

Legal commentary

by Endre Stavang*

“A promise is a promise and a man is a man” is an old saying that still holds true. Many lawyers earn their living drawing up major commercial contracts, and it is taken as a given that these contracts – by law – are binding in their original form. If this were not the case, the promisee would feel insecure as to whether the promisor would later be tempted to renege, and this insecurity would in some cases deter the promisee from entering into the contract at all. Lofty words such as predictability, legitimate expectation and justice can be used to denote the values lawyers assign to the principle of the binding effect of promises and contracts.

But – and there is a but – from the perspective of jurisprudence, the principle that contracts are binding is not much more than that – one principle among many others. Some of these other principles point in the opposite direction. Thus, in practice, there must be room for exceptions. The most prominent Nordic legal expert on the law of obligations in the 20th century, Jan Hellner, has for example said that although the principle that contracts are binding functions as a practical rule of law in many cases, it is not particularly applicable in legal discussion: “The principle (that agreements are binding) is not applicable as an argument in legal discussion. However, it functions as a practical rule of law in the great majority of cases. As such, it can be said to be almost a tautology – it only states the obvious. Water is wet, the earth is round, and contracts are binding.”¹ Nor does the principle say anything about the relationship to other principles or the fact that all contracts must be interpreted. And based on the general provision in Section 36 of the Contract Act, this can be taken even further, as stated in the first paragraph: “A contract may wholly or in part be set aside or changed to the extent its application would seem unreasonable or in conflict with good business practices. The same applies to unilaterally binding arrangements.”

This provision does not state that agreements are binding in their original form. On the contrary, it states that subsequent circumstances may have considerable influence on whether and to what extent a contract is binding. If complying with an agreement in its original form proves to be too costly, the agreement ceases to apply, wholly or in part. This pragmatic approach pervades contract law: to make the best of a situation as it is.

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¹ Jan Hellner, “Pacta sunt servanda”, article in Bratholm et al. (Ed.): *Samfunn – Rett – Rettferdighet. Festskrift til Torstein Eckhoffs 70-Årsdag* (Society – Law – Justice. Festschrift on the occasion of Torstein Eckhoff’s 70th birthday), TANO 1986, pp. 335–349, on page 348.

This is an elementary principle in law. Social scientists, however, are now asserting that there is much to be gained – and this also applies to government authorities – from keeping one’s promises – if necessary by providing assistance in the event of the threat of legal repercussions. The objective is confidence and credibility. For social scientists, this is perhaps not primarily valuable in itself, but is something that leads to higher investment, more consumption, less unemployment and – more generally – markets that meet human requirements to a greater extent and more efficiently.

I understand the topic of “keeping one’s word” as a kind of reference to the idea developed by economists and other social scientists of dynamic inconsistency or time inconsistency. This is probably part of human intuition, but in academia it has been further developed by Thomas Schelling and is reflected in second generation game theory on so-called dynamic interaction. In 1977, Kydland and Prescott published an analysis of time inconsistency in policy choices that extended the theory and applied it to fiscal and monetary policy. At its core, their finding was that many policy choices may be difficult to make in a dynamically consistent way. Assume that a rational and forward-looking authority chooses a schedule for its policy with a view to achieving the best possible outcome for the public in the period to which the policy applies. If the authority is given the opportunity to reassess and change the plan at a later date in the period, it is likely to do so because this will be the optimal approach for the period as a whole. But if people form expectations concerning the authority’s behaviour based on their experience at this later date, they may not have the incentive in the next period to do what was essentially the best thing from the start. Kydland and Prescott suggest that the authority can achieve more if their scope for weighing the advantages and disadvantages of the different alternatives for action in period 2 is limited and if this is announced in period 1.²

I do not intend to refer directly to monetary policy or the strategy or legal position of the central bank. Instead, I will examine whether this main idea – that there is much to be gained from keeping promises – is viable in law in a more general context. My question is what guidelines and legal framework the main idea should provide for government bodies and the branches of government. I will try out the idea on the sphere of natural resources law, i.e. the rules of law that apply to property, hydropower, oil, gas and environmental protection. This is a significant area in the sense that there is much to be gained from good law and much to be lost from its absence.

