Standard Contract Terms

1. The use of standard contract terms

The use of standard contract terms is not a modern phenomenon. Those who offer standardized products have always shown an interest in using standardized contract terms: Labeo D. 19,2,60,6 refers us to a case in which a lessor of a warehouse intimated by way of poster that he would not store certain goods. Ulpian D. 4,9,7 pr. explains how exclusion clauses became part of contracts of carriage by sea. The late Middle Ages and the early modern period saw the emergence of maritime insurance and of standard maritime insurance terms. At the same time we find that stable- and innkeepers posted exclusion clauses by public notices (→ innkeepers' liability). Yet, only in the 19th century did standard contract terms become a mass phenomenon. General conditions of insurance have led this development: as a consequence of the Industrial Revolution traditional means of protection against risks disappeared and private insurance became a high volume business. However, a developed insurance contract law was missing. Furthermore, the emerging actuarial mathematics made risks calculable and controllable through standard terms. Standard contract terms of carriers, notably of railway companies, standard terms of employment, standard instalment sales contracts, and standard tenancy contracts followed. Today, standard contract terms are omnipresent.

2. Reasons for their use

The reasons for using standard contract terms have always been the same. Even in codified systems not every specific contract is dealt with by the legislature. For other contracts we only find fragmentary legislation. Without detailed terms it would hardly be possible to entertain meaningful contractual relationships in such cases. Where we find a developed *ius dispositivum*, one party might want to modify it to its advantage. Those who offer standardized products want to achieve these objectives without costly individual negotiations: for them, the use of standard contract terms makes it more cost efficient to fill gaps of the *ius dispositivum* and to modify it.

3. Awareness of the problems resulting from their use

Whoever is exposed to standard contract terms (henceforth the other party) is likely to assert that he has not taken notice of them, or that they are unclear or unfair. Such complaints must have been heard routinely by lawyers even in past centuries. The German legal profession proved to be aware of such objections as early as the 19th century. Four problems resulting from the use of standard contract terms can be distinguished: how standard contract terms become part of a contract, how they have to be interpreted, and their *fairness control*. These three problems have always been discussed. The fourth problem—what are the legal consequences of non-incorporation or unfairness?—has only been an issue since the 20th century.

The arguments which were put forward in favour of reviewing standard contract terms for fairness in the 19th century remind us of the arguments which we find in today's discussion: there is an inequality of bargaining powers; only

the party using standard contract terms effectively makes use of his → freedom of contract; and especially railway companies abused a factual monopoly to enforce unfair terms. In the 1930s public welfare entered the discussion: whereas unfair terms in individual contracts only cause hardship to an individual party, it is also the general public which is exposed to standard contract terms and their unfairness therefore also constitutes an infringement of public welfare and justifies a special control on the part of the courts. At the same time, the idea of consumer protection began to be referred to, and it has dominated the debate since the 1970s (→ consumers and consumer protection law). Today it is widely believed that the justification for a fairness control is the existence of a partial market failure.

4. Terminology

In Europe two concepts are competing: (a) standard contract terms and (b) not individually negotiated contract terms. In Germany the term *Allgemeine Geschäftsbedingungen* (standard contract terms) was first used in 1875. Yet, in the 19th century it only described a factual phenomenon. It was in the 20th century that a special set of rules was developed to remedy the specific problems resulting from the use of standard contract terms. This development culminated in 1976 in the enactment of the *Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen* (Standard Contract Terms Act). The term *Allgemeine Geschäftsbedingungen* had become a legal concept delimiting the scope of application of this body of law. Today the → *Bürgerliches Gesetzbuch* (BGB) defines *Allgemeine Geschäftsbedingungen* as 'contract terms preformulated for more than two contracts which one party to the contract (the user) presents to the other party'. Other legal systems have developed similar concepts. In Poland, Art 71 *Kodeks zobowiązań* of 1933 dealt with the incorporation of standard contract terms ('regulamin, wydany przez jedną ze stron') into the contract, and so for Italy does Art 1341 → *Codice civile* of 1942 ('condizioni generali di contratto predisposte da uno dei contraenti'). In France, in turn, Saleilles coined the term *contrat d'adhésion* (1901). However, it was never turned into a legal concept defining the scope of application of a special set of rules as in Germany, Poland or Italy.

