ibid., paras. 230–31 (Victor, A. J., dissenting).

[87] STJ, Agravo em Recurso Especial No. 1.681.421-RJ, Relatora: Ministra Maria Isabel Gallotti, 24.08.2020, 2980 Diario da Justiça [D.J.], 27.08.2020, 4 (Brazil) (quoting the decision by the Rio de Janeiro Court of Appeals in the case).

[88] Ibid. The case in question concerned the abusive use of proxies by the administrator of a housing condominium to repeatedly elect himself and approve his accounts. Ibid.

[89] Ibid., 5.

[90] For a critique, see L. B. Timm, Ainda Sobre a Função Social do Direito Contratual no Código Civil Brasileiro: Justiça Distributiva versus Eficiência Econômica (2009) 2 *Revista da Associação Mineira de Direito e Economia* 1–39, 14.

[91] The Superior Court of Justice is Brazil's court of last resort on federal law. Its jurisdiction encompasses all matters of private law, including contract law.

[92] Search conducted on the website www.stj.jus.br on September 9, 2020. See www.stj.jus.br/sites/portalp/Inicio.

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Brazilian scholars have long argued "that the *substance* of courts' approach to contract enforcement" – rather than the duration and cost of procedures, as assumed by the international literature and the World Bank – is potentially distinct and problematic.[93] According to a survey of Brazilian judges by political scientists in the early 2000s, only 48 percent of respondents argued that contracts must be respected independently of social repercussions, whereas 61 percent of them declared that the achievement of social justice justifies breaches of contract.[94] A famous 2005 article by some of Brazil's most prominent economists blamed the country's "extraordinarily high interest rates" for private credit on legal uncertainty due to courts' "anti-creditor bias," which they attributed, among other things, to "deep social differences and the high levels of income concentration in the country."[95] Since then, local literature has emerged to challenge both the existence and root causes of the alleged legal uncertainty and anti-creditor bias.[96] Nevertheless, the use of constitutional principles and social considerations in adjudicating contract disputes in Brazil is largely accepted as a descriptive matter, though contested from a normative standpoint.

2.3.2.1 Consumer Housing Purchases and Heterodox Contract Remedies

One notable instance of doctrinal heterodoxy appears in the judicial treatment of contracts for the acquisition of new housing from construction companies. A fairly common market practice is for consumers to acquire new housing through monthly installments before and during construction, effectively prepaying for their unit and helping to finance the housing project. As in South Africa, this longstanding practice likely responds, at least in part, to failures in the country's credit markets, leading to inordinately high interest rates in consumer and financial credit.[97]

[93] See Pargendler, Comparative Contract Law and Development, 1736.

[94] B. Lamounier and A. de Souza, *As Elites Brasileiras e o Desenvolvimento Nacional: Fatores de Consenso e Dissenso* (São Paulo: Instituto de Estudos Econômicos, Sociais e Políticos de São Paulo, 2002), p. 21. For another prominent survey result along the same lines, see generally A. C. Pinheiro, Judiciário, Reforma e Economia: A Visão dos Magistrados (2003) Instituto de Pesquisa Econômica Aplicada, Texto para Discussão No 966.

[95] P. Arida, E. L. Bacha, and A. Lara-Resende, Credit, Interest, and Jurisdictional Uncertainty: Conjectures on the Case of Brazil, in F. Giavazzi, I. Goldfajn, and S. Herrera (eds.), *Inflation Targeting, Debt, and the Brazilian Experience, 1999 to 2003* (Cambridge, MA: MIT Press, 2005), pp. 265–93, pp. 265, 270, 286.

[96] See, e.g., L. L. T. Yeung and P. F. de Azevedo, Neither Robin Hood nor King John: Testing the Anti-Creditor and Anti-Debtor Bias in Brazilian Judges (2015) 6 *Economic Analysis of Law Review* 1–21, 17–18.

[97] The root causes of the financial market failures are contested. One prominent line of works attributes high interest rates to judicial bias toward debtors vis-à-vis creditors. P. Arida, E. L Bacha and A. Lara-Resende, Credit, Interest, and Jurisdictional Uncertainty, 274. Other commentators blame significant market concentration in the banking sector, as well as macroeconomic conditions. See, e.g., B. M. Salama, Spread Bancário e Enforcement Contratual: Hipótese de Causalidade Reversa e Evidência Empírica (2017) 71 *Revista Brasileira de Economia* 111–33, 120–25 (attributing the root of financial shortcomings to high interest rates).

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In this context, a common fact pattern is the contractual breach by a consumer who is unable or unwilling to make the agreed upon installment payments. From an orthodox perspective, the legal treatment of this fact pattern should be reasonably straightforward. The construction company should be able to seek enforcement of the contract by demanding payment or to terminate the contract and seek either expectation damages or stipulated damages. In the case of a falling market, expectation damages could be substantial. Stipulated damages clauses in the sales contract could be subject to judicial scrutiny if excessive.

The resolution of this type of dispute in Brazil has differed sharply from the description given here. Courts have come to recognize consumers' rights to terminate the contract at-will and obtain restitution of circa 85 percent of the installment amounts paid.[98] This solution diverges from standard contract law insofar as the construction company has no right to demand performance, and the damages are fixed between 10 and 25 percent of the amounts paid in. In practice, this means that the sole remedy for breach is a court-imposed liquidated damages clause, which may easily be either over- or under-compensatory. In other words, the basic notion of contract as an agreement backed by expectation damages is no longer available in this highly significant segment of the Brazilian economy.[99]

No statutory rules prescribe this outcome. The Consumer Protection Code of 1990 (*Código de Defesa do Consumidor*) states that:

> In contracts for the purchase and sale of movable and immovable goods against payment in installments, as well as in fiduciary alienations in guarantee, clauses that establish the total loss of installments paid for the benefit of the creditor claiming the termination of the contract for breach and the repossession of the sold product are deemed to be null and void.[100]

This provision can be understood as a form of statutory constraint on penalty clauses and, as such, is largely consistent with contract law orthodoxy. Brazil's President vetoed another more heterodox provision of the Consumer Protection Code requiring the restitution of all amounts paid minus the economic benefit received.[101]

[98] See, e.g., STJ, Agravo Regimental no Recurso Especial 1.500.990-SP, 3a Turma, Rel. Moura Ribeiro, J. 26.04.2016, DJe 10.05.2016 (Brazil).

