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The Defence of Economic Duress: Further Refinement Required Despite Encouraging Advances

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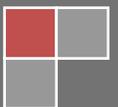


TABLE OF CONTENTS

Table of Contents	2
Chapter 1: Introduction: The test for determining duress and a need for clarification	4
Chapter 2: An Explanation of Duress Using Contract Law Principles	6
2.1 Freedom of contract	6
2.1.2 Reasonable expectations	8
2.2 Legitimate and illegitimate forms of opportunism	10
2.2.1 <i>Opportunism: permissible actions</i>	10
2.2.2 <i>Illegitimate opportunism – opportunities secured via threat</i>	11
Chapter 3: Problems with current judicial guidance and definitions of illegitimate pressure.	12
3.1 Early case law and policy challenges	12
3.2 The problems inherent in defining coercion and illegitimate pressures	14
3.3 The Lord Scarman criteria and “adequate” legal remedies	15
3.4 Roger Brownsword’s conception of good faith: A theoretical paradigm to work with	18
3.4.1 <i>The current view: market individualism and good faith as exception</i>	18
Chapter 4: Duress case law in the 21st century: progress and solutions	20
4.1 The definition of illegitimate: baseline expectations	20
4.2 Current case law: A marked departure from the past?	22
4.2.1 <i>DSND and Carillion</i>	22
4.3 The rule of good faith and its practical application	24
4.3.1 <i>Good faith as rule</i>	24

Chapter 5: Adam Opel v. Mitras: A case analysis	26
5.1 Adam Opel v Mitras: The facts	26
5.2 Analysis	27
5.3 Disseminating threats from offers: assimilating links and severing Others	29
Chapter 6: Conclusion	30
Table of Cases	32
Bibliography	33

Chapter 1: The test for determining duress and a need for clarification

This dissertation seeks to provide analysis of one of the most problematic aspects of the economic duress doctrine, namely the task of the courts to distinguish between “legitimate” and “illegitimate pressures”. Traditionally, the courts have outlined the test for establishing duress to be answered by asking, and answering two questions: first, was there an illegitimate threat made to the claimant, and second, did that pressure cause the claimant to act the way they did in assenting to the contract modification?¹ In theory, the questions have been kept mutually exclusive, and are seen as being answered in chronological order. However after careful reading of duress cases over the past 30 years, it can be discerned that both the nature of the threat, for which there is no set list categorizing the types that are deemed ‘illegitimate’, and the external facts of the case (such as a company’s financial position) will in fact have a degree of influence on the second of these two questions. In the most recent duress case decided in January of this year², the courts provided guidance for ascertaining whether or not an illegitimate pressure had occurred by laying out the following criteria:

(i) Economic pressure can amount to duress, provided it may be characterised as illegitimate and has constituted a “but for” cause inducing the claimant to enter into the relevant contract or to make a payment.

(ii) a threat to break a contract will generally be regarded as illegitimate, particularly where the defendant must know that it would be in breach of contract if the threat were implemented;

(iii) it is relevant to consider whether the claimant had a “real choice” or “realistic alternative” and could, if it had wished, *equally* well have resisted the pressure and, for example, pursued *practical and effective* legal redress” (author’s emphasis)³

¹Huyton v Peter Cremer G.m.b.H. & Co. (1999) 1 Lloyd’s Rep 620, at para 630

² Kolmar Group AG v Traxpo Enterprises Pvt Limited (2010) EWHC 113 (Comm)

³ Kolmar Group, para 92, citing DSND v. Subsea Limited (Formerly known as DSND Oceantech Limited) v Petroleum Geo Services ASA, PGS Offshore Technology AS (2000) WL 1741490, paragraph 131.

This author argues that the courts have become more commercially savvy in their evaluation of duress since the first set of duress cases beginning with the likes of *Pao On* and *The Atlantic Baron*, however there are still some modifications to the test of economic duress that the author would like to see, namely: 1.) A clearer distinction between ‘offer’ and ‘threat’ 2.) A test that further clarifies what a threat is within its proper context, by identifying the ‘baseline’ expectations of the parties reasonably expected throughout the contractual relationship. 3.) A more focused definition of ‘bad faith’ than the current guidance, which is currently decided on the facts and a judgement of subjective intentions of the parties, but for which there is no ‘underlying’ coherent principle for affirmation. 4.) A resolution of what would constitute an ‘adequate legal remedy’ as provided by the *Pao On* criteria.

This author argues that rationale for the clarification of criteria for determining whether a contract modification was entered into via coercion and threats, (and is hence void) is crucial to clarify. Allowing contract to be used as a weapon to enforce extorted contract modifications sends a very clear message to potential rogue or bullying contracting parties in a position to take unfair advantage within the context of the contract. This message is that the initial expectations relied on by a contractual partner hold little inherent value, and furthermore that any terms can be modified for personal gain, even if they do not give efficacy to the contract. From the perspective of the party threatened, clearer criteria to determine when modifications are illegitimate provide them with more legal certainty as to what the appropriate legal recourse is when there is an alleged duress situation. This is explained by the fact that the third party will comprehend what legal pressures do not merit legal remedies/legal intervention, and on the other hand, when an illegitimate pressure is applied, what their contractual rights are.

This dissertation is divided into four sections. The first section discusses the legal principles underpinning the theory of contract such as freedom of contract which are compromised in a situation where a contract modification has been the result of one party acting under duress. The author then proceeds to determine the problems arising from the court guidance in the past, using the distinction between opportunism and threats, and critiquing the traditional Pao On criteria used by Lord Scarman. This provides justification for the movement towards an ‘objective baseline’ approach to threats, and using ‘good faith’ as a rule. The third section explains what an objective baseline would look like, and correspondingly, explains Brownsword’s conception of ‘good faith as rule’. The final section provides an analysis of a recent case where the defence of duress was put forth and argues that while progress has been made in determining whether a legal remedy is adequate to mitigate duress, that there are still actual/practical flaws in the current judicial thinking surrounding the definition of what constitutes a threat. As a result of this, it is argued that a threat should be determined by looking at the contract in a more holistic fashion, rather than assessing the threat at a certain point in time.