The Unfair Contract Terms Directive (Dir 93/13) applies to not individually negotiated terms in consumer contracts, ie to terms which have been drafted in advance and whose substance the consumer has not been able to influence. This concept is different from that of standard contract terms as it does not require the term to be drafted for more than two contracts. Those legal systems which had already opted for the concept of standard contract terms also had to introduce this second concept. This causes frictions due to the different rationales underlying both concepts. These frictions have as yet not been satisfactorily solved.

5. Legal nature

In the 19th century it was beyond doubt that standard terms were contract terms which only became effective if the parties had agreed on their incorporation into the contract. Yet, in the early 20th century standard contract terms were compared to and later even equated with legislation (*Normentheorie, teoria normativa*). As a consequence it was suggested that standard terms could even be effective if the other party did not consent to them. Today it is again undoubted that standard terms are contract terms (*Vertragstheorie, teoria contrattuale*).

6. Incorporation into the contract

Until the 20th century, rules on the incorporation of standard contract terms had not been codified. However, as noted above, it was already clear in the 19th century that standard contract terms were effective only if the parties had agreed on their incorporation. If the other party had not expressly consented, his consent was presumed only if he was referred to the terms and if he had been given the opportunity to acquaint himself with them. Thus, the three requirements for the incorporation of standard contract terms were: (a) reference to them, (b) the opportunity to become acquainted with their content, and (c) consent. There was no need to codify these requirements as they followed from the general principles on formation of contracts. In Germany, however, these requirements begun to disintegrate in the 1930s. Standard contract terms were subsequently understood to be part of the contract when the other party had constructive knowledge of their existence. Similar developments can be identified in other legal systems (Poland, Italy). In contrast, English law at the same time adhered to the traditional requirements of incorporation (Denning LJ in *Olley v Marlborough Court Ltd* [1949] 1 KB 532, 549). The development in Germany was regarded as unsatisfactory and the legislature reacted by reintroducing the three requirements.

Such codified requirements are also known to Estonian, Lithuanian, Dutch, Portuguese and

Spanish law. Despite differences in detail these legal systems are in agreement in that they all, in substance, accept the three named requirements for the incorporation of standard contract terms. One main difference between them, however, is to be found with regard to the scope of application of these requirements. In Germany they apply to standard contract terms, used vis-à-vis consumers. In Spain the requirements of the *Ley sobre Condiciones Generales de la Contratación* apply to standard contract terms, even in business to business (b2b) transactions; those of the *Ley General para la Defensa de los Consumidores y Usuarios* apply to not individually negotiated contract terms in consumer contracts. Portuguese law applies them without restrictions to all not individually negotiated contract terms. In Estonia and Lithuania they apply to all standard contract terms, even in b2b transactions. The frictions which result from the existence of two competing concepts (see 4. above) become evident in these differences.

Other legal systems, such as those of France, England, Scotland and Austria, have refrained from codifying these requirements. They deduce them from the general principles on the formation of contracts. Still, there are no differences in substance even if the requirements are phrased differently. Austrian law only has a special rule on unusual terms.

The same picture is also evident on an international and European level: Dir 93/13 and the CISG (→ sale of goods, international (uniform law)) do not codify any requirements for the incorporation of standard contract, or not individually negotiated terms. The → UNIDROIT Principles of International Commercial Contracts (PICC) only have rules for three special problems (surprising terms, conflicts between standard and non-standard terms, and battle of forms), and refer for all other problems to the general rules on formation of contract. The → Principles of European Contract Law (PECL), the Draft → Common Frame of Reference, and the → *Acquis* Principles (Contract I) contain detailed rules on incorporation. However, in substance there are again hardly any differences. They all accept the three specified requirements, although they, too, phrase them somewhat differently.

