

The Role of Remedies in The Relational Theory of Contract – A Preliminary Inquiry

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Abstract: The article addresses a puzzle. The puzzle is the neglect of the vast literature on relational and long-term contracts to explore a seemingly key aspect, namely: How, if at all, should the relational nature of a contractual transaction affect the basic rules governing the award of remedies for breach of contract? The authors argue that contrary to a widely held assumption, formal rules of remedy do play a significant role in the relational context. Furthermore, understanding the function of formal remedies in the relational context is crucial for the development of a full-scale relational theory of contract. In light of this basic assertion, a theoretical model of relational remedies is then introduced. The model offers a number of guiding principles, which should be taken into account by courts (or legislators) when awarding remedies for the violation of contractual rights in a relational setting.

Resumé: Cet article traite d'une énigme. L'énigme est le manque d'intérêt de la vaste littérature sur les contrats relationnels et les contrats de longue durée pour un point semble-t-il crucial : comment la nature relationnelle de la transaction contractuelle affecte, si elle le doit, les règles de base gouvernant l'attribution de remèdes en cas d'inexécution du contrat ? Les auteurs soutiennent que, contrairement à une opinion largement répandue, les règles formelles relatives aux remèdes jouent un rôle significatif dans le contexte relationnel. De plus, comprendre la fonction des remèdes formels dans un contexte relationnel est crucial pour le complet développement de la théorie relationnelle des contrats. A la lumière de cette assertion basique, un modèle théorique de remèdes contractuels est alors proposé. Ce modèle offre un certain nombre de principes directeurs qui devraient être pris en compte par les tribunaux (ou les

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législateurs) quand ils accordent des remèdes pour la violation des droits contractuels dans un cadre relationnel.

Zusammenfassung: Der Beitrag spricht ein ungewöhnliches Phänomen an, namentlich, dass die reiche Literatur zu (relationalen) Langzeitverträgen einen Aspekt vollkommen unbeachtet lässt, der absolut zentral erscheint: Wie wirkt sich die relationale Natur der vertraglichen Transaktionen bei den grundlegenden Rechtsbehelfen aus, mit denen auf Vertragsbruch reagiert wird? Die Autoren argumentieren, dass – anders als häufig angenommen – formelle Rechtsbehelfe durchaus eine erhebliche Rolle auch bei relationalen Rechtsbeziehungen spielen. Darüber hinaus ist es auch für die Entwicklung einer vollständigen Theorie der relationalen Verträge unerlässlich, sich der Funktion formeller Rechtsbehelfe in diesem Kontext klarzuwerden. Nachdem diese zentrale Annahme erläutert wird, wird ein theoretisches Modell für das System von Rechtsbehelfen für Verträge mit relationalen Bezügen vorgestellt. Dieses umfasst eine Reihe von Leitprinzipien, die berücksichtigt werden sollten (von Gerichten oder Gesetzgebern), wenn es im Rahmen von relationalen Beziehungen darum geht, der geschädigten Partei einen Anspruch zu geben.

I Introduction

One of the leading contemporary theories of contract is the relational theory. Notwithstanding its remarkable development since the foundational works of Macaulay and Macneil,¹ this body of literature has generally neglected the discussion of legal remedies.² Scholarly literature pertaining to the relational

1 See *infra*, notes 3–4.

2 An exception is D. Campbell, 'The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract' 11 *Texas Wesleyan Law Review* 455 (2005) (relational theory to justify efficient breach of contract, and to rationalize the rules limiting both specific performance and compensatory damages). Campbell's approach is fascinatingly presented – and lightly criticized – in an article by S. Macaulay, 'Renegotiations and Settlements: Dr. Pangloss's Notes on the Margins of David Campbell's Papers' 29 *Cardozo Law Review* 261 (2007). However, these articles do not offer a comprehensive look at the question of remedies in the relational context. Macneil's writings on remedies focused, mainly, on the limitations of formal remedies within the framework of The Relational Theory of Contract: Selected Works of Ian MacNeil. I.R. Macneil, 'Essays on the Nature of Contract' 10 *South Carolina Central Law Journal* 159 (1979). Macneil has also dealt with the weaknesses of the simplistic efficient-breach analysis: I.R. Macneil, 'Efficient Breach of Contract: Circles in the Sky' 68 *Virginia Law Review* 947 (1982); I.R. Macneil, 'Contract Remedies: A Need for a Better Efficiency Analysis' 144 *Journal of Institutional and Theoretical Economics* 6 (1988). See also Chapter 7 (*The Analysis of Remedies*) in D. Campbell (ed), *The Relational Theory of Contract: Selected Works of Ian MacNeil* (London: Sweet & Maxwell, 2001) 265. However, in none of these articles does Macneil discuss the need to adjust the legal rules of remedies to the relational context.

theory has typically focused on extra-legal or informal devices for the regulation of long-term contractual relations, such as: consensual adjustment of primary contractual arrangements in light of changing circumstances, informal incentives for performance and cooperation, the tendency to abstain from relying on formal rights and duties, and the frequent use of Alternative Dispute Resolution mechanisms.

Much less attention has been devoted, however, to a different question, namely: how, if at all, should the existence of a relational contract affect the basic rules governing the award of remedies for breach of contract? To what extent, if at all, should the remedial response to the breach of a long-term relational contract differ from the ordinary or traditional legal response to contract breach?

The paucity of academic sources dealing in detail with this type of question is far from surprising. Relational contract theory views the formal legal infrastructure governing the contractual relationship as being of secondary importance compared to informal norms of decency, solidarity and cooperation. According to mainstream approaches to relational contracts, the primary obligations originating from a long-term relational contract are, at best, merely a basis for future adjustments and variations to be made by the parties. Hence, breach or violation of such terms should not be viewed as a trigger for asserting secondary rights of remedy, but rather as an occasion for renegotiation, readjustment, compromise and settlement. Under this conventional understanding, resorting to the formal law of remedies upon breach misses the mark. Instead of reflecting the parties' ongoing commitment to promoting their goals through cooperation and mutual agreement, such a move reflects a diametrically opposed set of values, such as confrontation and antagonism. Hence, so it is assumed, the formal law of remedies for breach of contract does – as it should – play a relatively marginal role in the context of relational contracts.

In our paper we challenge this widely held assumption. We argue that marginalizing the importance of formal remedies in the relational contexts is unwarranted. Formal legal remedies play a significant role not only when a short-term one-shot contract is violated, but in the relational context as well. Furthermore, understanding the function remedies play in the relational context is crucial for the development of a full-scale relational theory of contract. In light of this basic assertion, we move on to propose a theoretical model of relational remedies that would offer guidance to courts or other tribunals, whenever they are required to resolve relational contract disputes on a formal legal basis. This, in turn, so we argue, requires adaptation of some of the basic rules of contractual remedies to the distinct characteristics of relational contracts.

The paper unfolds in five parts. The second part discusses the reasons for our belief that contrary to the implicit assumption of the relational theory litera-

ture, remedies do play an important role in the relational context. The third part of the paper consists of a few preliminary clarifications regarding the nature and purpose of the theoretical model proposed in the paper. Then, in part four, we outline the model itself. We begin with a general presentation of the guiding principles offered by the model, and move on to demonstrate its possible implications on the resolution of specific remedial questions.

The paper concludes in part five, where we examine the extent to which the remedial provisions of the DCFR conform to the model offered in the article. We argue that while not explicitly distinguishing between relational and non-relational contracts as such, a considerable number of provisions in the draft common frame of reference reflect sensitivity to the unique nature of various types of relational contracts. In this respect, the DCFR may be seen as a first step towards recognizing the need to develop a relational theory of contract remedies.