Chapter 2: An Explanation of Duress Using Contract Law Principles

To understand duress and distinguish between threats (illegitimate pressures) and legitimate pressures that lead to legal modifications in contract, we require an explanation of contract law principles, namely, freedom of contract and reasonable expectations.

2.1.1 Freedom of Contract

When duress is argued, this author proposes that freedom of contract principles have been violated. But what exactly does this mean for the parties? In an article titled “Ideologies of

Contract”, John Adams and Roger Brownsword succinctly define that freedom of contract principles are “the parties’ freedom of choice...the parties should be free to choose their own terms...Contract is competitive, but the exchange should be consensual. Contract is about unforced choice.”⁴

Two things are noted here prior to discussing freedom of contract and threats. First, economic duress concerns freedom of choice only within the context of contract modifications, unlike undue influence and traditional duress (using force), which deal with freedom of terms *creating* the contract.⁵ Second, there is a large distinguishing mark between freedom to pursue opportunities which potentially lead to an unequal distribution of benefits, and freedom to choose the terms which implement or express those opportunities. Thus, these principles do not frown upon terms that distribute wealth unequally within the contract, so long as both parties agree to those terms and their implications. The opposite of ‘unenforced choice’⁶, a lack of choice that is enforced, is commonly referred to as a threat. There is a plethora of literature concerning the difference between offers and threats, and a more in depth analysis will follow of what should constitute a threat. For now, though, the author proposes that a threat is not consistent with the principles of freedom of contract, because a threat is properly defined as an offer and an acceptance combined by the threatening party, in the form of an ultimatum. There is no prospect for a counter-offer. The only way to ensure that the offer is ‘accepted’ is to remove freedom of the threatened party to make an alternative choice, which in the lexicon of the judiciary in duress cases, means removing an alternative legal or economic/business remedy to mitigate the

⁴ Adams, John and Brownsword, Rogers “The ideologies of contract” (Legal Studies, Vol 7, 1987) ,208, *hereafter* Adams and Brownsword “Ideologies of Contract”

⁵ Halson, Roger “Opportunism, Economic Duress and Contractual Modifications” (Law Quarterly Review, Vol 107, 1991), 659, *hereafter* Halson, “Opportunism”

⁶ Adams and Brownsword “Ideologies of Contract”, 208

additional risk presented from the contract modification. This idea was initially put forth in the Pao On case as part of the Lord Scarman guidance criteria for making a determination of whether the duress suffered could be adequately mitigated, and thus constitute a mere 'legitimate' pressure.⁷ The author argues later on in our analysis of a recent case where duress was pleaded as a defence, that exposure to a certain degree of risk above and beyond the reasonable expectations of the parties (see below, 2.1.2) constitutes a violation of freedom of contract principles. In some cases then, this would then be considered an appropriate dividing line for distinguishing legitimate from illegitimate pressures.

2.1.2 Reasonable Expectations

The second legal justification for duress is explained by the concept of reasonable expectations. As mentioned earlier, in a duress case, there is no controversy over the manner in which the parties entered the contract. In order to justify what is permitted or not permitted within the contract then, a central question for the judiciary to determine the answer to is whether the actions that were taken by the alleged threatening party were in the sphere of reasonable expectations, and how far they deviated from the core/central provisions of the contract. A breach of these reasonably held expectations would amount to breach of contract, which is one of the three guidelines of duress outlined by the courts in the Kolmar case decided in 2010.⁸ Two questions arise on the in the discussion of reasonable expectations: 1.) From a reasonable contracting party's point of view, was it feasible that their contractual partner should have foreseen the modification?⁹ The answer will depend on general industry practices, and, this paper

⁷ Pao On v Lau Yiu Long [1980] A.C. 614, para 635 (hereafter referred to as Pao On)

⁸ Kolmar Group v. Traxpo Enterprises Pvt Limited (2010)

argues, the potential information disclosures and representations by the other party. 2.) What makes a wealth transfer stemming from modification so abhorrent to us, since, as defined earlier, it is generally stated without concern that an unequal distribution of benefits within contract is permitted?¹⁰ Timothy Muris, discussing exploitive contracts, offers his perspective on the distinction:

The wealth transfer (in a coercion situation) is significant not because of its mere existence, but because the transferring act itself does not produce a beneficial product nor promote the productive goal of the contract; yet both perpetrating and protecting against such a transfer are costly.¹¹

When there are no clear-cut advantages to the transfer as described by Muris then, it is clearly observable that in a duress situation, one party is simply using the contract as a weapon to extract wealth¹², rather achieving mutual economic goals. It is argued in this paper that contract policy must guard against this in order to ensure that the costs of entering into a contract are economical in relation to their perceived benefit, and to ensure a degree of legal certainty. This in turn prevents the insertion of an exhaustive list of (implied or express) terms which guard against every preconceived possible action.¹³

Writing in the Harvard Law Review, Professor Steven Burton contends that this legal principle coincides with his definition of good faith, as a firm capturing only those opportunities which

⁹ “In some of these cases, the circumstances allegedly making the promisor's agreement involuntary is an incapacity of the promisor himself- his insanity, youth, ignorance or impecuniousness” Kronman, Anthony “Contract Law and Distributive Justice” (The Yale Law Journal, Vol. 89, No. 3 Jan., 1980), 479, hereafter, Kronman, “Contract Law and Distributive Justice”

¹⁰ Muris, Timothy “Opportunistic Behaviour and the Law of Contracts” 65 (Minnesota Law Review 1980-1981), 526, *hereafter*, Muris “Opportunistic Behaviour”

¹¹ Muris “Opportunistic Behaviour”, 526

¹² Halson, Roger “Opportunism”, 659

¹³ Kessler, Freidrich “Contracts of Adhesion – Some Thoughts About Freedom of Contract” (Columbia Law Review, Vol 43, 1943), 639, *hereafter*, Kessler, “Contracts of Adhesion”

were in “reasonable contemplation of the parties at the time of formation – to capture opportunities that were preserved upon entering the contract, interpreted objectively”¹⁴ This may depend on industry practice¹⁵, and it may depend on the level of risk that the parties could have reasonably be expected to be exposed to. Generally then, greater co-operation in expressing information will lead to more clearly defined expectations by the parties.

