Contract interpretation and relational contract theory: a comparison between common law and civil law approaches.

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Abstract

The paper focuses on the main legacy of the relational contract theory in the context of contract interpretation and its influence on contemporary scholarship. First developed in the United States, the relational contract theory has had a significant resonance within common law countries, emphasisng the importance given to 'contextualism' and the 'implicit dimensions' of contract, whereas no equivalent doctrinal elaboration can be said to exist within civil law countries. The paper suggests however, that interestingly, at least one civil law country – Italy and, to a certain extent, the recent European soft law documents (PECL, DCFR, CESL) recognise rules on contract interpretation which indirectly reflect some of the main claims of the relational contract theory. These rules, in turn, are necessarily linked to the underlying values that each legal system emphasises, and the view of the contractual relationship as mainly 'adversarial' or 'cooperative' in character. The study of the relational contract theory may therefore serve as a testing ground for any legal system, posing the choice between a 'drastic' reform of the classical common law precepts of contract law and its underlying ethic, or the welcoming of a contextual approach which does not completely discard the model currently in place.

Introduction

This article examines the importance assigned by civil and common law countries to 'context' within business agreements, by contrasting the English and American legal systems on the one hand, and the Italian legal system on the other. Given the differences in both the way contract is conceived and the rules on interpretation, it draws attention to the emergence of the relational contract theory[1] within the common law and its legacy for

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[1] The relational contract theory was first developed in the United States, through the work of two legal theorists, Stewart Macaulay and Ian Macneil. Although their literature is

contemporary scholarship. It finally seeks to understand the impact and consequences of a possible shift, if any, from a formalistic approach to a more relational approach in questions of contract interpretation.

English contract law, unlike its civilian counterparts, adopts as starting points the four-corners rule[2] and the parol evidence rule,[3] thus envisaging that the contract is to be viewed as containing the entire agreement between the parties. The question that needs to be answered is, given the current state of the art, to what extent the implicit dimensions of contract law and the tacit understandings between the parties can be taken into consideration.

In this respect, it should be noted that the interpretation of contracts has long evolved under the Anglo-Saxon paradigm from an exclusion of all external elements to a more relaxed view on interpretation that increasingly takes context into account.[4] This less extreme approach has been more explicit in the United States and is codified under the Uniform Commercial Code (UCC), although its implications have been criticised by some academics as leading to uncertainty.[5]

In looking into the common law systems, the theoretical claims of the protagonists of the 'relational'[6] versus the 'discrete' contract,[7] needs to be

extensive, it is worth mentioning one of the most cited works (if not the most cited) by Macaulay, where the roots of this theory can be traced: 'Non-contractual relations in business: a preliminary study' (1963) 28 *American Sociological Review* 55. A more recent article by the same author is Macaulay 'The real and paper deal: empirical pictures of relationships, complexity and the urge for transparent simple rules' (2003) 66 *Modern Law Review* 44. As for Macneil, to recall only two among his most well-known articles, reference can be made to 'The many futures of contract' (1974) 47 *Southern California Law Review* 691 and also Macneil 'Contracts: adjustment of long-term economic relations under classical, neoclassical and relational contract law' (1978) 72 *Northwestern University Law Review*.

[2] For an explanation of this rule, see Duhl 'Conscious ambiguity: slaying Cerberus in the interpretation of contractual inconsistencies' (2010) 71 *University of Pittsburgh Law Review* 71.

[3] See, for example, Richards *Law of contract* (10ed 2011) 132; Chen-Wishart *Contract law* (4ed 2012) 369; Stone *The modern law of contract* (8ed 2009) 258; Posner 'The Parol Evidence Rule, the Plain Meaning Rule, and the principles of contractual interpretation' (1998) 146 *University of Pennsylvania Law Review* 533.

[4] The debate on the role of context in the interpretation and enforcement of contracts in the UK is reflected in two collections: Campbell, Collins & Wightman (eds) *Implicit dimensions of contract* (2003); and Worthington (ed) *Commercial law and commercial practice* (2003).

[5] See, for instance, Bernstein 'Merchant law in a modern economy' Coase-Sandor Institute for Law and Economics *Working Paper No 639* 2013.

[6] Relational contract scholarship has long evolved from its original founders, and it is often difficult to depict the exact evolution of this school of thought. As Scott pointed out, the

examined. Although relational theorists do not speak with one voice, the position considered in this essay is not that which challenges the very choice of paradigm for contract law, but rather the 'doctrinal-prescriptive'[8] argument of this school of thought, which prescribes that contract law should be reformed so as better to support the relational nature of contract. Therefore, in all the various suggestions stemming from the relational contract theory, what is emphasised is the importance given to 'contextualism'or the 'implicit dimensions'[9] of contract, as opposed to a strict adherence to formalism, when interpreting the contract.

The key question revolves around the precise role to be assigned to the express terms of the contract: on the one hand, the discrete approach *prima facie* entails the recognition of express terms as the only and decisive terms of the contract, whereas the relationalists appear to state that one should instead consider either 'contextualism' in contract interpretation, or the so-called 'implicit dimensions' of contract. Once the importance of having regard to context and the need for reform of contract law in this field, have been established, a further question arises as to whether or not such a development can be conceived *only* by embracing or presupposing any particular theoretical commitment, that is, by adhering to the relational contract paradigm.

In fact, in examining the question of the importance to be given to context in contract interpretation, the position of other theorists who, for instance, view contract as a promise,[10] or those belonging to the law and

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relationalists have 'evolved in two separate, and often opposing, intellectual traditions[…]', which the author labels as those most associated with the 'law and economics' movement on the one hand, and those more close to the 'law and society' movement on the other. See Scott 'The promise and the peril of relational contract theory' in Braucher, Kidwell & Whitford 'Revisiting the contracts scholarship of Stewart Macaulay' *On the Empirical and the Lyrical International Studies in the Theory of Private Law No 10* (2013) 105.

7 By 'discrete' contract is meant the paradigm contract of classical contract law, which Macaulay criticises for being inadequate in the case of complex legal transactions. See Campbell 'What do we mean by the non-use of contract?' in Braucher *et al* n 6 above at 159.

8 In usefully listing and summarising the different lines of argument that are to be found with reference to the relational contract theory, Dori Kimel describes the 'doctrinal-prescriptive' argument as the one claiming that 'contract law should be reformed so as to better support the relational nature of contract'. See Kimel 'The choice of paradigm for theory of contract: reflections on the relational model' (2007) 27/2 *Oxford Journal of Legal Studies* 233–255.

9 Campbell, Collins & Wightman n 4 above.

10 One cannot but cite Fried *Contract as promise – a theory of contractual obligation* (1981) and also his more recent work: Fried 'Contract as promise *thirty years on*' (2012)

economics[11] school, may be taken into account. This leads one to conclude that the question of the relevance of context in contract interpretation does not necessarily concern one single theoretical paradigm and, as such, is important regardless of the initial theoretical point of departure.

A glance at certain civilian systems and at recent soft law documents within the European Union, offers an example of the possible implications arising from the institutionalisation and codification of norms that *do* prescribe a consideration of the implicit dimensions of contracts, and as a testing ground for whether this in fact does lead to uncertainty in interpretation.