These findings raise a number of questions: is the codification of the three requirements superfluous because it is possible to deduce them from the general rules on formation of contracts? Does such codification merely have a clarifying effect? Or does it lead to a higher degree of protection for the other party? When answering these questions attention has to be paid to surprising terms and to the circumstances in which the other party may be said to have had the opportunity to make himself acquainted with the content of the terms. If a codification of such requirements is thought to be advisable, should they apply only to standard contract terms or also to not individually negotiated terms, and should they apply solely to consumer contracts (→ consumers and consumer protection law) or also beyond?

7. Interpretation

The *contra proferentem* rule is generally accepted in Europe. However, its scope of application is also problematic: does it only apply to not individually negotiated terms? Is its application outside consumer contracts (b2b transactions) restricted to standard contract terms? Or is it a general rule of interpretation for all contract terms? Another matter of doubt is the relationship of this rule with other rules of interpretation: it is common to say that the *contra proferentem* rule only applies if a doubt in the meaning of a contractual term cannot be resolved by means of these other rules. Yet, the other rules of interpretation are different in the various European legal systems and, thus, also the question of their relationship with the *contra proferentem* rule will be answered differently, even if it is generally accepted that the *contra proferentem* rule is only of subsidiary application.

In Germany, standard contract terms are interpreted objectively (*objektive Auslegung*—objective interpretation) and in a typifying way (*typisierende Auslegung*—typifying interpretation). That implies two aspects: first, all the circumstances attending the conclusion of the specific contract are disregarded; secondly it is of no importance how the individual parties to the contract understand the standard contract terms but it is only of importance how typical parties to a contract to which these standard terms apply understand them. It is argued that standard contract terms are intended to apply to all cases uniformly and, as a consequence, they need to be interpreted uniformly. The parties must agree by means of an individually negotiated term to deviate from this objective meaning of the standard contract terms if they wish to not be bound by it. Although all European legal systems are in agreement that standard contract terms are to be interpreted in a typifying way and that, normally, there are no circumstances attending the conclusion of the specific contract which demand a

different interpretation, there is no corresponding rule that such circumstances have to be disregarded where they do exist.

8. Fairness control

Since the middle of the 19th century, German law has developed various means of fairness control: an early example of an overt judicial fairness control can be found in the Rhineland, for Rhenish courts held in the 1850s that railway companies could not exclude their liability. The → *Allgemeine Deutsche Handelsgesetzbuch* of 1861 was to a similar effect, and legislative history proves that the legislature thereby reacted to the practices of railway companies excluding their liability in standard contract terms. At the end of the 19th century the courts introduced the so-called *Monopolrechtsprechung*: the courts held standard contract terms to be void if the party using them had a factual monopoly and if it abused that monopoly to impose unfair terms on the other party. In insurance law, discussions whether to introduce → mandatory law in response to the practice of using unfair standard terms reach back to the middle of the 19th century. Here we also find first hints of an administrative control of standard contract terms. Until these means of an overt fairness control had been fully developed, the courts applied means of indirect fairness control to standard contract terms, eg, by way of interpretation. It was only in 1935 that Ludwig Raiser provided an explanation why it was justified for courts to carry out an overt judicial fairness control. Raiser believed that the underlying rationale of a judicial fairness control is the protection of public welfare: it is the general public that is exposed to standard contract terms; if these turn out to be unfair, public welfare is infringed. Unfair terms in individual contracts, in turn, may cause similar hardship to one individual party, but public welfare is not endangered. It was Raiser's explicit analysis and its subsequent acceptance which explains why in Germany overt judicial fairness control became so important, why it was restricted to standard contract terms, and why it was also applicable to b2b transactions. Judicial fairness control is not designed to protect an individual party, but goes beyond the individual and protects the general public. Today, one speaks of the protection of markets in case of a partial market failure.