2.2 Legitimate and illegitimate forms of opportunism

These sections provide an economic analysis of the actions facing a company who faces a threat, and provides a starting point for understanding and critiquing the Lord Scarman ‘Pao On’ test described in the next chapter. The author commences making formal links between the concept of good faith in contract law, and the concept of illegitimate pressure in the defence of duress.

2.2.1 Opportunism: permissible actions

A modification of terms within contract may be seen as perfectly acceptable, when market conditions have changed since the signing of the contract and therefore the modification is necessary to bring the benefits enjoyed by each party into line with original expectations.¹⁶

Another rationale may be explained in terms of the party itself and its relationship to the market.

If one party’s capabilities have changed, creating a situation whereby the market it operates in values its particular capabilities far more than when the original contract was signed, then in some circumstances the contract must adapt to reflect a drastic change in the value for those new benefits to be bestowed upon the other contracting party in the course of the contract.

¹⁴ Burton, Steven “Breach of Contract and the Common Law Duty to Perform in Good Faith” (Harvard Law Review, Vol 94, 1980), 373, hereafter, Burton “Breach of Contract”

¹⁵ “Lord Bingham...indicated...good faith ‘looks to good standards of commercial morality and practice’ ” MacDonald, Elizabeth “Scope and Fairness of the Unfair Terms in Consumer Contracts Regulations: Director General for Fair Trading v. First National Bank” *Modern Law Review*, Vol. 65 (2002) 768

¹⁶ Halson, “Opportunism”, 653

2.2.2 Illegitimate opportunism – opportunities secured via threat

In order to understand some of the concepts the author discusses in this paper, the reader must understand how concepts such as reasonable expectations and freedom of contract manifest themselves in contract formation and breach. A party might find itself in a situation whereby it is thinking of breaching a contract, and must decide whether the opportunity costs of discharging his duties and paying damages to the other party for breach in order to gain a new opportunity will outweigh the benefits of such an opportunity. Those damages paid by the promisor to the promisee represent, in market terminology, paying for the chance to gain a new opportunity. When there is duress, the promisor gains the benefit of the new opportunity by demanding that those benefits which will be conferred should he breach are paid for by the promisee to the promisor. In a situation where duress has been found, he does not pay for that opportunity, rather he gains the opportunity via an illegitimate threat, of the type discussed earlier. Professor Burton states that initially, when entering into a contract, the promisor promised to forsake those alternative opportunities. Thus in Professor Burton's analysis, bad faith performance, and accordingly what would be defined as an 'illegitimate pressure' in the doctrine of duress, "*occurs precisely when discretion is used to recapture opportunities forgone upon contracting – when the discretion-exercising party refuses to pay the expected cost of performance.*"¹⁷ This author contends that Professor Burton's conception of bad faith is correct, and that a possible solution to this problem would entail stricter information disclosure requirements as a 'rule' of good faith, regarding the contracting parties' true intentions. This idea will be discussed further in chapter four and five, when we outline solutions to the problem of distinguishing good from bad faith, and hence legitimate from illegitimate pressures.

¹⁷ Burton, "Breach of Contract" 373

Chapter 3: Problems with current judicial guidance and definitions of illegitimate pressure.

In the next chapter we will look briefly at the problems with the current thinking in the common law via an analysis of the case law on duress. In assessing the actions of the threatening parties and their corresponding effect on the threatened party, the courts must determine objectively whether the threatened party was actually harmed. Harm is defined as the threatened party losing something he had reasonably envisaged at the start of the contract (for instance losing a benefit outright, or losing a portion of the benefit as a result of having to offer more compensation). Crucially, this definition of harm means that if the threatening party threatens to withhold future business contracts from its contractual partner independent of the current transaction in question, this would not amount to the required harm necessary to prove an illegal action for the purposes of the duress test, although it might be immoral.¹⁸ The chapter is concluded by examining Roger Brownsword's theoretical conception of good faith as exception in explaining the judiciary's current view on the distinguishing mark between legitimate and illegitimate pressure.

3.1 Early case law and policy challenges

The early duress cases facing the judiciary in the 1970s and 1980s concerned a variety of different economic sectors and industries, including shipping¹⁹, manufactured household goods²⁰,

¹⁸ CTN Cash and Carry Ltd v Gallaher [1994] 4 All ER 714

¹⁹The Atlantic Baron [1978] 3 All ER 1170, Occidental Worldwide Investment Corp v Skibs A/S Avanti (The Sibeon and The Sibotre) [1976] 1 Lloyd's Rep 293

²⁰ Atlas Express v Kafco Ltd [1989] 1 All ER 641

convenience store goods²¹, and contracts to erect signs at a trade show.²² Although the sectors varied, the challenges facing the judiciary did not. From a policy perspective, they are generally described as two objectives pulling in opposing directions. From one perspective, the fact that we live in a market where conditions change, and the prices of goods fluctuate, means that the courts cannot simply strike down every modification, for the economy would potentially grind to a halt, contract, or both. On the other hand, there is a need for certainty and predictability in drafting a contract in which the parties, within reason, can rely on those provisions, and allocate their resources accordingly.²³ Adams and Brownsword comment that the courts prefer the former view, to ensure that parties are not given ample excuses to get out of a “bad bargain”²⁴ as a result of a liberally interpreted duress doctrine which strikes down modifications with ease.

Pao On was the case that broke ground, in terms of more concrete judicial guidance being supplied. The Lord Scarman guidance test is of crucial importance, and it is repeated here in full:

There is nothing contrary to principle in recognising economic duress as a factor which may render a contract voidable provided always that the basis of such recognition is that it must amount to a coercion of will, which vitiates consent. It must be shown that the payment made on the contract entered into was not a voluntary act.....

