

Walter | Medina | Scholz | Wabnitz (eds.)

# The Israeli Legal System

An Introduction

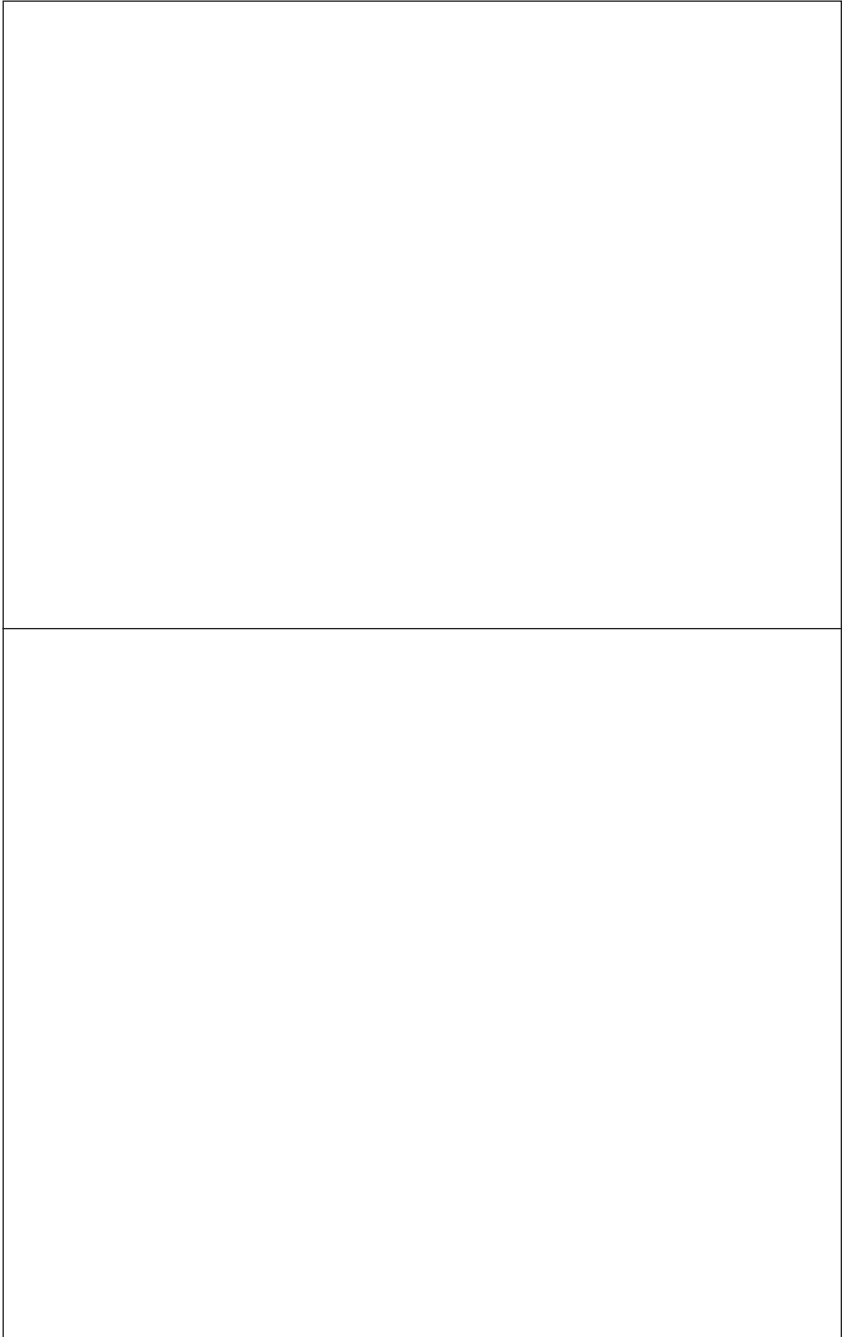


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Christian Walter | Barak Medina | Lothar Scholz  
Heinz-Bernd Wabnitz (eds.)

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## Preface

The idea for this book was generated many years ago among the editors and within the German Israeli Lawyer's Association. The initial project was to come up with a brief "Introduction to the Law of Israel", written in German. After several attempts in this direction, we realized that a broader approach was necessary which also implied the, more or less, simultaneous publication of an English and a German version of the book. We are very grateful that it was possible to bring together a group of prominent authors who are all experts in their respective fields and, except for some authors in the international section of the book, insiders in the sense that they live and work in Israel at the most prestigious Law Faculties of the country. The project could not have been realized without their personal commitment and admirable discipline. We are very grateful to all of them.

The realization of the book would also not have been possible without the tireless and extremely competent help of many hands at the Chair for Public International Law and International Law at Ludwig-Maximilians-University Munich (LMU). We want to specifically thank *Stefan Schäferling* for the English native speaker check, which he did on almost all chapters. The editorial assistance of *Ingeborg Neber-Germeier* and *Kathrin Tremml* was invaluable, notably in the final phase of the preparation of the book. We are also very grateful to the Central Council of Jews in Germany for its support of the project. Finally, we want to thank the publishers C.H. Beck, Nomos and Hart for realizing the rather unconventional project of publishing simultaneously an introduction to a foreign legal system, both in English and in German.

Munich, Jerusalem, Dresden and Hof in December 2018,

Christian Walter  
Barak Medina  
Lothar Scholz  
Heinz-Bernd Wabnitz



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## Part II – Civil Law

### § 4 Law of Contracts

Yehuda Adar<sup>1</sup>

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#### I. Introduction

This essay offers a glance at three major areas of Israeli contract law, namely the law of formation, the law of defects, and the law of remedies for breach of contract. While covering the whole field would be too presumptuous within the context of a concise survey,<sup>2</sup> the essay aspires to give the foreign reader a fair acquaintance with the most important statutory and judge-made principles which govern today these major areas of Israeli contract law. The essay opens with a brief introduction into the basic characteristics of Israeli contract law, to be followed by a

- 1 For their research assistance I am grateful to Motaz Ershed and Shiri Barshedsky-Werner. This article is dedicated to Gabriela Shaley, an admired teacher and mentor, a beloved colleague and one of the giants of Israeli contract law. Hebrew quotations were translated by the author.
- 2 For a critical survey of some further developments in contemporary Israeli contract law see, *Adar*, Contract Law: Trends and Shifts in 2010, 6 *Din U'Dvarim* (Haifa Univ. L. Rev.) 2011, 41 (84) (in Hebrew). For a general survey (in English) of the basic tenets of Israeli contract law see *Shalev/Lerer*: Israel, in: *Herbot* (ed.), *International Encyclopedia of Laws: Contracts*, 2014.

closer look at the three major areas mentioned, namely: the law of formation, the law of defects and the law of contract remedies.