II The Relevance of Remedies in the Relational Context

Today, 48 years since Macaulay's pioneering research into what he referred to as 'non-contractual business relations'³ and 37 years after the publication of Macneil's seminal article on 'the many futures of contract',⁴ it may safely be concluded that the relational theory is one of the richest and most influential contemporary theories of contract law.⁵

- 3 S. Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' 28 *American Sociological Review* (1963) 55; S. Macaulay, 'The Use and Non-Use of Contracts in the Manufacturing Industry' 9 *Practical Lawyer* 13 (1963); S. Macaulay, 'An Empirical View of Contract 1985' *Wisconsin Law Review* 465 (1985).
- 4 I.R. Macneil, 'The Many Futures of Contracts' 47 *Southern California Law Review* 691 (1974); I.R. Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law' 72 *Northwestern University Law Review* 854 (1978) (hereinafter Macneil, *Adjustment*); I.R. Macneil, *The New Social Contract* (New Haven: Yale University Press, 1979).
- 5 Although few books present comprehensive treatments of the relational theory, the literature dealing with aspects of the relational theory is rich and versatile. Important essays and collections include, *inter alia*: S. Nysten-Haarala, *The Long-Term Contract: Contract Law and Contracting* (Helsinki: Kauppakaari, 1998); 'Symposium, Relational Contract Theory' (1985) *Wisconsin Law Review* 461-757; 'Symposium in Honor of Ian R. Macneil: Relational Contract Theory in Context' 94 *Northwestern University Law Review* 737 (2000); D. Campbell, H. Collins and J. Wightman, *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (Oxford: Hart Publishing, 2003). Campbell (2001), n2 above. For a survey of the literature see D. Campbell and S. Clay, *Long-Term Contracting: A Research Bibliography and Review of the Literature* (Oxford: Oxford University Press, 1995). For a critique of relational contract theory see, eg: R.E. Barnett, 'Conflicting Visions: A Critique of Ian Macneil's Relational Theory of Contract' 78 *Virginia Law Review* 1175 (1992); J.M. Feinman, 'Relational Contract Theory: Unanswered Questions' 94 *Northwestern University Law Review* 737 (2000).

Although the exact content of the best relational theory is often disputed – as are the appropriate definition and scope of such a theory⁶ – authors writing on relational contracts seem to have held substantially similar presumptions regarding the role of remedies in long-term relational contracts. Under the traditional view, legal rules in general, and formal rules of remedy in particular, play a marginal role in factual settings that fall under the purview of a ‘relational contract’.⁷ A variety of reasons are given for this, most importantly the existence of more efficient and more attractive non-legal incentives for co-operation. Indeed, it has often been suggested that practical experience and empirical evidence support the conclusion that the most salient feature of remedies in the context of a relational contract is their ‘non-use’ by parties to such contracts.⁸

In this paper it is not our aim to challenge the assumption that, as a matter of empirical evidence, the actual operational use of formal remedies in cases of breach is fairly rare and limited.⁹ However, we do question the traditional tendency to point to this phenomenon as proof of the marginal role played by formal or legal remedies in the context of a relational contract. A number of reasons lead us to believe that such a conclusion would be unwarranted.

First, even if only a comparatively small fraction of all relational contractual disputes reach the stage of formal litigation – an empirical assertion which we do not challenge in this paper – this fact alone should by no means belittle the crucial role of contractual remedies in resolving the numerous cases that do find their way every year to the courts or to formal arbitration procedu-

6 See *infra*, text to notes 19–20.

7 ‘In a relational contract ... it is suggested that legal remedies play a secondary role ... and that non-legal factors ... play a critical role in the resolution of disputes.’ E. McKendrick, ‘The Regulation of Long-Term Contracts in English Law’, in J. Beatson and D. Friedman (ed), *Good Faith and Fault in Contract Law* (Oxford: Oxford University Press, 1995) 305, 309–310.

8 The phenomenon of abstaining from reliance on formal remedies was pointed out as early as 1975 in the work of H. Beale and T. Dugdale, ‘Contracts between Businessmen: Planning and the Use of Contractual Remedies’ 2 *British Journal of Law & Society* 45, 53–59 (1975), whose conclusions generally stand in line with those reached by Macaulay’s earlier research, *supra* note 3. The idea that contractual remedies are of virtually no use in the context of long-term relational contracts has become an underlying theme in the relational theory literature. This widely held view is presented and discussed in D. Harris, D. Campbell and R. Halson, *Remedies in Contract & Tort* (2nd ed, Cambridge: Cambridge University Press, 2005) 27–28, 31–38: ‘... the overwhelming conclusion of empirical studies is that formal remedies are not used in continuing contractual relationships.’ See, similarly, Campbell and Clay, n5 above, 54–55.

9 However, we do think this assumption requires re-examination and validation on the basis of fresh and updated empirical work. It is our impression that legal disputes around the most typical relational contracts (employment, partnership and joint entrepreneurship, distribution, etc) form today a substantial part of contract litigation.

res.¹⁰ Furthermore, the well-known problems of access to justice and of costly litigation, which are major barriers to formal litigation, are not in any sense unique to the relational context. Thus, the general reluctance of businessmen to refrain from contract litigation cannot, in itself, be regarded as evidence for the marginal role of formal remedies in the particular context of long-term or relational contracts (compared to their role in other non-relational contract disputes).¹¹

Secondly, we are skeptical regarding the conventional assumption that the very existence of a long-term relationship would usually suffice to safeguard against resorting to formal remedies. True, in a typical relational contract the parties' relations would generally be characterized by cooperation, solidarity and mutual consideration. But even so, crises may arise between the parties which will preclude the conciliatory function of the relational dynamic.

The return to a 'classic' pattern of confrontation following a crisis in the relationship is hardly surprising, if one recognizes that willingness to compromise and to behave cooperatively does not necessarily reflect altruistic motives. In many instances, such conduct would originate in a party's recognition of his or her dependence on future performance by the other party. Hence, a party may decide to cooperate and give weight to the other party's interests, in fear that behaving otherwise (eg, opportunistically or intolerantly) might lead to an unwelcome reciprocal response.¹²

However, as the carrying out of a long-term relationship approaches its final stages, the fear of counter reaction in future 'rounds' of the relational game is naturally diminished. At this stage one would expect an increase in opportunistic or manipulative conduct on the part of some contracting parties. This in turn would naturally invite reciprocal reaction, thus eventually leading to a 'classic' legal dispute.

Third, one should recall that the traditional scheme of remedies offered by the law of contract includes not only judicial, but also a diverse set of self-help remedies. These self-administered remedies – such as termination, reduction

10 Arguably, it is reasonable to assume that most litigated cases – whether arising from a discrete transaction or a relational contract – are typically those involving weighty interests, the legal resolution of which is considered worthwhile by the respective parties.

11 See, eg, the data regarding the paucity of litigated business contract disputes brought by Harris and Campbell, n 8 above, 31. This general data is brought as an example for the non-use of remedies in the relational context. However in our view, it is unhelpful in establishing such a claim.

12 In this sense the conduct of the contractual parties to a relational contract may be seen as representing a series of 'prisoner's dilemmas'. Each party fears the counter-reaction of the other party in the future, and therefore has an incentive for cooperative conduct in the present.

of price, set-off and the right to withhold performance of an opposing obligation – do not, in principle, require any formal litigation. Furthermore, contrary to an action brought before a court, the use of such remedial mechanisms does not entail the infliction of any immediate reputational loss on the breaching promisor. It is for this reason that resorting to ‘middle-way’ self-help remedies may not hinder further negotiation and co-operation between the parties, and may even encourage cooperation in times of crisis. Although, admittedly, this feature of self-help remedies is not unique to relational contracts, it may cast doubt on the validity of arguments emphasizing the marginal role of formal remedies in long-term contractual relations – at least in so far as they are based upon empirical findings focusing solely or primarily on the use of judicial remedies.

