Cambridge Law Journal, **67(1)**, March 2008, pp. 37–50
doi:10.1017/S0008197308000081 *Printed in Great Britain*

SHORTER ARTICLES

FROM CONTRACT TO UMBRELLA AGREEMENT

STEFANOS MOUZAS* AND MICHAEL FURMSTON**

IT IS now widely accepted that English contract law does not deal equally well across the whole range of agreements that are made. The model which fits best to English contract law is one in which the parties move immediately from no contract to completed contract. There is great difficulty with situations where the parties spend a long time in an area where there are obligations and understandings but not yet a fully completed contract. This article considers an important development that attempts to deal with this difficulty. That is the increasing use by contracting parties of what may be called umbrella agreements.

A PARADIGM SHIFT

Modern English contract law makes a major contribution to certainty and calculability of exchanges. There are types of contracts, say string contracts for the sale of petroleum or soya bean meal where "spot market" values predominate but not all commercial contracts are of this straightforward kind. For this reason, parties often turn to non-contractual relationships in business. Some important modern scholarship has explored this problem.[1] Are non-contractual relationships becoming the standard because of the expense, in terms of time, effort and money to draft, oversee and enforce contracts? Are immediate contracts too inflexible and divorced from the reality of contemporary business arrangements?[2]

* Senior Lecturer, Lancaster University Management School. Email: s.mouzas@lancaster.ac.uk
** Emeritus Professor and Senior Research Fellow, University of Bristol, School of Law. Professor of Law, Singapore Management University.

[1] S. Macaulay, "Non-Contractual Relationships in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55; H. Collins, *Regulating Contracts* (Oxford 1999). For a discussion and review, see D. Campbell, "Reflexivity and Welfarism in the Modern Law of Contract" (2000) 20 O.J.L.S. 477; J. Gava and J. Greene, "Do We Need a Hybrid Law of Contract? Why Hugh Collins is Wrong and Why it Matters?" [2004] C.L.J. 605.

[2] The fact that contracts often fail to capture the reality of a business deal is vividly illustrated by S. Macaulay, "The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules" (2003) 66 M.L.R. 44.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

Many business agreements such as those between retailers and final consumers, employment contracts or financial and credit contracts are nowadays regulated by statutes which do not always conform to traditional principles of contract law. The increasing importance of codified legal restrictions, as well as the growing importance of statutes, cannot be overlooked.[3] Furthermore, norms such as good faith or fair dealings set new objective standards in the conclusion of modern transactions.[4] Notwithstanding the dominance of traditional legal underpinning, a number of contemporary developments such as a) the provisions in the Convention on International Sale of Goods (the Vienna Convention), b) the United States' Uniform Commercial Code and Restatement (second) of Law of Contracts, and c) the gradual emergence of a European legal science[5] are affecting the way we view business agreements and our view of the rights, which arise from them. There is a gradual acceptance of international commercial standards and regulations; the need to take into account the surrounding circumstances of transactions is becoming apparent[6]; and courts are shifting away from literalist methods in questions of interpretation of contracts.[7] In this context characterized by rapid change, businesses are now moving away from immediate contractual decisions. This phenomenon constitutes a paradigm shift.

Businesses enter into umbrella agreements for the benefits that derive from facilitating the whole process of deal making. Umbrella agreements reduce the costs, in terms of time and effort to select, manage and oversee single transactions. They provide certainty regarding the conditions under which exchanges may take place; they also provide a platform for an on-going negotiation. In this way, umbrella agreements take the form of "constitutions" of contracts.[8]

[3] J. Beatson, "The Role of Statute in the Development of Common Law Doctrine" (2001) 117 L.Q.R. 247. See also R.Zimmermann, "Statuta Sunt Stricte Interpretanda? Statutes and Common Law: A Continental Perspective" [1997] C.L.J. 315.

[4] R. Zimmermann and S. Whittaker, (eds.), *Good Faith in European Contract Law* (Cambridge 2000). See also J. Beatson and D. Friedmann, (eds.) *Good Faith and Fault in Contract Law* (Oxford 2002); G. McMeel, "Prior Negotiations and Subsequent Conduct – The Next Step Forward for Contractual Interpretation?" (2003) 119 L.Q.R. 272.

[5] See R. Zimmermann, "Savigny's Legacy: Legal History, Comparative Law and the Emergence of European Legal Science" (1996) 112 L.Q.R. 576. See also B. Markesinis (ed.), *The Gradual Convergence: Foreign Ideas, Foreign Influences and English Law on the Eve of the 21st Century* (Oxford 1994).

