

THE SOCIAL FUNCTION OF CONTRACTS IN MARKET ECONOMIC SYSTEMS

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ABSTRACT: The purpose of this paper is to describe the current status in the Brazilian academic writings and case law regarding the social function of contracts (the first part addresses this topic) – identifying the social function of the contract under the view of the distributive character of the “social justice”, which is inherent to the Social State. Second, the paper suggests a critical analysis about the consensus that is arising among Brazilian jurists and judges concerning the social function, starting with a view defended by the school of economic analysis of the Law.

KEY WORDS: Social Function of the Contract – Solidarism – Contractual Welfarism – Economic Analysis - Market

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The new Civil Code (NCC), which was published in 2002 and became effective in 2003, brought about significant changes compared with the old one. Not from a quantitative standpoint (number of sections), but from a qualitative one (content of the rules). Maybe the most controversial rule is section 421, that provides as follows: "Section 421. The freedom to contract shall be exercised by reason and within the limitations of the *social function* of the contract". This is an unprecedented provision in the country's legislation, which has long included constitutional rules about the social function of the property (which will not be analyzed in this paper).

This paper intends to describe the current status in the Brazilian academic writings and case law regarding the social function of contracts (the first part addresses this topic) – which usually identifies the social function of the contract under the view of the distributive justice inherent to the Social State, with the purpose of balancing the economic and factual power between the parties. Second, the paper suggests a critical reading about the consensus that is coming up among Brazilian jurists and judges concerning the social function of contracts, starting with a view defended by the school of economic analysis of Law, substantiated by the work of Cooter and Ulen,² as well as by the contributions of the New Institutional Economics of North³ Williamson⁴ and Coase⁵ (which does

² COOTER, Robert e ULEN, Thomas. "Law & Economics". Boston, Addison Wesley, 2003, p. 10 e ss.

³ NORTH, Douglas. *Institutions, institutional change and economic performance*. Cambridge University Press, 1990, p. 3.

not necessarily exclude other scopes of approaches such as, for instance, Luhmann's theory of systems). In Brazil, the references are the works organized by Sztajn and Zylbersztajn⁶ and by Pinheiro and Saddi⁷.

It will be demonstrated at the end of this paper that the consensus among Brazilian academic writers is mistaken when it defends the social function based on an idea of distributive justice and when it seeks to make "social justice" by interfering with contractual relations. In other words, the national consensus fails when it supports that the contract would not be a space for the contracting parties, but for society as a whole, where the community interests and social welfare would prevail¹¹ since this reasoning ultimately creates a judicial precedent for constant magistrates reviews of contracts, with state interference on the agreement between the parties favoring the weaker party in the bargain.

From an economic perspective, even if the prevailing social interest is waived, the arguments supporting the distributive or Public Law criteria to contracts (private space) does not make sense, as it ends up confusing the community interest with the protection of the weakest party (often reflecting an individual interest instead of a community one). Social interest does not always mean

⁴ WILLIAMSON, Oliver. "The economic institutions of Capitalism". Nova Iorque, Free Press, 1985, p. 15 e ss

⁵ COASE, Ronald H. *The firm, the market and the law*. The University of Chicago Press, Chicago, 1988, p. 07.

⁶ SZTAJN, Rachel e ZYLBERSZTAJN, Décio. "Direito e Economia". São Paulo, Campus, 2005.

interference in order to favor one of the contracting parties. On the contrary, recent examples show that state interference with parties' bargained agreements can favor the weakest party in the dispute and harm community interests, as it disarranges the marketplace, which is based upon the expectations of the economic agents.

In this regard, the review of business contracts can lead to juridical instability, and to insecurity in the economic scenario, which would result in more transactions costs for the parties to negotiate and to enforce their deals. Furthermore, those contract review cases show that the risk or even the loss arising from the interference is shared by society as a whole, which ends up having to bear the costs of the least efficient economic unit, by having to share the losses the latter has suffered paying for the legally protected insolvent (as it paradigmatically occurs with banking interests, and as it has occurred in a soy financing agreement in the state of Goiás⁸).