[99] This bears resemblance to the cancellation right afforded by statute in South Africa to installment purchasers of real estate. See text accompanying notes 65–70.

[100] Lei No. 8.078, de 11 de setembro de 1990, Diário Oficial da União [D.O.U.] de 12.9.1990, art. 53 (Brazil). European scholars have described Brazil's consumer contracts law as offering a comparatively "very high level ... of consumer protection, and [a] strong tendency to favour the so-called weaker party." O. L. R. Junior and S. Rodas, Interview with Reinhard Zimmermann and Jan Peter Schmidt (2015) 4 *Revista de Direito Civil Contemporâneo* 379–413, 403 (quoting Jan Peter Schmidt).

[101] Brazilian law permits Presidential line vetoes. The original provision approved by Congress (but vetoed by the President) provided that "the debtor will have the right to the compensation or restitution of installments paid by the time of contractual termination, adjusted for inflation,

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The heterodox exit option granted to consumers followed from a series of incremental doctrinal steps based on somewhat traditional contract law principles.[102] In the first cases to reach the Superior Court of Justice, the Court held that "the defaulting debtor in principle has no right to request the termination of the contract," a conclusion to be altered only if "there is a supervening fact which is sufficiently strong to justify the breach."[103] The Court then found that currency devaluation and the application of various criteria for inflation adjustment under different national economic plans were supervening facts authorizing the termination of the contract because it was impossible, as a practical matter, for the consumer to perform.[104] The Court also found in such cases that contractual penalty clauses providing for the forfeiture of 90 percent of the amounts paid were abusive under the Consumer Protection Code – again not an outlandish conclusion in view of traditional suspicion of penalty clauses.[105]

In 2002 the Court settled a split between its chambers and confirmed that a consumer purchaser of real estate could unilaterally terminate the agreement due to the "insupportability" of installments. It also permitted the construction company to retain 25 percent of the amount paid "considering not only the costs of the company with the project but also the fact that, in this case, it was the plaintiff who took the initiative to breach the agreement."[106] The dissenting justices argued that the majority's interpretation was unreasonable in effectively implementing a vetoed statutory provision.[107]

Subsequent decisions did away with the requirement of changed circumstances or the impossibility or insupportability of payments by the purchaser, effectively

less the economic benefit obtained with use." This rule is similar to the result later embraced by courts, though it differed by not allowing consumers to sue for termination, and by requiring courts to ascertain the value of the economic advantage obtained by use (rather than universally applying a fixed rate such as 15 percent of payments made). It is noteworthy for offering restitution of benefits enjoyed by the purchaser as the sole remedy for this type of contract breach. The official message accompanying the Presidential veto specifically noted that, in disregarding the various costs incurred by sellers in installment contracts, the rule in question led to "unfair treatment" and "unforeseeable consequences for various sectors of the economy."

[102] This form of exit rights bears little resemblance to the far narrower cancellation rights awarded by EU law (and also Brazil's Consumer Protection Code) for contracts negotiated on the doorstep or outside of a trader's establishment, which are limited in time to seven days following the purchase.

[103] STJ, Recurso Especial No. 109.331-SP, Relator: Min. Ruy Rosado de Aguiar, 24.02.1997, D.J., 31.03.1997, 9638, 2 (Brazil).

[104] Ibid., summary opinion 1 (ementa) ("[W]hen the breach is justified in view of supervening fact preventing contractual performance, with resulting imbalance due to the devaluation of the currency, the successive application of economic plans and different criteria to adjust the credit amount, the debtor may request the termination of the contract").

[105] STJ, Recurso Especial No. 115.671, Relator: Min. Waldemar Zveiter, 08.08.2000, D.J., 02.10.2000, 161, 11 (Brazil).

[106] STJ, Embargos de Divergência em Recurso Especial No. 59.870, Relator: Min. Barros Monteiro, 10.04.2002, D.J., 09.12.2002, 281, 6 (Brazil).

[107] Ibid.

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permitting home buyers to terminate purchase agreements at will. Courts also increasingly settled on the retention of a fixed percentage by the construction company, typically 10 or 15 percent of the amounts paid, without examining the particular benefits accruing to the consumer or damages incurred by the company. This form of remedial heterodoxy – in the form of judicially-imposed liquidated damages that dispense with proof of benefit or harm – likely responds to the massive caseload facing Brazilian courts. From a functional perspective, courts effectively implied a termination option subject to a small liquidated damages clause in all consumer contracts for the purchase of new housing.

Concerns about inequality and social justice likely played a role in the development of this line of opinions, which effectively shifted labor and real estate market risks from consumers to construction companies.[108] During the period of soaring house prices in the early 2000s, the implied exit option benefited consumers and construction companies alike, as the latter obtained financing from the first purchasers and then resold the units for a higher price if the initial purchasers were unable to pay. The termination agreements written in the shadow of the exit option case law were called "*distratos*" – a term which, according to the Civil Code, designates a mutual agreement to terminate a contract, even though not all terminations were entirely voluntary given the prevailing jurisprudence.[109] Nevertheless, when the housing market bubble exploded around 2014, demand for *distratos* – evidently encouraged by the heterodox jurisprudence – became a major problem for construction companies, some of which filed for bankruptcy during this period.