- 1.) it is material to enquire whether the person alleged to have been coerced did or did not protest; whether,
- 2.) *at the time he was allegedly coerced into making a contract, he did or did not have an alternative course open to him such as an adequate legal remedy;* (author’s emphasis)
- 3.) whether he was independently advised; and
- 4.) whether, after entering the contract, he took steps to avoid it²⁵

²¹ CTN Cash and Carry Ltd v Gallaher [1994] 4 All ER 714

²² B&S Contracts v Victor Green Publications [1984] I.C.R. 419

²³ MacDonald, Elizabeth – “Duress by Threatened Breach of Contract” (Journal of Business Law, November 1989)

²⁴ Adams and Brownsword “Ideologies of Contract” 209.

²⁵ Pao On, para 635

Criteria 1, 3, and 4 are merely objective, factual tests and are easily confirmed via evidence supported by internal corporate memos, legal counsel correspondence, and so forth. Our focus here is on criteria 2, which is subjective and therefore contentious. It is not difficult to discern from the original Scarman criteria that a complete vitiation of the will whereby a party acts in a non-autonomous state is a high legal evidential hurdle for a claimant to overcome – most times, argues Stephen Smith, a party is not completely bullied into choosing ‘bad’, over ‘good’ choices, but rather must chose the best from a limited number of potentially unfavourable options²⁶ The next two sub-chapters will focus attention on the second criteria of the Scarman test.

3.2 The problems inherent in defining coercion and illegitimate pressures

This paper noted from the start that the definition of illegitimate is difficult to conceptualize and place clear boundaries around, and this partially to do with the fact that the notion of ‘pressure’ to secure a modification for one party may be classified ‘aggressive’, or ‘normal’ to one contracting partner and ‘coercion’ and ‘threatening’ to another depending on particular company resources, nature of the contract, business climate at the time, and numerous other factors. Complicating the situation even further is the fact that the judiciary, having seen many cases, and hearing conflicting testimony, may in fact have a completely different “third” commercial reality to the parties on hand.²⁷ The heart of the problem is discussed by Sian Provost:

If, as Objectivism holds, concepts are grounded in reality and man is capable of objective knowledge, then man's mind is independent of the minds of other men, his primary orientation is with reality, and his choices are solely within his own control....a man's mind is not within the control of others, whether one is coerced is not a psychological question-it is not dependent on what goes on in the mind of the alleged victim.... Because

²⁶ Smith, Stephen “Contracting under pressure – a theory of duress” (Cambridge Law Journal, Vol 56, 1997), 341, *hereafter*, Smith “Contracting under pressure”

²⁷ As was the case in the Atlantic Baron case, when the courts issued guidance to the parties that they should have been aware that in the near future it would be a ‘buyers’ market, and that the seller making the threat would have much less leverage , The Atlantic Baron, at para 720

coercion cannot depend on what goes on in the mind of the alleged victim, it must depend on some external factor-on whether the alleged aggressor has harmed the alleged victim in some way. Before one can decide whether someone is harmed, though, one must first decide what is his²⁸

The central paradox the analysis faces is defined as thus: in determining illegitimate coercion, the courts cannot at the moment ascertain the “state of mind” of a defendant or claimant, who is potentially acting in bad faith.²⁹ We recognize that although “harm” may have occurred in someone’s mind, the assessment from a subjective point of view is too hard a task, and it risks taking the judiciary away from their position of neutral arbiters of a set of facts from both sides. On the same token however, determining whether there was bad faith, which is traditionally defined contextually, is an essential criteria for assessing whether legal act duress has occurred.³⁰ Provost’s explanation, while providing guidance and a framework for case analysis, does not resolve any questions for practical purposes. What of an opportunity not taken advantage of that, “theoretically”, should have been “his”? What if the reason for this rejection of a so called ‘adequate’ legal remedy is explained by the fact that it does not provide the threatened party with the reasonable expectations he held? The next section discusses these questions in depth.

3.3 The Lord Scarman criteria and “adequate” legal remedies

To clarify from the outset, when the author discusses adequate legal remedies, this is not a discussion concerning the remedies for duress, but rather the “theoretical” or “potential” remedy that a claimant could have enacted upon initially encountering the illegitimate pressure – the

²⁸ Provost, Sian “A defence of a rights-based approach to identifying coercion in Contract Law” (Texas Law Review, Vol. 73, 1994-1995), 650

²⁹ Raineri v. Miles [1981] A.C. 1050 at 1086, cited in Tan, Daniel “Constructing a doctrine of Duress”, (Construction L.J. Vol 18, 2002), *hereafter*, Tan “Constructing a doctrine of duress”

³⁰ Tan, “Constructing a Doctrine of Duress” 91

second criteria of the Lord Scarman test. Stephen Smith has proposed that a “legal remedy” is adequate as an alternative course to completing the contract, whereby secondary rights under the contract are recognized - for instance, damages.³¹ There are two problems with this view. The first is that the legal remedy is not the same as specific performance, owing to the fact that a legal remedy to determine whether a modification is permitted may completely ignore sensitive time considerations in performing a contract.³² Secondly, the litigation costs and other transaction costs of discharging and finding a new contract partner translate into a situation whereby the compensation that can be recovered through damages are not equated to the value of the performance initially agreed on.³³ What is crucial to note is that in the early cases concerning duress, the judiciary did not issue guidance as to whether a theoretical “adequate legal remedy” would look like, providing little analysis of the facts at hand and the commercial necessity for the contract to be carried out without the delay of litigation.³⁴ This author strongly agrees with Hamish Stewart’s contention, which presents a very different view of the “adequate legal remedy”:

It is also true that contractual obligations are conveniently thought of as consisting of a primary obligation to perform and a secondary obligation to pay damages, and that P has no cause for complaint if a actually pays. But, in the threatened breach of contract cases, a's proposal is not, 'Unless you do as I say, I won't perform; but of course I will pay damages'; the proposal is rather, 'Unless you do as I say, I won't perform; go ahead and sue me if you like.' This proposal amounts to a threat to breach both the primary and the secondary obligations under the contract.³⁵

