Organisational contracts: rethinking the European paradigm

A literature review

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1. INTRODUCTION

1.1. CONTEXT AND AIM

Arguably, contracts are quintessential in the operation of the current economy. Scholarly attention consequently is abundant and acknowledged.[1] In law, however, almost all doctrinal research is about one kind of contract: that which regulates single, "on the spot" exchanges ("spot-contract"). Though this archetype forms the backbone of European contract law[2], it does not reflect the amount of time, the relations and the common interest that one contractual framework governs.[3] Some scholars therefore call for a new paradigm, arguing that there needs to be a second pole in general contract law, tailored to organisational contracts.[4] Others do not wish to create a distinction with spot-contracts, but champion a new outlook on general contract law as a whole.[5] The usage of terminology in this field is also opaque. At least three terms can be observed which sometimes overlap,

[1] For example, the 2016 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel was granted to Oliver Hart and Bengt Holmström for their contributions to contract theory.

[2] In this paper, I use this term to designate the aggregate of national contract laws within the European Union. Though EU law plays an important role in national contract law, there is by no means a harmonized contract law. I will also use the generic term "contract law".

[3] For example, a standard monograph in Belgian law of obligations contains but one paragraph on it, even though the late author did write about long-term contracts. W. VAN GERVEN and A. VAN OEVELEN, *Verbintenissenrecht*, Leuven/Den Haag, Acco, 2015, 66.

[4] S. GRUNDMANN, F. CAFAGGI and G. VETTORI, "The Contractual Basis of Long-Term Organization" in S. GRUNDMANN, F. CAFAGGI and G. VETTORI (eds.), *The organizational contract : from exchange to long-term network cooperation in European contract law*, Farnham, Ashgate, 2013, 3. The term "organisational contract" is defined in chapter 2.

[5] M. FONTAINE, "Bonne foi, contrats de longue durée, contrats relationnels" in H. COUSY, E. DIRIX, S. STIJNS, J. STUYCK and D. VAN GERVEN (eds.), *Liber Amicorum Walter van Gerven*, Deurne, Kluwer, 2000, 551; J. VANANROYE and R. FORIERS, "Een juridische zombie: de maatschap als kwalificatie voor een onbenoemd of feitelijk samenwerkingsverband", *Tijdschrift voor Rechtspersoon en Vennootschap* 2015, 771-72.

sometimes are synonymous and sometimes stand alone. Consequently, an objective of this literature review is to clarify their meanings.
This objective is part of the main aim, which is to systematically summarize and review the existing, relevant literature on the concept of the organisational contract within European contract law. To do so, the underlying question is: "*How do scholars in European contract law describe the organisational contract?*" I specifically choose the framework of European contract law as this allows to transcend the particularities and case law of national legal systems, allowing solid theory-building. Two sub-questions lead the way:

i) How is the organisational contract defined?
ii) What are the key elements of an organisational contract?

These form the structure of the following text. A chapter is dedicated to each one of them. Afterwards, a conclusion is formulated, containing topics for future research.

1.2. LIMITATIONS AND RELEVANCE

A literature review benefits greatly from a clearly delineated topic. Therefore, I will clarify what falls out of this paper's scope. First of all, organisational contracts are often associated with networks and governance of contracts.[6] These fields are well-developed in their own right. Secondly, this paper is about contract law. Organisational contracts essentially govern cooperation between parties, which is also the purpose of company law.[7] Company law, however, always deals with legal entities (with or without legal personality and/or limited liability). Furthermore, this paper's aim is to sketch a general framework, thus leaving out the literature on collaboration agreements.[8] Lastly, for the purpose of this paper and true to the research question, the focus will be on legal literature.

The literature about organisational contracts, however present, is not copious. One might ask the reason behind this. GRUNDMANN e.a. argue that scholarly work in this field is lacking because it is at the intersection of contract and company law.[9] In another contribution, GRUNDMANN partly

[6] The former places contracts in a framework of different agreements between different parties, influencing each other. The latter is a term from institutional economics designating the way contracts are negotiated and executed.
[7] See P. DIDIER, "Brèves notes sur le contrat-organisation" in X., *Mélanges en hommage à François Terré*, Paris, Dalloz, 1999, 635-642. It should be noted that "*contract-organisation*" is not a direct translation of "organisational contract", but rather encompasses contract, labour and company law.
[8] This body of literature is developed under the umbrella of "open innovation" and is seen in a context of research and development partnerships. For the role of contract law in these processes, see A. GORBATYUK, G. VAN OVERWALLE and E. VAN ZIMMEREN, "Intellectual Property Ownership in Coupled Open Innovation Processes", *International Review of Intellectual Property and Competition Law* 2011, 282-289.
[9] GRUNDMANN e.a., *o.c.*, 14-15.

attributes the lack of legal literature on the fact that legal scholars are reluctant in accepting other sciences' insights.[10] This literature review is intended to be a catalyst of the academic debate.