After significant lobbying from construction companies, a 2018 statute increased the maximum amount that could be retained in case of *distratos* to 50 percent of the amounts paid.[110] Strengthening the force of the contractual obligation was a step

[108] Brazilian courts have also protected purchasers of housing against the risk of insolvency on the part of construction companies. In the 1990s, Encol, one of the country's major construction companies, went bankrupt, causing great harm to consumers who had prepaid for their housing units. Even though many of Encol's units had been mortgaged to banks and duly registered, the Superior Court of Justice granted consumers who had paid the purchase price full title free of encumbrances, thus eliminating the banks' collateral. See STJ, Recurso Especial No. 415.667, Relator: Min. Aldir Passarinho Junior, 20.02.2003, 293 Diario da Justiça [D.J.], 07.04.2003, 1–2 (Brazil). Subsequent decisions concerning similar fact patterns invoked the social function of contracts to favor consumer purchasers, noting "the clear and systematic movement in the direction of correcting social distortions, in an attempt to reduce inequalities and afford mechanisms for the judge to seek the achievement of justice in the best possible way." STJ, Recurso Especial No. 691.738, Relatora: Min. Nancy Andrighi, 12.05.2005, 371, Diario da Justiça [D.J.], 26.09.2005, 8 (Brazil). This resulted in the enactment of a summary of the Court's uniform jurisprudence on the matter through súmula 308 in 2005, which states "the mortgage instituted by the construction company and the financing agent, before or after the preliminary agreement for the purchase and sale, has no effects vis-à-vis the purchasers of real estate." Ibid., 7–8.

[109] Código Civil (C.C.) (2002), art. 472 (Brazil).

[110] Lei No. 13.786, de 27 de Dezembro de 2018, DOU de 28.12.2018 (Brazil).

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toward orthodoxy, although the reform is still heterodox in sanctioning now statutory liquidated damages in lieu of a default of expectation damages.

Brazilian law also provides other instances of heterodox approaches to contract remedies in the name of equality, such as imposing a requirement of symmetry in the application of penalty clauses. This means that, if a consumer contract only stipulates a penalty for a breach by the consumer (but not by the trader), the same penalty should apply for the benefit of the consumer in case of a breach by the trader. These decisions are generally based on notions of good faith, contractual equilibrium, and the social function of contract, as well as on the overarching purpose of consumer protection.[111] In one such opinion, the Court quotes a scholar noting that the "principle of equilibrium" emerging from the Consumer Protection Code results from "the protection of the consumer in view of their vulnerability" as well as the "protection of economic equilibrium," as a corollary of the principle of equality in the Brazilian Constitution.[112]

The so-called inversion of penalty clauses for the benefit of purchasers of housing under construction was the subject of a judgment by the STJ in a collective proceeding which became binding on lower courts.[113] The issue was whether the penalty clause imposed by the contract in the event of a late payment by the consumer may be applied for the benefit of the consumer if the construction company delays the conveyance of the housing unit. The judgment in question was preceded by a public hearing (*audiencia pública*) that included testimony by several civil law scholars, economists, as well as associations of consumers and construction companies.[114]

The public hearing dealt not only with technicalities regarding the doctrinal evolution of penalty clauses in Brazil, but also with the broader economic and social stakes of the issue in question. The attorney for the purchaser in the case defended the "heterointegration of the contract, by the judge" as a mechanism to achieve "social justice."[115] One public defender emphasized how it had become commonplace to sell real estate to the poor who could not afford the installments, leading to loss of amounts paid by the consumer when terminating the contract and profits by the construction company in subsequent sales. He argued that lack of proper

[111] See, e.g., STJ, Recurso Especial No. 1.614.721-DF, Relator: Min. Luis Felipe Salomão, 22.5.2019, Diário da Justiça Eletrônico [D.J.e], 25.6.2019 (Brazil).

[112] STJ., Recurso Especial No. 1.548.189-SP, Relator: Min. Paulo de Tarso Sanseverino, D.J.e, 6.9.2017 (Brazil), quoting B. Miragem, *Curso de Direito do Consumidor* (São Paulo: Revista dos Tribunais, 2014).

[113] Brazil's 2015 Code of Civil Procedure permits the Federal Supreme Court (Supremo Tribunal Federal) and the STJ to issue collective judgments that resolve multiple appeals addressing the same question of law – a mechanism designed to enhance efficiency in the adjudication of mass litigation in the country. See Lei No. 13.105, de 16 de Março de 2015, D.O.U. de 17.3.2015, arts. 1036–41 (Brazil).

[114] STJ, Recurso Especial No. 1.614.721-DF, Public hearing of August 27, 2018, Superior Tribunal de Justiça Jurisprudência [STJJ], 28.08.2018 (Brazil).

[115] STJ, Recurso Especial No. 1.614.721-DF, Public hearing of August 27, 2018, 6.

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compensation for consumers in the case of delays would increase construction companies' incentives to make successive sales to persons unable to pay, leading to even greater harm to the poorest.[116] Gustavo Franco, a prominent economist and former president of the Brazilian Central Bank, appeared on behalf of an association of construction companies to argue against the inversion of penalty clauses, citing a "peril of populism" by which concerns about the disadvantaged and the weak would end up distorting the system and ultimately hurting the supposed beneficiaries of such a policy.[117] The STJ ultimately sided with consumers to issue a binding statement permitting the inversion of penalty clauses in all subsequent cases involving housing purchases.[118]

2.3.2.2 Health Insurance

There is also some evidence of heterodoxy in the field of insurance contracts. Brazilian courts have adopted pro-consumer approaches in prohibiting denial of coverage due to false statements or omissions of preexisting conditions by the insured, finding that insurance companies should bear the burden of requesting medical examinations. Numerous decisions also grant treatments deemed necessary for the realization of the insured's constitutional right to health despite clear contractual exclusions.[119] Commentators suspect that the near-disappearance of the market for individual (as opposed to collective) insurance contracts in Brazil is at least partly due to the excessively consumer-friendly case law of Brazilian courts.[120]

2.3.2.3 Legislative Backlash against Contract Law Heterodoxy

Brazil recently witnessed two legislative attempts to mitigate courts' heterodox approaches to contract law through new statutory rules on legal interpretation and

[116] Ibid., 7.
[117] Ibid., 64.
[118] "In a contract of adhesion entered into between a buyer and the construction company, in case there is a penalty clause for the breach of the acquirer, the same shall be considered for the determination of damages for the breach of the seller." Tema Repetitivo 971, STJ Precedentes Qualificados (Tese Firmada for STJ, Recurso Especial No. 1.614.721-DF, Public hearing of August 27, 2018).
[119] For a detailed analysis of the STJ's jurisprudence on health insurance contracts, see A. S. Guazzelli, A Busca da Justiça Distributiva no Judiciário Por Meio das Relações Contratuais: Uma Análise a Partir dos Planos de Saúde, Master's dissertation, University of São Paulo (2013) (finding support to the hypothesis that judges act in an arbitrary manner in favoring the weaker economic party, and concluding that "the judicial decisions may lead to undesirable effects, such as random wealth redistribution, favoring one individual to the detriment of the collectivity, and the incentive to opportunistic conducts").
[120] The few companies that still offer individual health insurance plans charge a price that is 100 percent higher than those under group insurance plans. Ibid., 37.