But that is not all. The current financial difficulties faced by welfare-protecting governments, fostering policies aiming to distribute wealth and not

⁷ PINHEIRO, Armando Castelar e SADDI, Jairo. "Direito, Economia e Mercados". São Paulo, Campus, 2005.

⁸ One example can be found in the digests of the Civil Appeal no. 79859-2/188, 1st Civil Panel of Judges of the Supreme Court of the State of Goiás, September, 2004 by which it was admitted to the courts to review an anticipated soy sales agreement with fixed price in favor of soy producers. It was argued that soy producers are weaker with respect to trader buyers and to keep the contract promise would mean to harm the farmers. This is so because the Court presumed that the weaker party were not strong enough to bargain and simply

necessarily in generating it, globalization, a networked society and the organization of economic blocs challenge the Social State model itself (as it was originally conceived), and, consequently, the distribution model based on the ideal of “social justice” and of “humanization” of capitalism by means of the contract. In fact, it is the development of the capitalist system that makes the means of social progress viable, so one must think of a legal system that better contributes to this purpose and not one that conflicts with it.

The method used in this research is fundamentally theoretical and uses bibliographical review and judicial precedents to illustrate the arguments.

I – THE CURRENT CONSENSUS REGARDING THE SOCIAL FUNCTION OF THE CONTRACT

We are moving towards a consensus in the national academic writings concerning the meaning of the social function of the contract provided for in the New Brazilian Civil Code (NCC). This (almost)⁹ unanimous opinion derives from

submit it self to the abusive will power of the traders. It was up to the Court to limit this will power of the traders. That decision was underpinned in the principle of the social function of the contract.

⁹ We say “almost” because four articles were found with (more or less) different positions: AZEVEDO, Antônio Junqueira de. “Princípios do novo direito contratual e desregulamentação do mercado (...). *RT*, São Paulo, vol. 750, abr. 1998, pp. 113-120; RODRIGUES JÚNIOR, Otavio Luiz Rodrigues. “A doutrina do terceiro cúmplice: autonomia da vontade, o princípio *res inter alios acta*, função social do contrato e a interferência alheia na execução dos negócios jurídicos”. *In* Revista dos Tribunais, vol. 821, março/2004, p. 81; LEONARDO, Rodrigo Xavier. “A teoria das redes contratuais e a função social dos contratos: reflexões a partir de uma recente decisão do Superior Tribunal de Justiça”. *In* Revista dos Tribunais, vol. 832, fev/ 2005,

the survey of articles published in major national periodicals between the years 2003 and 2005.¹⁰ A significant part of the researched authors understands the social function as the expression of “social justice” as directives within the contract scope inherent to the *Welfare State*. It is a phenomenon referred to as “publicizing”, “socialization” or even as “constitutionalization” of Private Law, which resulted in institutes traditionally belonging to Civil Law – such as the contract and property – being guided by distributive criteria inherent to Public Law, and to some extent, transferring to private parties some of government’s tasks.

p. 100; AMARAL, Pedro Eichin. “Função social dos contratos de transferência de tecnologia”, *In Revista da Associação Brasileira da Propriedade Intelectual*, nº 66, set.out/2003, p. 37.