- 2 Before delving into the particular areas this survey has chosen to investigate, three general comments are in place. First, it would be helpful to mention at the outset the basic structure of Israeli contract law. Israel is a comparatively young legal system. As a mixed jurisdiction, its development since its establishment in 1948 was influenced by both the Common law and the Civil law traditions (and to a lesser extent by Jewish law).<sup>3</sup> This dual influence is most clearly evident in the field of contract law.<sup>4</sup>
- 3 General contract law is governed today by two original and fairly comprehensive statutory arrangements. These statutes – the Contracts Statute (1973),<sup>5</sup> and the Contract Remedies Statute (1970)<sup>6</sup> – were enacted with the express intention of integrating them in due course into a single civil code.<sup>7</sup> It is therefore not surprising that in terms of style, structure and scope these two statutes clearly follow the traditional pattern of systematic European codifications rather than the piecemeal and peripheral character of private law legislation in common law systems.<sup>8</sup> This original legislation freed Israeli contract law from its prior subordination to the intricacies of the common law heritage and introduced the Israeli legal community to a fresh, original and presumably coherent and comprehensive body of contract law principles.<sup>9</sup> Indeed, with the exception of a single substantive amendment,<sup>10</sup> the Contracts Statutes have enjoyed a remarkable degree of stability, and are implemented daily in countless of contractual disputes, commercial and non-commercial alike.<sup>11</sup>

3 Jewish law plays a central role within Israeli Family law and the law of Succession. However, in other areas its influence has been much more subtle. For discussions of the Israeli system as a mixed jurisdiction see e.g. *Tedeschi/Zemach*, Codification and Case Law in Israel, in: *Dainow* (ed.), *The Role of Judicial Decisions and Doctrine in Civil Law and Mixed Jurisdictions*, 1974, 273; *Shalev/Herman*, A Source Study of Israel's Contract Codification, 35 *Louisiana L. Rev.* (special issue) 1975, 1091.

4 On the other hand, Israeli tort law is, to a large extent, a statutory reflection of the English law of torts. See *Adar/Shalev*, The Law of Remedies in a Mixed Jurisdiction: The Israeli Experience, 23 *Tulane European and Civil Law Forum* 2008, 111 (135-136).

5 The statute's official name is the Contracts Statute (The General Part) (1973) [known in Hebrew as "Khok Ha-Chozim"]. For a thorough examination of the scope and content of the statute see *Shalev*, General Comments on Contracts (General Part) Law, 1973, 9 *Isr. L. Rev.* 1974, 274.

6 The statute's official name is the Contracts (Remedies for Breach of Contract) Statute (1970) [known in Hebrew as "Khok Ha-Trufot"].

7 See e.g. *Barak*, The Codification of Civil Law, 3 *Tel Aviv Un. L. Rev.* 1973, 5 (in Hebrew); *Yadin*, The Succession Law as Part of the Israeli Civil Law Legislation, 3 *Tel Aviv Un. L. Rev.* 1973, 26 (in Hebrew); *Barak*, The Independence of the New Civil Codification: Risks and Opportunities, 7 *Mishpatim* (Hebrew. Un. L.J.) 1976, 15 (in Hebrew); *Yadin*, Towards the Codification of the Civil Law in Israel, 6 *Tel Aviv Un. L. Rev.* 1979, 506 (in Hebrew); *Barak*, The Codification of Civil Law and the Law of Torts, 24 *Isr. L. Rev.* 1990, 628.

8 For a discussion of the continental influences see e.g., *Shalev/Herman* 1975 (n 3), esp. at pp.1097-1101.

9 This process was described as early as 1975 as revolutionary, in the sense that "[...] Israeli contract law is now in a process of transforming from a common law system, both in substance and technique, into a system of independent and codified law." *Shalev*, From Common Law to Independence: Supreme Court Decisions on Contract Law in 1975, 2 *Tel Aviv Un. L. Rev.* 1976, 33. See also *Friedmann*, The Independent Development of Israeli Law, 10 *Isr. L. Rev.* 1975, 515.

10 Of the rules on contract interpretation, which took place in 2010.

11 The general body of statutory contract law makes no formal distinction between commercial contracts (B to B; C to C) and non-commercial consumer contracts (B to C). Protection of consumers

Second, it would be appropriate to mention here the two most important principles governing Israeli contract law, namely, freedom of contract and good faith. The interaction between these principles is responsible for the shaping of many rules of contract law. The freedom of contract has been recognized by the Supreme Court as a fundamental principle of contract law as well as a constitutional right.<sup>12</sup> At the same time, the civil law principle of good faith (*bona fide*) has also played a paramount role in the development of Israeli private law. Articles 12 and 39 of the Contracts Statute impose a wide duty of good faith and fair dealing in the contractual as well as the pre-contractual stage.<sup>13</sup> The principle is frequently described by judges and commentators as a “royal principle” of almost unlimited scope, applicable to any civil context, as well as to procedural law and even to public law.<sup>14</sup> The principle of good faith is relied upon by lawyers in almost every contractual dispute and is very frequently referred to in judicial decisions, either as a limitation on the freedom of contract or as a means to protect and reinforce it (e.g., against a party wishing to avoid a clear obligation by relying on a formal requirement).<sup>15</sup>

Third, I would like to add a general comment regarding the development of the general body of contract law in recent decades. In this respect, it seems fair to say that the development of the field has been usually characterized by a continuous, step-by-step progress, rather than by revolutionary developments. Such progress took place in the areas of formation and of defects, which will be presented in parts II and III of this article. Nonetheless, from time to time more dramatic shifts can be discerned on contract law's doctrinal scenery. For example, in the field of interpretation, a 2010 legislative amendment incorporated – with a questionable degree of success – a conservative element into the basic statutory rule of interpretation. This was done in order to relax some perceived concerns regarding a previous activist precedent set by the Supreme Court in the famous case of *Aprofim*.<sup>16</sup> Another important development took place in the area of precontractual liability where, after decades of uncertainty, the Supreme Court interpreted Article 12 of the Contracts Statute as encompassing expectation damages as an exceptional – but nonetheless

is carried out through particular legislation such as the Consumer Law (1981) and the Standard Form Contract Law (1982).

12 See e.g. CA 294/91 *Hevrat Kadisha G.H.S.A v. Kastenboum* (1992) IsrSc 46(2) 464, 533; FH 22/82 *Beit Yules v. Raviv* (1982) IsrSc 43(1) 441, 743.

13 For a discussion of these two important provisions see e.g. *Shalev*, The Pre-Contractual Process under Israeli Law in: Israeli Reports to the 13<sup>th</sup> International Congress of Comparative Law 1990, 15; *Shalev*, Precontractual Liability in Israel in: *Hondius* (ed.), Precontractual Liability, 1990; *Shalev*, Contract Law, in: Introduction to the law of Israel, 1995, 111 (115-119); *Shalev*, Contract Law, in: *Zamir/Colombo* (eds.), The Law of Israel: General Surveys, 1995, 212-222.

14 See e.g. *Shalev*, Good Faith in Public Law, 18 Isr. L. Rev. 1983, 127.

15 See e.g., CA 986/93 *Klemer v. Guy* (1996) IsrSc 50(1) 185 (insisting on a statutory formal requirement that a contract for the sale of land be in writing could be contrary to good faith, when the other party has heavily relied on an express oral understanding and when applying the statutory requirement would result in a ‘cry of injustice’).

16 CA 1376/98 *The State of Israel v. Aprofim Housing and Enterprise* (1995) IsrSc 49(2) 265. The original intention behind the amendment of Article 25(a) was to substitute a more conservative approach for the extremely liberal approach endorsed by the Supreme Court. However, as the recent case of PCA 3961/10 *National Insurance v. Sahar Ltd.* (Nevo e-database, 26.2.2012); demonstrates, the final formulation of the legislative amendment has failed to achieve such a goal. The problem has been widely discussed by Israeli scholars, and would therefore be left outside the scope of this article. See e.g. *Zamir*, Further Thoughts on Contract Interpretation and Supplementa-tion, 43(1) *Mishpatim* (Hebrew Un. L.J.) 2012, 5 (30-35) (in Hebrew); *Cohen*, The Faithfulness of the Interpreter, 35 *Iyunev Mishpat* (Tel Aviv. Un. L. Rev.) 2013, 587 (621-628) (in Hebrew).

legitimate – response to precontractual bad faith.<sup>17</sup> Finally, a number of interesting developments have occurred in the area of remedies for breach of contract. Given the paramount role of remedies in shaping the face of contract law, these developments will be presented in part IV of this essay.