[6] D. Campbell, H. Collins and J. Wightman (eds.), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (Oxford 2003). See also McMeel, n.4 above.

[7] This shift is vividly demonstrated in the speech of Lord Hoffmann in *Investors Compensation Scheme Ltd.* v. *West Bromwich Building Society* [1998] 1 W.L.R. 896. For a general discussion, see C. Staughton, "How do the Courts Interpret Commercial Contracts?" [1999] C.L.J. 303; K. Lewison, *The Interpretation of Contracts* (London 2004); A.W. Katz, "The Economics of Form and Substance in Contract Interpretation" (2004) 104 Colum. L. Rev. 496. See also Lord Nicholls "My Kingdom for a Horse" (2005) 121 L.Q.R. 577. The two cases cited by Lord Nicholls, *The Karen Oltmann* [1976] 2 Lloyd's Rep. 708 and *The Pacific Colocotronis* [1981] 2 Lloyd's Rep. 40 are reviewed in a further note by Alan Berg "Thrashing through the Undergrowth (2006) 122 L.Q.R. 354.

[8] M. Loughlin, "Constitutional Theory: A 25th Anniversary Essay" (2005) 25 O.J.L.S. 183. Also compare D. Strauss, "What is Constitutional Theory?" (1999) 87 *Cal L Rev* 581.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

To view an umbrella agreement as a constitution may be relevant to problems of interpretation remembering Marshall C.J.'s famous injunction that "we must never forget that it is a constitution we are expounding".[9] The validity and legitimacy of constitutions is based upon the evolution of consent among related actors over time.[10] This consent articulates a high order of shared conventions which comprise customary, expected, legal, and often non-legal rules and principles. Firms, for example, may agree with each other on a number of issues such as information sharing, domain consensus, lobbying, reciprocity and co-operation, and their agreements may be re-adjusted over time. Despite the increasing use of umbrella agreements in all sorts of businesses, there is a lack of empirically-based scholarly work on this topic.[11] Questions arise about 1) the distinguishing difference of umbrella agreements, 2) the content of clauses, and 3) the status of their legal enforceability.

Considering Umbrella Agreements

Umbrella agreements[12] between parties are private arrangements that provide a framework of clauses which regulate future contracts. Generally, they are not concerned with immediate contractual decisions[13] but rather they explicitly spell out the principles that guide future contractual decisions. There are two "tests" that we can use in order decide whether a private arrangement is an "umbrella agreement" or not. The first test concerns the "selection processes". Umbrella agreements are arrangements that do not predetermine future selection processes. Rather, they set up the framework of future selection processes.[14] The

[9] *McCulloch* v. *Maryland* (1819) 4 Wheaton 316, 407.

[10] R.E. Barnett "A Consent Theory of Contract" (1986) 86 Colum. L. Rev. 269. Compare R.E. Barnett, "Constitutional Legitimacy" (2003) 103 Colum. L. Rev. 11.

[11] Relational contract theory attempted to explain patterns of business agreements: see I. R. Macneil, "A Primer of Contract Planning" (1975) 48 Southern California L. Rev. 627; C. J. Goetz and R. E. Scott "Principles of Relational Contracts" (1981) 67 Virginia L. Rev. 1089, I. R. Macneil, in D. Campbell (ed.), *Relational Theory of Contract: Selected Works of Ian Macneil* (London 2001). It appears, however, that relational contract theory has to some extent caused a misunderstanding of the changing nature of contracts. The particulars of a "relational" contract derive from the specific *function* of the contractual arrangement and not from the fact that a contract is relational, see M. A. Eisenberg, "Relational Contracts" in Beatson and Friedmann (eds.), *Good Faith and Fault in Contract Law*, 297–304; E. McKendrick. "The Regulation of Long-Term Contracts in English Law", *ibid.*, 305–333.

[12] The term "umbrella agreement" is widely used in business. Civil law traditions refer to such an agreement as a "framework contract" or "framework agreement". For example, German lawyers use the term *Rahmenvertrag* or *Rahmenvereinbarung*: see W. Krüger, *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (Munich 2003), Band 2a, 1103–1104.

[13] Nevertheless, a number of business agreements might include immediate contractual decisions leaving some of the terms open. In these cases, it seems to be more appropriate to view these contractual arrangements as "open terms" agreement:, see M. P. Gergen, "The Use of Open Terms in Contract" (1992) 92 Colum. L. Rev. 977.