The completion of incomplete contracts: the rules on interpretation of contract in the common law and a comparison with civil law

The rules on the interpretation of contract in civil law and common law countries are closely linked to the underlying values that each system emphasises. While the common law views the contractual relationship mainly as 'adversarial',[12] civil law countries rather adopt a 'cooperative' view[13] which is also reflected in a series of soft law documents (DCFR,[14]

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45 *Suffolk U L Rev* 961.

[11] The 'law and economics' or 'economic analysis of law' school of thought is generally identified as stemming from the works of Coase 'The problem of social cost' (1961) 3 *Journal of Law and Economics*; and Calabresi 'Some thoughts on risk distribution and the law of torts' (1961) 70 *Yale Law Journal* 499. Posner brought economic analysis of law to the attention of the wider legal community in the mid-1970s, with *Economic analysis of law* (1ed 1973), thus contributing to the more recent legal debate.

[12] The traditional adversarial ethic permeating English contract law can be found in the reasoning of *Walford v Miles* [1992] 2 AC 128. See Lord Ackner at 138 where, with reference to the principle of good faith, it is said that 'the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations'. It is thus suggested that according to the English paradigm, at least in its traditional connotation, contracts are formed as a consequence of the pursuit of the parties' own-interest.

[13] The cooperative ethic is considered to be more relevant in the civilian contract law doctrine. Under Italian contract law, for instance, contractual obligations 'must take place with the loyal and honest cooperation of the parties to achieve the reciprocal benefits agreed in the contract': see Criscuoli & Pugsley, as quoted in Arrighetti, Bachmann & Deakin 'Contract law, social norms and inter-firm cooperation' 1997 *Camb J Econ* 179.

[14] Draft Common Frame of Reference (DCFR) – Principles, Definitions and Model Rules of European Private Law edited by the Study Group on a European Civil Code, Research Group on the Existing EC Private Law (Acquis Group), February 2009.

Feasibility Study,[15] PECL,[16] and most recently the CESL[17]). The different points of departure are said to stem from the fact that civilian countries – for example Italy or Germany – recognise a general duty of good faith (art 1337 Italian Civil Code and s 242 BGB) which has also made itself felt in commercial contract law. This duty entails that contractual obligations must display an honest 'cooperation' between the parties which, under Italian law is linked to the duty of social solidarity in article 2 of the 1949 Constitution.[18]

These differing ethics might have impacted on the rules governing the interpretation of contracts and on the role assigned to context in understanding the parties' obligations, although it must be remembered that neither 'cooperativism' nor 'individualism'/'adversarialism' is to be found in any system in its purest form. As has been pointed out, doctrinal adherence to adversarialism might be out of touch with business practice, whereas too great an emphasis on cooperativism, might over extend the idea of enterprise.[19] Furthermore, both ethics often give rise to misconceptions which do not actually describe the reality of their functioning.

In fact, on the one hand, the civilian cooperative view may be easily mistaken for an overall acceptance of 'altruism' and 'negation of self-interest',[20] while, on the other hand, the common law approach has long been considered to imply a rigid exclusion of duties such as good faith – a state now less true than it was in the past[21] in many common law jurisdictions.[22]

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15 Feasibility Study on a Common European Sales Law published by the Expert Group convened by the European Commission on 3 May 2011. This study has then culminated in the current 'CESL'. See n 17 below.

16 Lando & Beale 'Principles of European Contract Law, Parts I and II' prepared by the Commission on European Contract Law, 2000.

17 The Proposal for a Regulation of the European Parliament and Council on a Common European Sales Law, Brussels, 11.10.2011 COM (2011) 635, briefly known as 'CESL'.

18 Arrighetti *et al* n 13 above at 179.

19 Brownsword 'After Investors: interpretation, expectation and the implicit dimension of "new Contextualism"' in Campbell, Collins & Wightman *Implicit dimensions of contract: discrete, relational and network contracts* (2003) 124.

20 Deakin, Lane & Wilkinson 'Contract law, trust relations and incentives to cooperation: a comparative study' in Deakin & Michie (eds) *Contracts, cooperation and competition* (1997) 107.

21 Piers 'Good faith in English law – could a rule become a principle?' (2011) 26 *Tul Eur & Civ LF* 168.

22 See for instance the reasoning of Justice Leggatt in *Yam Seng Pte Limited v ITC* 2013 EWHC 111 (QB) at 125, where it is recognised that good faith has already been accepted in other common law jurisdictions such as Australia, Canada and the US. The concept has thus been 'gaining ground' in many common law systems and is not completely unfamiliar under English law, where the duty of good faith is implied in certain

Traditionally, adversarialism means that there is no requirement placed on one contractor to take into account the economic interests of the other party. The courts will enforce the agreement by taking an objective approach towards its interpretation, without implying any term in the contract unless it is essential to do so, and without recognising a general duty of good faith in the parties' dealings with one another. Even in a cooperative context, for example, a long-term commercial relationship as in *Baird Textile Holdings Limited v Marks and Spencer Plc*,[23] this adversarial thinking will reaffirm itself because, as Mance LJ put it, businessmen will be considered to be aware that, in the absence of contractual protection, 'their business may suffer in consequence'.[24]

By contrast, a cooperative approach entails that courts are more ready to intervene in gaps left by the contract in the name of good faith, and regard context as an important tool in interpreting the subjective, as opposed to the objective, will of the parties.[25]

A closer look to the norms of interpretation under Italian law, for instance, shows how the Italian Civil Code envisages norms aimed at establishing the subjective or 'historical' interpretation of the contract (art 1362), in revealing the 'real' intention of the parties. Subsequently, articles 1366 to 1370 deal with the objective interpretation of contracts, which focusses on the attribution of the rightful significance to the contract as a whole.

The objective criteria for the interpretation of contracts are secondary and auxiliary to the subjective criteria, and therefore apply only when the real intention of the parties is not clear. The rules on subjective interpretation, which are to be applied first, aim at assessing the 'overall behaviour' of the parties in the agreement, even after the conclusion of the contract.

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categories of contract, although it is not a 'default rule' to be applied 'into all commercial contracts' [131].

23 [2001] EWCA Civ 274.

24 *Id* at par 76.

25 For the difference between the civilian subjective approach and the objective one adopted in common law, see Hardy 'The feasibility study's rules on contract interpretation' (2011) 19/6 *European Review of Private Law* 825.