## II. Formation of contract: Questioning the dominance of the liberal approach

### 1. The basic regime

- 6 Under Israeli law, the basic rules governing the formation of contracts are found in the first eleven articles of the first chapter of the Contracts Statute. Within these provisions (art. 1-11), I would suggest an important methodological distinction between core or primary provisions and peripheral or secondary ones.
- 7 The first group includes articles 1, 2 & 5, which together define the basic normative infrastructure of the law of formation. While formally dealing with the definition of the terms “offer” (art. 2) and “acceptance” (art. 5) these provisions, in fact, define a fundamental and *cogent* rule of power.<sup>18</sup> Under this basic rule, no contract can be formed unless the parties' objective (rather than subjective) expression of will<sup>19</sup> reflects their decisive (reciprocal) intention to be legally bound towards each other,<sup>20</sup> by a sufficiently determinate (i.e., specific) set of obligations.<sup>21</sup> No formal requirement of *consideration* or *causa* exists under Israeli law.<sup>22</sup>
- 8 Hence, the consistent application of these articles by the courts has made it clear that the law's declaration that “a contract is formed by way of an offer and acceptance” (art. 1) should not be understood as a technical or procedural requirement for a two-stage process, whereby one party embraces a preexisting expression of will by another party. Rather, the substantive requirement is merely for a moment in time where, under an objective test of reasonableness, it is clear that both parties have simultaneously expressed their mutual decisive will to be legally bound by a sufficiently determinate agreement.<sup>23</sup>

17 CA 6370/00 *Kal Binyan Ltd. v. E.R.M RaAnnana for Building and Renting Ltd.* (2002) IsrSc 56(3) 289. For an analysis of this controversial decision see e.g. *Shalev*, More About Good Faith, 3 *Kiryat Hamishpat* 2002, 121.

18 For the distinction between rules of power and rules of duty see *Hart*, *The Concept of Law*, 1997, 2<sup>nd</sup> ed., pp.9-10, 80-81, 283-286.

19 The adoption of the objective rather than the subjective theory of the will is supported by the letter of the law which requires an external manifestation (“*He'ada*”) of the promisor's (as well as the promisee's) will. The objective test was consistently embraced by the Supreme Court. See e.g. CA 693/86 *Botkovski v. Gat* (1989) IsrSc 44(1) 57; CA 5511/06 *Aminof v. A. Levi Hashkaot Ve-Binyan Ltd.* (Nevo e-database, 10.12.2008); CA 5332/03 *Ramot Arazim Hevra Le-Binyan Ve-Hashkaot Ltd. v. Shiran* (2004) IsrSc 59(1) 931; CA 3601/96 *Barashi v. Barashi* (1998) IsrSc 52(2) 582; CA 8163/05 *Hadar Hevra Le-Bituach Ltd. v. Plonit* (Nevo e-database, 6.8.2007); see also *Shalev/Lerer* (n 2), para. 101.

20 The technical term encapsulating this requirement is, in Hebrew, “*Gmirat-Da'at*”. Literally, the term implies “resoluteness” or “decisiveness”. However, the Supreme Court made it clear that in the legal context the term encompasses both the resoluteness of the will and the intention to be legally bound. See e.g. CA 440/75 *Zandbank v. Danziger* [1976] IsrSc 30(2) 260, 267.

21 The technical legal term here is, in Hebrew, “*Messuyamut*”. On this requirement, to which they refer as 'definiteness', see *Shalev/Lerer* 2014 (n 2), para. 89.

22 *Shalev/Lerer* 2014 (n 2), paras. 102-103.

23 See e.g., CA 158/77 *Rabinay v. Man Shaked Ltd.* (1979) IsrSc 33(2) 281; CA 1049/94 *Dor Energia Ltd. v. Hamdan* (1998) IsrSc 50(5) 820.



Whereas this fundamental rule of power is a cogent one, the other provisions of the chapter are dispositive. Dealing with a variety of issues (e.g. the expiry of an offer or an acceptance, the effect of a belated offer or acceptance, the significance of a silent reaction, etc.), these provisions merely provide for a set of default legal solutions, from which the negotiating parties may freely deviate.<sup>24</sup> 9

## 2. The liberal approach to contract formation

Judicial decisions on issues concerning formation rarely give rise to blunt normative controversies – or to extended judicial discussions – on the appropriate rules of formation or on the appropriate approach to the application of these rules. As such, developments in this area seem to have been more subtle and less visible than in other areas. 10

Nonetheless, commentators seem to agree that the first decades following the enactment of the Contracts Statute have witnessed a rather consistent shift, within the jurisprudence of the Supreme Court, from a rather reserved and conservative approach to contract formation, towards a more liberal approach. While the traditional approach emphasized the need for certainty and predictability, as well as the need to incentivize parties to invest more in precontractual negotiations, the general tendency of the courts has become to give effect to interim agreements, thus lowering the bars for entering into the contractual realm. This trend was most evident in the context of preliminary agreements for the sale of land. These agreements, which in the past were often considered precontractual rather than contractual (usually for lack of sufficient determinacy or decisiveness) were now often recognized as preliminary contracts, which should be enforced notwithstanding their premature nature.<sup>25</sup> 11

In particular, one could perceive a growing disposition on the part of the courts to construct or supplement the missing conditions of the deal (payment conditions, tax issues, delivery and other performance dates, etc.) even where the same details had been previously described as 'essential' or 'indispensable'. Such construction or completion was most often carried out through the use of certain general 'completion provisions' in the Contracts Statute<sup>26</sup> or other more specific statutory provisions (e.g., in the Sale Law, 1968). 12

Furthermore, on the level of rhetoric, following a statement made as early as 1979 by justice Aharon Barak in the seminal case of *Rabinay*,<sup>27</sup> it became common to find courts maintaining that even 'essential' and 'crucial' missing details of a pre- 13

24 At least as long as the agreement is implemented in good faith. See e.g. CA 7824/95 *Tshuva v. Bar-Natan* (1998) *IsrSc* 55(1) 289; (insisting on a formal requirement for a written notice may amount to a violation of the duty of good faith when a clear oral notice was given).

25 For a succinct – and illuminating – description of this process see *Renner*, *Contract Law – Trends and Evaluation*, 21 *Mishpatim* (Hebrew Un. L.J.) 1993, 33 (34-46). See also *Mautner*, *Judicial Intervention in a Contract's Content and the Future Development of Israeli Contract Law*, 29 *Tel Aviv Un. L. Rev.* 2005, esp. at pp. 23-25. For a critique of the liberal approach to contract formation see, recently, *Mautner*, *Only the Final Professional Contract Rather than the Preliminary Agreement Should be Upheld*, in: *Adar/Barak* (eds.), *Essays on Contract – In Honor of Gabriela Shalev*, forthcoming (2019).