Last, but not least, even assuming – as we are willing to do – that explicit reliance on formal remedies is less frequent in the relational context, one cannot disregard the possibility that legal remedies have a significant – though indirect – influence on the conduct of the parties to relational contracts. Even parties to a fully functioning relational contract may act, consciously or unconsciously, under the influence of the implicit threat of being exposed to a legal sanction (ie, a legal remedy) for failing to comply with one’s contractual obligations. There seems to be no convincing reason to expect that the ‘radiating effect’ of legal rules, which has been emphasized by writers in other contexts,¹³ will stop at the doors of the relational sphere. Here too, one should expect the well-recognized phenomenon of ‘bargaining in the shadow of law’¹⁴ to take place – both before and after a violation of the agreement has taken place.

If this expectation is realistic, as we believe it is, the contracting parties’ mutual expectations, their attitude towards their duty to perform their own obligations, and their reaction to any deviation from the contract by the other party – are all influenced – at least to a degree – by their perception of the legal system’s position *vis a vis* each of these aspects. Hence, it would be a mistake to ignore the possible impact of the formal law of remedies on contracting

13 The argument that formal remedies are used as possible threats and that the parties’ relations are conducted with these threats in the background has been advanced by: M. Galanter, ‘The Radiating Effects of Courts’, in K. Boyum and A. Mather (eds), *Empirical Theories About Courts* (New York: Longman, 1983) 117, 121–124; C. Menkel-Meadow, ‘Toward Another View of Legal Negotiation: The Structure of Problem Solving’ 31 *UCLA Law Review* 754, 764–794 (1984).

14 See R. Mnookin and L. Kornhauser, ‘Bargaining in the Shadow of the Law: The Case of Divorce’ 88 *Yale Law Journal* 950 (1979). For an application of the idea to the contractual area see S. Wheeler, *Reservation of Title Clauses: Impact and Implications* (Oxford: Clarendon Press, 1991) 1, 63.

parties – not only in the prototypical case of a discrete one-shot bargain, but in long-term relational contracts as well.¹⁵

Such influence may be less evident in emotionally loaded relationships (eg financial agreements between married couples). However, in other contexts, especially business or commercial contracts, which serve primarily as a vehicle for the enhancement of economic gain, the radiating influence of formal remedies for breach – whether fixed by the contract itself or otherwise provided by the law – is probably substantial.

It is therefore our view that contrary to what is commonly assumed, the question of what the formal regime of remedies for breach offers the aggrieved party to a relational contract is by no means an irrelevant or unimportant issue. From both the standpoint of the parties to a relational contract and of the legal system itself, this question is a crucial one. In contract, as elsewhere in the law, awareness of the legal principles governing the award of remedies for breach of a primary right or duty arising from a legal relationship is vital for a full understanding of the nature of that relationship.

Furthermore, marginalizing the role of remedies in the field of relational contract entails a risk, namely, the risk of overlooking the possible necessary adjustments – internal rather than external, legal rather than non-legal – of the formal law of remedies to the relational context. Indeed, there is no reason to assume that the adjustment of the classical law of contract to the relational context should cease at the doors of the realm of remedies. Just as the need for adjustments has been recognized in other contexts (eg, with regards the rules on formation, interpretation, and adaptation of primary obligations to changing circumstances), here too one should expect certain adjustments of the general rules of remedy to the relational context.¹⁶

15 A similar criticism was raised by the authors of an important treatise on contractual remedies. Discussing, in the relational context, the widely recognized phenomenon of non-use of formal remedies, they state: ‘... [the presumed] exceptional use [of remedies] is not, however, an entirely accurate account of the role of remedies ... Even in functioning relational contracts, the formal remedies remain as possible threats, and the parties’ relations are conducted with these threats in the background ... The formal remedies may never be invoked, but they have a most important influence on the actions of the parties, for their existence ... radiates an influence on the nature of any settlement and on any continuing relations.’ Harris, Campbell and Halson, n 8 above, 34.

16 As noted above, the literature on relational contracts has generally neglected the question of whether, and to what extent, the remedial rules of the classical law of contract should be altered or adjusted to suit the relational nature of a contract. Nevertheless, some authors have acknowledged the need for some adjustment of the law of remedies to the relational context. For example, Ewan McKendrick, though claiming that, apart from rules of interpretation, relational contracts do not require any distinctive regulation, remarked that ‘consideration might usefully be given to the development of a more flexible remedial regime on the occurrence of a breach of contract ...’. McKendrick,

More specifically, we believe that judges and arbitrators resolving disputes between parties to relational contracts will oftentimes find a need to deviate from a traditional rule governing the remedy, or to apply it in a flexible way that will better suit the dynamic and long-lasting character of the relationship. Such adjustments may be necessary, if the remedy awarded is to properly serve its goal, ie, to vindicate the distinct interest a party to a relational contract has in its performance, without imposing an exaggerated burden on the party in breach.

For example, recognizing the complex non-economic aspects of a certain contractual relationship may call for a more liberal application of certain remedies. On the other hand, the same characteristic feature of relational contracts may limit the desirability of other remedies, the award of which should raise no particular problems in the context of a simple economically oriented bargain.

In the remainder of this paper we wish to provide some preliminary thoughts on what a desirable model of relational remedies should look like, ie, on what kind of adjustments may be expected to take place when the general law of contract remedies is applied in the relational context. Such adjustments, so we believe, are not only natural and foreseeable; they are also justifiable on substantial grounds and with reference to various policy considerations. That being said, it should be noted that within the confines of this preliminary study we do not aim to examine the possible justifications and policy arguments in any depth. Rather, we shall try to demonstrate, by way of illustration, the need for certain adjustments in the traditional rules. As we shall see, these adjustments directly derive from the nature of a relational contract and from certain prominent features that we believe should influence decisions on the remedial level. Whether or not moral or economic rationales provide a justification for any specific adjustment we recommend (or for any change at all in the rules of contract remedies), is an important question which deserves separate treatment, and one which we intend to deal with more systematically in a future article.¹⁷

n7 above, 333, n92. A similar recommendation was made by the authors of *Remedies* (Harris, Campbell and Halson, n8 above, 37). While discussing the problems associated with the traditional use of formal remedies in the relational context, these authors noted that: '... it would appear necessary, from the point of view of the substantive law, to design remedies which facilitate more and hinder less the making of the necessary ... modifications of obligations in relational contracts.'

- 17 For example, we believe that the adjustments we recommend in the rules regarding the right to terminate a contract upon breach (infra, text to notes 45–46) may be justified with reference to the reasonable expectations of the parties to a relational contract, namely, the expectation that each party will do its best to avoid the loss to the other party of that party's initial investment – even in the face of a serious violation on the part of that party. Similarly, we believe that the adjustment we recommend in the rules on

III The Nature of the Required Model of Remedies: Some Preliminary Observations

Before going into the details of the model proposed in this paper, a number of clarifications are in place, regarding its nature and purpose.