Finally, the principle of good faith, which completes the rules on contractual interpretation under Italian law[26] (as under German law[27]), is traditionally conceived as a tool to use sparingly, in particular to avoid courts having to 're-write' the contract for the parties. In other words, good faith and reasonableness, although guiding the overall interpretation of the contract, should at no point become a solution for the parties' 'sloppiness'.[28]

While explicitly characterising the civilian systems, it should, however, be remembered that the principle of good faith is not completely unknown in the common-law world, and the traditional view that good faith does not sit well with commercial agreements where parties are in an adversarial position, has increasingly been discarded in New Zealand and Australia.[29]

In two recent decisions,[30] the courts helped define the content of good faith, and in each it appeared relevant to consider the particular circumstances at stake. In general terms, the courts considered that good faith entailed cooperating with the other party and acting honestly and fairly, which means also taking into account the other party's interests, though not to the point of disregarding one's own interests. Lastly, the more recent *Yam Seng Pte Limited (A company registered in Singapore) v International Trade Corporation Limited* decision in England, has pointed out how 'commerce takes place against a background expectation of honesty', an expectation which naturally underlies 'almost all contractual relationships'. Yet this is not expressly formulated as a contractual obligation as, in many instances, such a provision to request the other party to act honestly 'might well damage the parties' relationship by the lack of trust which this would signify'.[31]

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[26] Article 1366: 'Interpretazione di buona fede – il contratto deve essere interpretato secondo buona fede' ('Interpretation according to good faith – The contract must be interpreted in good faith').

[27] Article 242 of the German Civil Code of 1896: 'Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern' ('The debtor is bound to perform according to good faith, ordinary usage being taken into consideration').

[28] Chan 'Resolving ambiguity through extrinsic evidence' (2005) 17/1 *Singapore Academy of Law Journal* 280.

[29] Cheyne, Grierson & Taylor 'Commercial good faith' 2001 *New Zealand Law Journal* 245.

[30] *Aiton Australia Pty Ltd v Transfield Pty Ltd* [1999] NSWSC 996 and *New Zealand Licensed Rest Homes Association Inc v Midland Regional Health Authority* High Court, Hamilton, CP 34/97, 15 June 1999.

[31] Justice Leggatt n 22 above at 135.

A point of convergence between English and Italian law is that in the latter we also encounter norms regarding the literal interpretation of the contract which are in line with the most orthodox English view on objective interpretation. In fact, article 1362 prescribes that one look at the 'literal meaning' of the words used, although this criterion should be superseded whenever it does not reflect the common intention of the parties. Interestingly, this same position is found in article 5: 101 PECL and in article 8:101 DCFR.[32] Consequently, elements beyond the text – such as the overall behaviour of the parties – become relevant in the interpretative process, including their behaviour in both the negotiation phase and in their subsequent conduct after the conclusion of the contract.[33]

One may, therefore, well wonder whether the signal *Baird Textile* case would have been decided differently in a civilian country or under one of the European soft law documents. In that case, the parties had been dealing with one another in the supply of garments for thirty years and there was no dispute as to the cooperative nature of their relationship. However, in the absence of any express framework contract governing their dealings, when Marks and Spencer decided to terminate the relationship, the Court of Appeal was unable to rely on the cooperative nature of their dealing to imply a contract. While any attempt to imagine how a civil law court would have looked at this case is merely speculative, some observations are in order.

Taking again the example of Italy, it is interesting to note that the Supreme Court has stated that in the case of contracts (other than formal contract) whose duration is undetermined, the assessment of the 'overall behaviour' prescribed by the norms on interpretation needs to take into account the expansion of the relationship over time. In a case regarding specifically the interpretation of a provision within a labour contract, the Court stated that the *long-term* character of the relationship becomes a

> further reason to privilege the actual and concrete behavior of the parties over a text which was written far back in time. When, in fact, a contractual relationship is open-ended (not only in the case of a labour contract but in any other long-term contract generally) and proceeds over an extended period of time (...) its content is not only to be determined by reference to the original terms, but also by reference to

32 For a comparison of these two norms, see Pennasilico *Contratto e interpretazione* (2012) 8.

33 Both of which, as we shall see, are excluded under English law: see McMeel 'Prior negotiations and subsequent conduct – the next step forward for contractual interpretation' (2003) 119 *LQR* 272.

> subsequent agreements and, more generally, to all modifications which have intervened, whether orally or tacitly, during the course of the relationship.[34]

The English Court of Appeal, on the other hand, well recognising that the parties were here involved in an 'end game', whereby at least one party no longer wished to deal any further with the other, stated that it was not possible for it to write a 'reasonable' contract for the parties after the existing cooperation had come to an end and would, therefore, no longer serve as a guide to the interpretative process.[35]

The result in *Baird Textile* is not surprising, and is supported by the traditional adversarial ethic permeating English contract law. However, it does pose a question and at the same time sound a warning. The question it poses is, most obviously, whether context should be taken into account in contract interpretation and what its possible limits are. The warning, as has been rightly stated, is for contextualists: if literalism is to be displaced, it must be determined whether contextualism is able and ready to revert to an individualistic ethic, rather than a cooperative one.[36]

With reference to the possible shifting to a different ethic, it must be stated that some authors considered cooperation to be even a 'technical necessity'[37] in certain types of contract, such as in production processes or where there is a high risk of shifts in demand in the markets.[38] Adopting a different ethic of 'cooperativism' rather than 'adversarialism', it is said, would be preferable socially and economically. Indeed, focusing only on viewing economic transactions as arms-length individualistic processes, and ignoring the relational work behind the contractual settings, means pursuing a 'disruptive' idea that market participants are required only to pursue their self interests. And this 'theoretical illusion' has had 'horrendous consequences in the global financial crisis'.[39]

However, such preference does in itself not prove that contextualism cannot coexist and be supported by a different type of ethic, such as the individualistic one found in the common law. Furthermore, it has been

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34 Cass Sez Lav 13.10.2006 n 22050 (*Metro Italia Cash and Carry SpA v VA and Others*).

35 *Mance LJ* par 68.

36 Brownsword n 19 above at 127.

37 Arrighetti *et al* n 13 above at172.

38 Deakin, Lane & Wilkinson '"Trust" or law? Toward an integrated theory of contractual relations between firms' (1994) 21 *Journal of Law and Society* 332.

39 Block 'Relational work and the law: recapturing the legal realist critique of market fundamentalism' (2013) 40/1 *Journal of Law and Society* 27.

rightfully pointed out how modern complex business relationships involve both rivalry and cooperation.[40] English contract law, influenced by a liberal conception of the freedom of the individual, starts by insisting on the autonomy of the contracting parties.[41] Both Italian and German commercial law, on the other hand, have counterbalanced this position with the need to uphold cooperation, as dictated by an ideology of social market economy.[42]

It seems, however, correct to state that these differences permeating the common law and civil law systems, should not be unduly emphasised or accentuated. The fact that English contract law – with its emphasis on objective interpretation – might start from an adversarial approach and has no general duty of good faith, does not constitute an impediment for judges to apply their good sense in ensuring that the contract becomes the fair framework for people's dealings. As one judge who has been educated and exposed to both the civil and common law influences of the South African mixed legal system has said, there is, in the end, 'not a world of difference' between the principle of good faith and 'the reasonable expectation of the parties'.[43] It is further significant that the conservatism of the English legal system has been a strong factor in firms and businesses choosing which jurisdictions should govern their dealings, given the certainty it provides and given that such a different position constitutes a valid alternative with respect to all other legal systems, including various European soft law documents.[44]

Therefore, it could be said that there is no need for English law to adopt a different core value in order to assess its willingness to adopt a general doctrine of good faith.[45] Although the comparative study of other jurisdictions always represents an occasion for self-reflection on whether the values embodied within one's legal system are acceptable or current.[46] this

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[40] Deakin et al n 38 above at 110.