26 See. Ch. 5 (“Performance”), esp. art. 40-46.

27 *Rabinay* case (n 23), at para. 7.

liminary agreement can be completed.<sup>28</sup> For example, in a 2013 case, the Supreme Court mentioned this 'conventional wisdom':

14

The demand that a memorandum of intentions must be determinate enough has been softened over the years. Whereas in the past it had to contain all the essential and necessary details of the deal such as the parties' names, the asset, the nature of the deal, the price, the payment dates and arrangements over costs and taxation, it was later set forth that a memorandum may answer the determinacy requirement *even where it does not include some of the essential details*, as long as these details can be completed according to the law or the common custom.<sup>29</sup>

15 Indeed, in a number of Supreme Court cases, one could identify a growing judicial willingness to construct even the most essential details of the deal, such as the exact parcel of land to be transferred,<sup>30</sup> the missing price of an apartment,<sup>31</sup> and the content of a vague and open-ended settlement agreement.<sup>32</sup>

16 Another creative idea, to which the courts resorted in order to prevent a presumably unjustified retreat from an interim agreement, was the principle of "optimal performance". Under this judicial doctrine, an interim agreement should be upheld even when lacking determinacy, as long as the party demanding enforcement is willing to complete the missing detail in the most favorable manner from the perspective of the party wishing to avoid the deal. Although problematic from a theoretical and a normative point of view,<sup>33</sup> the doctrine was embraced and implemented in a number of Supreme Court cases.<sup>34</sup>

### 3. Retreat from the liberal approach?

17 Without venturing as far as to argue for any revolutionary break with the liberal approach, I would like to point out what I regard as signs of a gradual but nonetheless significant retreat from the liberal approach to contract formation, of at least some Supreme Court justices. I focus here on the clearest examples for such a retreat, but will argue that the conservative approach reflected in these judgements

28 See e.g. *Botkovski* case (n 19), at 66.

29 CA 9255/11 *Daniel v. Plonit* (Nevo e-database, 11.8.2013), at para. 19 (per Barak-Erez, J.) (emphasis not in original).

30 CA 3380/97 *Tamgar Hevra Le-Bniya Ltd. v. Goshen* (1998) IsrSc 52(4) 673 at para. 18, (per Or, J.) and cf. CA 686/83 *Elisian v. Hevrat Ya'acov Yahalomi Inc.* (1987) IsrSc 41(4) 160, where enforcement was denied (per Shamgar CJ) under similar conditions, for lack of determinacy.

31 See CA 2143/00 *Levin v. Shuler* (2003) IsrSc 57(3) 193. In that case, the district court constructed the (non-agreed) price by reference to a professional appraisal, an approach which was endorsed by the dissenting opinion of Justice Strasberg-Cohen in the Supreme Court. The majority, however, refused to construct the price and declared the transaction void for lack of determinacy.

32 PCA 6976/00 *Beit Hapsanter v. Mor* (2001) IsrSc 56(1) 577. In this case Justice Dorner went as far as announcing the demise of determinacy as an independent requirement for the formation of contracts. *Ibid.*, at para. 12.

33 For a critique of the use of 'optimal performance' see *Adar*, Contract Law: Trends and Shifts in 2010, 6 Univ. Haifa L. Rev. 2011, 41 (52) (in Hebrew). For a judicial critique of such use see CA 10859/07 *Hevra Kadisha v. Levi* (Nevo e-database, 22.1.2012), at paras. 18-19 (per Grunis, CJ).

34 The doctrine had been initially suggested as a tool for completing missing parts of a deal by *Friedmann/Cohen*, Contracts, vol. 1, at 289 (in Hebrew) and was later endorsed in a number of Supreme Court cases. See e.g. *Dor Energia* case (n 23), paras. 15-16; *Tamgar* case (n 30), at para. 16; CA 7193/08 *Adani v. David* (Nevo e-database, 18.7.2010), at para. 5 (per Amit, J., dissenting).

may have the effect of reinforcing the more restrictive approach to contract formation and establishing it as a legitimate rival to the liberal approach.

The clearest retreat from the liberal approach to date is, in my view, the Supreme Court's decision in *Hevra Kadisha v. Levi*.<sup>35</sup> The case involved a bid whereby the seller (Hevra Kadisha) invited potential buyers to submit offers to purchase a specific parcel of land. Levi's offer to purchase the land for a certain price was accepted by the seller, subject to a request concerning the payment of certain taxes. The buyer accepted this request and asked the seller to deposit the cashier's check attached to his offer. However, a controversy arose with respect to two issues: First, the payment conditions, which were not previously agreed upon; and second, the question of whose burden it was to evacuate a tenant still occupying the land. Following a set of renewed negotiations, the buyer ultimately offered to accept these additional burdens. However, at that point, the seller broke off the negotiations, most probably for economic reasons. The district court upheld the buyer's claim. It held that the seller's notice of acceptance concluded the contract and that the missing details were non-essential and therefore could be constructed on the basis of the post-contractual negotiations, including the buyer's announcement at trial that he would cover any costs associated with the evacuation of the tenant. The seller appealed.

The Supreme Court overruled the district court's decision. The main judgement was given by Chief Justice Grunis, who advanced a sophisticated argument in support of his conclusion that no binding contract was formed between the parties.

First, it was held that the seller's acceptance was not absolute but conditional (on accepting the additional requirements) and as such could only be considered, at the most, a new offer.<sup>36</sup> However, the buyer's later "acceptance" of this new "offer" did not create a binding contract, because the seller's representative has made it clear all along, that any agreement would be subject to a final approval by the seller's management.<sup>37</sup> The court also mentioned the fact that the non-agreed details were not merely absent from the parties' preliminary agreement but were actually in dispute. Under such circumstances, the seller's notice to the buyer as well as the buyer's 'acceptance' of this notice was merely an invitation to negotiate over the remaining conditions of the deal. In other words, at no stage were both parties (at the same time) decisive enough about their will to create a legally binding relationship.<sup>38</sup>

Furthermore, in the Court's view, the agreement reached by the parties at the preliminary stage lacked determinacy (specificity). The payment conditions and the question of whose burden it was to evacuate the tenant – two issues which in the court's view were essential to the deal – were not settled at that point. And though the Supreme Court had previously recognized its power to add reasonable payment conditions to incomplete preliminary agreements, this power should not be exercised when, as in the case at hand, the parties have implicitly indicated their will to set the missing terms themselves.<sup>39</sup>

35 *Levi case* (n 33).

36 *Levi case* (n 33), para. 8. According to art. 11 of the Contracts Statute, any notice of acceptance which deviates from the original offer is equivalent to a new offer.

37 A position that the buyer has implicitly accepted (by not protesting against a provision to that extent in one of the drafts he received at a later stage).

38 *Levi case* (n 33), at paras. 9-11.

39 *Levi case* (n 33), at paras. 12-14.

- 22 In this context, Chief Justice Grunis took the opportunity to express a general dissatisfaction with the judicial tendency to construct non-agreed details on the basis of vague statutory standards such as “reasonable time”, “reasonable price”, “intermediate quality”, etc.<sup>40</sup> In the Chief Justice's own words:
- 23
- Remedying a void in a contract by resorting to “default provisions” which make use of a vague standard [...] gives rise, in my view, to a number of difficulties [...]. First, [such use] invites disputes between the parties as regards interpretation [...]. Furthermore, deciding what is reasonable may require additional proceedings [...]. Second, *a liberal approach to the determinacy requirement and the adding of provisions by reference to vague standards might produce uncertainty to contracting parties [...]* as to whether a contract has been formed, and as to the terms of such contract [...].<sup>41</sup>
- 24 Finally, Chief Justice Grunis criticized the district court's use of the 'optimal performance' principle. Relying on the buyer's belated expression of will during trial, even when it seems favorable to the seller, could not compensate for the lack of mutual consent over the pertinent issue at the decisive point in time where the agreement was actually formed.<sup>42</sup> In light of all the above, the Court overruled the district court's judgement and denied the buyer's claim.<sup>43</sup>
- 25 Whilst probably the clearest judicial endorsement of the conservative approach, the *Levi* case is by no means a one-off that should be ignored or underestimated. Indeed, in a number of fairly recent cases, decided both prior to the *Levi* case and subsequently, the rulings of the Supreme Court on the validity of preliminary agreement have become less homogenous, in terms of both their rhetoric as well as their end results. For example, in a case decided two years prior to *Levi*,<sup>44</sup> a majority of the Supreme Court denied the validity of a preliminary agreement on the basis of the fact that the parties intended to complete the missing details (again, payment arrangements) by themselves.<sup>45</sup> Similarly, a year after *Levi*, the Supreme Court overruled a finding of the lower instance and denied validity from a fairly detailed agreement merely because the taxing arrangements, which in the court's view were crucial to the parties, were not consistently settled in the documents signed by the parties.<sup>46</sup> The *Levi* case was cited in dozens of cases, so that its restrictive approach and rhetoric must have reached the eyes of many judges, in all instances.
- 26 Finally, a somewhat innovative statement of the previous President of the Supreme Court, Chief Justice Miryam Naor, is worth mentioning. In a 2013 decision, in