[14] The underlying assumption is related to the notion of contract as "Selection framework" (*"Selektionsumfeld" als Vertragsgegenstand*): see H. C. von der Crone, *Rahmenverträge. Vertragsrecht-Systemtheorie – Ökonomie* (Zurich 1993). The notion of "future selection processes" does not imply that umbrella agreements are necessarily long-term business agreements; the onus is on contracting parties to define the duration of their relationship.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

second test concerns the "function" of the private arrangement. It is not the time horizon but the function of an arrangement that determines whether an agreement between parties is an umbrella agreement or not; and the function of an umbrella agreement is to supply clauses that can be used in a defined set of transactions.[15] The parties to such an umbrella agreement are usually not required to specify new terms in their future transactions nor are they required to refer to the pre-existence of an umbrella agreement.[16] The advantage for buyers is that if they need a particular product or service, they only need to specify the quantity and price or arrange continuous stock replenishment. It must be emphasized that the buyer has no obligation to buy a specified amount of goods or to accept future offers. However, the buyer (*e.g.* a grocery retail chain) may agree with the seller (*e.g.* a manufacturer) that successive orders will be met. The advantage for sellers is that they gain a source of incremental business and that they only need to deliver according to the needs of their customers. For this reason, umbrella agreements are often encountered in regular, stable and established business relationships.

1. Distinguishing Umbrella Agreements

In a rapidly changing commerce, the boundaries between different forms of agreements are fluid and, in practice, there is always a continuum of forms and variations. In general terms, we can differentiate between the "negotiation" and the "agreement" as a two polar regime[17]. In addition to the two "polar regime" of negotiation and agreement, we can also distinguish in the "intermediate regime" between several types of "preliminary" or "non-immediate" agreements. In the following, we distinguish between umbrella agreements and other types of agreements by drawing a line between a) umbrella agreements and pre-contractual agreements, b) umbrella agreements and open terms agreements and c) umbrella agreements and general terms and conditions.

[15] This *functional* differentiation is critical for understanding the nature of umbrella agreements. Scholarly work has rather obscured the difference between contractual decisions and the framework in which contractual decisions are made, compare e.g. I. R. Macneil, "Barriers to the Idea of Relational Contract", in F. Nicklisch (ed.), *The Complex Long-Term Contract* (Heidelberg 1987); R. H. Weber, *Rahmenverträge als Mittel zur rechtlichen Ordnung langfristiger Beziehungen*" (1987) 106 Zeitschrift für Recht 401.

[16] A good example of regulating umbrella agreements is provided by the German BGB 305 Abs. 3 which provides that contractual parties are allowed to agree in advance specified general terms and conditions for a particular set of transactions. For comments, see W. Krüger, *Münchener Kommentar Zum Bürgerlichen Gesetzbuch*, Band 2a, 1103–1104.

[17] A. Farnsworth, "Precontractual Liability and Preliminary Agreements: Fair Dealings and Failed Negotiations" (1987) 87 Colum. L. Rev. 217.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

Umbrella Agreements and Pre-contractual Agreements

Both umbrella agreements and pre-contractual agreements such as the letter of intent, agreement in principle, commitment letter, memorandum of understanding, or heads of agreement are manifestations that contemplate further contracts. While umbrella agreements are usually not concerned with contractual decisions, pre-contractual agreements encourage and possibly oblige parties to enter into a future contract.[18] Even though pre-contractual agreements are commonly used in modern transactions, their legal status is uncertain. Unless a pre-contractual agreement is found to be a complete agreement, English courts will probably decide that no contract has been concluded between the parties.[19] Although there is no general obligation in English law to negotiate in good faith, parties to a pre-contractual agreement may be liable in tort and may be forced to pay reliance damages for bad-faith negotiations.[20] US courts are more willing to accept pre-contractual agreements than are English courts.[21] In Germany, a pre-contract (*Vorvertrag*) is a binding contract, in which it is agreed that the parties to a pre-contract will conclude the main contract (*Hauptvertrag*).[22]

Umbrella Agreements and Open Terms Agreements

While an umbrella agreement defines the framework for future contractual decisions, an "open terms" agreement defines most of the terms of a business deal.[23] The parties to an open term agreement continue their negotiation on those terms which are still open. The barrier to a final and complete agreement involves further negotiations.[24] If the barrier to a final and complete agreement involves awaiting the occurrence of contextual contingencies, businesses may

[18] The expression "pre-contract" can be traced back to Thoel, *Handelsrecht* (Göttingen 1854), at p. 62. Nowadays, pre-contractual agreements serve a practical purpose. In circumstances, for example, where an activity has to be completed before a contract is concluded or where parties cannot enter into a contract because the consent of a third party is required, and that cannot be obtained at the time of the pre-contractual agreement.

[19] The view of contract law is that the process of contract formation has "hard edges", see P.S. Atiyah, *An Introduction to the Law of Contract* (Oxford 1995).