Despite its clear theoretical relevance, the practical impact of the literature on organisational contracts remains unclear. Let us think of an example to remedy this. Belco and Gerco have concluded a contract which contains an obligation for Belco to deliver machines and maintain them on a regular basis and for Gerco to pay for the machines as a whole and for each round of maintenance. Since the machines are meant to operate without replacement for at least ten years, the companies are allied for this extended period of time. Changing circumstances create problems which parties did not imagine at the moment of consent. If their relation turns sour, both companies are disadvantaged: Belco does not have a steady source of income anymore, while Gerco needs to find someone else to maintain the machines.

Over the course of time, they have thus built up a common interest, a "going concern value".[11] In European contract law, there are insufficient safeguards to protect this value. Concerning the performance of obligations, Belco and Gerco are only required to do just that, not to cooperate, and there is no general system to adapt existing provisions to previously unknown circumstances. Concerning termination, there is no way for a party to leave the contractual framework without destroying it (through resolution or unilateral notice), along with its going concern value.[12] This shows that the current European contract law is not fully adjusted to organisational contracts. A better understanding of the latter thus helps in interpreting and adapting European contract law in practice.

2. DEFINITION OF THE ORGANISATIONAL CONTRACT

In the literature on long-term and relational contracts, the terminology often differs. On the one hand, many authors stress the temporal aspect of the organisational contract by calling it a long-term contract. However, in their contributions, they all suggest that this contract has an important relational aspect as well.[13] On the other hand, some scholars use the latter aspect as

[10] S. GRUNDMANN, "'Towards' a Private Law Embedded in Social Theory: Eine Skizze", *European Review of Private Law* 2016, 409-423.

[11] This economic term normally means the value which is maintained while a company is still operational and lost when it is liquidated. Within the contractual framework, it can be understood as the value that is maintained as long as parties perform their obligations.

[12] This issue becomes especially apparent when more than two parties are involved. In Belgium, there are attempts to tackle the problem of partial resolution. See I. SAMOY and A. MAES, "De ontbinding van meerpartijenovereenkomsten na het cassatiearrest van 17 oktober 2008", *Tijdschrift voor Belgisch burgerlijk recht* 2011, 189-199. The literature on multi-party agreements falls outside of the scope of this literature review.

[13] Belonging in this category are W. VAN GERVEN, M. FONTAINE, C. DELFORGE.

starting point, but also stress the duration element.[14] All in all, these terms largely overlap. FONTAINE thus downplays the distinction.[15]

To add to the confusion, some scholars use the term "organisational contract" as encompassing networks and governance of contracts. Others do not, whether they use "organisational contract", "relational contract" or "long-term contract" or use multiple terms as synonyms. Henceforth, this definition will be used: an organisational contract is 'a contract aiming to govern "complex economic activities without creating a new legal entity"'.[16] Let us have a closer look at these defining elements. First of all, it is a contract. It is subject to the general rules of contract law, insofar as there are no more specific rules. Oftentimes, the organisational contract is what is called "unnamed": it undisputedly is a contract, but is not governed by a specific body of rules.[17] Second, an organisational contracts aims to govern cooperation. This aspect is thrice significant: cooperation necessarily occupies a period of time, (further) shapes a relation between them and implies that parties have to work together (see chapter 3). Third, an organisational contract does not aim to create a legal entity. This means that parties do not wish to fall under any company law regime, as this creates automatic obligations for directors and shareholders.[18] Moreover, there is no joint property, nor limited liability, nor sharing of profits.[19]

[14] For instance I.R. MACNEIL, C. GOETZ and R. SCOTT.

[15] FONTAINE, *o.c.*, 551. Similar view in D. MALTESE and M. FARINA, "Theory of the Firm and Organisational Contracts: The Remedial Aspects of Good Faith", *European Business Law Review* 2016, 54. Partly nuanced view in C. GOETZ and R. SCOTT, "Principles of Relational Contracts", *Virginia Law Review* 1981, 1091. For an elaboration on the conceptual confusion, see paragraph 3.2.