40 See, respectively, art. 41, 45, 46 of the contracts statute (and cf. art. 9(a), 20(a) of the sale statute).

41 *Levi* case (n 33), at paras. 15-16 (emphasis not in original).

42 Without explicitly saying so, the Court in fact criticized here the use of the 'optimal performance' doctrine, discussed above, *supra* paras. 16 and 17.

43 Justice Hendel expressed his consent to the entire judgement of Chief Justice Grunis. Justice Hayut (currently CJ), on the other hand, agreed with the conclusion (with a slightly different emphasis) but did not in any way disclose her view as regards the general problem discussed by Grunis.

44 *Adani* case (n 34).

45 For a detailed discussion of the case and its significance in terms of signaling a retreat from the liberal approach see *Adar* 2011 (n 33), at 48-54. But see, on the other hand, a relatively liberal decision of the court in CA 9247/10 *Rosenberg v. Saban* (Nevo e-database, 24.7.2013); where the lack of payment arrangements in a very brief and partial agreement for the sale of shares did not prevent the courts from giving it full contractual effect.

46 *Daniel* case (n 29).

which she denied a request for a rehearing of the *Rosenberg* case,<sup>47</sup> Justice Naor (as she then was) said the following:

The court's ruling is consistent with the established precedent under which a contract does not require consent over every detail but only over the *essential and crucial details* of the transaction, and under which, where the parties have expressed willingness to be bound and have agreed upon what they viewed as essential details, *other details* are susceptible to normative completion.<sup>48</sup>

This seemingly obvious statement reflects an important change in the rhetoric of the Supreme Court. As mentioned earlier, a common rhetoric recognized the authority of the courts to resort to external normative completion even when the missing details were deemed essential and crucial.<sup>49</sup> The words of Justice Naor implicitly reject this approach, making it crystal clear that all essential details must appear in the parties' agreement *itself*, and cannot therefore be supplemented by reference to external sources. 27

Whether or not the more restrictive approach to contract formation will gain any more strength, and will expand its impact on the practice of the lower courts and the legal community as a whole, remains to be seen. 28

### III. Defects in formation: Balancing personal responsibility with equality in exchange

#### 1. The basic regime

Chapter 2 of the Contracts Statute is titled: "Termination of the Contract Due to A Defect in Its Formation". This title is slightly misleading, as the chapter contains two provisions which deal with what can be described as 'artificial' rather than 'true' defects. In these two situations – a 'contract for the sake of appearances' under section 13, and a 'clerical error' under section 16 – a disparity (intentional in the former case, unintentional in the latter) exists between the parties' common understanding of the transaction and the external manifestation of their common will. As the 'defect' (the non-intentional clerical error or the intentional appearance) is, in these cases, only in appearance, the legal rule simply ignores it, giving effect to the true common will of the parties: Under section 13 the intentionally misleading 'contract' is declared void,<sup>50</sup> whereas under section 16 the unintentional clerical error is to be disregarded and rectified according to the parties' true understanding. 29

The remainder of Chapter 2 depicts four situations where the law regards the contract as sufficiently defective so as to justify a unilateral retreat from it by the aggrieved party. These situations include mistake (art. 14), misrepresentation (art. 15), coercion (art. 17) and exploitation (art. 18). Whereas under the ordinary rules of formation only the objective rather than the subjective will is binding upon the 30

47 *Rosenberg* case (n 45), in which case effect was given to a partial and brief preliminary agreement.

48 *Ibid.*, at para 14 (emphasis not in original).

49 *Supra* paras. 12 and 13.

50 However, the section protects the interests of third parties which have innocently relied on the appearance of a contract.

parties,<sup>51</sup> in any of these four cases a party may be allowed (but not obligated) to reject the objective manifestation of her will and treat the contract as void due to its original defectiveness.<sup>52</sup>

- 31 Apart from listing the elements of each specific “defect” (i.e., each cause for termination), Chapter 2 contains a number of general provisions (sections 19-21) which apply to all four defects. These articles concern the conditions for a valid termination notice (art. 20), the option of partial termination (art. 19) and the duty of reciprocal restitution arising out of a valid termination by the aggrieved party (art. 21).

## 2. The basic principle underlying the law of defects – The intersection of a bad bargain and a bad conduct

- 32 A detailed outline of the elements of each of these causes for termination, and their interpretation by the Israeli courts is outside the limited scope of this survey.<sup>53</sup> Instead, I would like to use the limited available space to highlight what I regard as the basic guiding principle which governs this area.
- 33 My claim – which I am not able to fully defend here – is that while they differ from each other in some respects, the four paradigmatic defects in formation have an important common denominator. Arguably, they all involve factual scenarios where two factors exist *in tandem*: The first factor takes into account the aggrieved party's perspective. It requires that party to prove that her will, as expressed in the agreement, was defective in some significant sense and that this defect, unless ignored, will lead to the enforcement of a clearly imbalanced (and thus unprofitable) bargain from that party's perspective.
- 34 However, the first element never stands alone. Under the Israeli law of contracts, a serious defect in a party's will is usually irrelevant, unless it coexists with an additional element. This additional factor concerns the conduct of the other party. Such conduct must be shown to have been *morally or socially wrongful* in a way that makes the other party responsible for the conclusion of the defective transaction. More specifically, the other party must be shown to have acted *wrongfully* – either by causing the defect itself (as in cases of duress or misrepresentation) or by knowingly or unreasonably giving its consent, thus allowing the other party to enter into an imbalanced contract (as in cases of mistake or exploitation).
- 35 Absent any of these two elements – a defective will leading to a bad bargain, coupled with a wrongful conduct causing or at least accepting such a bargain – the general law of contracts will not uphold a unilateral right to terminate a contract which, *ex hypothesi*, was validly formed under the rules of formation.<sup>54</sup>
- 36 That said, it must be emphasized that the mere conjunction of these two factors is not always sufficient for a right to terminate to arise. Whether or not such right will arise will depend upon a number of policy considerations, which are reflected in the particular elements of each of the four statutory defects, as set by statute and interpreted by the courts. These policies require taking into account a variety of

51 See *supra* para. 7.

52 In this sense termination due to a defect is retrospective in its nature.

53 For a brief outline see *Shalev/Lerer* 2014 (n 2), at paras. 171-236.

54 Interestingly, when the wrongfulness element is absent (such as in the case of a mistake unknown to the other party), the aggrieved party may still ask the court to exercise its discretion to release her from the bargain, subject to a possible award of damages against her. See art. 14(b).