Our first comment concerns the general purpose of the theory advanced in the paper, and its relation to other possible theories of relational contracts. Legal theories – and relational theories of contract are no exception – may vary in their nature and purpose. Positive or descriptive theories seek to faithfully describe a legal state of affairs, as reflected in a legal institution or a legal rule of law. A legal theory may instead, or in addition, aim to explain or justify the existing law, by reference to external values (moral, economic, political or cultural) in order to achieve better understanding of the law. Further still, a normative legal theory may wish to evaluate the desirability of an existing legal phenomenon, and – where needed – to recommend reform of a particular legal rule or institution. Finally, a legal theory may point out the desired approach to a legal problem, without necessarily making any judgment about the manner in which positive law actually treats that problem. The theory presented in this paper falls into the last category. It purports neither to criticize existing rules of remedy, nor even to present them in any detail.¹⁸ Rather, it aims to offer a systematic way of thinking about remedial issues in the context of relational contracts. As such, the model of remedies we recommend is universal in character. Its goal is to increase awareness – of courts and legislators – to the need to adjust general principles and rules of remedy to the particular features of the relational setting. In particular, so we hope, the proposed model may assist judges and arbitrators, relying on the formal rules of remedy offered by contract law, to apply those rules in a manner that would best suit the relational character of the legal relationship between the disputing parties.

A further comment concerns, on a more concrete level, the special character of the theoretical model we propose in this paper. It should be clear from the outset that we do not argue for a new system of remedial principles to substitute for the traditional ones provided by the general law of contract remedies. We believe that such a far-reaching proposal is unwarranted in the rela-

forseeability of damage (*infra*, text to notes 41–42) may be justified in terms of economic efficiency, as they may reduce transactions costs, and alleviate information problems.

¹⁸ The reason for that is twofold. Firstly, reviewing the existing law in detail and examining the ways relational contracts are actually treated, is a descriptive mission, outside the scope of this paper. Secondly, the law of remedies in different legal systems may approach this issue differently, from a methodological as well as conceptual point of view. This fact makes it difficult to discuss an ‘existing law of remedies’, within a project of a universal character such as ours.

tional context. In order to see why this is so, it is necessary to add a note regarding the nature and definition of a relational contract.

The concept of a relational contract has long been recognized as vague and elusive.¹⁹ Even today, maybe even more than in the formative periods of the relational theory, there is no consensus regarding the scope and limit of the term 'relational contract'.²⁰ However, there does seem to be wide agreement among writers that this concept does not admit of a rigid, categorical definition. In particular, the term 'relational contract' is not limited to certain types of contracts (at least in so far as 'type' is defined by the content or purpose of the contract). Scholars discussing relational contracts have generally eschewed any attempt to provide any such rigid definitions. It is generally accepted in the literature that whatever the best definition of a relational contract may be, it should be flexible enough to encompass, at least potentially, almost every kind of contractual bargain.

A brief overview of some common definitions should suffice, in order to clarify this point. Take, for example, the view that associates a relational contract with a long-term contractual relationship.²¹ Even according to this relatively 'thin' definition,²² any type of contractual bargain (including, for example, a sufficiently lengthy lease agreement or even a contract for the sale of goods, if the contract includes commitment of the seller to supply the goods over a lengthy period of time) may in principle fit into the relational context, as

19 '... although the phrase "relational contract" is regularly used in the literature, its meaning is not at all easy to elucidate.' McKendrick, n 7 above, 307. One of the causes for this typical vagueness has been the tendency of leading relational theorists to refrain from a 'positive' definition of the constitutive elements of a relational contract. Instead, a 'negative' definition was commonly adopted, according to which a relational contract is a contract, the nature of which departs substantially from the nature of a discrete, one-shot commercial bargain (a concept which had not always been clearly defined). For a critical discussion of this phenomenon see, eg, McKendrick, id, 307–308.

20 The inherent vagueness of the term is reflected in the fact that neither the legislation nor the courts implement the concept of a 'relational contract' to distinguish between different types of contracts. In this sense, a relational contract does not represent a formal legal category, but rather a theoretical or sociological concept. The point is made by J. Bell, 'The Effect of Changes in Circumstances on Long-Term Contracts' in D. Harris and D. Tallon, *Contract Law Today: Anglo-French Comparisons* (Oxford: Clarendon Press, 1989) 195, 195. See also McKendrick, n 7 above, 305.

21 '... the phrase *long-term contracts* has become virtually a synonym for relational contracts.' M.E. Eisenberg, 'Relational Contracts', in Beatson and Friedman, n 7 above, 291, 293. Cf C.J. Goetz and R.E. Scott, 'Principles of Relational Contracts' 67 *Virginia Law Review* 1989, 1991 (1981).

22 For a criticism of such a definition of a relational contract see Eisenberg, n 21 above, 293–294 ('... long duration does not of itself make a contract relational, and short duration does not of itself make a contract discrete.').

long as the duration of its performance extends over a substantial period of time.²³

A similar conclusion is in order regarding definitions focusing on the incompleteness and indeterminacy of the reciprocal obligations of the parties as the defining character of a relational contract.²⁴ It is evident that the presence of such features does not depend on the content of the parties' obligations. Hence, just as under the previous definition, relational contracts remain a wide and open-ended category, under which any type of transaction may fit.

According to a third view, the relational contract is distinguished not by its duration or by its incompleteness, but rather by the existence of a 'relationship' – in addition to a mere 'exchange' – between the parties. Under this approach, which we find intuitively the most appealing, the defining element of a relational contract is the existence of a personal interrelationship between the two sides of the exchange. Whenever such an interrelationship is present – and only then – should the bargain be classified as a relational contract.²⁵

Here too, as with the two other definitions mentioned earlier, it is obvious that the proposed classification does not attempt to exclude, *a-priori*, any specific type of contract. It is rather the opposite that is true, namely: each of the proposed definitions is capable of encompassing any kind of contractual transaction, as long as the legal relationship created by the parties is lengthy enough, vague enough, or personal enough. Indeed, given these wide and flexible definitions of the relational phenomenon, it would not seem unreasonable to assume – as has been indeed suggested by some authors – that in modern times most contracts are in fact – at least to some extent – relational in one sense or another.²⁶

23 This vague formulation has led one writer to adopt a more rigid test for distinguishing a long-term relational contract from a short term discrete contract. See, eg, T. Daintith, 'The Design and Performance of Long-Term Contracts', in T. Daintith and G. Teubner (ed), *Contract and Organisation; Legal Analysis in the Light of Economic and Social Theory* (Berlin/New York: de Gruyter, 1986) 164, 175, proposing a five-year period of performance as the borderline between a long-term and a short-term contract.

24 Such an approach was professed by Goetz and Scott, n 21 above ('A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations.'). For a forceful critique of this definition see Eisenberg, n 21 above, 294–295. The incompleteness feature is discussed, among other features of relational contracts, in R. Speidel, 'The Characteristics and Challenges of Relational Contracts' 94 *Northwestern University Law Review* 823, 828–829 (2000).

25 Such a definition was proposed by Eisenberg, n 21 above, esp 296–298. The existence of personal relationship was also pointed out to as a typical characteristic of a relational contract by Speidel, n 24 above, 830–831.