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application. A 2018 amendment to the Introductory Law to the Brazilian Legal System, which provides general standards of interpretation and choice of law, introduced a new rule which provides that "in the administrative, controlling and judicial spheres, one may not decide based on abstract legal values without considering the practical consequences of the decision."[121] The new provision is generally understood as an attempt to mitigate rising legal uncertainty due to an excessive use of broad principles (such as legality or human dignity) in legal decision-making in the country.

In 2019, the new "Law on Economic Freedom," initially enacted by President Bolsonaro as a provisional measure, sought to restrain state interference in economic activity, including private contracts.[122] Among other things, the statute amends the Civil Code to provide that contracts are to be interpreted in favor of economic freedom, that the allocation of contractual risks by the parties shall be respected, and that judicial rewriting of contract terms should only occur in an exceptional and limited manner. In specifically articulating implicit tenets of contract law's orthodoxy, it is difficult to make sense of these new rules except as a reaction to the prevailing heterodox approach of Brazilian courts. Nevertheless, the Law on Economic Freedom does not alter the protections of the Consumer Protection Code and, at any rate, its practical effects remain to be seen.

2.3.3 *Colombia*

Colombia's Constitutional Court expressly appeals to fundamental rights – such as the right to a vital minimum, health, housing, human dignity, and equality – in resolving disputes involving parties deemed to be weak and vulnerable with respect to contracts for the provision of public services. Colombia's Constitution, enacted in 1991, imposes on the state a duty to ensure the efficient provision of public services to all residents, which may be carried out by the state directly or by private parties subject to state regulation, control, and monitoring.[123] The Constitution goes on to provide that regulation of the provision of public services by statute should take into account the criteria of cost, solidarity, and, most notably for the present purposes, income redistribution.[124] However, the Constitutional Court of Colombia has intervened in contract disputes to promote the distributive concerns enshrined in the constitution even in the absence of statutory authorization. Some of its decisions can be justified as orthodox responses to concerns about imperfect information or substantive unfairness, but others appear to produce heterodox outcomes.

[121] Decreto-lei No. 4.657, de 4 de Setembro de 1942, as amended by Lei No. 13.655, de 25 de Abril de 2018, DOU de 26.4.2018 (Brazil).
[122] Lei No. 13.874, de 20 de Setembro de 2019, D.O.U. de 20.9.2019 (Brazil).
[123] Constitución Política de Colombia [C.P.], art. 365.
[124] See ibid., art. 367.

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Contract cases typically reach the Constitutional Court through *tutela* claims, a type of action guaranteed by the constitution to protect fundamental rights against public authorities, as well as private parties in exceptional circumstances defined by statute.[125] While contract law disputes are generally subject to ordinary jurisdiction and remedies, *tutela* may be invoked by "subjects of special constitutional protection," such as the elderly, the ill, minors, the disabled, female heads of households, and persons earning less than the minimum wage.[126] Contract disputes potentially impinging on fundamental rights such as life, health, or the vital minimum are thus subject to *tutela* claims and constitutional review.[127] The Court's contract law jurisprudence has focused primarily on insurance and public utility contracts.

2.3.3.1 Health and Life Insurance

Colombia's Constitutional Court has decided several cases involving health and life insurance contracts in favor of disadvantaged plaintiffs based on constitutional principles protecting health and the vital minimum. In a 2005 *tutela* decision, the Court found that a private health insurer's refusal to renew a contract, while generally permissible, violated the constitutional right to health given the circumstances of the case. The plaintiff was an elderly person with multiple ailments that urgently required medical treatment, and the health insurance contract in question was in force for over four years. The Court rejected the argument that the social right to health applied exclusively against the state's social security framework, finding that "the contract's object has an inseparable relation to the effects of the constitutional right to health, so that the interpretation of the scope of contract clauses is contingent, in any case, on the need to guarantee the correct exercise of this right."[128] In a subsequent 2011 decision, the Court held that a health insurance company could not terminate a contract for the continued nonpayment of the monthly premium when the insured was HIV-positive, citing the fundamental rights to dignified life, health, personal integrity, social security, and equality.[129] It found that, even though the patient was receiving treatment through Colombia's standard health coverage, the relevant question was "the abuse of the company as the dominant party of the contract."[130]

[125] Ibid., art. 86.
[126] G. Z. Bahamón, Constitutionalización y Protección de Derechos Fundamentales en el Contrato de Seguros: Análisis Jurisprudencial-Corte Constitucional de Colombia (2016) 45 *Revista Ibero-Latinoamericana de Seguros* 233–68, 236.
[127] Ibid., 239.
[128] Corte Constitucional [C. C.] [Constitutional Court], julio 8, 2005, Sentencia T-724/05 (Colombia).
[129] C. C., October 27, 2011, Sentencia T-811-11.
[130] Ibid., 8. The Court also argued that the company had tolerated the insured's default and was therefore stopped from seeking termination of the contract (allanamiento a la mora).

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2.3.3.2 Access to Water

The Court has also appealed to the fundamental rights to human dignity, life, health, and equality to limit a water company's ability to stop the provision of water due to nonpayment by "subjects of special protection."[131] The plaintiff in the case was a 54-year-old woman who was the head of her household, physically incapacitated to work, and responsible for two minor sons. While the Court upheld the statutory provision permitting the suspension of supply as a means to promote the efficient, continuous, and uninterrupted provision of public services to all, it also determined that denial of water to subjects of special protection was disproportionate and, therefore, unconstitutional. The Court held that, in response to nonpayment, the company should investigate the credit situation of the user and negotiate payment agreements consistent with their ability to pay. If the payment obligations were still not performed, the company could limit the water supply to 50 liters per person.[132]

2.4 EXPLAINING DIVERGENCE

The decisions and doctrines set out in Section 2.3 are difficult to reconcile with contract law orthodoxy. We first explain why defenders of orthodoxy would argue that these alternative approaches are either illegitimate or ineffective. We then identify ways in which economic, political, and legal features of Brazil and South Africa, and to a lesser extent Colombia, deviate from the assumptions that underpin contract law orthodoxy.