factors, such as the degree of fault reflected in the conduct of the non-terminating party (e.g., full awareness of the other party's defective will or merely negligence), the extent of inequality in the exchange, and the degree of self-negligence on the part of the aggrieved party (in not avoiding the bad bargain).<sup>55</sup>

The following section demonstrates, by way of illustration, the interaction between these policy considerations in one of the most controversial areas within of the law of defects, namely, that of misrepresentation by default (or passive misrepresentation). 37

### 3. Balancing conflicting policy considerations: The scope of the duty of disclosure

A well-known controversy within the law of mistake and misrepresentation concerns the question of whether and to what extent a party, aware of the other party's mistake, should be under a legal duty to prevent that mistake by disclosing to the other party the relevant information. 38

While different legal systems have embraced different approaches to this problem, it is universally recognized that a serious dilemma arises here. On the one hand, the fundamental principles of autonomy and personal responsibility seem hostile to an imposition of such a duty, at least where the party under mistake could have easily avoided that mistake by undertaking a simple inquiry. On the other hand, an altruistic sentiment may support an opposite conclusion, at least when the bargain made by the mistaken party is clearly detrimental from his or her point of view. 39

With respect to this dilemma, the Israeli the law of mistake and misrepresentation takes a fairly moralistic position. Under article 14(a), a mistaken party may terminate the contract, if the mistake was a crucial one,<sup>56</sup> and if the other party was or should have been aware of this fact. Similarly, under article 15, misrepresentation can take place "by default", whenever a party failed to disclose a detail which he or she were obliged to disclose under "law, custom, or the circumstances of the case". Indeed, although a narrower approach to the duty of disclosure has been expressed from time to time by certain judges,<sup>57</sup> the more liberal approach has gained prominence in the rulings of the Supreme Court. 40

Thus, in one of the early cases decided on the issue, the seller of a certain parcel of land failed to disclose to the buyer, a professional contractor, that there were serious limitations on the ability to develop the plot. The majority of the court ruled that the circumstances as well as the principle of good faith gave rise to a duty of the seller to disclose these limitations to the buyer. This was so, regardless of the fact that the latter could have easily discovered this information by himself, and that his failure do to so may have amounted to clear negligence. The Court said: 42

55 The latter element is not explicitly mentioned in the Statute, but was recognized as part of the statutory exception under which a mistake cannot relate merely to the profitability of the bargain (see Article 14(d)). For discussions of this factor see *Friedmann/Cohen* (n 34), 717-719; CA 7920/13 *Karmel v. Talmon* (Nevo e-database, 29.2.2016), para. 23 (per Justice Mazuz).

56 A mistake would be considered crucial if it had clearly influenced the decision to conclude the contract both subjectively (from the mistaken party's subjective point of view) and objectively (under a test of reasonability).

57 See e.g. CA 280/87 *Kopelman v. Beinkin* (1989) IsrSc 43(2) 753, para. 5 (per Justice Maltz).

Good faith conduct during negotiations means decent and honest conduct, i.e., a duty not to mislead the other party by failing to disclose material information [...] in our case [...] the appellant knew that his plot was different from any other plot, [...] also he knew or must have known that the respondents' decision to purchase the plot depended on reception of the correct information [...]. Under these circumstances the appellant should have disclosed what was known to him, and failing to disclose is equivalent to bad faith conduct [...].<sup>58</sup>

- 43 Justice Landau, representing the restrictive view, thought that imposing such a wide duty of disclosure was unwarranted. He said:

The buyer had the opportunity to check the features of the plot and its planning status [...]. After all, he is the one involved in the building business, being a contractor, not the seller [...] he did not. This was gross negligence [...]. We are dealing with an ordinary commercial contract and should not set a too high level of morality [...] lest we are to harm the stability of commercial life and the expectations of a person who signed a contract [...].<sup>59</sup>

- 44 Future cases have implicitly rejected this narrow view, and recognized a right to terminate a contract even absent any active misrepresentation on the part of the other party, and even when the mistaken party could have avoided the mistake with reasonable efforts.<sup>60</sup>
- 45 Finally, it should be mentioned that under article 14(b) of the Contracts Statute, the courts are allowed, as an exception to the principle formulated above, to release a mistaken party from a losing contract even absent any default of the other party (e.g., in case of a mutual mistake), if justice so requires. This power, however, has been perceived (rightly so, in my view) as exceptional. As such, it is rarely, if ever, exercised by the courts.<sup>61</sup>

#### IV. Remedies for breach of contract: Theoretical expansion

##### 1. The basic regime

- 46 As mentioned earlier, remedies for breach of contract are governed by the Remedies Statutes which, as far as technique and style are concerned, clearly reflects continental influence. The Statute is relatively short and is divided into three chapters. The first chapter (“General Provisions”) contains two articles, the first of which provides a set of definitions to some basic terms used by the statute, such as

58 Ibid., at para. 41.

59 Ibid., at p. 241.

60 See e.g. CA 2469/06 *Swisa v. Hevrat Zaga Bagosh* (Nevo e-database, 14.8.2008), para 12; PCA 1565/95 *Sea Trade and Service v. Vienstein Ltd.* (2000) 54(5) 638, para. 2 (per Tirkel J.).

61 See e.g. CA 406/82 *Nahmani v. Galor* (1987) IsrSc 41(1) 494, where the court refused to terminate the contract on the basis of justice considerations. More recently see *Karmel* case (n 55), where a majority of the Court (Mazuz J. dissenting) refused to release a buyer of a plot from a losing contract which due to the buyer's mistake as to the plot's potential was not only unprofitable but clearly detrimental to him. For a critique of the decision see *Zamir*, Mistake as to the Worthwhileness of the Transaction: The Object's Value, Future Developments, Assumption of Risk, and Negligence, in: *Adar/Barak* (eds.), *Essays on Contracts – In Honor of Gabriela Shalev*, forthcoming 2019, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2819884](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2819884) (published also in: 10(2) *Univ. Haifa L. Rev.* 57 (1918)



“Breach”, “Damage” and “Enforcement”.<sup>62</sup> Article 2 is the statute's most important provision. It reads:

Upon breach, the aggrieved party is entitled to demand enforcement of the contract, or to terminate it, and is further entitled to damages instead of or in addition to any of the said remedies, all subject to the provisions of this statute.

Thus, this preliminary provision presents the main remedies available to the aggrieved party, clarifies the interrelations between them, and sets the basic structure of the Israeli law of remedies for breach of contract.<sup>63</sup> 47

The second chapter of the Remedies Statute elaborates on each of the three remedies mentioned in article 2. Section 1 (articles 3 to 5) recognizes the aggrieved party's right to enforce performance of the contract, and defines four limitations on this right. Section 2 (articles 6 to 9) sets the rules governing the remedy of termination which, when activated, results in mutual restitution of the performances rendered to each of the parties prior to termination. Section 3 (articles 10 to 16) announces the aggrieved party's right to compensatory damages for the losses caused by the breach (i.e., expectation or performance damages), and allows the parties to set liquidated damages, the amount of which may nonetheless be reduced by the court if greatly disproportionate to the damage reasonably foreseeable, at the time of formation, as a result of the breach.<sup>64</sup> Finally, in the third chapter (“Miscellaneous”) several important issues are discussed, such as anticipatory breach,<sup>65</sup> frustration of the contract, and the self-help remedies of detention of performance and set-off (articles 17 to 20).<sup>66</sup> 48

From a substantive point of view, the Remedies Statute reflects a rather mixed approach. Indeed, this is not surprising given that it was strongly inspired by the 1964 Hague Convention on the International Sale of Goods, which itself represents a compromise between common law and civil law approaches.<sup>67</sup> For example, a civil law approach was clearly adopted with respect to the remedy of enforced (specific) performance, which is considered, as in most civil law systems, a primary remedy and an invested right of the aggrieved party.<sup>68</sup> On the other hand, the basic provi- 49

62 The latter remedy is defined as an injunction ordering the defendant to either take a certain action (including the payment of a sum of money due or the removal of the negative effects of breach) or refrain from acting in violation of a contractual duty.