¹⁰ Only the major authorities will be mentioned in order to avoid a very extensive list: WALD, Arnaldo. “O Novo Código Civil e o solidarismo contratual”. *Revista de Direito Bancário, do Mercado de Capitais e da Arbitragem*, vol. 21, p. 35; NERY, Rosa Maria Andrade. “Apontamentos sobre o princípio da solidariedade no sistema do direito privado”. *Revista de Direito Privado*, vol. 17, p. 70; DA SILVA, Jorge Cesa Ferreira. “Princípios de direito das obrigações no novo Código Civil”. *In “O Novo Código Civil e a Constituição”*. SARLET, Ingo (org.). Porto Alegre, Livraria do Advogado, 2003, p. 99; PENTEADO JR, Cássio M.C. “O relativismo da autonomia da vontade e a intervenção estatal nos contratos”. *Revista de Direito Bancário, do Mercado de Capitais e da Arbitragem*, vol. 21, p. 211; GOGLIANO, Daisy. “A função social do contrato (causa ou motivo)”. *In Revista Jurídica*, nº 334, agosto/2005, p. 09; MARTINS-COSTA, Judith. “Reflexões sobre o princípio da função social dos contratos”. *In Revista DireitoGV*, vol. 01, p. 41; PACHECO, José da Silva. “Da função social do contrato”, *In Revista Advocacia Dinâmica*, informativo mensal, nº 34, 2003, p. 496; SANTOS, Eduardo Sens. “A função social do contrato”. *In Revista de Direito Privado*, vol. 13, p. 99; WAMBIER, Teresa Arruda Alvim. “Uma reflexão sobre as ‘cláusulas gerais’ do Código Civil de 2002 – a função social do contrato”. *In Revista dos Tribunais*, vol. 831, janeiro/2005, p. 59; THEODORO DE MELLO, Adriana Mandim. “A função social do contrato e o princípio da boa fé no Novo Código Civil Brasileiro”. *In Revista dos Tribunais*, vol. 801, julho/2002, p. 11; besides the work of THEODORO JÚNIOR, Humberto. *O contrato e sua função social*. Rio de Janeiro : Forense, 2003. Under a little different viewpoint, but reaching practically the same results, SALOMÃO FILHO, Calixto. “Função social do contrato: primeiras anotações”. *In Revista dos Tribunais*, vol. 823, mai/2004, p. 67. Salomão Filho sees, in the social function of the contract, the integration of diffuse and collective community interests in the contract (a theory called “institucionalist”). Older publications predicted this contract's social model. See MACEDO, Ronaldo Porto. “Contratos relacionais”. São Paulo, Max Limonad, 1999; LOBO, Paulo Luiz Neto. *O contrato: exigências e concepções atuais*. São Paulo : Saraiva, 1986; GRAU, Eros. “Um novo paradigma de contratos?”. *In Revista da Faculdade de Direito da Universidade de São Paulo*, v. 96, p. 423 e ss. MARTINS-COSTA, Judith. “Crise e Modificação da Noção de Contrato no Direito Brasileiro”, *in “Revista Direito do Consumidor”*, São Paulo, Editora Revista dos Tribunais, vol. 3, pp. 127 a 154; AMARAL NETO, Francisco dos Santos. “A autonomia privada como princípio fundamental da ordem jurídica”. *In Revista de Direito Civil*, vol. 47, p. 07. For compared right, GILMORE, Grant. “The death of contract”. Columbus, Ohio State University Press, 1995. ATIYAH, P. “The rise and fall of the freedom of the contract”. Oxford, Clarendon Press, 1979.

The principle of the social function is perceived, within this “near” consensus, as a limitation to the principle of contractual freedom – now seen as of a typically bourgeois nature and consolidated by the civil codes of the 19th Century such as the *Code Civil* and the *Burgerlichesgesetzbuch* (BGB) – which is considered individualistic. The social function of the contract would ensure the prevalence of the community interests over individual interests. Essentially, this means (although not all the above-mentioned authors agree on that) the protection of the weakest party in the bargain, which would often not manifest his/her own free will, but succumb to the greater bargaining power of the economically stronger party or even to (re) distribute the economic benefits of the contract in spite of the bargain of the parties. Therefore, this is a contract concept model that assumes contractual freedom to be fictitious, and it is more appropriate to speak about submission when the economic power unbalances the bargaining power between the parties. This would also mean identifying the legitimate interests of third parties (therefore extraneous to the contract) to be protected. Hence, as the arguments go, there would be a need for the State (the Congress and the courts) to interfere with the contract so as to adjust the parties’ bargaining position.