[41] In the words of Justice Leggatt, English law 'is said to embody an ethos of individualism' n 22 above at 123.

[42] Zweigert & Kötz, as quoted in Deakin et al n 38 above at 111.

[43] Lord Steyn as quoted in Banakas 'Liability for contractual negotiations in English law: looking for the litmus test' 2009 *In Dret, Revista Para el Analisis del Derecho* 7.

[44] *Id* at 17; J. Steyn 'Contract law: fulfilling the reasonable expectations of honest men' (1997) 113 *The Law Quarterly Review* 442.

[45] Again quoting Justice Leggatt, it is rightfully said that 'it would be a mistake […] to suppose that the willingness to recognize a doctrine of good faith in the performance of contracts reflects a divide between civil law and common law systems or between paternalism and Anglo-Saxon individualism' n 22 above at 125.

[46] Cartwright 'The English law of contract: time for review?' (2009) 2 *European Review of Private Law* 156.

is not the key question, If contracts, 'like all human communications',[47] are made against a background of facts and understandings which are often not reflected in the text, perhaps good faith becomes just one of the many 'unsaid clauses' of the contract which the parties fail to state expressly. Consequently, what should ultimately be asked, is whether the interpretation of contracts from the standpoint of contextualism is a positive development. In this regard, some preliminary thoughts can stem from the reaction of academics towards those European soft law documents which have adopted a contextualist approach. The Feasibility Study, for instance, has been criticised as leading to too great a degree of uncertainty.[48] Similarly, what has resulted in the development of the Feasibility Study, namely, the CESL,[49] has been criticised on parallel grounds by Lisa Bernstein, who has underlined how Europe could perhaps draw some important conclusions from the reaction of businesses in the United States to article 2 of the UCC which already envisages a contextual approach. Interestingly with regard to the UCC, it was found that businesses prefer their dealings to be governed by the more formalistic approach as reflected in the rules and jurisprudence of New York, rather than by the 'CESL-like' law of California.[50] The rules of the CESL make reference to concepts such as good faith and reasonableness, which is to be determined by the 'circumstances of the case' and the 'usages and trades' of the professions involved,[51] with a similar content to what was previously envisaged under the DCFR and the PECL.

However, as we shall see in the following paragraphs, a shift from a literalist approach has already taken place – even in the common law – by means of the criteria of contractual interpretation set by Lord Hoffmann, a shift which initially purported to be no more than a consolidation of existing judicial reasoning, but which has indeed signalled an essential milestone in the courts' understanding of contract interpretation disputes.[52] Thus, it becomes important to understand the precise implications of such an approach and whether it entails adhering to any particular view of contract law.

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47 Leggatt n 22 above at 133.
48 Hardy n 25 above at 817.
49 The Proposal for a Regulation of the European Parliament and Council on a Common European Sales Law: see n 17 above.
50 Bernstein 'An (un) common frame of reference: an American perspective on the jurisprudence of the CESL' 2012 *Common Market Law Review* available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2067196 (last accessed 2 August 2012) 18.
51 CESL art 5.
52 Brownsword n 19 above at 104.

From a comparative standpoint, Italian law embodies the coexistence of a 'contextual' criterion to contract interpretation alongside a literal one. This has been said by one commentator to emphasise that a central role in the interpretative process is given not only to the 'contract' itself, but to the whole 'relation' or economic operation behind the actual document.[53] If this suggested reading of the norms is correct, it could be said that there is at least one civil law country in which a position strikingly similar to what relational contract theorists envisage, is being adopted, albeit without any explicit theorising.

Another interesting example is provided by Scotland. In the drafting of the Scottish Report on Interpretation in Private Law 1997 (RIPL), the European DCFR was a source of inspiration and a 'health check' for Scottish contract law.[54] The RIPL extended the importance of extrinsic evidence, as opposed to the written document, in assessing the parties' common intention. However, this development did not necessarily require describing contracts as relational. As in fact stated in the Report, not only did Scotland maintain the same rules on interpretation it had known before, but these rules ought to be such that the interpreter (be it a court or other) is able to determine what facts and circumstances can be taken into account. In defining 'context', the RIPL distinguished between that which is provided by the juridical act itself, and that which is best described as the 'surrounding circumstances', that is, the facts which are external to the juridical act. Both are to be considered in the process of interpretation, but limits subsist to the admissibility of surrounding circumstances. These, in fact, do not include the parties' direct and individual statements of intention, the negotiating stage, and the subsequent conduct.

The RIPL thus maintains an objective approach to interpretation, in contrast to the DCFR's more subjective one[55] and restricts the material which can be considered (excluding pre-contractual negotiations as well as subsequent conduct as opposed to art II.-8:102(1)(a),(b) DCFR). In sum, the Scottish reform embraces the doctrinal prescriptive claim of the relationalists that contract law should be reformed. It does not, however, accept that part of the same claim for which mainstream (ie non-relational) theory of contract fails to take into account the true relational nature of contracts.

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53 Pennasilico n 32 above at 10.

54 Scottish Law Commission ' Promoting law reform, review of contract law' *Discussion Paper on Interpretation of Contract* n 147 February 2011.

55 *Id* at 14.

Indeed, the example of Scotland suggests that the fact that the formalist flavour intrinsic in the traditional and orthodox parol evidence rule no longer reflects the reality of business behaviour, is recognised by upholders of both the relational as well as the classical contract theory.[56]

Lord Hoffmann, Professor Macaulay, and the legacy of the relational contract paradigm in English contract law

Although, as we have seen, the differing starting points of both the civil- and the common-law traditions should not be overemphasised, it is perhaps true that their opposite default approaches reflected themselves in the rise in the 1960s of the theory labelled the 'relational contract theory' in the common-law world. Arguably, it may be said that in countries where judges have traditionally been given more space for policing contracts by inferring terms within their frameworks, and the contract is viewed as a cooperative enterprise, as in the civil law jurisdictions, there was never an urge to ease any formalistic approach to contract interpretation, nor to oppose the presumption that a contract contains all the negotiated and genuinely agreed terms of the parties.

On the other side, in the academic literature of the common- law tradition, Prof Macaulay's paper, 'Non-Contractual Relations in Business – A Preliminary Study'[57] became the most widely cited paper on contract law in the past 50 years.[58] Its empirical observations led to the conclusion that most larger firms attempt to draft complete contracts, although legal sanctions are often unnecessary as there are other effective devices that businessmen employ to adjust their relationship, such as reputational sanctions, trust, reciprocity, and the discipline of future relations. His observations were further developed by Macneil within the socio-relational movement, whose primary aim was to explain how contractual relationships are embedded in a wider social context, albeit not offering normative arguments as to the form that relational contract law should take. On the question of contract interpretation, the socio-relationalists commentators, as opposed to relational contract scholarship, have advocated a contextual approach, arguing that extrinsic evidence should not be excluded as this would undermine the

[56] Sharma 'From sanctity to fairness: an uneasy transition in the law of contracts' (1999) 18/2 *New York Law School Journal of International and Comparative Law* 157.

[57] Macaulay 'Non-contractual relations in business – a preliminary study' (1963) 28 *American Sociological Review* 55.