26 Such a conclusion was reached by Eisenberg, n 21 above, arguing that 'It is discrete contracts that are unusual, not relational contracts. The great bulk of contracts either create or reflect relationships. A contract to build something as simple as a fence creates a

What are the implications of this insight and how does it affect the nature of the theoretical model proposed in this article? Our response is simple: accepting that relational contracts is not a rigid category but rather an open-ended concept that emphasizes certain features of a contractual relationship, leads inevitably to the conclusion that no manageable test exists for distinguishing, *ex ante* and *a-priori*, between transactions that may fit the relational model of contracting and those who never will. If this is true, successful adjustment of any body of law to the relational context could therefore not be achieved by replacing that body of law with an alternative set of specific rules designed 'only' for relational contracts. Putting it differently, if any kind of contract is capable of being defined – either *ex ante* or *ex post* – as a relational contract, creating rigid rules of remedy that would suit all relational contracts is probably an impossible task.²⁷

Indeed, some leading relational theorists have gone as far as claiming that the distinction between transactional or regular contracts and relational contracts is not a factual one, but rather a purely analytical distinction. As such, it only underscores certain dimensions which in fact coexist, with other non-relational dimensions, in practically every contract.²⁸ In other words, all contracts are relational contracts and all contracts reflect varying permutations and degrees of relational characteristics with those of discrete transactions.

While rejecting this far-reaching conception as impracticable, we do concede that, as explained above, the analytic category of relational contracts is neither rigid nor limited in its scope. Thus, we concede that every kind of contract may potentially – depending on the facts of the transaction and of the relationship – assume certain features that endow it with a relational character.

relationship. A contract to sell almost anything is likely to either create or reflect a relationship; even contracts on perfect spot markets are likely to be between traders or brokers who have continuing relationships of some sort, not between strangers.' (id, 297).

27 This has been acknowledged by a number of writers, who criticized mainstream relational theory for tacitly assuming that the recognition of a separate category of relational contracts entails the creation of special legal rules to deal with such contracts. For such a critique see, eg, Eisenberg, n 21 above, 298–299, arguing that: 'Once relational contracts are properly defined ... it is easy to see that they should not be governed by special rules. ... because most contracts are relational, the general principles of contract law – whatever those should be – must be catholic enough to govern relational contracts.' Eisenberg's approach is further explained in M. Eisenberg, 'Why There Is No Law of Relational Contracts' 94 *Northwestern University Law Review* 805 (2000). Cf McKendrick, n 7 above, arguing that although more flexibility is in place when interpreting relational contexts and adjusting them to changing circumstances, no formal category of 'relational contract' should be recognized by the law.

28 See eg, D. Campbell, 'The Relational Constitution of the Discrete Contract', in D. Campbell and P. Vincent-Jones (eds), *Contracts and Economic Organisation: Socio-legal Initiatives* (Aldershot: Dartmouth, 1996) 40.

In summation, the amorphous character of the very concept of a relational contract dictates the adoption of a flexible theoretical model that will be elastic enough to be useful in every contractual dispute involving relational elements. This, in turn, calls for the construction of a model of contract remedies that will guarantee correlation between the typical features of relational contracts on the one hand, and the unique character of the remedy provided for by the law of contract, on the other hand. In order to do that, a theory is needed that will enable the court ordering a remedy (or assessing the lawfulness of a party's use of a self-help remedy), in any given case, to take into account, and give effect to, the distinctive characteristics of the relationship between the disputing parties. Such an approach was professed, as a general approach to relational theory, by Elizabeth Mertz:

... relational contract does not rely on a picture of rigidly distinct treatments for hermetically sealed compartments containing kinds of contract or types of law (discrete v relational), but rather on a range of contextually responsive tools capable of being deployed where (and to the degree) appropriate. ... The core inquiry would not center on a yes or no answer to the question of whether a contract is relational, but rather on determining what kinds of relational aspects to the contract might require contextual analysis by the court in order to reach optimal results.²⁹

In what follows we shall endeavor to outline some basic guidelines for the construction of a theoretical model of relational remedies that would answer to these demands.

IV The Model at Work: Theory and Practical Implications

A The First Step: Identifying the Pertinent Features of the Relational Contract

The usefulness of a relational theory of remedies does not, in our view, depend on which definition one adopts for a 'relational contract'. However, it does seem vital for any such theory to single out the most relevant features of a relational contract, ie, those features which should be expected to have substantial impact on the application of general remedial rules in the relational context.³⁰

29 E. Mertz, 'An Afterword: Tapping the Promise of Relational Contract Theory – 'Real' Legal Language and A New Legal Realism' 94 *Northwestern University Law Review* 909, 914–915 (2000). Cf Eisenberg, n21 above, 303: '... although different types of economic relationships present different kinds of economic problems ... these problems do not derive from the fact that the contracts are relational, but from the specific attributes of the proposed relationship.'

30 The following discussion will assume that a 'relational contract' has been identified. However, it is noteworthy that the applicability of our model does not necessitate such a presumption. It is equally useful and relevant, so we believe, even under the premise – adopted by some relational theorists – that no manageable test can properly distinguish between a relational and a non-relational contract (since every contract is both relational

Reviewing the literature, we have identified three features of relational contracts that should have a major influence at the remedial stage, and therefore deserve close attention.

The first feature, although not necessarily the most important one, is the duration of the contractual relationship.³¹ Whether explicitly agreed upon or not, the fixing of a lengthy period of performance naturally results in difficulties of foreseeing future events. Thus, long duration creates difficulties of assessing the possible impact of such events on both the ability of each party to perform its obligations and the expected profit from performance.

Such uncertainty, which inheres in any long-term contractual relationship, has long been recognized in the literature as justifying significant adjustments (to the relational context) of traditional rules of interpretation, as well as rules providing an excuse for non-performance due to unexpected change of circumstance.³² Less attention, however, has been devoted to the possible impact of such inherent uncertainty at the remedial level. As will be demonstrated shortly, such influence is indeed expected not only when determining the primary rights and duties of the parties, but when determining their respective secondary (remedial) rights as well.

A second feature, which we believe is of paramount importance at the remedial level, is the 'personal relationship' feature of relational contracts.³³ As will be demonstrated below, close and direct personal interrelationship between parties to a contract should have an enormous influence on the remedial reaction in case of breach. This is so, regardless of when the relationship was created. Whether preceding the formation of the contract (eg, a relationship between a regular customer and a retailer preceding a simple sale), coinciding with it and created by it (such as in the case of a contract of employment) or following subsequent events (eg, when a one-night hotel reservation turns gradually into a two months lease agreement) – the existence of a truly personal relationship between the parties should definitely affect the reaction of the law of remedies to the breach of the contract.

Third and finally, attention should be given to another distinct feature, which in

and non-relational to some extent). Even if that was the case (and we do not say it is), drawing attention to the features we examine would be useful, since it will facilitate the adjustment of existing rules and principles concerning remedies to the specific characteristics of the relationship under examination.

31 This feature is discussed *supra*, text to notes 21–23.

32 The issue has received wide attention in the relational theory literature. D. Campbell and D. Harris, 'Flexibility in Long-Term Contractual Relationships: The Role of Co-Operation' 20 *Journal of Law & Society* 166 (1993); P.D.V. Marsh, *Contract Negotiation Handbook* (3rd ed, Ashgate: Gower, 2001) ch 5 (Adjustment of Long-term Contracts) 19–22.