63 In this respect, it resembles article 1590 of the Quebec Civil Code of 1994.

64 See, respectively, articles 10 (right to expectation damages) and 15 (liquidated damages).

65 For a discussion of this concept see *Shalev*, Remedies on Anticipatory Breach, 8 Isr. L. Rev. 1973, 8.

66 The last five articles (21 to 25) of the statute are of secondary importance and deal with matters of jurisdiction and procedure.

67 Convention relating to a Uniform Law on the International Sale of Goods (Hague, 1964). The official text of the ULIS convention is available at: [www.unidroit.org/english/conventions/c-ulis.htm](http://www.unidroit.org/english/conventions/c-ulis.htm). A revised version of the convention was later adopted in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), available at: [www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf](http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf).

68 This liberal approach to the availability of specific performance was recently endorsed and implemented by the Supreme Court in the case of CA 5131/10 *Azimov v. Binyamini* (Nevo e-database, 7.3.2013), where, notwithstanding the substantial distress involved in enforcing the contract on the promisor, the Court enforced a contract for the sale of an apartment, emphasizing that only in rare and exceptional cases should the court deny enforcement based on considerations of justice.

sions governing compensatory damages and termination following breach strongly resemble traditional common law solutions.<sup>69</sup>

- 50 In retrospect, one may confidently say that the Remedies Statute has been very successful in providing the legal community with a fairly comprehensive – and yet manageable and coherent – set of practical rules which, at the same time, is sufficiently concise and elastic so as to allow considerable flexibility in its application.<sup>70</sup> Notably, the Remedies Chapter of the Draft Israeli Civil Code is based on the structure and content of the Remedies Statute.<sup>71</sup>

## 2. Additional remedies

- 51 As just mentioned, the Remedies Statute recognizes only three traditional remedies: Enforcement, expectation (performance) damages, and termination (followed by mutual restitution). At first, it was thought that this set of remedies was exhaustive, and that no further remedies could be judicially recognized.<sup>72</sup> However, during the years, the Supreme Court has deserted this approach, and has recognized a number of interesting judicial remedies which are not explicitly recognized by the Remedies Statute. In what follows, I will very briefly try to sketch this development.

### a) Reliance damages

- 52 The Remedies Statute does not explicitly recognize the right of the aggrieved party to 'reliance damages', i.e. damages intended to put the promisee in the economic position he would have occupied had he not entered the contract. However, as in other legal systems, the question arose whether the aggrieved party should be entitled to demand reliance damages, instead of expectation damages. While courts have often awarded these damages in practice, until the seminal case of *Melon Zukim*<sup>73</sup> the theoretical and legal basis for awarding reliance damages remained unclear.
- 53 The case involved a damage claim by a contractor against the municipality of Netanya for the breach of an agreement under which both parties engaged in a building project for the development and construction of a hotel. The claimant failed to establish with reasonable certainty the extent of its expected loss of profits. The question then arose, whether the claimant was entitled, instead, to reliance damages – in that case, damages for a variety of proven expenses the claimant incurred prior to the failure of the project. The court unanimously agreed that the answer was positive.

69 For English law's influence on the Remedies Statute see e.g. *Shalev/Herman* 1975 (n 3), at pp. 1101-1103. For a detailed overview of the provisions of the Remedies Statute see *Shalev*, Introduction to the Law of Contract, in: International Encyclopedia of Law – Israel, 1995, 100-123.

70 The Remedies Statute is applied regularly in both commercial and non-commercial contexts (e.g. labor law and consumer law disputes).

71 For a detailed analysis of this innovative law reform see *Adar/Shalev*, Remedies for Breach of an Obligation: A Look at the Remedies' Section of the New Israeli Civil Code, 6 Ono Academic College L. Rev. 2006, 185 (232) (in Hebrew); *Adar/Shalev* 2008 (n 4).

72 CA 140/73 *Sharam v. Grinberg* (1974) IIsSc 29(1) 194, 195-196, (since the enactment of the Remedies Statute there is no authority to award 'nominal damages').

73 CA 3666/90 *Melon Zukim v. Netanya City* (1992) IIsSc 46(4) 45.

Justice Maltz explained that, although the aggrieved party was only entitled to claim expectation damages, reliance damages could and should be seen as an appropriate evidentiary substitute for such expectation damages. This was so, for under the assumption that the contract was a profitable one – an assumption that the contract breaker is free to rebut – reliance damages will always be lesser than the expectation damages to which the promisee would have been entitled, had he not met the difficulty of proving the extent of his loss.<sup>74</sup> 54

While consenting to the result, Justice Cheshin adopted a rather different approach. In his view, the reliance interest of the aggrieved party should be protected not merely as an evidentiary substitute but as an independent and autonomous interest, standing on its own legs. This meant that reliance damages could be awarded even when it was clear that the contract was a losing one, so that reliance damages would put the aggrieved promisee in a better position than the one he would have been in had the contract been performed.<sup>75</sup> The third judge, Justice Matza, agreed that such a rule was normatively desirable, but expressed doubts as to whether there was sufficient formal basis for recognizing such a wide right to reliance damages.<sup>76</sup> Justice Maltz, on the other hand, rejected Justice Cheshin's approach. To him upholding such a reliance doctrine was equivalent to endorsing punitive damages, which were clearly not available under Israeli law as a remedy for breach of contract.<sup>77</sup> 55

Although this judicial controversy was not hitherto settled, it seems that most reliance damage judgements reflect the narrower approach, endorsed by justice Maltz. Under this approach, which I have elsewhere defended, the remedy will only be awarded when it is objectively difficult to prove whether the contract was profitable or rather a losing contract.<sup>78</sup> 56

## b) Disgorgement damages

Should the aggrieved promisee be allowed, instead of enforcement or expectation damages, to claim damages aimed at stripping the promisor from the profit he has managed to reap through breach? 57

In the now famous *Adras* case,<sup>79</sup> the Israeli Supreme Court dealt extensively with this question, and gave it a clear affirmative answer. Unlike courts in other Western legal systems, the Court recognized such a right of disgorgement, although the exact conditions under which the remedy may be granted, as well as its scope, are still far from clear. Importantly, under Israeli law, disgorgement damages for breach of contract are not limited to cases where the aggrieved party had a proprietary or quasi-proprietary interest in the promised asset. Indeed, in the *Adras* case itself, the remedy was awarded for the violation of a contract for the sale of a chat- 58

74 Justice Maltz justified this assumption on the basis of an idea of 'evidentiary loss': the contract breaker should be held responsible for the evidentiary difficulty to prove whether the contract was profitable or not, because his default created that difficulty. *Ibid.*, at 57.

75 *Ibid.*, at 75-78.

76 *Ibid.*, at 80-82.

77 *Ibid.*, at 58.

78 Examples for the narrow approach are brought by *Shalev/Adar*, *Contract Law – The Remedies: Towards Codification of the Civil Law*, 2009, pp. 59-60 (in Hebrew). For a critique of the wide approach to reliance damages see *ibid.*, at pp. 58-59.