[20] Beatson and Friedmann edited a comprehensive anthology of cases and articles regarding pre-contractual liabilities, see n.4 above.

[21] M. Furmston, T. Norisada and J. Poole, *Contract Formation and Letters of Intent* (Chichester 1998), ch. 10. For a comparative analysis see R. B.Lake and U. Draetta, Letters of Intent and Other Pre-Contractual Agreements: A Comparative Analysis and Forms (New Hampshire 1989).

[22] F. J. Sacker, *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (Munich 2001), Band 1, 1474–1470; J. von Staudinger, *Kommentar zum Bürgelichen Gesetzbuch mit Einführungssgesetzen und Nebengesetzen* (Berlin 2003), Buch 1, ed. R. Bork, at p. 567.

[23] Farnsworth regards agreements with "open terms" and "agreements to negotiate" as preliminary agreements, in other words as lying between negotiation and agreement. See A. Farnsworth, "Precontractual Liability and Preliminary Agreements: Fair Dealings and Failed Negotiations" (1987) 87 Colum. L. Rev. 217.

[24] Open terms are "contractual provisions that expressly grant a party substantial, but not completely unfettered discretion in performance"; for example, a promise to use best efforts, see M. P. Gergen, "The Use of Open Terms in Contract" (1992) 92 Colum. L. Rev. 977.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

consider drafting a contingent contract. The alternative route is to regulate contractual performance by a definite term that is subject to a contingency under a party's control.[25] An agreement between a retailer and a manufacturer to take requirements is an example of such a term. It should be noted that open terms agreements such as those found in professional services or commodity business do not imply a "reciprocal, on-going relationship".[26]

Umbrella Agreements and General Terms and Conditions

While umbrella agreements are encountered in regular and stable business relationships, general terms and conditions are usually applied in discrete and anonymous transactions.[27] General terms and conditions are contract terms which one of the contracting parties has defined in advance with the intention to incorporate them into future transactions.[28] General terms and conditions are a demonstration of an on-going rationalisation and adaptation process to the evolving needs of commercial practice.[29] They are designed and used by businesses to increase their efficiency and to promote economies of scale by replicating similar commercial transactions. It is obvious that general terms and conditions are used to pass on risks and liabilities to other contractual parties. It is hardly surprising, therefore, that exclusion or limitation clauses are among the most contentious cornerstones of general terms and conditions.[30]

2. Examples of Umbrella Clauses

We now provide a consideration of the content of clauses inherent in umbrella agreements.[31] "Umbrella clauses" usually start with the

[25] This alternative route is often found in business relationships that demonstrate a high degree of symbiotic interdependence, see E. Schanze, "Symbiotic Arrangements" in *The Palgrave Dictionary of Economics and Law* (1998) 3.554.

[26] The use of open terms simply reduces the parties' incentive to haggle over risks that will have offsetting impact; thus they reduce the "cost of contracting": *ibid.*, at p. 999 and p. 1081.

[27] Businesses use also the expression "umbrella agreement regarding general terms and conditions". This expression is in accordance with the German BGB 305 Abs. 3.

[28] R. Christou, *Boilerplate Clauses*: *Practical Issues* (London 2002).

[29] The impetus for their growth in use during the second half of the nineteenth century came from the massive industrialisation and rapid expansion of services, particularly in the financial, insurance and transportation sectors. The significant publication of Raiser's monograph in 1935 instigated a discussion of the importance of general terms and conditions and the need for an effective control by administrative authorities and courts see L. Raiser, *Das Recht der Allgemeinen Geschäftsbedingungen* (Hamburg 1935). Despite Raiser's enormous influence among academic scholars, legislative powers in Europe needed more than forty years to react with an actual drafting of statutes. See *e.g.* Unfair Contract Terms Act 1977 and AGB-Gesetz 1976. See also J. Adams and R. Brownsword, "The Unfair Contract Terms Act: A Decade of Discretion" (1988) L.Q.R. 94; S. Bright, "Winning the Battle Against Unfair Contract Terms" (2000) 20 Legal Studies 331.

[30] General terms and conditions are now subject to control by legislative and judicial powers. Courts in civil law traditions adopt a doctrinal approach by making reference to the rules *conta proferentem, venire contra factum proprium, contra bonos mores* and use the provisions of the civil code.