In this regard, the words of Judith Martins Costa are paradigmatic: “The principle of the social function, now expressly supported by the Civil Code

constitutes, in general terms, the social expression within Private Law, projecting, in its regulatory corpora, and in various legal subjects, the guideline of social solidarity (Federal Constitution, section 3^o, III, *in fine*). (...) the principle of the social function, (...) indicates a path to follow, as opposed to predatory individualism”¹¹.

What about judicial precedents? In Brazil, as in countries of Roman-German-Canonic tradition in general, they are strongly influenced by academic writings, which play a fundamental role in the juridical *praxis*. Therefore, court decisions will often be highly influenced by the opinions of academics.

In this respect, on the basis of the social function of the contracts, some judges have been reviewing contracts under the political reasoning of protecting the weak against the strong, society as whole (for example, the borrower) instead of the individual (for example, the financial institution). By the same token, a portion of the judiciary has been prohibiting the interruption of water and electricity supply, as well as of everything related to “human dignity”, even if the interruption is allowed in the relevant water or electricity regulations and in the agreements entered into by and between the parties. One example can be found in the digests of the Civil Appeal no. 70010372027, 9th Civil Panel of Judges of the Supreme Court of the State of Rio Grande do Sul, August 10, 2005:

¹¹ MARTINS-COSTA, Judith. “Reflexões sobre o princípio da função social dos contratos”. *In* Revista

“NATIONAL HOUSING SYSTEM. CONTRACTUAL REVIEW
ACTION. INCOME COMMITMENT PLAN. PRICE TABLE.
CAPITALIZATION. SOCIAL FUNCTION OF THE
CONTRACT. INSURANCE.

Possibility of reviewing and adapting the contract, thus
balancing the business relations between the parties within
those parameters conferred by the Rule of Law and the
inherent function of the Judiciary.

(...) 6. The iniquitous application of the *PRICE TABLE* is
withdrawn, and the calculation method for simple interest is
adopted, with the purpose of avoiding the anatocism and the
geometric and exponential progression of the interests.

7. When the contract stipulates debit balance indexation
according to the savings account index, monthly interests are
embedded into the balance and each monthly rate is applied
to the previous one, resulting in the computation of interests
on interests. These shall be excluded and only the Referential

Rate (TR) shall be maintained, since it is accepted as an updating index.”

In this case, as it usually happens in literally thousands of cases in course in the Rio Grande do Sul Courts, the Supreme Court of the State of Rio Grande do Sul has changed the housing financing agreement executed between the bank and the borrower, in order to “strike a balance” to the bargain. The Supreme Court understood that the PRICE table (an interest calculation method used in financial mathematics) used to calculate the interests was abusive because it generated the computation of interests in interests, and that is anatocism, which, according to the understanding of the same Court, is not lawful.

Another judgment of the Supreme Court of the State of Rio Grande do Sul (TJRS) stated: “The **social function of the contract** has the objective of preventing the burden of onerous and harming clauses on economically weaker contracting parties” (Attachment of the Civil Appeal No. 70011602091, Fifteenth Civil Panel of Judges, Supreme Court of the State of Rio Grande do Sul, decided on June 8, 2005).

In the High Court of Appeals (STJ), due to the social function of the contract principles, those banks which operated with credit lines for construction companies have their mortgage rights weakened. The STJ has preferred, in more than one

occasion, to protect the interests of the real estate purchaser (High Court of Appeals, Appellate Review no. 187.940, Relater Associate Justice Ruy Rosado de Aguiar Jr. and Appellate Review no. 316.640, Relater, Associate Justice Nancy Andrighi). For these cases, the construction company has taken out a bank loan for the construction of a building (guaranteed by a mortgage over the property being built), and undertaken to sell the future apartment to the final purchaser (which, it must be noted, is not forbidden by law). Thus, the construction company used the funds received from the bank as well as from the purchasers. But in the aforementioned cases the construction company did not pay the bank, which resulted in the mortgagee seeking to take possession of the property.