As my first illustration – mostly to check that I have understood the basic point – I will look at the regulations prohibiting the erection of new buildings and the application of the authority

² The Royal Swedish Academy of Sciences, Finn Kydland and Edward Prescott’s Contribution to Dynamic Macroeconomics: The Time Consistency of Economic Policy and the Driving Forces behind Business Cycles. Advanced information on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 11 October 2004, http://nobelprize.org/nobel_prizes/economics/laureates/2004/adv.html, p. 1–31 on pp. 2 and 5.

to issue a demolition order, cf. the Neighbouring Properties Act (Naboloven), Section 11, first paragraph:

“...If a building or other structure is unlawfully erected in such a way that part of the building stands on a neighbour’s property, the neighbour is entitled to have it removed or modified. If as a result, expenses or losses incurred are so great as to be clearly disproportionate to the gain, and the owner of the building is not to blame to any appreciable extent, the owner may be awarded exemption from liability if the neighbour receives compensation in an amount that must not be set lower than the damage or inconvenience.”

As we can see, the provision states that a building erected unlawfully on a neighbour’s property shall be removed. However, the provision also states that the structure may remain standing if removal results in a waste of resources as assessed at the time of removal. Both lawyers and social scientists would probably say that the latter could easily undermine respect for the basic principle that buildings shall only be built on one’s own property. From this perspective, the third rule in the provision should be noted: if the builder was negligent at the time of building, the building must be removed even though the cost at the time of removal seems excessive.

There is much to suggest that the reasoning behind Section 11, first paragraph of the Neighbouring Properties Act may be important for other parts of natural resources law. This should, however, be assessed for each of the three branches of government: the legislative, the executive and the judicial branch. I will offer an example related to each branch.

My first example refers to the *legislative* branch of government. It is a long established idea that the Constitution should limit the competence of the majority (see Articles 97 and 105 of the Constitution of the Kingdom of Norway). This can be perceived as a guarantee for positions under property law that increase investors’ confidence that they will receive the expected return on their investments. My example, however, refers to something slightly different: the constraints on an owner’s actions that are considered necessary for nature conservation. According to Norwegian legal tradition, owners must accept such encroachments on property without compensation. This was a source of frustration to property owners for a long period. The notion eventually emerged that property owners could respond by making their land less preservation-worthy, for example by destroying a natural or cultural feature of unique value or cutting down a forest worthy of preservation – before a preservation order had been considered. For this and other reasons, the Willoch government of the 1980s proposed new statutory provisions to compensate property owners affected by nature conservation decisions to a greater extent than had been customary. The idea was that conservation work could then be carried out in a more conciliatory atmosphere. In a sense, the authorities chose to honour a kind of tacit agreement between the government and

property owners that there should be some balance between the parties that cannot be disturbed without financial compensation. It is this “agreement” that is binding.

My second example refers to the *executive* branch of government. My starting-point here is that municipalities and other government bodies, including the Norwegian parliament, are entitled, within certain general limits under administrative law, to make new decisions in the future notwithstanding decisions made in the past. A parliament cannot, for example, commit a future parliament to a decision concerning licensing policy. Something similar will apply to the exercise of local government authority, for example in deciding on and implementing area development plans. For major development projects, it will be of great value to private parties if they can be sure that future municipal councils will not change the area development plan on which they have based their investments. It has long been unclear to what extent precommitment is within the authority of the municipalities. This may result in private investment that is lower than socially desirable. However, new provisions in the Planning and Building Act provide legal authority for development contracts that may ensure a greater degree of predictability. Nevertheless, there is no explicit provision regarding precommitment of municipal executive authority, and as a result we have to rely on judicial precedents. A key Supreme Court ruling reported in 2007 (the road project judgment) stated the following:

“As the Supreme Court has pointed out earlier, government must have the authority to precommit their authority to a certain extent in relation to a contract if this is considered necessary or desirable in order to promote the purpose of the authorising legislation. The precommitment must, however, be kept within reasonable limits and the extent to which precommitments can be binding will differ across the different areas of government administration. The decision must depend on an assessment of the interest in the administration of government authority and public funds in the best interests of the people and the need to achieve the desired goals or solutions by precommitting the exercise of authority. To ensure that the question of binding a current administration to future commitments has been adequately assessed, the precommitment must be required to have a clear basis in the relevant contract.”