[31] The present study is based on an empirical investigation of umbrella agreements between firms in the United Kingdom and Germany. During the period between 2005 and 2006, we collected and

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

description of the scope of business by defining types of products or range of services and circumscribe the basic principles that set out a framework according to which voluntary and informed exchange may take place. Therefore, the clauses presented in Table 1 deal with sensitive issues of exclusivity, confidentiality, notification and communication systems, subcontracting, warranties, property rights, re-negotiation, termination rights as well as force majeure or hardship.[32]

These examples demonstrate that umbrella agreements are not concerned with the specification of quantities or prices of one particular transaction. Instead, they are concerned with normative aspects such as confidentiality or exclusivity of exchange, invoicing, transfer of property rights, terms of payment and exchange of information. These clauses indicate a consensus between contracting parties over *how* exchanges may take place. Clauses may also translate the financial consequences of fulfilling or breaching exchange promises (e.g. in the event that an invoice is not paid within a certain period) by specifying the "conditions" of a possible exchange.[33] Re-negotiation is usually regulated by clauses that allow annual or periodic business reviews.[34] The possibility of re-negotiation may be limited by the inclusion of "force majeure" or by agreed alternatives to litigation.[35] Notification and information clauses provide evidence of the use of control systems which may include electronic data interchange or key communication dates throughout the year. Control systems can verify contractual performance on an on-going basis and they can support the exercise of termination rights.[36] Clauses in umbrella agreements draw our attention to those critical aspects that exercise an influence on the possibility of future contracts. For example, parties may agree that any future order can be revoked in writing or that they have the

analysed agreements between multinational fast-moving consumer goods companies, pharmaceutical companies, service providers and grocery retailers. The method of data collection placed an emphasis on obtaining contemporary umbrella agreements and in-depth interviews with corporate lawyers and business managers. This approach helped us carry out a closer examination and triangulation of primary data.

[32] Although extreme contextual circumstances such as catastrophes, strikes, lock-outs and governmental interventions are more likely to be regulated by *force majeure* clauses than by the doctrine of frustration, umbrella agreements in UK have not yet embraced these clauses. It can be argued that *force majeure* clauses represent a potential for improvement in UK umbrella agreements given the fact that the application of the doctrine of frustration may bring the whole contract to an end, irrespective of the wishes of the contracting parties. For an analysis of force majeure clauses, see E. McKendrick (ed.), *Force Majeure and Frustration of Contract* (London 1995).

[33] Treitel differentiates between "conditions precedent" as the order of performance and "conditions" related to the conformity of performance, see G. H. Treitel, "'Conditions' and 'Conditions Precedent'" (1990) 106 L.Q.R. 185.

[34] For the importance of re-negotiation see I. Ayres, "Valuing Modern Contract Scholarship" (2003) 112 Yale L.J. 881.

[35] J. Effron, "Alternatives to Litigation: Factors in Choosing" (1989) 52 M.L.R. 480.

[36] A monitoring of contractual performance is particularly useful in cases where time is of the essence and there is delay in performance by the promisor. See J. E. Standard, "The Contractual Last Chance Saloon: Notices Making Time of the Essence" (2004) 120 L.Q.R. 137.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

Table 1: Examples of Clauses in Umbrella Agreements

Relevant Category	Umbrella Clauses
Product range/ Services	*e.g.* Information Technology/ Financial Services/ Consumer Products
Exclusivity	Both parties have the right obtain competitive offers at any time
Information	If an actual conflict of interest arises between trustees and a third part, the parties will immediately inform all other parties./ A 12 month timing plan/ Key dates throughout the year
Notification	Notification regarding product damages need to be made within two weeks/
	Mutual notification regarding all future capital investment and R&D
Subcontracting	Subcontracting is only possible upon consent
Assignment	All requests need to be made in writing /
	Verbal requests need to be confirmed in writing
Volume/ Price	To be agreed / It is agreed a 'continuous stock replenishment'/
	It is agreed a unilateral price determination
Invoicing	Unless otherwise agreed, on a monthly basis.
	Payment in 60 days/ Delivery cost is paid by the supplier (Delivered Duty Paid)
Re-negotiation	Annual re-negotiation / Business reviews quarterly/
	Any controversy shall be finally settled by Arbitration (International Chapter of Commerce)
Force Majeure	Parties bear no liability for damages occurred as a result of war, political unrest, strikes, lock-outs and governmental interventions/ A party may suspend performance of its obligations to the extent that such performance is delayed, impeded or prevented by unforeseeable circumstances
Guarantee	The customer reserves the right to demand the elimination of deficiencies or to allow the return of products within twenty days at suppliers' cost
Liability	The obligation to remedy deficiencies apply also to services obtained from subcontractors/
	The customer reserves the right to return products within 20 days at suppliers' cost
Secrecy	All information exchanged is confidential and shall not to be available to third parties without written consent of the other party
Property rights	No transfer of property rights. Supplier ensures that no third person has obtained property rights/
	All material, charts models and e-files will become property of B1
Saving Clause	Unless it is of major importance, invalidity of one or more clauses will not have any effect on the umbrella agreement as a whole
Legal venue	London /United Kingdom
Amendments	The supplier has the obligation to revoke any orders in writing which she does not wish to accept
Addition	Need to be made in writing
Duration	Indefinite Agreement/ Annual re-negotiation
Termination	Each party has the right to terminate the agreement immediately with regard to a particular type of services/ Giving one year's prior notice/ Giving 14 days prior notice