Here, another peculiarity of the Brazilian legal system comes to mind. Precedents from higher courts are not binding on the lower courts. Therefore, in spite of the High Court of Appeals judgment prohibiting legal intervention on banking interests (as a general rule) – because this subject pertains to the monetary policy within the authority of the Central Bank of Brazil – the State Courts may continue decide against the High Court of Appeals' case law.

The inhuman aspect of this “social” or “solidarist” model, as it has been called, is the high risk of “politization” of Law, or, in Luhmann’s¹² language (and

¹² Niklas Luhmann, ‘The Unity of the Legal System’’. In “Autopoietic Law: A New Approach to Law and Society”. Org. Gunther Teubner. Florença, Berlin, Walter de Gruyter, 1988, p. 242 e ss.

maybe Weber's ¹³ and Parsons's language)¹⁴ the attempt of domination of the judicial reasoning by political reasoning. Thus, the legal system, which has its own language, its own binary code (lawful-unlawful), gets contaminated by the political language, by the political code (can-cannot), and even by the political reasoning.

This "politization" of the judicial system goes beyond the Judiciary due to the ascendancy of the academic circles over it.¹⁵ A study by Armando Castelar Pinheiro shows that more than 70% of the surveyed judges prefer to make "social justice" instead of applying "black letter" law and contractual terms.¹⁶

Therefore, for this "solidarist" model, the social function of the contract would mean correcting the power imbalance within the contractual sphere, in order to correct the social inequality, disregarding the consequences to the economic system.

In economic analysis, this reasoning does not make sense, especially if one takes into account that law and, specifically, contracts exist in a market environment, as we will see in the next topic.

¹³ DULCE, Maria Jose Fariñas. "La sociología del derecho de Max Weber". Madrid, Editorial Civitas, 1991, p. 257-8 e 267. For further reading about this topic, which is out of this study scope, see WEBER, Max. "Economía e Sociedade". V.2. Brasília, Editora UnB, 1999, p. 1-153; FREUND, J. "La rationalisation du droit selon Max Weber", *in* Archives de Philosophie du Droit, v. 23, p. 69 e ss., 1978

¹⁴ Cf. ROCHER, Guy. "Talcott Parsons e a Sociologia Americana". São Paulo, Editora Francisco Alves, s/d, p. 30 and following, and specially page 39 and following. The complex Parsonian social action system appears in PARSONS, Talcott. "O sistema das sociedades modernas". São Paulo, Editora Pioneira, p. 15 e ss

¹⁵ ENGELMANN, Fabiano. "Sociologia do campo jurídico: juristas e usos do direito". Porto Alegre: Editora Sergio Antonio Fabris, 2006

II – THE SOCIAL FUNCTION OF THE CONTRACT IN A MARKET ECONOMY

From the viewpoint of the economic analysis of law, the existence of community interests worthy of protection in contractual relationships should not be ignored. However, the community can be identified in the market framework lying behind the contract being enforced, and behind the legal proceedings related to the dispute pertaining to it. In this regard, the community in a financial housing agreement is represented by the chain or network of borrowers (and potential borrowers) who depend on the compliance of the agreement of that individual, in order to feed the national housing system with funds, therefore making new loans possible for those who need them.¹⁷ Thus, if the chain is broken by contractual breaches, that community will lose (as it will be left without funds and pay higher interests). This happens because, conceptually and even in real life, banks do not lend their own money, but funds acquired from the market.

This understanding also applies to insurance policies. In this regard the phrase coined by the jurist Ovídio Baptista da Silva concerning the contractual relations linked to insurance and social security issues is most appropriate, where

¹⁶ Castelar. "Direito e Economia no Mundo Globalizado: cooperação ou confronto?". In TIMM, Luciano (org.). "Direito e Economia". São Paulo, THOMSON/IOB, 2005. In the same direction, the introduction by Gustavo FRANCO, in the same work quotes.