33 See *supra*, text to note 25.

our view is characteristic of many relational contracts. Some authors have argued, that the most important feature of relational contracts concerns the nature and extent of the investment the contract requires from each of the parties (hereinafter: the investment factor). More specifically, it has been suggested that a relational contract is a contract in which the nature and extent of the initial investment made by each of the parties to the transaction (or the one each party undertakes to make in the future) make the costs of withdrawing from it prohibitively high. As a consequence, the parties to a relational contract may be regarded as being practically 'locked into the relationship', as they realize that a complete withdrawal from the bargain will be harmful to both.³⁴

In our view, each of the three factors discussed above represents a central and dominant aspect of relational contracts. Furthermore, and more importantly for our purposes, these typical characteristics of relational contracts all play a crucial role in the determination of the remedial rights of parties to a violated relational contract.³⁵

B The Second Step: Highlighting the Remedial Implications of the Pertinent Features of the Relational Contract

As just explained, under the theoretical model we propose, a judge or an arbitrator applying the formal law of contract remedies to a relational contract is required to focus attention on three distinct characteristics of such a contract. These are:

- (a) The extent to which the contract defines – or necessitates – a lengthy period of performance;

34 The connection between what we call the 'investment factor' and the relational structure of a business contract was first emphasized and developed as an economic insight by Oliver Williamson. Williamson argued that initially high transaction costs – when they do not prevent contracting – typically create relational characteristics between the parties to an economic bargain. O.E. Williamson, 'Transaction Cost Economics: The Governance of Contractual Relations' 22 *Journal of Law & Economics* 233 (1979). The investment factor has been recognized as a typical feature of relational contracts by legal scholars. See eg, McKendrick, n7 above, 310, mentioning the phenomenon of parties to a relational contract investing '... so heavily in the relationship that they are effectively locked in to each other.'

35 At the same time, it should be clear that we do not hold the view that a contract must reflect each and every one of these three elements in order to be considered relational. On the contrary: under our understanding of the concept of a relational contract, a contract that lacks one, or even two of the three characteristics, would still rightly be considered relational, as long as at least one of the features (long duration, personal relationship or heavy investment) is clearly present. On the other hand, when none of these characteristics is present, the contractual relationship should be defined as non-relational, or what sometimes is called 'transactional' or 'discrete'.

- (b) The extent to which the contract creates an intensive inter-personal relationship, or is carried out in the framework of such an existing relationship;
- (c) The extent to which entering into the contract requires a substantial investment, which would make the retreat or withdrawal from the contract very costly or very risky for one of the parties, or for both.

What are the potential implications of each of these three traits of the relational contract at the remedial level? In other words, in what specific ways should each of these three characteristics affect the remedies of the aggrieved party? More concretely: How, if at all, does each of the features affect the choice of remedy? To what extent does each of them influence the operational rules relating to any of the specific remedies to which a plaintiff may be entitled following a violation of the contract? In addition, what can be said of the interrelationships between the three features? Do they all operate in the same remedial direction, or is it possible for them to work in different or even contradictory directions?

In this paper, we do not purport to answer any of these questions in a detailed and systematic manner. To do so would require further research, and probably a separate article. At this stage of the development of the theory, it will suffice to lay out, by way of illustration, some preliminary thoughts regarding the possible remedial implications of each of the pertinent characteristics of relational contracts.³⁶

In doing so, it would be useful to distinguish between two types of influence. First, on a very general level, each of the three characteristics discussed may influence the *choice of remedy* – a fundamental issue for the law of remedies in any legal system.³⁷ Namely, each of the features may operate as a limitation on the freedom of the aggrieved party to choose freely among the remedial venues available to him upon breach. Second, on a more concrete level, each of the features may have a more subtle influence on the internal doctrinal rules pertaining to any given remedy, to which the aggrieved party is entitled.

In what follows we briefly highlight some of these influences, in order to illustrate the possible implications of the relational model of remedies advanced in this paper.

³⁶ And, in addition, to discuss the possible integrated influence of the different features, in cases where they coexist at a single relationship. This will be done in the next subsection.

³⁷ The choice of remedy is the first question to arise whenever a party to a contract suffers a violation and considers resorting to a formal remedy. It is not exclusive to the relational context. Nevertheless, as we shall see, in the context of relational contracts the resolution of the choice of remedy requires special attention and raises an array of difficult questions which may not arise in non-relational transactions.

(1) Extended Period of Performance

As pointed out earlier, an extended period of performance increases the probability that unexpected and unplanned events will occur, which would significantly raise the costs of performance, and thus reduce the profitability of the bargain from the standpoint of one of the parties, or both. Such 'change of circumstance' may, of course, justify a variation of the contract itself ie, an adjustment of the primary rights and duties of the parties as reflected in the original agreement.³⁸ This, however, is not a question of remedies. Under our model a different question needs to be addressed, namely: assuming that the change of circumstance does not amount to an excuse for the non-performance of a pre-determined obligation, in what respect may such a change in circumstance affect the remedial rights of the parties?

A first possible implication concerns the choice of remedy; more specifically, the choice between remedies that seek to literally enforce the violated transaction and those which seek merely to provide the party suffering the breach with a right to compensation (most typically through an award of compensatory damages). It is submitted, that an extended period of performance should in most cases justify a sympathetic approach toward a plaintiff's claim for enforcement (ie, specific performance or an injunction). The reason lies in the difficulty of assessing and quantifying – at the moment the damages are computed – the benefit of which the aggrieved party has been deprived as a result of the breach. This inherent difficulty makes the computation of damages uncertain and conjectural, a fact that undermines the ability of monetary compensation to protect the plaintiff's expectation interest. In this sense, an extended period of performance should generally be seen as supporting a plaintiff's claim for specific enforcement of the contract.

Secondly, on a more concrete level, an extended period of performance may influence the operational rules of specific remedies to which the plaintiff may be entitled. For example, assuming a plaintiff is, in principle, free to exercise his right to specific performance of the dishonored agreement, a change in circumstance (which is a common occasion in a long-term contractual relationship) may result in the plaintiff being denied such right – due to its becoming impossible, too burdensome, or simply unjust. Alternatively, such a change of circumstance – occurring between the formation of the contract and the judicial determination of the defendant's liability – may persuade the court, at the plaintiff's request, to apply a doctrine of approximated enforcement (sometimes known as *cy près*).³⁹

³⁸ See *supra*, part I (Introduction) at 2–3.

³⁹ Doctrines allowing approximated enforcement of contractual obligations have been endorsed by a number of legal systems. They usually require, as a precondition for awarding such a remedy, that the deviation from the original obligation be minimal or

Extended duration may also affect the rules for assessing compensatory damages. To start with, due to the conjectural nature of long-term ventures, one should expect the courts to demonstrate considerable tolerance towards plaintiffs who have not succeeded in proving their loss – or the extent of their loss – with reasonable certainty. In light of the inherent difficulties of computation typical to such contracts, courts should be expected to relax traditional requirements of proof, especially when specific enforcement of the transaction would be unreasonable or impossible.⁴⁰

In addition, some adjustments may be required with regard to the rules on legal causation and remoteness. For example, under the English rule of *Hadley v Baxendale*⁴¹ a precondition of liability in damages is the foreseeability of the loss, the existence of which is examined in the time of contracting. However entrenched, it is submitted that such a rule may not be justified in the context of a long-term relational agreement. Here, unlike under a one-shot discrete transaction, each party should be expected to foresee – or at least to take into account – the possibility that further events might change the nature and extent of the other party's loss from non-performance. Hence, it is not at all obvious that a defendant should be exempt from liability for the (foreseeable) loss caused by his breach of the contract, just because sometime in the distant past (ie, upon formation) that loss could not have been expected to result from future non-performance.⁴²

(2) Intensive Inter-personal Relationship

Similar to the preceding feature, this feature may influence both the choice of remedy, and specific rules pertaining to particular remedies.

On the first level, one should expect the law of remedies to respond to the existence of an intensive inter-personal relationship with two somewhat contradictory reactions. On the one hand, the non-economic character of the relationship may lead a court to look favorably at the aggrieved party's claim for enforcement (when such a claim is made). On the other hand, however, the very existence of such a personal relationship would in most cases present a

trivial. However, it is submitted that in the relational context, especially when the contract is characterized by a lengthy period of performance, such remedies would be administered more liberally, that is, more frequently, and even in cases where the deviation from the original obligation is significant.