2.4.1 *The Case for Orthodoxy*

The orthodox view that contract law should not be designed to achieve distributive goals rests on two main sets of arguments. The first set focuses on *legitimacy*. One of those arguments rests on the libertarian proposition that forcible redistribution by the state generally cannot be justified, except, importantly, where it is required to rectify unjust transfers of resources.[133] Since contract law involves enforcement by the state, this view rules out redistribution through contract law in most cases.[134] Our impression is that relatively few modern legal scholars endorse this line of argument. A more widely accepted, though controversial, view is that judges lack the legitimacy to decide upon distributive objectives. According to at least some political theories, decisions about the distribution of resources in society are illegitimate

[131] C. C., October 3, 2011, Sentencia T-740/11 (Colombia).
[132] Ibid.
[133] R. Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), pp. 151–53.
[134] A. T. Kronman, Contract Law and Distributive Justice (1980) 89 *Yale Law Journal* 472–512, 473–74.

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unless made by democratically elected officials, which judges often are not.[135] This view is, to be sure, fiercely resisted by critical legal scholars.[136]

The second and arguably most central pillar of contract law orthodoxy is a set of pragmatic arguments about *effectiveness*. The common feature of these arguments is a claim that fiscal policy, meaning the rules and practices concerning taxation and public spending, is superior to contract law as a means of achieving distributive justice.[137] At least five distinct arguments support this conclusion.[138]

1. *Accuracy and predictability*. Fiscal policies can be conditioned on information – such as parties' income, location, profession, and number of dependents – that may not be available to either a tribunal adjudicating a contractual dispute or to parties when they enter into their contract.[139] This means that rules of contract law conditioned on distributive information would not only be inaccurate, but would also lead to inefficient uncertainty among contracting parties.[140]
2. *Comprehensiveness*. Redistribution through fiscal policy is likely to be more comprehensive.[141] Tax and spending programs can be applied to everyone in society, as opposed to just the parties subject to a given body of contract law. By contrast, when distribution is deliberately altered through regulation of contracts only people who participate in the relevant transactions will be affected.
3. *Efficiency*. Rules of contract law aimed at distributive objectives can induce inefficient behavior – meaning behavior whose costs exceed its

[135] K. A. Kordana and D. H. Tabachnick, Rawls and Contract Law (2005) 73 *George Washington Law Review* 598–632, 623–24.

[136] See, e.g., Kennedy, Distributive and Paternalist Motives in Contract and Tort Law 564–65; R. M. Unger, The Critical Legal Studies Movement (1983) *Harvard Law Review* 561–675, 565.

[137] See J. Rawls, *Political Liberalism: Expanded Edition* (New York: Columbia University Press, 2005), pp. 267–68; see also L. Kaplow and S. Shavell, Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income (1994) 23 *The Journal of Legal Studies* 667–81 (arguing that redistribution of income through the income tax and welfare system can be more efficient than through other legal rules).

[138] D. A. Weisbach, Should Legal Rules Be Used to Redistribute Income? (2003) 70 *The University of Chicago Law Review* 439–53, 446–53.

[139] See Rawls, *Political Liberalism*, p. 267. Separate institutions are required to preserve background justice because "the rules governing individual agreements and ... transactions cannot be too complex, or require too much information to be correctly applied." Ibid.

[140] Ibid., pp. 267–68. See also M. Weber, *Economy and Society: An Outline of Interpretive Sociology* (New York: Bedminster Press, 1968), pp. 883, 886–87 (claiming that "the modern class problem" has led to demands for "social law" to be based on ethical postulates such as "justice" which, if accommodated, would undermine the formality and rationality and thus calculability of law that has supported capitalist economic development in Continental Europe).

[141] See Kaplow and Shavell, Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income, 675.

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benefits – that fiscal policy does not.[142] An example might be a warranty of habitability which requires sellers of buildings to make improvements whose costs exceed their value to certain buyers. In principle, policymakers could confer the same benefit on the relevant buyers more efficiently by granting them a tax credit financed by an increase in income taxes.

4. *Avoidance*. Perhaps the most powerful argument against using contract law to achieve distributive objectives is that contracting parties may be able to avoid the effects of distribution-motivated rules. The law can mandate that one party to a contract confer a benefit on their counterparty, but the target of the regulation is likely to adjust the price or other terms of the contract, or refuse to contract altogether, in order to offset the costs of the mandate. The overall distributive effects of the intervention will depend on the effects of those adjustments.
5. *Interdependence*. Sometimes the welfare of the people burdened by an intervention motivated by distribution will be intertwined with the welfare of the intended beneficiaries. In the extreme case, distributive concerns are irrelevant to the resolution of contractual disputes because there is complete identity between the interests of the parties to the contract, as in the case where the parties are firms owned by diversified shareholders with equal interests in both firms.[143] One common critique is that it may be difficult to determine the overall effects of a measure that initially distributes wealth from firms to individuals. While also questionable in the United States, this concern tends to be less powerful in the Global South, where stock ownership tends to be much more concentrated, and lower among the general population, than in the United States.

2.4.2 *Explaining Heterodoxy*

Distributive demands, and the relative legitimacy and effectiveness of judges and fiscal institutions, all vary from time to time and place to place. Accordingly, as Anthony Kronman pointed out in a classic article, the case for contract law orthodoxy is highly contingent on the social and institutional context.[144] For instance, US scholars have occasionally recognized that contract law may be an appealing second

[142] Ibid., 669; S. Shavell, A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation? (1981) 71 *The American Economic Review* 414–18.

[143] A. Schwartz and R. E. Scott, Contract Theory and the Limits of Contract Law (2003) 113 *Yale Law Journal* 541–620, 555–56 ("[I]t is difficult to create distributional benefits for the shareholders who own most business firms").

[144] Kronman, Contract Law and Distributive Justice, 508–10.