[58] Scott n 6 above at 105.

capacity of the courts to assess the 'real' deal concluded between the parties.[59]

It could be claimed that any model that commands the loyalty of one or more generation of scholars – such as the relational contract theory – has undoubtedly more than a grain of truth and is therefore worth developing further. However, as pointed out by Kimel, given the differing views expressed within its framework, the claims of this school of thought are not always easily definable. Consequently, the definition of what is a relational contract cannot be reduced to what Melvin Eisenberg suggested when he defined it as one 'that involves not merely an exchange, but also a relationship, between the contracting parties'.[60] Rather, the crux of the definition appears to be a document that advocates the creation of obligations over and above what can be gleaned merely by the express terms established by the parties. A relational contract is more akin to a 'marriage' than a 'one-night stand'.[61]

The academic impact of the relational contract theory has been, among others, to draw attention to the importance of a contextual approach to contract regulation. It has, to a great degree, served to emphasise the understanding of commercial relationships as complex settings where both worlds of contract and trust coexist, so that the legal reasoning needs to be applied in order to establish and appreciate both the competitive and cooperative character of the transaction. The existence of a trusting relationship may, in other words, serve to provide an essential element of context which needs to be taken into consideration in the interpretative process of assessing the parties' scheme.

While socio-legal scholars differ in their views on the precise implications of the relational theory over contractual interpretation, they seem to agree generally that a contextual approach should be preferred to the traditional four-corners rule. For instance, Feinman believes that relational analysis is 'contextual with a vengeance'[62] requiring a pragmatic approach that starts

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[59] *Id* at 120.

[60] Kimel n 8 above at 236.

[61] Gordon 'Macaulay, Macneil and the discovery of solidarity and power in contract law' 1985 *Wisconsin LR* 565, 569.

[62] Feinman 'Relational contract theory in context' (2000) 94 *Nw U L Rev* 737.

from the assumption that there is an agreement, rather than there is none, and that this is made in a spirit of cooperation rather than competition.[63]

A striking feature, at this point, is to observe that within the common-law world, the English legal system has not seen any equivalent scholarly debate – at least not until the last decade – on the relevance of context in contractual interpretation. The issue only started to emerge in the late 1990s through a series of cases in which the courts sought to establish the role of context and its relationship to express terms. Unlike its American counterpart, this became an entirely judicially led development within the law of contract.[64] Here, there were no pre-existing legal provisions – such as those found in the Restatement (Second) of Contracts or the UCC[65] – to signal the importance of the contextual dimension, but the outcome of using context as a source of obligations in commercial settings has appeared surprisingly similar to that advocated by the relationalists' work.

This new extended objective approach within English law, has thus acquired the potential of being read through the lenses of neoclassical law, signalling an adaptation of the classical principles of contract law better to cope with commercial realities, or can be explained in terms of reinforcing the claims of the relational school of thought, and so envisaging that contracts are to be interpreted and constructed differently to the form to which we are accustomed.

The choice between these two readings requires a deeper understanding of the development which has taken place in the English world, largely under the pen of Lord Hoffmann.[66] The process initiated by this judge, has been expanded on over a period of fifteen years prior to his retirement in 2009, and is represented by four landmark House of Lords' decisions which address both the problem of how courts should interpret contracts, and the extent to which liability can be established by explicit or implicit terms.[67] It

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63 The object of contracting is not merely the allocation of risks, but the very intention to cooperate: see Gordon n 61 above at 565.

64 Wightman 'Contract in a pre-realist world: Professor Macaulay, Lord Hoffmann and the rise of context in the English law of contract' in Braucher *et al* n 6 above at 378.

65 See art. 1–303 on 'course of performance, course of dealing and usage of trade' and art 1–304 on good faith.

66 Lord Hoffmann has served as judge in the High Court between 1986 and 1992, in the Court of Appeal between 1992 and 1995 and finally in the House of Lords between 1995 and 2009.

67 These decisions are *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896/ *South Australia Asset Management Corporation v York Montague*

has entailed an ever-increasing recognition of the interpretation of contracts as contextual, thus meaning, broadly, that the process of interpretation requires judges to look beyond the mere text agreed to by the parties. This is the natural consequence of the principle whereby obligations are assumed by the parties and not imposed upon them. Consequently, the duty of the interpreter to discover what the parties must have agreed on, is effectively carried out when she takes into account not merely the written terms of the contract, but also the context in which these were drafted.

If the judge's function is to discover the 'presumed intention of the parties', then re-evaluating the contextual method, rather than the textual one, merely entails discovering the contractual obligations that can be inferred from the agreement between the parties. By means of background information, and with a few notable exceptions like the omission of prior negotiations or subsequent conduct,[68] the courts are thus able to 'fill the gaps' of the agreement that would otherwise only be filled by application of the rules of law.[69]

In this light, the contextual shift is no more than the natural consequence of the judges' everyday task of interpreting the parties' agreements.[70] The point of convergence with the relational contract school of thought is that, once it is accepted that contextual interpretation carries with it the possibility of undermining the importance of the written text, the 'thing' which needs to be interpreted becomes not the contract itself, but the whole relation between the commercial parties in its entirety.[71]

It would, however, be wrong to attribute to Lord Hoffmann the intention of destabilising the relevance of express terms. In fact, the most obvious task assigned to the courts remains that of interpreting the express terms as the usual source of obligation in commercial contracts. Lord Hoffmann's approach has therefore only served to expand the questions that can be answered with reference to the agreement between the parties, hence reducing the application of rules that would otherwise apply.

Ltd [1997] AC 191 / *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48, [2009] 1 AC 61/ *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10 [2009] Bus LR 1316.

68 McMeel n 33 above at 272.

69 Mitchell 'Contracts and contract law: challenging the distinction between the "real" and "paper" deal' (2009) 29/4 *Oxford Journal of Legal Studies* 680.

70 Mitchell 'Obligations in commercial contracts: a matter of law or interpretation?' (2012) 65/1 *Current Legal Problems* 459.

71 Mitchell n 69 above at 463.

In other words, the principle of freedom of contract – which originally guided the development of English contract law and, although limited over the course of the years, has never completely disappeared – assigns a specific role to rules: principally that of operating as a default, unless the parties wish to contract out of them. The role of the contextual approach initiated by Lord Hoffmann is that of further restricting the operation of the rules in favour of what can be found to be governed by the parties' agreement, and what can reasonably be expected to be incorporated in the contract by means of construction (implication of terms) or interpretation.[72] The contextual interpretation of contract therefore becomes just one of a series of devices used within the neoclassical law of contract, and which allow courts to assign a central relevance to the parties' agreement, such as, for instance, the implied terms, collateral contracts, terms subject to ongoing variations, and estoppel by convention.

With specific reference to commercial contracts, it should be pointed out that these, as opposed to any other type of contract, are *par excellence* the field where English common law has developed over centuries, and which appears more at ease in recognising the fundamental values of freedom of contract, so that upholding the 'reasonable expectations of the parties' becomes more than mere rhetoric.[73] The interpretative shift recognises that long-term commercial contracting involves a normatively rich context, which provides even more substance and evidence of the parties' intentions.