³¹ Smith, “Contracting under pressure”, 320

³² *Atlas Express v Kafco Ltd* [1989] 1 All ER 641

³³ Robison, Thornton, “Enforcing Extorted Contract Modifications” (Iowa Law Review 1982-1983) 704

³⁴ *The Atlantic Baron* [1978] 3 All ER 1170

³⁵ Stewart, Hamish “A formal approach to contractual duress” (The University of Toronto L.J.),186 Quoting Cf. Robert Nozick, 'Coercion,' eds., Sidney Morgenbesser, Patrick Suppes & Morton, *hereafter*, Stewart “A formal approach to contractual duress”

From Stewart's perspective then, the correlation between looking at legal remedies and the application of illegitimate pressure merits further analysis. In order to prove that there was no bad faith, the defendant must show that theoretically, he would have made a modification offer, breached the contract if the counter-offer was not suitable, paid damages, and moved on to a third party contracting partner. However, a duress situation is more accurately described as party who wants to remain *in* the contract, and is trying to exploit it for his personal ends. He has never contemplating paying damages, because he has no intention to move to another contractual partner. It logically follows that he must initiate a threat for his new contractual demands to be met, for if this was simply an example of everyday "business pressure", he would either move to another contractual partner, or pursue legal action in response to non-compliance with a perfectly legitimate business demand. In a rare display of a contractual party demonstrating this formally in writing rather than via more subtle actions, the defendant in *Huyton v Peter Cremer* threatened outright to breach the contract and not provide modified compensation if the claimant were to pursue legal redress at a later date.³⁶ Following this line of thinking then, the freedom of the threatened party to pursue other opportunities has been undermined by the threat making party when he is forced to remain in the contract³⁷, because the opportunities upon signing were either captured (by signing the contract and agreeing to what would occur), or have disappeared by virtue of the claimant forsaking an alternative opportunity based on reasonable reliance. When this is case, this author argues that good faith is *not* defined as the possibility that harm was suffered at the hands of the defendant who is not providing legal redress and other opportunities

³⁶ *Huyton v Peter Cremer* (1999) 1 Lloyd's Rep 620

³⁷ "Breach of duty and corruption can be interpreted as wrongful interferences with freedom. I distinguish these proposals from those that remove important options to emphasize that option-removing proposals can be prima facie wrongful limits on freedom even if they breach no duty." Altman, Scott "Divorcing Threats and Offers" *Law and Philosophy*, Vol. 15, No. 3, 1996, 216, hereafter, Altman, "Divorcing Threats and Offers"

which he himself removed in the first place. The reality which best express a starting point “rule” to determine whether the threatened party’s opportunity was illegitimately taken away, is to create a test whereby the burden should fall on the defendant to challenge the prima-facie assumption that he had no intention of terminating the contract after the modification was threatened.

3.4 Roger Brownsword’s conception of good faith: A theoretical paradigm to work with

We have discussed Professor Burton’s conceptualization of good and bad faith, and now we come to the central question: if the concept of “illegitimate pressure” has been expanded to include legal commercial pressures, how will the courts define the boundaries of good faith in making contract modifications? The author argues that the current judicial attitudes and tools for assessing bad faith are untenable, especially as they relate to determination of what constitutes an illegitimate pressure.

3.4.1 The current view: market individualism and good faith as exception

Traditionally, duress has been the realm of commentary focusing its analysis on placing duress in the same category as “fraud”, and treating duress as a rarely used exception where unacceptable behaviour by one of the parties has lead to the creation of something which is not a mutually agreeable, enforceable legal set of rights, and hence the courts can intervene and render a contract made by the parties void.³⁸ Thus, duress has traditionally been said to find a room in the residence of what Roger Brownword calls the classical theory of contract and its related cousin – economic individualism, whereby the economic interests and opportunities of each party reigns

³⁸ Brownsword, Roger “Two concepts of good faith”, (Journal of Contract Law, Vol 7, 1994), 205, hereafter, Brownsword “Two concepts of good faith

supreme over all other considerations, including mutual co-operation.³⁹ Following this, good faith is simply defined as any practice which does not include a number of bad faith exceptions, a view initially espoused by Professor Robert Summers.⁴⁰ These classical contract principles are discussed by Friedrich Kessler as:

The..rules of (contract), of which freedom of contract is the most powerful symbol, is closely tied up with the ethics of free enterprise capitalism and the ideals of justice of a mobile society of small enterprisers, individual merchants and independent craftsmen... The play of the market if left to itself must therefore maximize net satisfactions. Justice within this framework has a very definite meaning. It means freedom of property and of contract, of profit making and of trade...⁴¹

This does not mean that no business practices are left untouched by the courts.⁴² It does suggest that certain practices, or “exceptions” which are frowned upon, would have to be compiled by the courts and put clearly on display for guidance. The feasibility of this is questionable at best, as the comments section to the U.S. Restatement Second rules of contract stated that “a complete catalogue of types of bad faith is impossible”⁴³. It is not intelligent policy to compile a list without a coherent underlying principle, especially since a principle is essential if we are to know how contract law will progress and demonstrate consistency when adding new exceptions in the future. This glaring problem merits a solution.

³⁹ Brownsword, “Two concepts of good faith”, 197

⁴⁰ Summers, Robert “Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code” (The Virginia Law Review, 1968, Issue 2), 201

⁴¹ Kessler, “Contracts of Adhesion”, 640

⁴² “Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations” – Lord Ackner ([1992] 1 All ER 453 at 460-1.) Brownsword, “Two concepts of good faith”, 197

⁴³ Farnsworth, E. Allan “The Concept of Good Faith in American Law”, Speech Delivered to the Centre for Studies and Research on Comparative Rights and Foreign Law, Presentations, Conferences, and Seminars) 3, Rome, April 1993.

Chapter 4: Duress case law in the 21st century: progress and solutions

In this chapter, after reviewing and critiquing the judicial attitude towards illegitimate pressure and its interlinked criteria of bad faith, we return to our central question, which is defined as creating a dividing line between “everyday” commercial pressures, and illegitimate pressures that constitute duress.