[16] GRUNDMANN e.a., *o.c.*, 3. The term "organisational contract" was introduced in this work. Henceforth, it is used to combine the perspectives of authors writing about "organisational contracts", "long-term contracts" and "relational contracts".

[17] W. VAN GERVEN, "Langdurige overeenkomsten. Prijsbepaling, Aanpassing wegens onvoorziene omstandigheden, Conflictregeling" in X., *Hulde aan René Dekkers*, Brussel, Bruylant, 1982, 378. Examples of these unnamed contracts are research contracts, licensing of immaterial assets, leasing, voting contracts within companies, maintenance contracts ... See page 377.

[18] In company law, there has been a quest for a *light vehicle*: a form of company that offers the asset protection of legal personality (incorporation) combined with as few automatic obligations as possible. See L.E. RIBSTEIN, *The Rise of the Uncorporation*, Oxford/New York, Oxford University Press, 2010, xvi + 277 p.

[19] GRUNDMANN e.a., *o.c.*, 7: "common purpose implies the agreement to have inputs pooled and share profits according to a pre-established ratio; a shared objective implies, primarily, only a common interest (and at least no agreement to share profits)".

3. KEY ELEMENTS OF THE ORGANISATIONAL CONTRACT

In this chapter, I describe the basic elements that every organisational contract features. They will be, in this order: i) long duration; ii) a relation between parties; and iii) a duty of cooperation.

1.1. DURATION

The first and most important element in an organisational contract is time. Lawyers often have a narrow vision in this respect: time is but a factual element. However, DELFORGE calls for a double understanding of time: there is also time in the subjective sense, being duration, as experienced by parties.[20] Other authors do not use this distinction.[21]

GRUNDMANN e.a. indicate three time-bound issues in the current paradigm of contract law.[22] These stem from the *praesumptio similitudinis* that the rules on content, performance and breach still follow those of spot-contracts".[23] First of all, a contract of long duration often entails uncertainty about the future, which in turn makes it impossible for parties to foresee everything at the moment of negotiation (see also paragraph 3.2). DELFORGE in this respect deems parties' confidence in each other to be vital for the contract's survival.[24] Second, organisational contracts entail investment specificity.[25] This means that parties make a particular investment that is unusable outside of their contractual relation (in the example from paragraph 1.2: if Belco were to buy specific instruments to maintain Gerco's machines).[26] Parties thus become vulnerable: if their relation deteriorates, the investment is a sunk cost; the asset no longer generates income. Third, the incentive structure in a contract is severely influenced by its duration. This becomes relevant for termination: if one party has invested less into the cooperation, it can blackmail the other by threatening termination – especially when contractual terms are incomplete. Conversely, the possibility

[20] C. DELFORGE, "Le contrat à long terme : quand la relation enrichit le contrat..." in C. DELFORGE (ed.), *Actualités en matière de rédaction des contrats de distribution*, Brussels, Bruylant, 2014, 8-10 (henceforth: 'DELFORGE, "Le contrat à long terme"'); C. DELFORGE, "Le contrat à long terme entre firmes", *Revue interdisciplinaire d'études juridiques* 2016, 58.
[21] Duration, though a factual element (thus disagreeing with DELFORGE's distinction) has legal consequences, for instance in the interpretation of contractual terms. VAN GERVEN, *o.c.*, 381.
[22] GRUNDMANN e.a., *o.c.*, 10-11.
[23] *Ibid.*, 9.
[24] DELFORGE, "Le contrat à long terme", 18-21.
[25] Though this is a literature review of legal scholarship, there is seminal work of economist O. WILLIAMSON on incomplete contracts. See, among many others, O. WILLIAMSON, 'Transaction-Cost Economics: The Governance of Contractual Relations', *Journal of Law & Economics* 1979, 233–261.
[26] The sharing of company-sensitive information is also a critical point. On this specific problem: GRUNDMANN, S., CAFAGGI, F. and VETTORI, G. (eds.), *The organizational contract: from exchange to long-term network cooperation in European contract law*, Farnham, Ashgate, 2013, 181-268.

of termination is necessary to pressure the other party into performing its obligations.

FONTAINE indicates that organisational contracts are often preceded by long and intense negotiations, pre-contracts, or even full-fledged part-contracts which will later on become part of the main long-term contract.[27] He also stresses that the termination of an organisational contract rarely happens from one day to the next. Rather, obligations are extended after the shared objective has been achieved.[28]

Clearly, legal scholars have been concerned with long-term contracts in the past. This topic does not show any gaps permitting future research. That might change if legislation regulating the temporal aspect of contracts were to be enacted.