¹⁷ LEONARDO, Rodrigo Xavier in "A teoria das redes contratuais e a função social dos contratos: reflexões a partir de uma recente decisão do Superior Tribunal de Justiça". In Revista dos Tribunais, vol. 832, fev/2005, p. 100 seems to agree with it.

there exists a “*a relation of community interests*”¹⁸. In these operations, it is necessary to generate a large number of analogous contracts in order to form the community fund that will support the interest of everyone, whose satisfaction and safety will depend, on a large scale, on the preservation and compliance with this chain of contracts.

Hence, one cannot think about the community interests in a contractual relationship and disregard the environment in which it is enforced – which, undoubtedly, is the market.¹⁹ The analysis focus cannot be on the relationship itself, which is always bilateral. Society will be represented by the participants (actual or potential) that integrate a certain market of goods and services (which, in the case of the housing financing example, are those borrowers who integrate the national housing system).

Thus, it is necessary to know that there is a market, which is a space for social and community interaction. Indeed, the market exists as a spontaneous social institution, i.e., as a social fact. In Coase’s words, the market “is an

¹⁸ Cf BAPTISTA DA SILVA, Ovídio Araújo. Speech in: FORUM DE DIREITO DO SEGURO JOSÉ SOLLERO FILHO, 2., Porto Alegre, 2001. São Paulo: IBDS, 2002. p.82

¹⁹ “(...) the market is widely accepted as a tool, and not as an enemy of the economic and social development”. According to TREBILCOCK, Michael J. “The limits of Freedom of Contract”. Cambridge, Harvard University Press, 1993, p. 268. The same author also clearly shows how the western contemporary society has chosen the market system and defines the choices for the economic and social efficiency. In this, “(...) the decisions on the production and the consumption are de-centralized and depend on a myriad of individual decision by producers and consumers, acting as a consequence of individual preferences and incentives, thus minimizing the role played by social conventions and *status*”. Cf. TREBILCOCK, “The limits...”, p. 268.

institution that exists to facilitate the exchange of goods and services, i.e., it exists with the purpose of reducing the costs when exchange operations are conducted."²⁰ In fact, when it serves as a public space for exchanges, it guarantees a behavior reference that affects the expectations of the economic agents (those that participate in the struggle supply and demand forces), whose result is a balanced status (positive or negative) – good or bad. If the market as a fact did not exist, how to explain that soon after a large soy crop (and therefore of a large supply in the market) its price tends to lower? How to deny that the rental of beach houses tends to increase in the summer (during the high season), when the demand for them increases?

The market is not separate from society; it is an integral part of it. And thus, as any social fact, it can be regulated by legal rules (with a higher or lower social and economic effectiveness). If there were no market, it certainly could not be the object of legal relationships. Therefore, one cannot say that the market is something artificially guaranteed by the legal system as it is stated by some who attack the spontaneous characteristic of the market forces. What one can discuss is whether it always works properly and efficiently. And the answer to this question is no. Hence the possibility of intervention or regulation by legal institutions.

²⁰ Cf. COASE, Ronald. "The firm, the market and the law". Chicago, University of Chicago Press, 1988, p. 07.

Since markets are imperfect, transaction costs (costs incurred by the parties to negotiate and to enforce an agreement) are unavoidable.²¹ One of the significant roles of the law is to reduce these transaction costs. It can also be stated that, at least from an economic viewpoint, the more developed the legal principles, the more propitious is the environment for their natural development, due to the reduction in transaction costs. The more solid and fairer the legal system of a country are (guaranteeing the property and business contracts), the better their institutions.²² For this reason, this paper intends to interpret section 421 of the New Civil Code in a way that strengthens the legal institutions (the contract, among them) for a good performance of the economic system.

The economic analysis provides measuring tools for this social functioning of contracts (or for the “externalities” according to the economic jargon) within the market scope, such as Pareto's analysis (there will not be a collective improvement unless the improvement of a person does not correspond proportionally to the loss of another), or as Kaldor-Ricks' analysis (which accepts some considerations about costs and benefits of gains and losses on certain changes).