It might be said that the Court has drawn up guidelines in this case that enable municipalities to make promises, and that the Planning and Building Act assumes that promises made by municipalities will normally be binding. As we can see from the wording of the Supreme Court ruling, the authority to make binding precommitments is generally regulated by three factors: first, the extent to which precommitment is desirable or necessary to promote the purpose of the Act; second, an assessment of the advantage of the exercise of discretionary authority against the need for binding precommitment; and third, how clear the basis for precommitment is in the relevant agreement.

My third example refers to the *judicial* branch of government. Passing judgment is a form of political activity in the sense that in difficult cases the judge applies discretionary judgment. A judge's personality and ethical principles *ex ante* will therefore influence his or her decisions *ex post*. This may result in reduced predictability, and as a result private parties may adapt to this uncertainty in various, perhaps undesirable ways. How can these harmful effects be reduced?³ One possibility is to give emphasis in the application of law to objectively verifiable factors such as for example preparatory work (*travaux préparatoires*, which clarifies the intention of the lawmakers) and previous decisions (precedents). Where the wording of a law leaves substantial scope for discretion, the *travaux préparatoires* and precedents can narrow this down, making judgments more predictable. But some freedom of choice will almost always remain in difficult cases. The question then arises as to which ideology should determine the effect of a judge's ethical principles. There are two schools of thought here. Some would say that judges should take account of the concrete reasonableness between the parties at the time the conflict is to be resolved. Others argue that greatest weight must be given to general, normally applicable considerations. The most decisive factor will then be the reasonableness between the type of parties contesting the case, and the relevant time will be prior to the conflict. The first of these models can be called the *ex post*-school, and the second the *ex ante*-school.

Which school is the most suitable from our perspective? The answer is clear enough that a judge's ethical principles should be reflected in general assessments of which considerations are relevant *ex ante*. This corresponds to the old rule in the Swiss code of civil law: if no answer is to be found in the act, the judge shall apply the optimal rule from a legislative perspective. Such an approach ensures that the judge is forward-looking and takes account of the long-term consequences of his or her decision. This can be interpreted as the will to "keep one's promises".

I have provided three examples of how the judicial system can "keep promises". However, it would be easy to find contradictory examples to show that other considerations can be more important than confidence and credibility. In addition to what I have already said about this, it may, for example, be more important that a popular majority wins through at any time than that there is an optimal climate for investment, as clearly reflected in the road project judgement of 2007. Here, the Norwegian Supreme Court stated:

"Any doubts related to the possibility of a municipal authority precommitting its authority to allocate funds derive first from the possibility that the facts may change or that new information may emerge that was not available to the municipality when the contract was concluded. When a municipality has entered into a contract for a transport sector project, demographic developments or requirements imposed on municipal services might lead to an increase in municipal

³ For an example of the view held by economists that it is relevant to examine the problem of dynamic inconsistency in the light of courts' rulings, see Luca Anderlini, Leonardo Felli and Alessandro Riboni, "Statute Law or Case Law?", CESifo Working Paper No. 2358 July 2008, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1187642, pp. 1–48.

expenditure on social welfare or welfare services for the elderly or on the school and daycare institutions sector that could not have been envisioned when the contract was concluded. Second, political priorities may also have changed, as a result of a change in public opinion or a change in policy following an election. Insofar as it is accepted that an administration can precommit its authority, it will be difficult to accomplish a change in policy. This will constitute a constraint on democracy. In view of these doubts, the courts have been reluctant to accept agreements whereby the public administration can precommit its authority (see *NOU 2003:24* “More effective building legislation”, and Eckhoff and Smith, *Administrative Law*, which includes references to case law).”

In my opinion, there is every reason to continue to mull over these questions. We are facing complex problems of governance where interpretation and discretion are probably essential to our efforts to achieve good results.