40 When specific enforcement is available, a question arises as to the plaintiff's right to choose between enforcing the contract and terminating it due to the breach. This problem is discussed *infra*, see IV (B) (2).

41 [1854] 9 Exch 341.

42 For further discussion of the possible implications of a long-term relationship on the rules of remoteness and the rules on damages more generally see: Campbell (2005), n 2 above.

serious obstacle from the standpoint of a party seeking to enforce the contract. This is so, for under most western legal systems the remedy of enforcement will not be granted when it requires the giving – or receiving – of a personal service. Thus, in a somewhat paradoxical way, the closer the relationship between the parties before the breach, the more problematic it is to enforce their mutual obligations after its occurrence.

On the other hand, with respect to the remedy of termination, the same factor would work at the opposite direction. A failure to perform an obligation arising from a close inter-personal relationship may frequently involve a breach of trust or of a fiduciary duty (not necessarily in the technical sense). As such, it may support the conclusion that the non-performance constituted a fundamental breach, and as such endowed the aggrieved party the right to terminate, ie, to unilaterally withdraw from the bargain.

Secondly, on a more concrete level, inter-personal relations may also require some adjustments in the traditional rules of damages. For example, the traditional reluctance of courts to compensate victims for non-pecuniary losses resulting from breach of contract may not be justified, especially when the loss complained of originates in a breach of an inter-personal relationship of trust and interdependence.⁴³ In these cases the law of damages should be applied more flexibly: to the extent that it does not recognize the right to non-pecuniary damages, the law of damages should be altered so as to adequately express the emotional, non-financial dimensions of relational contracts.

In the same vein, one may expect the law to adopt a more liberal approach toward claims for extra-compensatory damages (eg, disgorgement damages or punitive damages), at least in cases where the violation has been deemed inexcusable or opportunistic.⁴⁴

(3) Heavy Investment and High Costs of Retreat

How should this typical characteristic of relational contracts affect the remedial rights of the parties in case of breach? It is submitted that the main impact

43 Such a result may be formally justified by reference to the idea that in a relational contract of this sort, mental distress should be regarded as a foreseeable consequence of breach.

44 Indeed, American case law seems to be moving in this direction in recent decades, in terms of widening the scope of the right to collect non-pecuniary and punitive damages. See, eg, *Parker Chapin Flattau & Klimpl, LLP v Bamira*, 803 NYS 2d 19 (2005), where an award of 5 million \$ in punitive damages was affirmed in the appellate court against an individual (and a law firm that acted as his agent) for breach of fiduciary relationship by the defendant arising out of a commercial partnership with the plaintiff. For a summary of the (unpublished) decision in the first instance see, eg http://www.lpklaw.com/show_article.php?aid=104&desc=1 (accessed 12.05.11).

of this factor should be reflected in a tendency, on the part of the legal system, to limit the right of the aggrieved party to terminate the contract following its breach.

Thus, when other proactive measures are available to the victim in a relational contract of this sort, he may be expected – even in the face of a fundamental breach of the contract – to refrain from exercising his legal right to terminate it. Indeed, we believe that, as a general rule, the victim of breach should not be allowed to terminate a relational contract in which this characteristic features highly, without first resorting to less drastic remedies, such as reduction of price, and – most importantly – the right to withhold performance. These two moderate, middle-way remedies enable the aggrieved party to protect his legitimate interests, without renouncing the entire legal and commercial relationship – a step that will seriously jeopardize the other party's interest in the performance of the contract.⁴⁵

Furthermore, whenever the victim is aware of the heavy investment made by the other party, we believe he should not be allowed to terminate without first giving the latter a reasonable opportunity to rectify the breach.⁴⁶ In our view, in the special context of a relational contract with the feature here discussed, this principle should not be regarded as a mere recommendation, but as a binding legal principle which forms part of the formal law of remedies.

C The Final Step: Integrating the Remedial Implications

Having examined the remedial implications of each of the features separately, we have now reached the final stage where their integrated influence must be considered. What is the interrelation between the three relational features we discussed in the preceding sections? And how are their influences at the remedial stage to be integrated in any specific case?

The answer we propose is, in theory, relatively simple. The concrete answer to any of the remedial questions that may arise following the breach of a relational contract should be the result of a process of balancing between the different remedial implications of each of the features present in the relational contract at hand.

Yet, in practice, the balancing is not always a simple task. For example, when a

45 As mentioned earlier, the ability to use non-judicial remedies, such as reduction of price, withholding performance and – as a last resort – termination, plays a significant role in preserving the relational context, in the sense that they do not entail the opening of a formal, judicially-imposed, resolution of the dispute. See *supra*, at part II (the third reason for the relevance of traditional remedies in the relational context).

46 We would, though, leave an exception for cases of opportunistic and inexcusable violations, which by their very nature reduce the possibility of future cooperation.

particular relational contract features only one of the three characteristics, applying the appropriate rule of remedy will necessitate adjusting the relevant principles and rules provided by the law of contract remedies – whatever form they may take – only to this unique feature. On the other hand, where a contract features a number of characteristics, the needed adjustments will have to be considered in light of the combined and simultaneous influence of all those characteristics. Even this may not pose great difficulty, when the different features work in the same remedial direction, ie, when giving weight to their remedial implications provides similar answers to the remedial issue in question.

However, as we have already seen, this is not always the case. At times, the various characteristics, operating simultaneously in a contractual setting, may work in different and even conflicting directions. For example, where the relational contract is characterized by both a prolonged duration, and a heavy investment on the part of the breaching party, these features will frequently ‘work together’, at least as far as the choice between enforcement and termination is concerned.⁴⁷ On the other hand, the same question may be much more difficult to answer, when the third relational feature (heavy investment) is present alongside with the ‘intensive inter-personal relationship’ factor. The reason should be obvious by now: while the former feature generally supports the right to demand enforcement of the agreement, the latter feature presents a serious obstacle to such a claim.⁴⁸

Needless to say, the influence of each of the factors or features need not be of the same weight in any given case. Correct balancing should therefore entail not only the determination of the existence (or non-existence) of any of the factors, but also their relative weight. This, in turn, requires a complex intellectual process, through which all the relevant implications are taken into account, given their appropriate normative weight, and finally balanced against each other.

IV Concluding Remarks: The Relational Theory of Remedies and the DCFR

A reader expecting to find in our paper a comprehensive code laying out in detail new rules of remedy for relational contracts would probably be disap-

47 As we have seen, the first feature will usually justify a sympathetic approach towards a plaintiff’s claim for specific performance of the contract, while the second feature usually operates as a restraint on the right to terminate, thus indirectly supporting the preservation of the contractual relationship (ie, ongoing performance). See supra, IV (B) (1) and (3) respectively.

48 See supra IV (B) (3) and (2) respectively.

pointed. Earlier in the paper we explained why this is so. Relational contracts do not constitute a clearly differentiated category of contracts. Rather, they represent a broad and open-ended category, including a wide spectrum of contractual situations – ranging from the pure transactional (discrete) contract, moving to transactions bearing some of the features of relational contracts (in various degrees), and finally, transactions reflecting all the typical characteristics of a non-discrete contract and thus falling under the classic examples of a relational contract (eg, partnerships, contracts of marriage, long-term distribution contracts, etc).