²¹ COASE, Ronald H. *The firm, the market and the law*. The University of Chicago Press, Chicago, 1988, p. 07.

²² See NORTH, Douglas. “Institutions, Institutional Change and Economic Performance”. Cambridge, Cambridge University Press, 1990. See also WILLIAMSON, Oliver. “Por que Direito, Economia e Organizações?”. In “Direito e Economia”. ZYLBERSTAJN e SZTAJN (org.). São Paulo, Campus, 2005, p. 16 e ss. WILLIAMSON, Oliver. “The economic institutions of Capitalism”. Nova Iorque, Free Press, 1985, p. 15 e ss. More radical is the position of GRANOVETTER, Mark. “Economic action and social structure: the problem of social embeddedness”. In *American Journal of Sociology*. Vol. 91, nº 03, 1985, p. 481. Equally interesting is the approach of MALLOY, Robin Paul. “Law in a Market Context”. Cambridge, Cambridge University Press, 2004.

For an example of this reasoning, see the research conducted by the Institute PENSA/USP for the case that was named "green soy".²³ It has empirically proven that the appellate review of rural contracts in the state of Goiás (one of them quoted above) has caused difficulties for farmers of that place to finance crops in the following year, thus showing that the benefits of those who filed lawsuits was negatively counterbalanced by the losses of the remaining group that worked in that soy planting market.²⁴

The facts were that some crops, like soy, were financed, in many cases, by private capital, in other words, *traders* purchased the crop in advance, paying the farmer immediately, and the latter was able to fund his harvest. And in the following year, this farmer, who had already estimated his profit in the advanced sale price, delivered the product.

But there was an unexpected valuation of the soy, and some farmers filed a suit to review these agreements, alleging there was unpredictability, unjust enrichment, etc, so as not to comply with the agreement, i.e., in order to avoid delivering their yield to the traders.

²³ For a diagnosis of the problem, see Newsletter Valor Econômico – Ano 5 – número 990 – Quarta-feira, 15/02/2006. Caderno 'Agronegócios'.

²⁴ According to the announcement in the Seminar at Instituto PENSA, at USP, on December 5, 2005.

The Supreme Court of the State of Goiás, based on the social function of the contract, reviewed the agreements and released the farmers who filed the lawsuits (who were deemed to be in a weak bargaining position) from having to fully comply with the agreement. This second order outcome was not perceived by judges who decided the cases.

The consequence (to the farming community) of the judicial decisions was that all the others farmers who did not file lawsuits were harmed, since the traders of the region did not want to continue with this advanced purchasing of the crop. This is because there would be an obvious risk of loss to the traders in proceeding with such transaction, since if in the year following the agreement the soy price would be lower than the agreed, they would have to bear the loss, and if it were higher, farmers would file lawsuits allowing them not to comply with the terms of the agreement.

On the other hand, there are interesting court decisions that, even without resorting to the economic analysis tools, intuitively realize this social function of the contract in a market environment:

“To admit the legality of the procedure intended by the claimants (contractual review of a real estate financing) would imply in the appearance of a dangerous precedent, with serious consequences for the complex and strict national

housing system, whose structure and operating mechanism has been well explained by Caio Tácito [...]: 'furthermore, the real estate agreements are, in this case, an integral part of an interconnected whole, of a global financing system that has the additional role of maintaining the stability of its sources of finance[...].' FEDERAL REGIONAL COURT – 4th region. Rehearing en Banc in the Civil Appeal no. 17,224, Relater: Federal Associate Justice Luiz Carlos Lugon. "What supports the economic reasoning that, in a point in time of monthly inflation rates next to zero, interests exceeding 1% per month are abusive? **With all due respect, there is no basis for this, much less of an economic nature.** In any commercial or industrial activity, the price of the product sale cannot be lower than its respective cost. (...) The interest rate is fully disconnected from the inflation rate. **The inflation is low, but the cost of the money is high (...) and this cannot be reduced by legal writing. This is economic policy dictated by a government decree, which goes against the the control of the courts**". (Special Appeal no. 271,214 of the High Court of Appeals, Relater Associate Justice Ari Pargendler, dated of March 12, 2003).