However, the exact extent to which this normatively rich background should be taken into account by the courts, remains a matter of dispute. It appears that there is no specific rule that answers the issue of *quantum* – and indeed even in countries with a civil law tradition, which are more comfortable with the recognition of a contextual approach to interpretation, there is no hard and fast rule to be found on the exact amount of data that the courts are able to consider. The importance of this approach, as opposed to a more literalist one, is that, particularly in the case of commercial contracts, courts might be more confident in taking into account the contextual framework of the agreement, rather than having to regulate the agreement with reference to an autonomous set of strict rules – given the above-mentioned rich context in which these are usually struck and the upholding of the idea that the purpose

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72 *Id* at 472.
73 *Id* at 471.

of contract law is to facilitate commerce and the reasonable expectations of the players in this field.

This development in the English law of contract, if it is a development and not merely a reassertion of the existing power of the parties to contract out of the general law and embrace an enhanced pragmatic approach to the interpretation of commercial contracts,[74] finds resonance in the thoughts of the relationalists, but is seen by many as no more than a response to the perennial criticism of classic contract law.

This criticism has, as one commentator states, been with us since the framing of contract law in Williston's treatise (*The Law of Contracts* 1920) and the original Restatement of Contracts.[75] In essence, the criticism revolves around the role of contextualisation within classic contract law and is both internal and external. The internal criticism refers to the fact that '(…) the general rules on contract law do not, by themselves, explain the outcomes of the cases decided by the courts'. The external criticism, refers to the fact that the law does not reflect actual contracting practice and would therefore need to be further developed in order to become an efficient tool for contracting parties in the real world. Neoclassical law has sought to respond to these shortcomings without the need to develop an entirely different conception of the law (hence it is 'neo'-classical[76]). It succeeds in maintaining a unitary body of contract principles, without attempting to regulate all consensual transactions (so that labour law and corporate law, for example, are now distinguished from contract law).

What the neoclassic model envisages, as compared to the classical, is a set of both rules and standards. The core, as has been explained, is based on the assumption that parties act in self-interest but within a context of trade costume embedded in social values. Contract, therefore, is still about achieving one's purposes, but these purposes are largely understood in relation to the context in which they arise.[77]

If that is the case, it is questionable whether contracts necessarily need to be regarded as relational. In fact, in terms of the neoclassic account of the legacy left by relational theorists, this school of thought can be 'comfortably

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[74] *Id* at 484.
[75] Feinman n 62 above at 738.
[76] Neoclassical law being viewed as a development and as superseding classical contract law in the second half of the twentieth century: see Wightman n 64 above at 382.
[77] Feinman n 62 above at 739.

accommodated' within the mainstream conception of modern contract law, rather than constituting a real challenge to neoclassical law.[78]

Relational contract, therefore, emerges as a 'refinement of neoclassical contract law' and an 'unnecessarily detailed account of the need to contextualize' inasmuch as it underlines the necessity of treating long-term relationships as inherently different from discrete contracts.[79] The main legacy of the relational contract scholarship, therefore, would be only to recommend that the classic law of contract recognise the existence of relational contracts as a special subcategory of the general law, where greater reliance should be placed on fairness and cooperation as opposed to the general short-term and adversarial view which characterises all other contracts.

Such an account and understanding of the implications of the relational contract theory is widely encountered throughout academic literature. However, Feinman describes it as overly limited, since the real repercussions of the relational view on contract law are far more extensive. In fact, if one were to engage more accurately with relationalist literature, it would become clear that this understanding of the law 'dramatically broadens and dramatically fragments the scope of contract law'[80] by sustaining the belief that contract encompasses all human activities where an exchange takes place. This holds the potential for including tort and property law issues within its definition, and reclaiming other areas which have been separated, such as labour law.[81]

Furthermore, the relational view provides for much more general concepts, while at the same time fragmenting their application by stating that they should work differently in different contexts. Therefore, while the neoclassical view recognises that rules should operate differently according to the factual differences of each given case (in contract for sale as opposed to a contract for construction, for instance), the relational view begins with far more general contract rules which then must, however, be tailored to each case by requiring a far greater degree of contextualisation. The result of such contextualisation is to place contracts within the relational-discrete continuum, so that, while the principles of relational contract law have a

78 *Ibid*.
79 *Id* at 740.
80 *Id* at 741.
81 Gordon n 61 above at 573.

higher degree of generalisation, they accentuate the differences between all the possible settings.

Therefore, according to Gordon, if contract scholars were really to engage with the ideas advanced by Macaulay and Macneil, they would have to write very differently about their subject.[82] In particular, they would have to face the challenge brought to our liberal conception of the foundations of the law. While in the present view, the terms of social interaction are based on freely given consent by the parties – whether or not tempered by the rules imposed by the state – the discovery of relational contract propels the element of society centre stage. Society exists before and independently of any choice made by the parties and any constitutional-democratic restraint imposed by the state. Therefore, economic choices and actions are deeply rooted and interwoven in the social sphere, in local customs, and in the need for loyalty and cooperation in an interconnected community. And whilst it cannot be said that Macaulay and Macneil 'discovered' contracting societies, as mainstream contract law has already recognised the relevance of social background conditions – for instance in the assessment of the inequality of bargaining power – these conditions normally constitute only the background against which the rules and the choices of the parties operate. They remain supplementary, rather than primary, sources of contracting norms. In the relational view, one cannot even start to understand the expectations of the contracting parties without grasping the social conditions in which these are generated.[83]

With some risk of over-simplification, it appears that the relational contract law presents two main propositions. First, contract is fundamentally about cooperation. Secondly, the majority of contracts contain relational elements. The first point does not suggest that relational contract theory advocates communitarianism, but it does represent a counter-balance for or correction of the classical position, and recognition that contracts can uphold different values and foster both reciprocity and competition. In the light of all these elements, relational contract law becomes a substantial alternative to, and not merely a subcategory of, the neoclassical view of contract. Neoclassical contract law has as its focus the exercise of autonomy by the contracting parties, so that the context constitutes an element by which to construct the expectations stemming from their agreement. In contrast, relational contract underlines the interrelation between individuals and the social dimension of

[82] *Id* at 573.
[83] *Id* at 574.

their relationships, focusing on their mutual trust, responsibility, and collaboration.[84]

In this light, the developments effected by Lord Hoffmann and other leading judges, have embraced a so-called 'commercial realism' perspective to contract interpretation, but have not marked a sea-change from the previous state of the law. The oft-cited signal case – *Investors Compensation* – itself came after others in which context was held to be a necessary component of contract interpretation: thus, for instance, in *Prenn v Simmonds* Lord Wilberforce stated that the time 'has long past when agreements… were isolated from the matrix of facts in which they were set',[85] meaning that contractual interpretation is inherently contextual.[86]

And while this development is not universally welcomed, as taking the contextual 'matrix' in which contracts are formed into account may lead to 'the proliferation of inadmissible material' and a 'huge waste of money, and of time' for the courts,[87] the core of the issue here lies in the exact limits of the surrounding circumstances which can be taken into account, rather than on the understanding and construction of contracts as structurally different from their mainstream neoclassic description.