Accordingly, we claimed, it would be impossible to create a closed list of remedial rules – designed only for relational contracts – which would suit each and every relational contract. Instead, we proposed a theoretical model to guide courts and legislators who seek to adjust existing rules and principles so that they can best suit the relational context. Our main purpose has been to develop a principled way of thinking about remedies in relational contracts. We believe this way of thinking is relevant and useful whether or not one adheres to the relational theory of contract, and whether or not one professes a clear definitional distinction between relational and discrete contacts. A further advantage of our proposed relational theory of remedies lies in its universal character, which makes it applicable to any sophisticated legal system. Furthermore, implementing the theory does not necessitate legislative intervention. It can be effectively applied on a case by case basis, through judicial application of the flexible principles of the law of remedies, which in most systems leave sufficient room for judicial discretion.⁴⁹

Indeed, even assuming that in the classical period of contract law, remedies were tailored to suit only discrete (non-relational) contracts (and we doubt if that has ever been the case), this is clearly not the situation today. In modern times, the law of remedies has been characterized by tremendous flexibility, significant broadening of the range of remedies, and by judicial discretionary powers to decide issues concerning the choice of remedies, their availability, as well as their scope and extent. There has been wide recognition of the need to relax rigid rules and to subject contractual rights to principles of justice, reasonableness, and decency.⁵⁰ Hence, what is necessary today in order to give effect to the relational theory of remedies advanced in this paper, is nothing

49 However, we do believe that the general principles proposed in this article can be usefully incorporated into the framework of an existing (or a proposed) civil code, or more specific legislation concerning contractual remedies. Such legislative initiative may facilitate judicial efforts to adapt remedial rules to the relational context.

50 The principle of good faith is not recognized as a general rule of direct application in the Common Law jurisdictions. However, even the Common Law systems contain many particular rules that are functionally equivalent to good faith: *DCFR Outline Edition* (2009) Introduction § 72 (43).

more than awareness to its existence, and to the possible need of adjusting certain rules of remedy to suit the relational context. To exemplify this, it will suffice to take a brief look at some of the remedial provisions of the European Draft Common Frame of Reference (DCFR).

Firstly, it should briefly be mentioned, in the general sense, that while the DCFR does not explicitly relate to the relational contract theory, the document as a whole evidences a number of relational notions, such as solidarity, cooperation, and the contractual validation of consensual norms of conduct. This is expressed both in the general principle of good faith interspersed among its various sections⁵¹ and in other contexts, such as contractually validating practices endorsed by the parties in the course of the contract⁵² and imposing the obligation of cooperation between the parties to the contract (both on the general level⁵³ and in specific contractual contexts⁵⁴). A striking example of the function played by the relational theory in the DCFR framework is found in section III-1:110. This section regulates the court's authority to alter the contract, or to terminate it, in the wake of a change in circumstances. First of all, subsection (1) lays down the basic principle of the duty of fulfilling contractual obligations even in the face of changing circumstances.⁵⁵ However, immediately afterwards, sub-section (2) specifically addresses situations, in which the performance of the original obligation would be unjust due to a change in circumstances. In those situations the court is authorized to change the substance of the obligation in order to render it reasonable and fair, or, under certain circumstances, to terminate the contract subject to the conditions set forth by the court.⁵⁶ Without a doubt, this section reflects insights based on the theory of relational contracts. However, as is standard practice within the framework of that theory, the contract is dealt with on the level of its primary obligations and not on the level of remedies. The remedies chapter of the DCFR does not contain a similar, general arrangement, but in our view,

51 See, eg art I-1:102(3)(b), II-3:301, II-8:102(1)(g), III-1:103(1).

52 See art II-1:104(1): 'The parties to a contract are bound... by any practice they have established between themselves.'

53 Art III-1:104.

54 Art IV.C-2:103 (Services), art IV.D-2:101 (Mandate), art IV.E-2:201 (Commercial agency, franchise and distributorship). It clearly stands out that the 'obligation to co-operate' articles within the chapter of specific contracts appear particularly in those types of contracts that are usually characterized as relational contracts.

55 'An obligation must be performed even if performance has become more onerous, whether because the cost of performance has increased or because the value of what is to be received in return has diminished.'

56 'If, however, performance of a contractual obligation... becomes so onerous because of an exceptional change of circumstances that it would be manifestly unjust to hold the debtor to the obligation a court may: (a) vary the obligation in order to make it reasonable and equitable in the new circumstances, or (b) terminate the obligation at a date and on terms to be determined by the court.'

as clarified above, even within the existing framework the space for judicial discretion is broad enough to enable most of the required adjustments.

We would like to briefly demonstrate this point. The general obligation of good faith which also applies to remedies,⁵⁷ allows a sufficiently broad margin for the exercise of judicial discretion. This discretion may influence both the choice of remedies and the internal rules governing the administration of specific remedies (for example, rules limiting the extent of compensation). On the first level, broad discretion has been granted the courts on both the question of when enforcement should be available and the question of whether 'the debtor's non-performance is excused'.⁵⁸ If the court determines that this is indeed the situation, the aggrieved party will be entitled to all other remedies, apart from enforcement and indemnification.⁵⁹ This broad discretion regarding the enforcement remedy is also found in the framework of the internal limitations on the remedy of enforcement.⁶⁰ In our view, the chapter in the DCFR dealing with enforcement lacks a provision granting the court the general authority to subject an injunction to conditions fixed by the court. A provision of this sort would allow greater flexibility in the adjustments that may be required at the time of granting an enforcement order in the framework of a relational contract. There is also judicial discretion for purposes of availability of the remedy of rescission. Rescission is only an option in the case of a fundamental breach,⁶¹ and the definition of fundamental breach leaves relatively broad margins for judicial discretion.⁶² The discretion regarding the availability and scope of damages finds expression in the requirement of foreseeability, according to which the party in breach must indemnify only for 'loss which the debtor foresaw or could reasonably be expected to have foreseen at the time when the obligation was incurred⁶³ as a likely result of the non-performance'.⁶⁴

It bears mention that the DCFR recognizes remedies of a more moderate nature, which may be applied without any judicial intervention. These ar-

57 Art III-1:103(1): 'A person has a duty to act in accordance with good faith and fair dealing... in pursuing or defending a remedy for non performance...'

58 Art III-3:104(1) sets the conditions, leaving room for wide judicial discretion: 'A debtor's non-performance of an obligation is excused if it is due to an impediment beyond the debtor's control and if the debtor could not reasonably be expected to have avoided or overcome the impediment or its consequences.'

59 Art III-3:101(2).

60 Art III-3:302(3).

61 Art III-3:502(1). Termination is also possible in case of delay in performance, which does not amount to a fundamental breach. However, this would be possible only if the creditor gives the debtor a notice fixing an additional period of time for performance. See art III-3:503(1).

62 Art III-3:502(2).

63 See *supra*, text to notes 41–42.

64 Art III-3:703.

rangements (such as withholding performance,⁶⁵ price reduction,⁶⁶ the ability to fix an additional period for performance⁶⁷) add a further dimension to the usefulness of the DCFR in the context of relational contracts.

Academic writing in the fascinating field of relational contracts has, to date, focused almost exclusively on the influence of the relational contract on the primary obligations of the parties (via interpretation, renegotiation and settlement, and alternative dispute resolution mechanisms). However, until very recently, there has been almost no discussion of the possible influence of the relational nature of the contract on the secondary rights of the parties, namely, on their remedial rights. In this article we argued that the formal law of remedies plays a significant role in the relational context, both before and after the eruption of a legal dispute. We hope that our endeavors to direct attention to this as yet virgin territory, will serve as a fresh starting point for an ongoing academic effort to explore the subtle interface between the law of remedies and the relational theory of contract.

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65 Art III-3:401.

66 Art III-3:601.

67 Art III-3:103.