right to obtain competitive offers at any time. Moreover, umbrella agreements may embed future options that open the doors to new business opportunities or perform important risk management

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

functions. Firms, for example, may include the option to accept the transfer of property rights on future inventions within a specified period; similarly, the right to terminate the co-operation can also be regarded as embedded option.[37] Umbrella agreements establish fundamental rules and principles which, otherwise, are implicit. For example, parties may include the clause that they will notify each other regarding all future investments; or that all information is confidential and that this duty of secrecy continues for further 5 years after the umbrella agreement expires. Parties may also include clauses that empower parties to make decisions or perform agreed tasks.

3. Are Umbrella Agreements Legally Enforceable?

It has always been a central question in contract law to determine the circumstances in which an agreement or promise is legally binding. It is desirable to distinguish between enforceability of umbrella agreements and the enforceability of other types of preliminary agreements such as pre-contractual agreements or open terms. Of course these are not terms of art and there will be fuzzy edges and overlaps but the core ideas are different. A recent study of a large sample of appellate cases in the USA has shown that the legal doctrines invoked in preliminary agreements are also used in claims to support pre-contractual liability.[38] In the case of a preliminary agreement, the parties are negotiating a specific deal but have not reached the end of the road. If there is no deal, the promisee who possibly made relationship-specific investments, may believe that she was induced to invest because of the promisor's assurances. Courts are usually asked to protect the promisee's reliance interest against the promisor's claim that no contract had been concluded between the parties. In these circumstances, the courts will award reliance damages only if

> … the parties had settled on sufficient material terms to support an inference that they wanted legal weight to attach to their preliminary agreement.[39]

In contrast, in the case of an umbrella agreement, the parties have agreed on key terms of the agreement which will then be used for a range of contracts. The question may be posed as to whether this

[37] The buyer's right to terminate future transactions is creating a call option that equals to an "insurance against decreases in the buyer's valuation of the exchange". See R. E. Scott and G. G. Triantis, "Embedded Options and the Case against Compensation in Contract Law" (2004) 104 Colum. L. Rev. 1428, at 1490.

[38] See A. Schwartz and R. E. Scott "Pre-Contractual Liability and Preliminary Agreements" (2007) 120 Harv L Rev 662.

[39] *Ibid.*, at p. 702.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

umbrella agreement is legally enforceable. In any system this will be a question whose answer depends on the context in which it arises. In Germany, for example, courts will enforce the reasonable expectations of the parties as expressed or implied by the umbrella agreement, unless it is against the law.[40] An umbrella agreement is regarded as a "continuous obligation" (*Dauerschuldverhältnis*); it does not, however, constitute an obligation to conclude future contracts.[41] As such the legal enforceability of umbrella agreements differs substantially from other pre-contractual agreements, in which it is agreed that the parties will conclude the main contract.[42] Moreover, an individual umbrella agreement takes precedence over general terms and conditions,[43] while an umbrella agreement with dynamic, changing or open general terms is not legally enforceable.[44]

The question whether an umbrella agreement is legally enforceable is more likely to receive a guarded answer in English law than in most other systems. Disputes will more often arise where the umbrella agreement has to be considered in the light of a specific transaction. Here it is likely that the umbrella agreement will have effect. This can be seen by looking at the list of typical clauses in Table 1. Most of these clauses are well capable of taking legal effect in the context of a particular transaction. There are, however, three reasons that could explain why in English law umbrella agreements might not be legally binding. First, an umbrella agreement could be regarded as void because of the lack of certainty.[45] Unless the umbrella agreement is expressed in a sufficiently certain form, courts will not be able to enforce it. Second, parties to an umbrella agreement might not have the intention to enter into legal relations. An informal agreement, for example, is drafted to help plan and prioritise joint activities and thus may not be legally binding.[46] Third, the requirement of consideration is an additional barrier to recognising legal enforcement of an umbrella agreement.[47]