Whether to adapt tradition or embrace the new: The implications of viewing contracts as 'relational'

The view expressed in the preceding paragraph that this judicially-developed extended objective approach within the English law of contract does not represent a revolutionary change (it is not even 'new wine in old bottles, but old wine in old bottles'),[88] is not uncontroversial. Wightman, for instance, has argued that the appearance of a more explicit reference to context, even if within the framework of discovering the parties' objective intent, has the potential to move the law closer to the relational contract law.[89] In his view, this broader objective approach, within which context becomes relevant, requires us to establish what obligations the parties have undertaken with reference to what a reasonable person would understand them to be. Much of existing case law, in which such an approach was developed, involves situations where the parties were at cross purposes, as in the famous case of

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84 Feinman n 62 above at 748.
85 *Prenn v Simmonds* [1971] 1 WLR 1381,1883.
86 Wightman n 64 above at 384.
87 Staughton 'How do the courts interpret commercial contracts?' 1999 *CLJ* 303 307.
88 Wightman n 64 above at 395.
89 *Id* at 383.

Smith v Hughes[90] where one party thought the oats he was buying was old while in fact it was fresh. Yet the implications of the extended objective approach inaugurated by Lord Hoffmann are quite different when the issue involves interpreting a contract in which the specific situation at stake was not envisaged by the parties.

Here, reference to context does not resolve ambiguity, that is, it does not involve choosing between alternative meanings of the contract, but requires one to take the perspective of the reasonable promisee in order to assess what obligations she would have assumed in a case which was not envisaged by the parties at the time of contracting. This outcome, although clothed in the discovery of the parties' reasonable intent, is relational rather than neoclassical, in that it considers the social web, the practices, and the expectations which characterise the specific context in which the contract has emerged.[91]

From that perspective, the traditional objective approach could become a channel for the introduction of contextual norms, and a key to a third domain of contractual obligation which is given neither by the actual agreement of the parties, nor by the generic rules imposed by the law of contract, but rather by the expectations and norms deriving from specific contexts and business sectors.

On the contrary, if the issue is that of considering whether the law of contract gives relevance to the implicit understandings of the parties, other commentators such as McKendrick and Bridge believe that traditional English contract law contains *in itself* all the elements to respond to relational contracts.[92] Even the introduction of a general doctrine such as good faith, which would appear to be useful in interpreting contracts which could be viewed as 'relational', is unnecessary given that its function can be assumed by other doctrinal devices such as implied terms.[93]

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90 [1871] LR 6 QB 597.

91 Wightman n 64 above at 398.

92 McKendrick 'The regulation of long term contracts in English law' in Beatson & Friedmann (eds) *Good faith and fault in contract law*' (2013) as cited in Wightman 'Beyond custom: contract, contexts, and the recognition of implicit understandings' in Campbell, Collins & Wightmann 4 above at144.

93 Bridge 'Does Anglo Canadian contract law need a doctrine of good faith?' (1984) 9 *Canadian Business Law Journal* 385.

Interestingly, the topic of the proper shape that the common law should adopt in order to respond to the relational character of contracts is not addressed directly by Macaulay or Macneil. Their normative arguments are considered to be 'tentative'[94] at best, whereas it is the socio-relationalists who followed Macneil who took upon themselves the task of further developing these arguments, and argue that relational contracts between commercial parties demand a relational 'common law'.

In the debate over whether or not the law should embrace the prescriptive elements of the relational contract theory, it should be remembered that such an approach would entail, as Kimel underlines, that contract law would adopt, and adopt explicitly, the main features of relational contracts.[95] The law would give legal status to those obligations that realise the parties' expectations and arise out of the context of the contractual relations, even if they are not explicitly spelled out in the contract. It is therefore important for the law to reflect on whether or not any shift from a textual to a more contextual approach, as has already occurred in England, necessarily entails welcoming such radical reform.

There appear to be a number of reasons why the current development of contractual interpretation should be viewed within the framework of the neoclassical paradigm without any need for a shift towards a different approach.

First, the relational approach would appear to be at odds with the way in which courts interpret contracts in practice. With reference to the meaning to be assigned to the context, Sir Christopher Staughton has helpfully underlined that these 'surrounding circumstances', 'background', or the 'matrix' – as it is often called – must refer to situations which are known to the parties at the time of contracting, since each of them is entitled to be aware of the elements which will reveal the meaning of the agreement they entered into. If some, many, or even all traders in a particular industry interpret the contract to have a certain meaning, that on its own does not amount to a surrounding circumstance, as the parties to that particular contract may have intended it to mean something different.[96]

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94 Speidel & Hillman, as cited in Scott n 6 above at 116.
95 Kimel n 8 above at 244.
96 Staughton n 87 above at 312.

The insistence on the relevance of context as advocated by the relationalists would, therefore, not reflect the process of interpretation followed by the courts. As Sir Christopher Staughton stated, judges first look at the wording of the contract and what is written there, without asking the parties what they meant by it. They then take into account surrounding circumstances known to the parties. They lastly look at how the market functions, and at any custom which is considered to be binding upon them. This is, however, not the same as looking at what the people in the market think the contract means, however numerous they may be.[97]

Secondly, asking the courts to consider the evidence arising from the contextual factors in order to assess what are the relational duties which arise from the relationship would mean trusting that the courts are able to assess, *ex post facto*, the obligations to which the parties would have agreed to if they could have anticipated the particular contingency in issue. This involves asking the courts to impose fair outcomes in cases where disputes arise, which may include, for example, the redistribution of burdens through loss-sharing, or the imposition of new pricing mechanisms which are considered fairer by the judges. Further, a court charged with finding relational duties should be able to use its informational advantage *ex post facto* (once the dispute has arisen and not at the time of contracting), to supersede the text of the contract and even infer that the presence of a merger clause is not to be deemed conclusive as to the irrelevance of other external elements by which the agreement should be governed.[98] This broader discretion assigned to courts in evaluating contextual factors, as pointed out by Barnhizer, renders outcomes more unpredictable[99] and, furthermore, the increased relevance of context might be too important to leave in the hands of generalist courts with no particular expertise in commercial matters.

In this light, it becomes clear why in the drafting of the UCC – which could be considered as the legal text in which the contextual approach is best portrayed and the closest example of a relational approach – Karl Llewellyn had initially sought to couple the contextualist interpretative regime with merchant juries who would have specific knowledge of the subject matter of the contracts. By then abandoning merchant tribunals, he ended up with

[97] *Id* at 313.
[98] Scott n 6 above at 116.
[99] Barnhizer 'Context as power: defining the field of battle for advantage in contractual interactions' (2010) 45 *Wake Forest Law Review* 607 as cited in Bix 'The role of contract: Stewart Macaulay's lessons from practice' in Braucher *et al* n 6 above at 249.

what has been described as the 'worst of all possible worlds':[100] mandatory application of context by a generalist court and restrictions imposed on the parties as to their ability to limit the material to be considered in the interpretation of the agreement.