79 FH 20/82 *Adras Building Materials Ltd. v. Harlow and Jones G.M.B.H* (1988) *IsrSc* 42(1) 221.

tel (steel), which was resold by the promisor to a third party at a price higher than the contract price.<sup>80</sup> The Supreme Court based this extraordinary remedial right on restitutionary principles, namely, the idea that the defendant's enrichment from a breach can be conceptualized as arising from the unauthorized use of the claimant's right to the performance of the contract and thus as having been made "at his expense".<sup>81</sup>

- 59 Similarly, in the more recent case of *Agrifarm*,<sup>82</sup> disgorgement damages were awarded for the breach of a negative obligation not to sell certain shares held by the defendant in the stock market without first offering these shares to the claimant. The claim was approved by the Supreme Court, which awarded damages in a sum equal to the profit made by the defendant in the other transaction. The Court reaffirmed its commitment to the principles and reasoning laid down in the *Adras* case.
- 60 In addition, however, the Court in *Agrifarm* emphasized the need to deter intentional and opportunistic breaches of contract.<sup>83</sup> In the Court's own words:

Recognizing the right of the aggrieved party to receive the sums gained by the contract breaker [...] is based on the idea that "contracts should be performed" and on policy considerations, namely, deterring a party from breach through the annulment of the financial incentive underlying the violation of the contract.<sup>84</sup>

### c) Punitive damages

- 61 Damages intended to punish defendants for outrageous behavior have been recognized in Anglo-American systems around the world.<sup>85</sup> However, for various reasons, punitive damages have not been recognized as a legitimate remedy in contract actions, at least not explicitly.<sup>86</sup> In Israel, the courts have adopted this distinction, and have recognized their authority to award punitive damages in tort cases.<sup>87</sup> However, this authority has not been extended to the contractual realm, where the idea of punishment is traditionally regarded as alien to the law of contract.<sup>88</sup>

80 I discussed the *Adras* case and its reasoning in: The CISG in Israel, Ch. 31, in: *Di-Matteo* (ed.), *International Sales Law: The Global Challenge*, 2014, 518 (523).

81 See especially Justice Barak's reasoning in *Adras* case (n 79), at para. 24; CA 8728/07 *Agrifarm International Ltd. v. Meirson* (Nevo e-database, 15.7.2010), at paras. 35, 38-39.

82 *Agrifarm* case (n 81).

83 The need to deter opportunistic breach was recently recognized by the American Restatement. See Restatement (Third) of Restitution and Unjust Enrichment, Section 39 (disgorgement for opportunistic breach).

84 *Ibid.*, at para. 13 (per Danziger J.). See also at para. 37, for the pertinent policy considerations.

85 For a general survey of the theoretical and normative problems associated with the remedy of punitive damages see *Adar*, *Touring the Punitive Damages Forest: A Proposed Roadmap*, 1 *Osservatorio di diritto civile e commerciale* (The Civil & Commercial Law Observer) 2012, 275-322.

86 A detailed analysis and survey of the field can be found in *Adar*, *The Punitive Award as A Sanction in Contract* (Doctoral Thesis, Hebrew University of Jerusalem, Faculty of Law, 2004) (In Hebrew).

87 See e.g. CA 140/00 *Etinger Estate v. Reconstruction and Development of the Jewish Quarter in the Old City* (2004) IsrSc 58(4) 486; CA 9656/03 *Marciano Estate v. Dr. Zinger* (Nevo e-database, 11.4.2005).

88 For example, in the *Melon Zukim* case (n 73), Justice Maltz rejected the view that reliance damages should be awarded in losing contracts, because in his view this would amount to awarding punitive damages, and as such would run contrary to the "well-established precedent that in Israeli contract law there is no room for punitive damages for breach of contract." *Ibid.*, at 58.

While this traditionally presumed distinction has not been questioned directly, notions of punishment have, at times, infiltrated the realm of contract remedies. A most dramatic example in this context is the *Agrifarm* case, which was just mentioned. Interestingly, the Court in *Agrifarm* proposed an alternative – and most innovative – legal basis upon which it would be possible to justify awards of disgorgement damages, namely, the notion of “deterrent restitution”.<sup>89</sup> Based on an idea mentioned in a famous article by professor Daniel Friedmann,<sup>90</sup> Justice Danziger proposed to recognize this new remedy, which would enable courts to award disgorgement damages *even when under traditional restitutionary principles the right of the claimant to disgorgement could not be properly established*.  
 More specifically, deterrent restitution could be employed where the enrichment made by the defendant could not easily be traced back to the breach of the contract, and thus could not be conceptualized as being made “at the claimant’s expense”. In these cases, disgorgement of the profit could not be justified under the *Adras* rule, which as mentioned above was based on restitutionary principles. However, for policy reasons concerning the need to make sure that “a wrong does not pay”, courts should be willing to strip defendants of their unlawful profits even when a restitutionary basis for the award is lacking. In the words of Justice Danziger:

My conclusion that under the circumstance a duty of restitution has arisen, would not have been different even if I had accepted the defendants’ claim that their enrichment was not made “at the expense” of the claimants. In my view, even in such a case it would have been appropriate to apply the rule under which “a wrongdoer does not profit from his wrongdoing” [...]. True, injecting punitive elements into private law is not a simple matter. Private law’s traditional aim is to regulate relationships between individuals, and it focuses on remedying the loss caused to the injured party [...] not on the punitive idea that the wrongdoer should be punished. However, in my view, the need to regulate human conduct necessitates the activation of “deterrent restitution” in appropriate cases.”<sup>91</sup>

Notably, the Supreme Court moved on to discuss the preconditions for an award of deterrent restitution to be made, as well as the policy considerations which should guide the court’s discretion in deciding whether or not to apply this innovative doctrine. As preconditions the Court proposed that the breach should be intentional and unjustified, as well as that the defendant had not already been stripped of his profits (e.g. by a previous award of damages or restitution). Additional relevant factors concern the question of whether the breach amounted to a violation of trust, whether there were other persons whose interest in the profit was stronger than the claimant’s, and the existence of alternative means of enforcement such as criminal or administrative sanctions, to which the defendant might be exposed.<sup>92</sup>  
 In my view, the *Agrifarm* case represents an important shift from the traditional conservative approach, under which contract remedies are not the appropriate tool for combating dishonesty and opportunism in commercial contexts. The case signals the growing willingness of the Court to apply more aggressive remedies to protect the social institution of contracting. While not explicitly endorsing punitive

89 *Agrifarm* case (n 82), at paras. 40-43 (per Danziger J.).

90 *Friedmann*, Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong, 80 Colum. L. Rev. 1980, 504.

91 *Ibid.*, at paras. 40-41, 43.

92 *Ibid.*, at para. 42.

damages, the *Agrifarm* case has opened up the possibility for lower courts to take into account punitive considerations more frequently and more openly when resolving contractual disputes. In my view, such an open approach should be welcomed.

## V. Conclusion

- 67 This essay aimed to achieve three purposes. First, to acquaint the foreign reader with some of the basic characteristics of Israeli Contract law, such as the style and content of the statutory infrastructure of the law, the relationship between statutory and case law, and the fundamental principles governing this field, namely, freedom of contract and the principle of good faith in negotiations and in the performance of contracts.
- 68 Second, the essay aspired to give the readers a somewhat more careful look at three major sub-fields in this general body of law, namely, the law on formation of contracts, the law of defects in formation, and the law of remedies for breach of contract.
- 69 Finally, the essay offered a glance into the complexity characterizing some of the major developments in each of these three areas. While some of the developments are more drastic (e.g., in the field of remedies) than others (as in the law of formation), all of them are significant. Resolving the challenges to which these developments give rise, is the challenge of Israeli contract law in the years to come.

## Literature

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