[40] For an overview of legal restrictions applied, see BGB 307–309.
[41] J. von Staudinger, *Kommentar zum Bürgelichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (n.22, above), Buch 1.
[42] K. Laranz, *Lehrbuch des Schuldrechts. Erster Teil, Allgemeiner Teil* (Munich 1987), at p. 88.
[43] See the example of BGB 305b *Vorrang der Individualabrede*.
[44] M. Stoffels, *AGB-Recht* (Munich 2003).
[45] Theoretically, unless all terms of a contractual arrangement are agreed there are no binding obligations. See J. Beatson, *Anson's Law of Contract* (Oxford 2002).
[46] D. Allan, "The Gentleman's Agreement in Legal Theory and Modern Practice" (2000) 29 Anglo-American L. Rev. 204.
[47] Although the doctrine of consideration defines the key measure of contractual liability, courts are prepared to find practical benefits as consideration, see *Williams* v. *Roffey Brothers and Nicholls (Contractors) Ltd.* [1991] 1 Q.B. 1. See also M. Chen-Wishart, "Consideration: Practical Benefit and the Emperor's New Clothes", in Beatson, and Friedmann (eds.), *Good Faith and Fault in Contract Law*, 123–150.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

In the English case law it is clear that the leading case is *Baird Textiles Holdings* v. *Marks and Spencer* even though the transaction in this case was held out not to be contract. [48] Baird had been one of the four principal suppliers of garments to Marks and Spencer for 30 years. In October 1999, Marks and Spencer, without warning, terminated the relationship. It is clear that as a matter of policy, Marks and Spencer chose not to have any express contract governing the long term relationship. There were individual contracts for the supply of garments ordinarily ordered twice a year. On the other hand Marks and Spencer took a very active interest in Baird's business. They effectively controlled all supplies to Baird; discouraged Baird from dealing with other retailers and required Baird to obtain their consent before they took over other companies. It is clear that in the relationship, Marks and Spencer was very much the senior partner but Baird was itself a substantial company. In 1998, it supplied about £205m of goods to Marks and Spencer, whose business represented between 30% and 40% of its total turnover.

It is worth asking why Marks and Spencer deliberately chose not to have an express contract. It would seem that the most plausible answer is that the requirements were very flexible, not just in volume, but because of the nature of the goods, and in the detailed breakdown of the goods supplied. Such flexibility could be obtained at very little risk because Baird was extremely unlikely to go elsewhere. The unlikelihood of Baird going elsewhere arose from the second part of the Marks and Spencer strategy - the inculcation of the belief that the relationship would last forever. Baird led extensive evidence (including statement from very senior former Marks and Spencer directors) that Marks and Spencer repeatedly affirmed that the relationship would be a continuing. There seems to be clear evidence that Baird relied on these undertakings and behaved in a way that they would not have behaved if they had thought the next order might be their last. Why then was it that they were left without a remedy? As far as contract is concerned, the answer is that it was not possible to say with absolute certainty what the contract was. Baird has been getting about 15% of Marks and Spencer orders but no one suggested that they could complain if they only get 10% in the next cycle or even 5%. The flexibility was so great that by English standards, there was no contract. One can of course imagine a system of contract law which would reach a different result, particularly one which made extensive use of the concept of good faith but for English law, the use of estoppel looks a more attractive option. It is clear that

[48] See *Baird* v. *Marks & Spencer plc* [2001] EWCA Civ 274, [2002] 1 All E.R. (Comm) 737.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

Baird undertook very substantial expenditure in the belief that the relationship would continue. The facts were reminiscent of the famous American case of *Hoffman* v. *Red Owl Stores Inc.*[49] where Hoffman was encouraged by Red Owl to sell his existing business, move house and buy a new site for a new store in the expectation that he would get a Red Owl franchise. The Wisconsin Court held that whilst there was no contract, Hoffman could recover his reliance loss by relying on promissory estoppel.

In the present case the Court of Appeal recognized that if English law had gone as far as the Australian Courts in *Walton Stores (Interstate) Ltd.* v. *Maher*[50] the case would at least have had to go to trial, but they took the position that only the House of Lords could take that step. Probably the most important factor in this conclusion is that English law has not so far treated estoppel (other than proprietary estoppel) as creating a cause of action.

Where does this case leave umbrella agreements? We suggest that there is nothing in the case which would prevent most clauses in umbrella agreements being treated as legally binding provided that the obligations of the parties are defined with an acceptable minimum of certainty. If Marks and Spencer had chosen in 1969 to incorporate their deal with Baird in a legally enforceable agreement, it seems very unlikely that it would have survived without amendment or renegotiation for thirty years. So long as their assurance that the relationship would go on for ever was accepted, Marks and Spencer could get virtually everything they wanted without a contract; and the deals were not unattractive to Baird.