4.1 The definition of illegitimate: baseline expectations

The author stated from the outset that an analysis of a threat versus an offer is crucial, however, going even conceptually deeper than the threat, we see that the very idea of the threat is rooted in baseline expectations and bad practices, which are in turn directly related to the concept of good and bad faith. Support for this is provided by Hamish Stewart who says that “to enforce a contract made under conditions (of bad faith) that negate the very idea of freedom of contract would be contradictory”⁴⁴. In a theoretical case presented by Nozick, a company had ‘informed’ its employees it would go out of business if they formed a union, but it did not disclose to them that this statement was not true.⁴⁵ This, argued Nozick which constituted a threat, because it robbed the employees of the true freedom to make a choice in the first place. This would be held to be a threat, even if, absent the threat, the firm ceasing to operate was inevitable.⁴⁶ In the latter scenario, there is freedom to make a decision, despite the fact that the likely option will be heavily unfavourable to their interests. From this, we can see that withholding crucial information constituted a form of bad faith, which is directly correlated to a threat, and hence an

⁴⁴ Stewart “A formal approach to contractual duress” 209

⁴⁵ Stewart “A formal approach to contractual duress” 187

⁴⁶ Stewart “A formal approach to contractual duress” 187

illegitimate pressure undermining freedom of contract principles, which are discussed in depth in section 2.1.1. Judicial opinion has noted that in cases of lawful act duress, the good or bad faith of the party applying the pressure would be highly relevant.⁴⁷

A compelling argument has been made thus far that clarification between subjective and objective views of what a reasonable expectation of what is 'mine' is crucial to determining whether there has in fact been coercion and threats. George Fletcher proposes a theory which creates a "baseline" to determine what the normal state affairs for a given situation are⁴⁸, so that for instance, if one party says to another party: "speed up production, or I will pay your factory an unexpected visit and fire workers at random", this warning may not constitute a threat if, a) this is a normally occurring practice between the parties, irrespective of the ultimatum, b) the threatened party understands that I would like to shed some workers from a bloated workforce, irrespective of whether I make the threat or not, or c) the behaviour (of speeding up production) is forced, however it is crucial that the factory speeds up production or it will go out of business. Thus, identifying variables in the business/contract relationship and creating an objective baseline based on the contracting parties' resources, market position, etc. provides a contextual background from which to assess a threat from a normal business pressure. The next section discusses the evolution of this practice in some of the recent case law on the issue.

⁴⁷ *Huyton*, para 637

⁴⁸ Fletcher, George "Blackmail: the Paradigmatic Crime" (University of Pennsylvania L.R., Vol 141, 1993), 117

4.2 Current case law: A marked departure from the past?

4.2.1 DSND and Carillion

DSND⁴⁹ and Carillion⁵⁰ were two cases decided in 2000 with very different outcomes – in DSND, it was said that the ‘threatened’ modifications although not originally envisaged, did not amount to breach, but rather necessity on the defendant firm’s part, thus it was held that there was no duress.⁵¹ In Carillion however, the main finding for duress centred around an internal memo written by the threatening party, which stated ““No deliveries until we get agreement”, which referred to the fact that Carillion’s contracting partner, Felix, was attempting to force Carillion to sign a final account figure in order for the appropriate construction materials to be released, that in Carillion’s view, was in excess of Felix’s true entitlement.⁵² The courts also stated that in Carillion, after assessing the situation, Carillion could not afford to stall, as there were time requirements in completing the contract.⁵³ Contrasting the two cases, it is clear that in DSND the courts did in fact look at the specific company resources and economic perspectives to ascertain that DSND itself was placed in a difficult position, and as a result of pressures placed on it, it then had to modify the terms of its agreement.⁵⁴ In Carillion however, there was absolutely no question that both in the defendant’s mind, and the claimant’s mind, that this was a threat, albeit, from Carillion’s point of view, it was a threat in response to non performance of what was interpreted by Felix as an essential, standard business practice. In his analysis of the

⁴⁹ DSND v. Subsea Limited (Formerly known as DSND Oceantech Limited) v Petroleum Geo Services ASA, PGS Offshore Technology AS (2000) WL 1741490, hereafter, DSND

⁵⁰ Carillion Construction Limited v Felix (UK) Limited, 2000 WL 33148847, hereafter, Carillion

⁵¹ DSND

⁵² Carillion, para 13

⁵³ Carillion, para 39

⁵⁴ DSND, para 134: “I would say that the suspension of work on the RTIAs pending resolution of the insurance/indemnity question, even if it was a breach of contract, and even if it amounted to pressure, did not amount to illegitimate pressure. It was reasonable behaviour by a contractor acting bona fide in a very difficult situation”

case, Daniel Tan has disagreed with the courts, and said that Felix, in asking Carillion to sign the final account, indeed was not acting out of line with industry expectations.⁵⁵ Thus in Carillion, on the subject of pressure, the courts looked at all theoretical business options to discern whether they were adequate, and found that there were none. This case looked at the initial payment plan, and the court did state that the proposed modification did in fact stray widely from Carillion's reasonable expectations.⁵⁶ This opens a Pandora's Box of questions. If as Daniel Tan indicates, it was standard industry practice to ensure that the final account was settled prior to performance, does one contracting party's actions in not agreeing to this practice provide justification for a threat from his counterpart? Is straying from industry practice and disclosure of information before hand considered to be acting in 'bad faith?' Is the threat to Felix's economic interests by letting an agreement to the final account, possibly resolved through mediation or arbitration in the distant future considered? Would the fact that the Felix's reasonable expectations having been breached would justify non-performance? In DSND the court weighed up the competing interests and reasoned that if a party could mitigate its risk from duress, that the second *Pao On* criteria of duress, namely that the illegitimate pressure has caused the threatened party to act the way it did, would not fail:

The fact is that, if PGS had truly felt that they were subject to duress, then on their view of the situation they would have had no difficulty in terminating under Article 16.1, and claiming the costs resulting from the termination from DSND. PGS had the benefit of a parent company guarantee.⁵⁷

⁵⁵Tan, "Constructing a Doctrine of Duress", 91

⁵⁶ Carillion, para 8

⁵⁷ DSND, para 134

These are questions that must be resolved to get to the heart of what constitutes illegitimate pressures, however, it is argued here that in assessing both company interests, and industry practices⁵⁸ is a very good start when attempting to derive an ‘objective baseline’ in determining whether a breach of industry expectations could be seen as acting in bad faith.