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best mechanism for achieving distributive goals if the fiscal system cannot be counted on for that purpose.[145]

Contract law heterodoxy emerged in the Global South under social, economic, and institutional conditions that deviate substantially from the conditions assumed by the conventional justifications for the orthodox approach. First, substantial and unjustifiable inequality bolsters the legitimacy of state-led efforts to improve the welfare of disadvantaged groups. Profound inequality and segregation also make it easier to aim redistributive measures accurately at relatively privileged actors without affecting members of disadvantaged groups. Second, states that experience high levels of inequality may be unable to achieve adequate distribution solely through fiscal institutions. Third, leading judges in these countries have responded to these circumstances by embracing the idea of transformative constitutionalism, which expressly legitimizes pursuit of distributive objectives by the judiciary in the course of resolving private disputes.

The legal systems in which we observe contract law heterodoxy are also heterodox in other areas. In fact, Brazil, Colombia, and South Africa are well known among comparative lawyers for their embrace of a heterodox approach to constitutional law known as "transformative constitutionalism."[146] This term was coined to describe South Africa's distinctive approach to constitutional law and has subsequently been applied to Brazilian and Colombian constitutional law as well.[147]

As its name suggests, transformative constitutionalism starts from the premise that constitutional law should transform rather than simply reflect the society it governs.[148] Proponents argue that the project of social transformation would be doomed to failure if inequality and injustice in the private sphere were shielded

[145] Z. Liscow, Is Efficiency Biased? (2018) 85 *University of Chicago Law Review* 1649–718, 1664; L. A. Fennell and R. H. McAdams, The Distributive Deficit in Law and Economics (2016) 100 *Minnesota Law Review* 1051–130, 1053, n. 5; see B. H. McDonnell, The Economists' New Arguments (2003) 88 *Minnesota Law Review* 86–118, 111; R. S. Markovits, Why Kaplow and Shavell's "Double-Distortion Argument" Articles Are Wrong (2005) 13 *George Mason Law Review* 511–620, 556–57, 597–601; C. R. Sunstein, Willingness to Pay vs. Welfare (2007) 1 *Harvard Law & Policy Review* 303–30, 314–15; Z. Liscow, Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency (2014) 123 *Yale Law Journal* 2478–511, 2502, n. 52.

[146] See generally O. V. Vieira, U. Baxi, and F. Viljoen (eds.), *Transformative Constitutionalism: Comparing the Apex Courts of Brazil, India and South Africa* (Pretoria: Pretoria University Law Press, 2013); D. Bonilla Maldonado (ed.), *Constitutionalism of the Global South: The Activist Tribunals of India, South Africa, and Colombia* (Cambridge: Cambridge University Press, 2013).

[147] K. E. Klare, Legal Culture and Transformative Constitutionalism (1998) 14 *South African Journal on Human Rights* 146–88, 150. But see D. W. Arguelhes, Transformative Constitutionalism: A View from Brazil, in P. Dann, M. Riegner, and M. Bönnemann (eds.), *The Global South and Comparative Constitutional Law* (Oxford: Oxford University Press, 2020), pp. 165–89, 167 (arguing that Brazil's Supreme Court has been a "late bloomer" compared to Colombia's, and that it has at best played a marginal role in fighting poverty and inequality).

[148] Klare, Legal Culture and Transformative Constitutionalism, 150.

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from scrutiny. Accordingly, a key precept of transformative constitutionalism is that the constitution is to be used to reshape the laws that govern relations between private actors, including contract law.[149]

While there is debate about whether transformative constitutionalism only appears in the Global South, it definitely relates to societies that have undergone profound political changes.[150] In the paradigmatic cases, those changes included the adoption of new constitutional texts following nation-wide consultations and deliberations. Brazil underwent this process in 1988, in the course of transitioning to democracy after a long period of military rule. Colombia's 1991 Constitution was adopted in an effort to open up a two-party political system that was captured by a handful of powerful actors, leading to widespread popular frustration and political violence. In South Africa, the 1996 constitution was adopted to mark the end of the apartheid regime and the advent of multiracial democracy.

In each of these cases the reformed constitution was clearly designed to achieve economic as well as political change. The Brazilian constitution is the most explicit. It states that "[t]he fundamental objectives of the [state] are," among other things, "to eradicate poverty and substandard living conditions and to reduce social and regional inequalities."[151] Both the Brazilian and South African constitutions also make special provision for expropriation of rural land for the purpose of land reform.[152] In South Africa, the "commitment to land reform" is listed along with a broader commitment "to reforms to bring about equitable access to all South Africa's natural resources."[153] South Africa's constitution also guarantees, in qualified terms, equitable access to land.[154] Finally, all three constitutional texts guarantee access to key goods such as education, healthcare, housing, and social security.[155]

For the present purposes, the critical feature of transformative constitutionalism is that it allows courts charged with resolving contractual disputes to invoke constitutional norms as a basis for altering the distribution of resources in society, especially when the aim is to reverse inequality that can be linked to historic injustice. This directly contradicts the idea that it is illegitimate for judges to use

[149] Davis and Klare, Transformative Constitutionalism and the Common and Customary Law, 410–11.

[150] M. Hailbronner, Transformative Constitutionalism: Not Only in the Global South (2017) 65 *The American Journal of Comparative Law* 527–65. See generally Versteeg, Can Rights Combat Economic Inequality? (describing broader concerns about inequality in the constitutional jurisprudence of certain Global North countries).

[151] Constituição Federal [C. F.] [Constitution] art. 3 (Brazil). See also ibid., art. 170 (specifying that the economic order must accord "with the dictates of social justice," "the social function of property," and "reduction of regional and social differences").

[152] Ibid., art. 184; S. Afr. Const., 1996 art. 25.

[153] S. Afr. Const., 1996 art. 25(2)–(4).

[154] Ibid., art. 25(5).

[155] C. F. art. 6 (Brazil); Constitución Política de Colombia [C.P.], art. 48, 51, 67; S. Afr. Const., 1996, art. 26, 27, 29.

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contract law as a tool for promoting distributive objectives, a key intellectual foundation of contract law orthodoxy.