Therefore, as we have already stated, we are not accepting that the market is a perfect regulatory environment and that law can do nothing about it except enforce private agreements.

There are imperfections in the market: they can be found in the competition framework, which makes free competition and free initiative difficult due to a great concentration of the economic power; b) there can be problems related to information asymmetry, among others.²⁵

In relation to the first identified issue, in Brazil the Antitrust Law (Law 8884/94) as the *Sherman Act* in the United States that deals with market structures, and tries to inhibit the abuse of the economic power, resulting in the creation of the Brazilian regulatory agency for competition: the Administrative Council for Economic Defense (CADE). By controlling economic power that could reasonably affect the market – penalizing the abuse of dominant positions in a given market, and by means of agreements among competitors such as cartels – one would be indirectly controlling the power imbalance between the contracting parties.²⁶

²⁵ On this subject, see in further detail, COOTER, Robert e ULEN, Thomas. "Law & Economics". Boston, Addison Wesley, 2003, p. 10 e ss.

²⁶ FORGIONI, Paula Ana. *Os Fundamentos do Antitruste*. São Paulo: Revista dos Tribunais, 1998.

To correct the information asymmetry problem there the Consumer Defense Code (Law 8038/90) is already in place. This Code guarantees, in section 6, wide access to information on products and services traded in the market, under the penalty of strict liability on the supplier. For this reason, the Consumer Defense Code pairs up with the Competition Law, and both complete each other for the effective market regulation.²⁷

Considering all these issues, if we follow this line of thought, what can the contract offer to the market?²⁸

- a) It can offer a regulatory framework for legal protection;
- b) It can minimize communication problems;
- c) It can safeguard the assets of each economic agent;
- d) It can create protection instruments against opportunism;
- e) It can generate reimbursement and risk allocation mechanisms;
- f) It can create incentives to future renegotiations ex post when necessary.

²⁷ MARQUES, Cláudia Lima. "Contratos no Código de Defesa do Consumidor". 2ª ed., São Paulo, Editora Revista dos Tribunais, 1995, p. 27.

²⁸ One could make the analysis of the contract more complex as a regulatory system involving institutional, interactive and social aspects, but this subject has already been approached in an article named "A hipercomplexidade do contrato em um sistema econômico de mercado", published in the book Law and Economics. Luciano Timm (org.). São Paulo, THOMSON/IOB, 2005.

In short, the contract provides security and predictability to the economic and social transactions, protecting the expectations of the economic agents – which corresponds to an important institutional and social role.

CONCLUSION

We have tried to demonstrate the position of Brazilian jurists and the national Judiciary on the controversial section 421 of the New Civil Code, which limits the freedom of the contracting parties to its social function.

It has been examined that most jurists and judges tend to see this article as a manifestation of the “publicization” of Private Law, which would now be guided by distributive fairness criteria to benefit the less favored. This understanding has been justifying the position of some country courts that support the contract review, entitling the judge (State) to interfere in the agreement entered into between the parties, to avoid clauses, and to establish rights and obligations not bargained by the parties, because the contract would not be a space for freedom (but for oppression), with the judge being left with the responsibility of having to adjust the contracting parties’ bargaining powers.

In this paper we defended that the economic analysis of law can be used to explain the social function of the contract in a market environment. This position

allows the perception of the community as the weak party not just in the contract, but also in the society as a whole which, effectively or potentially, integrate a certain market of goods and services. Furthermore, the economic analysis of law the contract's external elements to be measured under certain aspects, thus leading the interpreter to the path that generates less losses to the community or, in other words, more social efficiency.