4.3 The rule of good faith and its practical application

The concept of mitigating threats via reducing risk will be discussed in depth in our analysis of an important case decided recently called Adam Opel v Mitras. To provide context for our arguments, we look at how a concept of “good faith as rule”, would work in contrast to Brownsword’s concept of, “good faith as exception”. It is argued that one of the underlying principles of a ‘rule’ of good faith should be a material disclosure by both parties to ensure that the types of problems seen in Adam Opel will not occur in the future.

4.3.1 Good faith as rule

Brownsword’s article is entitled “two concepts of good faith”, and the Professor does propose an alternative theory, whereby good faith would be seen as the starting point ‘rule’, rather than an exception. Logically related to this paradigm shift in thinking is that parties cannot simply pursue opportunities without regard to the interests of their contractual partners in mind⁵⁹, and it would thus follow that outcomes of the contract would be scrutinized, rather than assuming that the play of the market would ‘maximize net satisfactions’⁶⁰ Kessler provides a justification, and a more active judicial approach to ensuring good faith and freedom of contract as rule rather than exception:

⁵⁸ Carillion, para 32

⁵⁹ Brownsword, “Two Concepts of Good Faith”

⁶⁰ Kessler “Contracts of Adhesion” 640

With the decline of the free enterprise system due to the innate trend of competitive capitalism towards monopoly, the meaning of contract has changed radically. Society, when granting freedom of contract, does not guarantee that all members of the community will be able to make use of it to the same extent. On the contrary, the law, by protecting the unequal distribution of property, does nothing to prevent freedom of contract from becoming a one-sided privilege.⁶¹

Support for, and implementation of Brownsword's "good faith" rules would allow the courts to draw clearer lines between the related (but conceptually different) ideas of re-distribution and opportunism (legitimate pressures), and threats (illegitimate pressures). If a firm had acted in bad faith, breaking those pre-determined standards by which the courts could intervene, and its contract partner in response to this, applied pressure and attempted to enforce the contract, it would merely be seen as an everyday, industry standard commercial pressure. In that respect then, the underlying concept of illegitimacy, defined dually by a threat in proportion to the risk at hand, and the commercial practice of another party, would gain more traction in the realm of British contract law. This is explained by the fact that a firm acting in bad faith may not be able to escape contractual obligations in response to a "threat." If the courts do not believe that the threatening pressure was disproportionate to the initial expectations, and the pressure is indeed necessary to enforce the contract, they would simply classify it as an ordinary business pressure. In practical terms, as we have argued, we need to create a baseline of expectations based on Fletcher's theory, and then ascertain what actions would lie within, or outside of a "rule of good faith" to determine legitimate from illegitimate actions.

⁶¹ Kessler "Contracts of Adhesion", 640

Chapter 5: Adam Opel v. Mitras: A case analysis

5.1 Adam Opel v Mitras: The facts

Adam Opel v. Mitras⁶² is one of the more recent duress cases decided in 2007. It is an interesting case which illustrates that the courts have indeed moved forward to calculate the resources, competencies, and general position of the parties in order to distinguish the differences between a threat, a benefit, or an adequate legal remedy. The facts are as follows. The car manufacturer Opel signed a long term contract with Mitras to provide plastic moulding injections for the mounting of bumpers. Opel gave notice halfway through the contract that it would switch suppliers, leaving Mitras in an unenviable position of having 5 years left to recoup its initial outlay costs. In response to these unexpected actions, Mitras attempted to increase the price of the parts in the six months remaining in the contract, and stated unequivocally that shipments would be halted if the new prices were paid. Indeed, the threatened breach turned into an actual breach, and Mitras halted shipments for a short period of time. In the judgement, the cost of what the Opel would have lost if they had not acceded to the threat was calculated by Donaldson QC⁶³, and an analysis of whether on the facts of the case, a legal remedy would actually be adequate was also provided. It was determined that the pressure was illegitimate, the legal remedy was not adequate, given the fact that the firm would lose a large sum of money every day that production was stopped, and the legal remedy was not seen as “adequate”, and

⁶² Adam Opel GmbH v Mitras Automotive (UK) Ltd [2008] EWHC 3205 (QB)

⁶³ *Adam Opel*, para 32

duress was established.⁶⁴ This does in fact represent a level of commercial sophistication shown by the courts not seen in the previous cases.

5.2 Analysis

In this case, it is argued that the courts have moved towards a more subjective view of assessing profits and potential losses on the facts, and determined an artificial baseline, implying that if Opel stood to lose a small amount of money, the situation would be analogous to a normal conflict with a supplier, and a legal remedy would be considered adequate. However, Opel stood to lose a lot from the breach of contract, and thus the legal remedy would not be adequate. The baseline did not attempt to look at the losses in comparison to what the entire contract was worth to determine whether it was material, nor did it look at the losses in comparison to Opel's revenues, which are, this author argues, material distinctions to be made. There was little analysis of the costs incurred as a result of Mitras's reliance in contractual negotiations, proving that the subjective approach to defining what is "his" as described by Provost earlier, has not been used to ascertain what both parties can expect from the contract, and hence define "harm" incurred. Thus, rather than moving to a commercial reality, we see that the courts have preferred one commercial reality over another commercial reality.