1.2. RELATION

The seminal work in the theory of relational contracts is MACNEIL's 1974 article.[29] He introduced the distinction between transactional and relational contracts. An example of the former is the contract at a gas station between the owner and a motorist. Normally, this transaction is completed immediately and has no further consequences. The opposite of that is a marriage, which essentially takes place within a relation.[30] The transaction-inspired contract law arises from the theory of consent: obligations have binding force because they correspond with the parties' will at the moment of consent. Once again, the importance of duration is highlighted.

What, then, is this relational contract exactly? GOETZ and SCOTT define it quite strictly:

> "*A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of inability to identify uncertain future conditions or because of inability to characterize complex adaptations adequately even when the contingencies themselves can be identified in advance.*"[31]

Though they do not deny that the long-term element of a contract contributes to its relational character, they do not view it as essential. This is contrary to FONTAINE's view (see chapter 2).

The theory of the relational contract also has its limits. FONTAINE stresses the common law heritage of the relational contract. Civil lawyers are more

[27] FONTAINE, *o.c.*, 547. Also VAN GERVEN, *o.c.*, 378-380.
[28] FONTAINE, *o.c.*, 547. For example, a right of first refusal clause gives the holder of the right the option to enter in a new phase of the parties' relation, after the shared objective is achieved.
[29] I. MACNEIL, "The Many Futures of Contracts", *Southern California Law Review* 1973-74, 691-816.
[30] *Ibid.*, 720-721.
[31] GOETZ and SCOTT, *o.c.*, 1091.

familiar with preliminary negotiations, filling gaps in the contract by falling back on supplementary legislation and general principles.[32] Also, the relational contract becomes especially important in business relations between repeat players, who have a greater tendency to conclude very detailed arrangements. Between non-commercial parties, implicit understandings are often left that way, which is especially non-problematic in civil law for the reason stated above.

Legal scholarship on the theory of relational contracts shows no problematic gaps, though the conceptual framework is not always clear. Especially civil lawyers find a way around the present design of European contract law, thus partly discrediting the starting hypothesis that European contract law is maladjusted. Although the theory of the relational contract does aid in understanding contracts,[33] it does not show poignant inconsistencies in European contract law.

1.3. COOPERATION

VAN GERVEN writes that parties in an organisational contract do not just have a duty to keep the peace. They should also actively cooperate.[34] He attributes this duty to a particular interpretation of good faith.

Good faith has been seen as a way for the judge to interpret a contract, to mitigate abuse of contractual terms and to impose autonomous obligations to parties.[35] It is considered to be essential in modern contract law as a general principle. Defining the concept of good faith is a sheer impossible task, as it is essentially flexible. However, the reader can find a definition of "good faith and fair dealing" as provided by article 1:103 Draft Common Frame of Reference.[36] Good faith in current European contract law is a code of conduct, trying to steer parties away from grossly egoistic demeanour. As shown by the very general statements in the DCFR[37], a harmonized concept

[32] FONTAINE, *o.c.*, 549-550; also MALTESE and FARINA, *o.c.*, 55-56.
[33] FONTAINE, *o.c.*, 550.
[34] VAN GERVEN, *o.c.*, 383-384. Also G. MORIN, "Le devoir de cooperation dans les contrats internationaux. Droit et pratique", *Droit et pratique du commerce international* 1980, 9-28.
[35] For Belgium: F. VERMANDER, "De aanvullende werking van het beginsel van de uitvoering te goeder trouw van contracten in de 21ste eeuw: inburgering in de rechtspraak, weerspiegeling in de wetgeving en sanctionering", *Tijdschrift voor Belgisch Burgerlijk recht* 2004, 572-582. For Europe: R. ZIMMERMANN and S. WHITTAKER, *Good Faith in European Contract Law*, Cambridge, Cambridge University Press, 2000, 669-673.
[36] STUDY GROUP ON A EUROPEAN CIVIL CODE and RESEARCH GROUP ON EC PRIVATE LAW (ACQUIS GROUP), *Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR)*, Munich, Sellier. European Law Publishers, 2009, 178. Can be consulted via http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf (last accessed on 7 November 2016).
[37] Similarly, the Acquis principles do not give a conclusive definition of good faith. See ACQUIS GROUP. RESEARCH GROUP ON THE EXISTING EC PRIVATE LAW, *Contract I: pre-contractual obligations, conclusion of contract, unfair terms*, Munich, Sellier. European Law Publishers, 2007, 255-271.