2.4.3 *The Significance of Heterodoxy*

To this point, our analysis has presumed that contract law heterodoxy matters from a practical standpoint. In this section, we examine three possible challenges to that conclusion. First, the divergence we observe may be formal rather than functional. Second, heterodox features of contract law may affect a relatively small proportion of the population. Third, firms might take steps to avoid the impact of distributive interventions.

2.4.3.1 Functional Convergence

A classic lesson of comparative law is that not all differences in legal doctrines and styles of legal reasoning translate into distinct outcomes of similar controversies. Instead, many comparative scholars believe that the opposite is true, with different doctrinal labels often bringing about similar or identical results. Prominent comparativists Konrad Zweigert and Hein Kötz famously argued for a presumption of functional similarity in the response of different legal systems to practical problems, despite apparent doctrinal differences.[156] That presumption may well apply to the problems addressed by contract law heterodoxy, even though Zweigert and Kötz limited their analysis to "advanced" legal systems, perhaps in an effort to exclude the Global South.

Our case studies deal primarily with legal arguments about the role of inequality and social rights in the adjudication of contract disputes. As noted throughout the country narratives, we believe that an orthodox approach could lead to the same result in at least some of the cases examined. Although prevalent, functional similarity does not appear to be universal, to the effect that contract law heterodoxy is, in many cases, consequential from an economic standpoint. Moreover, the greater tendency to invoke distributive or social justice considerations in contract law reasoning is interesting in its own right.

A more comprehensive approach to functional equivalence would consider not only whether courts across different jurisdictions would decide a given case in the same way by invoking different contract law doctrines, but also whether they might arrive at similar outcomes by invoking other bodies of law. This kind of functional substitution may well serve to limit the practical significance of contract law

[156] See K. Zweigert and H. Kötz, *Introduction to Comparative Law*, 3rd ed. (Oxford: Clarendon Press, 1998), p. 4. See generally R. Zimmermann and S. Whittaker (eds.), *Good Faith in European Contract Law* (Cambridge: Cambridge University Press, 2000) (finding significant convergence in the outcome of various hypotheticals).

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heterodoxy. For instance, in the United States (and, to a lesser extent, other common law jurisdictions), bankruptcy offers vulnerable parties a fresh start from harsh bargains, while civil law jurisdictions are more likely to offer responses through contract law.[157] US bankruptcy law is considered to offer a safety net which at least partially compensates for a weak welfare state,[158] and several progressive scholars advocate using bankruptcy law to achieve social objectives beyond economic efficiency.[159] More generally, US law often tackles some of the same distributive concerns through specific legislative (rather than judicial) interventions, including in the realm of consumer finance, healthcare, and the provision of public services.[160]

2.4.3.2 Lack of Comprehensiveness

The project of relying on contract law to achieve distributive objectives presupposes a minimum degree of access to formal markets and courts. This means that the impact of contract law heterodoxy is generally limited to parties who were able to enter into contracts with nontrivial stakes and who have access to courts (as well as, arguably, future contracting parties whose contract terms are shaped by the courts' jurisprudence). The poorest of the poor, however, are likely to lack access both to significant contracts and to courts, especially when the effects of their poverty are compounded by a lack of information or other forms of vulnerability. Consequently, the primary beneficiaries of contract law heterodoxy presumably will be members of the middle class and lower middle class, not the poorest. This limitation of the potential effect of contract law heterodoxy is a concrete manifestation of the problem of comprehensiveness discussed in Section 2.3.

Lack of comprehensiveness is not a definitive indictment of contract law heterodoxy given growing global concern about the shrinking size and increasing precarity of the middle class. Moreover, the problem appears to be no more acute than the one observed in the context of transformative constitutionalism and the right to health. Various scholars argue that "the judicialization of the right to health" may be regressive in favoring relatively wealthy citizens with access to courts, unlike public health policies that would benefit the poorest segments of the population.[161]

[157] Pargendler, The Role of the State in Contract Law, 145–46, 175–76.

[158] See, e.g., R. M. Lawless and E. Warren, Shrinking the Safety Net: The 2005 Changes in U.S. Bankruptcy Law, 1 (2006) University of Illinois Law & Economics, Working Paper No. LE06–031.

[159] See generally D. A. Skeel Jr., Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship (2000) 113 *Harvard Law Review* 1075–129.

[160] See R. Van Loo, Broadening Consumer Law: Competition, Protection, and Distribution (2019) 95 *Notre Dame Law Review* 211–62 (arguing that consumer law can and should be designed to have significant distributive effects); Patient Protection and Affordable Care Act, 42 U.S.C. § 18001(d)(3) (barring discrimination in provision of health insurance against individuals with preexisting conditions).

[161] See, e.g., C. Portugal Gouvêa, Social Rights against the Poor (2013) 7 *Vienna Online Journal on International Constitutional Law* 454–75, 465–68; V. A. Da Silva and F. V. Terrazas,

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The fact that the impact of contract law heterodoxy depends on access to courts and formal contracting means that its prospects in any given jurisdiction will depend on a range of institutional arrangements. In the United States, for example, beyond the costs of legal proceedings (including legal representation), the widespread use and enforceability of arbitration clauses in consumer contracts limits the emergence and potential application of heterodox contract law.[162] By contrast, Global South jurisdictions such as Brazil generally resist the use of arbitration in consumer contracts, which remain subject to judicial review – a mode of dispute resolution more conducive to heterodoxy.[163]

2.4.3.3 Avoidance

A central critique of contract law heterodoxy is that it can backfire. As the argument goes, attempts to favor certain groups in contract disputes may lead to price increases or other unfavorable contract terms that hurt precisely such parties in the future (the risk of "hurting the people you are trying to help"). Courts in the Global South are increasingly cognizant of the distinct ex ante incentives caused by contract law decisions, which can lead judges to pause before seeking to help the disadvantaged party in any given case due to the risk of harming similarly situated parties in the future.[164] This may be why most of the examples of heterodoxy we document involve changes in contract law doctrines of relatively broad application – such as rules on prejudgment interest or recovery of partial payments for real estate – that disproportionately benefit members of disadvantaged groups, as opposed to rules targeted solely at members of those groups. These kinds of rulings cannot be avoided simply by discriminating against members of the disadvantaged groups because they apply to transactions with a more broadly defined group of people. Even if the effects of these sorts of heterodox rulings are neutralized by changes in contracting behavior, the intended beneficiaries will not be the only ones to suffer. Therefore, the breadth of these rulings dilutes both their positive effects on intended beneficiaries and the negative effects of any efforts at avoidance.