In creating a baseline of what is acceptable or not, based on economic/business considerations, the courts in *Adam Opel* did not look at the initial dealings between the parties to make a determination as to whether there should have been more disclosure of information by Opel, who was attempting to provide a measure of long-term guarantee to Mitras so that they could invest in research and development and a construct a manufacturing plant to meet long term demand. It

⁶⁴ *Adam Opel*, para 37

should be stated from the outset of the analysis that the current policy is that a contracting party who has made a threat cannot rely on this type of “defence” concerning lack of disclosure to justify his actions in making a threat.⁶⁵

Turning to Brownsword’s notion of good faith dealing as an exception, and the pre-existing good faith principles, the contracting parties are under no obligation to do so, so long as they do not provide information that does not mislead.⁶⁶ Indeed, those adherents to the status quo of good faith as exception might be inclined to say that whether Opel provided information or not at the beginning or not about a potential design switch, is irrelevant to assessing what whether Mitras’s options constituting removing options from Opel, because Opel would breach the contract irrespective. They are two different scenarios however. Provided that the pertinent information was provided from the start, the opportunities forsaken and captured would have been calculated differently, because there was not nearly as much risk involved. There is always risk involved in contracts, but the question is if whether exposing a contractual partner to a large degree of unnecessary risk is equated to bad faith in negotiation, because of the removal of crucial options which would amount to inhibition of freedom of contract.⁶⁷ On this author’s analysis, disclosure of necessary information would be one of the “rules” of good faith, which stresses co-operation rather than pursuit of interests at any cost.

⁶⁵ *Raineri v. Miles* [1981] A.C. 1050 at 1086, as cited by Daniel Tan, “Constructing a doctrine of duress”, 91

⁶⁶ Brownsword, “Two concepts of good faith”, 213

⁶⁷ “(It has been argued in the past that) If the person is bluffing, then one in fact has the same options after the threat as before. This...mistakes the nature of the options. After a bluff the recipient no longer has the option of declining the proposal without risk.” Altman, “Divorcing Threats and Offers”, 214

5.3 Disseminating threats from offers: assimilating links and severing others

From the above analysis then, this author argues that in order to distinguish a illegitimate from legitimate pressures, the courts must in fact weigh the actions of the parties against each other to determine if a party's threat to recapture those opportunities originally forsaken were in lieu of, and on par with the lack of disclosure from its contractual counterpart, and subsequent harm. The establishment of good faith as a "rule" in a given contract would derive from a baseline of reasonable expectations, looking at both industry practice, and the relationship of the parties themselves. From the starting point, we argued that the proper way to interpret a threat was that it was an offer combined with an acceptance, given in the form of an ultimatum. This supports the view that the test for duress is properly seen as one party who is wishing to remain in the contract at all costs, as the analysis put forth in the critique of the Lord Scarman criteria suggested. In effect, this party, utilizing economic justifications mentioned earlier, by threatening its contract partner to remain in the contract, has managed to capture forsaken opportunities, or reward, whilst transferring extra risk to its contractual partner that were not reasonably expected.

Threatened breach of contract, as seen in the cases of DSND, Carillion, and most recently Opel, provides us with a credible personification of the theory of baseline expectations – where a threatened breach of contract comes into play, although the courts cannot entirely be sure if a threatening party would have actually breached a contract, the pressure is deemed to be illegitimate because it has introduced risk. This is not simply "everyday business" risk. Rather, additional risk in economic duress is defined as occurring when the contracting party subject to the threat (or a reasonable contracting partner) would have never entered into the contract, had they known that there would be this risk of breach of contract, unless certain other, additional obligations outside of the realm of reasonable industry practice were undertaken. Further, this

would fall in line with the definition of a threat, in which the only way to secure compliance is to take away a voluntary acceptance, since the acceptance is based on a certain set of facts, and not the real intentions of the threatening party. Indeed, proof for this comes from DSND where the defendants prevailed, because it was said that the claimant was insulated from its potential options being limited and/or removed.⁶⁸ The risk in a duress case is such that the party's freedom to exercise its basic competencies⁶⁹ or to potentially shield itself from this risk has been decimated. This is what raises the ire of the courts, rather than the traditional re-distribution of benefits view that finds fault in a grossly disproportionate benefit distribution after a modification. Thus a judge, rather than re-distributing the wealth of a contract, is in actual fact, re-distributing risk to the original levels when the contract was signed in a case where duress is successfully argued. Note though, that this should not be equated to a redistribution of opportunities exercised from specific competencies/skills between the parties, but only the risks and rewards, and opportunities 'locked' on to at the beginning of the contractual relationship.

Chapter 6: Conclusion

This author has argued that the only way to solve the problem of distinguishing illegitimate from legitimate pressures is to look more closely at the concept of good faith in contract law. Good and bad faith are not static, absolute concepts, and thus the courts cannot expect to come up with a rule of disclosure which could satisfy all situations. However, looking at disclosure of information from the beginning of contract in assessing a threat is an important first step to providing clarification to future litigants. This involves a detailed analysis of the contracting

⁶⁸ DSND, para 134

⁶⁹ Kronman, "Contract Law and Distributive Justice", 472

companies' resources, cost of the contract, obligations entered into as a result of the contract, industry standards, and then the formulation of what a reasonable "rule" would look like for the parties if they were to act in good faith. As a result of looking at disclosure of information, we find that the reasonable expectations of the parties and a baseline of expectations is required to determine the threat in its proper context.

Putting forth solutions to the problem of distinguishing illegitimate from legitimate threats has not been an easy task, but it is essential. It is essential for drawing the lines between what the free market system allows, or promotes: opportunism, and what it does not allow – attempting to use legal rights to remove one's self from a transaction stemming from poor foresight.

In contrast to those who feel as though a "rule" of good faith and co-operation such as greater disclosure of information will curtail the pursuit of individualistic goals in the market, there is economic justification from Altman. He argues that threats are never necessary to produce beneficial bargains⁷⁰, and this is because, as we have shown, market prices can easily become distorted as a natural reaction to additional extra risk that has been imported into the contract. Prices to perform future contracts would potentially be sold below cost as a result of a modification which extracts extra benefit and crystallizes into "reality"– or prices for goods are raised by the claimant to account for the additional risk that they may be required to provide much more compensation than what they had originally been envisaged.

⁷⁰ Altman, "Divorcing threats from offers" 220

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Atlas Express v Kafco Ltd [1989] 1 All ER 641

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