A study of one hundred and thirty-seven litigated cases between 1998 and 2002 published in 2003 finds that businesses are often indifferent to legal enforcement because they are able to create efficient non-legal sanctions to enforce their commitments.[51] Non-legal sanctions may take three different forms;[52] First, non-legal sanctions may involve the loss of relationship-specific assets, such as the partial or complete loss of future business. Retail chains, for example, often impose on consumer goods manufacturers the non-legal sanction of brand de-listing. As umbrella agreements between retailers and manufacturers are reviewed on an annual basis, a de-listing of brands is often a rather ephemeral non-legal sanction. Second, they may

[49] 133 NW 2d 267 (1967).
[50] (1988) 164 C.L.R. 387.
[51] R. E. Scott, "A Theory of Self-Enforcing Indefinite Agreements" (2003) 103 Colum. L. Rev. 1641.
[52] Charny's pioneering work on non-legal sanctions contributed to a better understanding of alternative mechanisms of enforcing commitments See D. Charny, "Nonlegal Sanctions in commercial relationships" (1990) 104 Harv. L. Rev. 373. See also R.E. Scott, n.51 above; B.D. Richman, "Firms, Courts and Reputation Mechanisms: Towards a Positive Theory of Private Ordering" (2004) 104 Colum. L. Rev. 2328.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

involve reputation costs. However, reputation costs are likely to be ineffective in heterogeneous and large business sectors.[53] Third, non-legal sanctions may also involve the loss of access to business or the sacrifice of status privileges. Such a sacrifice is the loss of a "preferred supplier" status or "category captain" status, which are reserved for the exceptional contractual partners.

Conclusion

Umbrella agreements epitomise the re-conceptualisation of contracts provided by Llewellyn in 1931.[54] By arranging umbrella agreements, parties balance the need for certainty and calculability of exchanges with the need to remain flexible. Thereby, parties are better able to maximise their joint gains over time. In these circumstances, firms may retreat from immediate contracts and embrace umbrella agreements to simplify and facilitate the complexity of the contracting process. Umbrella agreements thus imply two universal features: First, umbrella agreements reduce the costs, in terms of time and effort to select, manage and oversee single transactions.[55] Second, umbrella agreements maximise the parties' possibility to embrace opportunities through an ongoing negotiation. What is the relevant implication of umbrella agreement for practice? The present article shows that contracting parties need to draft their umbrella agreements in such a way that their expectations are manifested with certainty and predictability and they need to include mechanisms for continuous negotiation.[56] What are the criteria that firms may use in order to decide in favour of umbrella agreements? Our study indicates that the parties' decision to draft umbrella agreements is a function of a) the complexity and intensity of contracting; b) the cost in terms of time and effort to select, handle and monitor a series of single contracts; c) the effectiveness of alternative arrangements such as implicit contracts, commitment letters or open terms.

[53] A. Schwarz and R. Scott "Contract Theory and the Limits of Contract Law" (2003) 113 Yale L.J. 541.

[54] Llewellyn described contract as a "framework highly adjustable, a framework which almost never reflects real working relationships, but which affords a rough indication around which relationships vary, an occasional guide in cases of doubt and a norm of ultimate appeal when the relationships cease in fact to work": see K. N. Llewellyn, "What Price Contract? An Essay in Perspective" (1931) 40 Yale L.J. 704, at 737.

[55] Transaction costs are often hidden and underestimated expenses; they may also include contract drafting costs, unforeseen contingencies, enforcement costs, renegotiation requirements as well as coping with information asymmetries between the contracting parties. See J. Tirole, "Procurement and Renegotiation" (1986) 94 J. Pol. Econ. 235.

[56] One route for determining the appropriate terms is to apply a form of backward recursion. Parties need to hypothesise a re-negotiation stage and then ask how the initial terms will impact on re-negotiation. Then they need to return to their agreement and draft terms which are "re-negotiation proof". See A. Schwartz, "Relational Contracts in Courts: An Analysis of Incomplete Agreements and Judicial Strategies" (1992) 21 J. Legal Studies 271.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press

Umbrella agreements lead to the essential question of how contracting parties wish to relate to one another. Legal research needs to recognise that contract is becoming a dynamic and flexible process; and it is not a snapshot taken at the moment the exchange was agreed.[57] The present study has, hopefully, provided a platform to start this new exploration.

[57] M.A. Eisenberg, "The Emergence of Dynamic Contract Law" (2000) 88 Cal. L. Rev. 1743.

https://doi.org/10.1017/S0008197308000081 Published online by Cambridge University Press