of good faith in Europe remains utopian. Still, every member state is characterised by some degree of judicial review in this respect.[38]

MALTESE and FARINA have made an analysis of the role of good faith in contracts, especially when it comes to remedies. They conclude that "duties of good faith and fair dealing have been and are being applied by Courts of both systems" and that "[t]his is especially more likely to happen when the parties' entry [*sic*] in an agreement that takes the form of a long-term contract, characterised by an intrinsic relational colour."[39] This conclusion is too rash. Though the authors cite multiple English cases to show that common law in Europe is not as hostile towards good faith as it used to be, there is no general doctrine of good faith in the English legal order. Moreover, for the civil law countries, they mainly draw on a decision by the Italian *Corte di Cassazione* to show a progressive interpretation of good faith in civil law systems. This is too reductive. For instance, the commentary to the Acquis principles clearly shows different approaches and discussions with regards to the generalization and scope of application of the principle of good faith.[40] MALTESE and FARINA do not solve these problems.

For the first time in this literature review, a gap appears. So far, there have been no conclusive studies on the role of good faith in organisational contracts.[41] While MALTESE and FARINA's work shows indications that the principle of good faith is likely to be applied within the framework of an organisational contract, there is no conclusive work done on how far this duty of cooperation reaches: are parties bound by a stricter version of the duty of good faith when they enter into an organisational contract when compared to a "normal" spot-contract?

[38] According to RANIERI, good faith remains a continental phenomenon. F. RANIERI, *Europäisches Obligationenrecht: ein Handbuch mit Texten und Materialien*, Berlin, Springer, 2009, 1884-1885. ZIMMERMAN and WHITTAKER take a more nuanced, functional approach. R. ZIMMERMANN and S. WHITTAKER, *o.c.*, 687-690.
[39] MALTESE and FARINA, *o.c.*, 83.
[40] ACQUIS GROUP. RESEARCH GROUP ON THE EXISTING EC PRIVATE LAW, *o.c.*, 268-269.
[41] In English legal literature, there has been a case study of a progressive judgment: D. CAMPBELL, "Good Faith and the Ubiquity of the 'Relational' Contract", *Modern Law Review* 2014, 475–492.

4. CONCLUSION

As set out in the introduction, the objective was to systematically summarize and review the existing, relevant literature on the concept of the organisational contract within European contract law. The first aim was to conceptually define the terms "organisational contract", "long-term contract" and "relational contract". In doing so, I have tried to shed light on the obscure terminology which is often used in this body of literature. The first also encompasses the literature on contracts governing cooperation and on networks and governance of contracts. I kept myself to the former part of literature. The second designates a contract in which the duration component is the starting point, which in turn influences parties' relation. The third starts from this relation and views duration as a contributing, though not essential factor. This conceptual confusion has little practical impact.

Secondly, I showed how legal scholars describe the key aspects of the organisational contract. Duration and relation, the first two, have been getting scholarly attention, even though this literature is not yet well-recognized in the present doctrine on European contract law. The third aspect of the organisational contract remains controversial in legal literature. This stems from the uncertainty and discussion surrounding a general principle of good faith in European contract law. Even on the continent, where this is considered less controversial, there have been no conclusive studies on the topic.

Thus, a possible, merely descriptive research question could be: "*How does good faith shape the duty of cooperation in organisational contracts?*" Research can be done by comparing different legal systems within European contract law with regards to the way they handle good faith in organisational contracts.[42] Furthermore, comparisons can be made with collaboration agreements and company law. Both comparative approaches would lead to i) a thorough understanding of how legal systems deal with the notions of good faith and cooperation within organisational contracts and ii) how other, related fields of law shape the duty of cooperation. The hypothesis here is that the principle of good faith is applied more strictly in the context of an organisational contract, meaning that parties not only have to refrain from grossly egoistic behaviour, but also have to actively work together. This stems from the fact that they have a common interest, i.e. the going concern value.

Taking it one step further, one could also normatively wonder: "*How should good faith shape the duty of cooperation in organisational contracts?*" Answering this question would require interdisciplinary analysis, possibly from a law and economics perspective, of parties' behaviour when confronted with various

[42] A good general starting point in this respect could be the comparative work of R. ZIMMERMANN and S. WHITTAKER, *o.c.*, xxxiii + 720 p., which does not include organisational contracts. The added value here would be to focus on organisational contracts, 16 years after ZIMMERMANN and WHITTAKER published the book.

conceptions and degrees of the duty of good faith. In short, there is still a lot to be said about the duty of cooperation within the framework of the organisational contract. To be continued.