Claiming the Right to Health in Brazilian Courts: The Exclusion of the Already Excluded? (2011) 36 *Law & Social Inquiry* 825–53, 830–31; O. L. M. Ferraz, Harming the Poor through Social Rights Litigation: Lessons from Brazil (2011) 89 *Texas Law Review* 1643–68, 1651–68.

[162] See K. V.W. Stone and A. J. S. Colvin, The Arbitration Epidemic: Mandatory Arbitration Deprives Workers and Consumers of Their Rights (2015) *Economic Policy Institute* 26; J. P. Nehf, The Impact of Mandatory Arbitration on the Common Law Regulation of Standard Terms in Consumer Contracts (2017) 85 *George Washington Law Review* 1692–716, 1695.

[163] Lei No. 8.078, art. 51, § VII, de 11 de Setembro de 1990, Código de Proteção e Defesa do Consumidor [C.D.C.] de Setembro 1990 (Brazil) (deeming null and void the clauses that impose mandatory arbitration of consumer contracts disputes).

[164] For an example of this concern, expressed by Judge Theron in *Beadica 231 CC (5) SA*, see text accompanying note 83.

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Another concern is that contract law heterodoxy may impact industrial organization and market structure. By imposing an "equity tax" on the contract law system, heterodox contract laws may encourage firms to eschew contracts entirely, such as by embracing vertical integration. One study by Brazilian economists found that global fast-food chain McDonald's changed its strategy in Brazil from relying primarily on franchisees (as it does in most jurisdictions) to adopting a significant majority of company-owned stores.[165] The shift occurred after courts rewrote the economic terms of franchise agreements based on constraints of Brazil's landlord–tenant laws when franchisees sued following the devaluation of the country's currency in 1999.[166]

Yet increased vertical integration may not be a particularly attractive outcome for Global South jurisdictions whose economies are already dominated by large business groups. Scholars argue that weak contract institutions are one reason for the prevalence of family-owned business groups in the Global South, as vertical integration and the family's reputation substitute for formal contract enforcement.[167]

Paradoxically, at least some manifestations of contract law heterodoxy may favor relatively large business groups. Not only are they able to avoid market contracting to a greater extent through vertical integration, they may also be relatively attractive contracting partners because they are less likely to qualify for special legal treatment in the event of a dispute. In short, small businesses may benefit from heterodox contract adjudication, ex post, yet suffer from its expected effects ex ante through price adjustments and lost contracting opportunities. Conversely, firms belonging to large business groups could avoid both effects. What is perhaps even more troubling, by weakening private contracting as a commitment device, heterodox approaches to contract law could raise barriers to entry and again favor business groups with established reputations.

2.4.4 *Prospects for Convergence*

The conditions correlated with the emergence of heterodoxy in Brazil, South Africa, and Colombia are beginning to emerge in the United States and other Global North countries. There has been a tremendous rise in economic inequality in the United States and, to a lesser extent, other Global North countries, at the end of the twentieth century.[168] In many countries, including the United States, inequality is

[165] V. L. Dos Santos Silva and P. F. de Azevedo, Contratos Interfirmas em Diferentes Ambientes Institucionais: O Caso McDonald's França Versus Brasil (2006) 41 *Revista de Administração* 381–93, 382, 389–90.

[166] Ibid.

[167] See e.g., R. J. Gilson, Controlling Family Shareholders in Developing Countries (2007) 60 *Stanford Law Review* 633–56, 641–45. See generally T. Khanna and Y. Yafeh, Business Groups in Emerging Markets: Paragons or Parasites? (2007) 45 Journal of Economic Literature 331–72.

[168] See, e.g., T. Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: The Belknap Press of Harvard University Press, 2017), pp. 297–98.

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explained in part by a history of racial injustice. This has prompted increased calls for attention to distributive considerations by scholars and political leaders, and lamentations about the state's inability to achieve the desired levels of distribution through tax and transfer schemes.[169] The manifestations of contract law heterodoxy that have emerged in Germany and other countries during the COVID-19 pandemic may mark the beginning of a trend.[170]

If inequality continues to rise, the pressure to abandon contract law orthodoxy in the United States and similarly situated Global North countries will become stronger. If and when that happens, scholars and lawmakers in the Global North will benefit from studying the heterodox approaches that have emerged in countries such as South Africa, Brazil, and Colombia. Whether contract law heterodoxy is viewed as a promising policy alternative or as an ill-devised strategy, its real-world significance shows how inequality might affect the operation of foundational private law institutions.

2.5 CONCLUSION

Documenting examples of contract law heterodoxy in the Global South illuminates both the factors shaping legal developments in the Global South and the normative stakes of contract law more generally. Contrary to conventional understandings, private law in the Global South is not merely a flawed copy of foreign counterparts or a remnant of indigenous (and backward) customs. Nor do the differences between Global North and Global South countries exclusively concern the efficiency of judicial enforcement. Instead, the economic, social, and institutional challenges faced by Global South jurisdictions have promoted adaptations to contract law adjudication, including notably greater concern for distributive outcomes. While it is unclear whether this stance is beneficial, it is likely consequential from an economic standpoint.

The emergence of heterodox legal approaches in the Global South also draws attention to the potential link between inequality and the delegitimization of orthodox contract law doctrine. Economic dislocation during the Great Depression and the COVID-19 crisis also prompted more heterodox approaches to contract law in the Global North. For those opposing contract law heterodoxy, this may offer a warning on the importance of mitigating inequality through other means. For those favoring contract law heterodoxy, it may show the feasibility of a broader array of tools to fight social injustice. At any rate, the phenomenon reveals that contract law around the world is not as orthodox and uniform as scholars typically assume and that there are valuable lessons to be learned from turning the lens of legal scholarship toward the Global South.

[169] Fennell and McAdams, The Distributive Deficit in Law and Economics; Z. Liscow, Redistribution for Realists (2022) 107 *Iowa Law Review* 495–562.

[170] See Section 2.2.4.

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