Thirdly, the adoption of the relational paradigm would necessarily compel the common law to rethink its traditional ethic underpinning contract law. The underlying values would require – more akin to the civil law approach – that greater emphasis be placed on trust, cooperation, and reciprocity rather than adversarialism, as the former are considered essential to relational contracts and thus to a proper analysis of contract law.[101] Contracting would hence be viewed primarily as a cooperative behaviour, though as we have seen, in reality complex business transactions involve both elements of cooperation and of rivalry.[102] While the traditional adversarial approach of English contract law, with its historical origins in the mid-nineteen century when the model contracts were discrete transactions between merchants dealing at arm's length,[103] could be rendered less rigid and indeed a gradual change in values could be welcomed, one must consider whether the law is ready for a drastic shift in core ethic or should rather aim towards the adoption of a more balanced view which recognises the co-existence of a variety of fundamental values within contract law.

Fourthly, while the socio-legal findings of the relational school have certainly served to raise awareness of the social complexity of economic transactions, taken on their own they appear an oversimplification which has been heavily criticised in recent years for undervaluing the importance of formal contracts and legal institutions. Assigning too great a relevance to the agreement as a whole, as opposed to what has been written by the parties, may undermine the role and importance of rules and render the law 'no more than a commodity'[104] designed to follow the market needs and be overly reliant on fuzzy categories such as 'reasonable expectations' which necessarily lead to uncertainty.

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100 Scott n 6 above at 128.

101 Feinman 'Ambition and humility in contract law' in Braucher *et al* n 6 above at 148.

102 See n 40 above.

103 The English model is historically constituted by discrete contracts where parties move directly from no contract to completed contract: see Mouzas & Furmston 'From contract to umbrella agreement' (2008) 67 *Cambridge Law Journal* 37; Cartwright n 46 above at 103.

104 Mitchell n 70 above at 477.

Instead, the role of written contracts should not be underestimated, and it could be rather said that cooperative relations are possible to establish precisely because the agreement is supported by a 'detached core' – namely, a formal contract – that regulates the essence of the agreement.[105] Some authors have thus explained how in commercial dealings one can distinguish between 'relationship preserving norms' and 'endgame norms' in the agreement[106]: a formalistic approach tends to be increasingly present once the relationship breaks down, so that parties are more willing to insist on their legal rights and more prepared to use courts to enforce them. Similarly, Hugh Collins distinguishes three normative systems operating within transactions: the business relation; the economic deal; and the legal contract.[107] While the first two govern the agreement during its performance, the latter operates when the relationship is breaking down, and so acquires particular significance in this phase. Given the recognition of these different normative systems, it could be said that a relational approach, by itself, would not be able to face the complexity of commercial dealings.

Indeed, Macneil himself had envisaged the coexistence of discrete and relational contracts within a single agreement. It is precisely because of this acceptance that both discrete and relational norms may operate at different stages of the agreement according to the emphasis put by the parties, that the relational theory, as it has been stated, is not 'easily falsified'.[108]

Finally, the preservation of the neoclassical paradigm and a more textualist approach to contract interpretation, would avoid the possibility of strategic behaviour by the parties. In commenting the contextual norms of the UCC, Lisa Bernstein has pointed out that the Code prevents the parties from choosing their preferred mix of legal and extralegal obligations, and favors strategic behaviour whereby the supposedly disadvantaged party will, *ex post facto,* seek to enforce a particular meaning for a term by suggesting that this was intended in accordance with some private practice or usage-based language. Instead, a more formalist approach would enable the parties to opt into contextualism if they so wish, but would prevent opportunistic

[105] Kimel n 8 above at 247.

[106] Bernstein 'Merchant law in a merchant court: rethinking the Code's search for imminent business norms' (1996) 144 *Univ Pennsylvania LR* 1724–90.

[107] Mitchell n 69 above at 675.

[108] Hughes, Doheny, Petsoulas & Vincent-Jones 'Co-operation and conflict under hard and soft contracting regimes: case studies from England and Wales' in (2013) 13 (suppl): S7 4 available at: http://www.biomedcentral.com/1472-6963/13/S1/S7 (last accessed 12 June 2014).

behaviour by forcing parties to decide *ex ante* what meaning to assign to a specific term.[109]

Altogether, it appears that the reflections put forward by the relational contract theory have certainly served to underline some important weaknesses within the existing law. However, they have admittedly not translated into an alternative theory 'to which those dissatisfied with the classical law can move'.[110] It can thus be said that, at first glance, the rules of interpretation in their newly developed post-Lord Hoffmann approach, are capable of taking into account context, and mitigate the most orthodox outcomes of a purely literalist approach, without, on the other hand, leaving unrestricted boundaries to which 'surrounding circumstances' might be taken into account in the interpretative process.

The adoption of the relational model would serve to view long-term relationships as a continuum, where each of the several contracts is given meaning in relation to the others, and the economic and functional link existing between these contracts is emphasised. Under a relational approach, the very fact that the drafting of the contracts took place bearing in mind the ongoing relation between business over an extended period, would have to be viewed as 'context' by the court. Instead, the advantage of 'keeping' the classical contract theory, is that it would force the parties to write down what they 'know today' about the conditions which might be relevant in their agreement, without relying solely on the relational character of their transaction and the imposition of non-legal sanctions.

Conclusion

It should be noted that establishing whether or not courts should apply a fully contextual approach to the interpretation of contracts, does not necessarily require a rethinking or reshaping of the law of contract, and it is possible for a formalistic approach to coexist alongside the recognition of the importance of context in contractual interpretation. For instance, Schwarz and Scott maintain that formalism should be stipulated as a default rule. Such favour for formalism and for a textualist approach would, in fact, give the parties the possibility of limiting the evidentiary bases that support

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[109] Bernstein 'Merchant law in a modern economy' (draft paper for the UCL Conference on Philosophical Foundations of contract law 2013 (forthcoming) 20.

[110] Campbell n 7 above at 186.

the court's interpretations and designing exactly 'how much context' they would want the courts to take into consideration.[111]

Therefore, rather than adopting a definite position, it would appear that it is more important to establish – from whatever theoretical angle one may approach contract – the exact implications of a more or less stringent contextualist approach. On the one hand, the orthodox formalistic interpretation of contracts, as existing in the common-law tradition, upholds the value of predictability and certainty. But this may often compromise other important values which are more apparent in the civil law rules on contract interpretation – such as the need to establish substantive justice and to pursue the real intention of the parties. The possibility of allowing courts a more or less active role in the interpretation of contracts and the construction of terms, may entail certain advantages such as speeding up the process of doing business by drafting an incomplete contract, intentionally leaving gaps in the agreement that could otherwise be difficult for the parties to fill, or reducing the cost of drafting a very complete and lengthy contract.

All in all, the objective of relaxing some of the classical rules on contract law may be seen as a positive trend. Attention should be diverted to those suggestions within the less controversial branches of the relational literature that argue, for instance, that there is scope for lessening the rigidity of the classic 'offer and acceptance'-format, or for tempering the law's aversion to issues of indefiniteness and agreement to deal in good faith, but overall such suggestions should be seen more as constructive elements to improve the contract model in place, rather than seeking the 'execution of the classical law of contract'[112] and the adoption of an alternative theory.

[111] Schwarz & Scott 'Contract theory and the limits of contract law' (2003) 113 *Yale Law Journal* 541.

[112] Campbell n 7 above at 185.