Other legal systems did not develop a comparable overt judicial control of unfair terms as early as the German courts. In France and Italy it has only been introduced with the implementation of Dir 93/13. The rationale underlying the fairness control embodied in the directive is distinct from the one developed in Germany. The directive is designed to protect individual consumers because consumers are typically in need of protection. As a consequence, the fairness control is not limited to standard contract terms. The protection of one consumer cannot depend on the fact that other consumers are also exposed to similar contract terms. Yet, whereas public welfare may be infringed when standard contract terms in b2b transactions are unfair, with the rationale underlying the directive one would need to ask whether a business is typically in need of protection, and one is tempted to answer this question in the negative.

Thus, there are different rationales underlying the competing legal concepts: that of standard contract terms and of not individually negotiated contract terms (see 4. above). The scope of application of the fairness control can only be defined if there is a clear idea which rationale is to be followed. The multitude of approaches in Europe suggests that a consensus has not been reached as yet: in Italy, Spain, Poland, Latvia and Slovakia the judicial fairness control applies to all not individually negotiated terms in consumer contracts. In Portugal it extends to not individually negotiated terms in b2b transactions as well. The PECL follow a similar approach. In France all contract terms in consumer contracts are subject to a fairness control, and in the Scandinavian legal systems such a control goes even beyond consumer contracts. In Lithuania, all terms in consumer contracts may be reviewed, whereas in b2b transactions only standard contract terms are subjected to a fairness control. In Germany and under the DCFR, all not individually negotiated contract terms are the object of a fairness control in consumer contracts, but in b2b transactions only standard contract terms receive such scrutiny. The fairness control of the *Acquis* Principles (Contract I) includes all not individually negotiated contract terms even in b2b transactions, but the fairness standards for consumer contracts and for b2b transactions are different. It is doubtful whether the distinctions which one is able to observe in Lithuania, Germany, the DCFR and the *Acquis* Principles are still explainable in terms of one single rationale.

In addition to the fairness control outlined above, all European legal systems know an administrative fairness control and a judicial fairness control in collective proceedings. The former is traditionally of great importance in Scandinavia. Both forms of fairness control are in all European legal systems limited to standard contract terms. There thus seems to be a consensus

as to the rationale underlying these means of fairness control.

9. Consequences of non-incorporation and unfairness

It is undisputed that, as a general rule, the contract continues to be effective if some standard contract term, or not individually negotiated contract term, is not incorporated into the contract or if it is invalid due to its unfairness (→ invalidity). The remaining terms of a larger catalogue of terms that are not affected by the non-incorporation or determination of unfairness will continue to be effective. However, it is as yet unclear whether an unfair term can be reduced to its fair nucleus (*geltungserhaltende Reduktion*).

10. Principle of transparency

The principle of → transparency is said to be an overarching principle of the law regulating standard, or not individually negotiated, contract terms. Article 5 Dir 93/13 demands that written terms 'must always be drafted in plain, intelligible language'. Yet, the legal consequences of a violation are unclear. Article 5 only calls for an 'interpretation most favourable to the consumer'. Nevertheless, non-incorporation and invalidity are also discussed as possible legal consequences.

11. Possible future developments

The harmonizing effect of Dir 93/13 was limited. It is unlikely that the Proposal for a Directive on Consumer Rights (COM(2008) 614 final) will remedy this problem. Although this proposal pursues full instead of minimum harmonization, it only contains fragmentary rules. The only requirement for an incorporation of a term found in the proposal is that the consumer must have had the 'real opportunity of becoming acquainted' with the term. And the only rule on interpretation is the *contra proferentem* rule. Thus, apart from that, the Member States would themselves need to regulate the questions of incorporation and interpretation. Outside the scope of application of the proposed directive, Member States could even still follow different approaches with respect to the fairness control. Before a true harmonization is possible European private law scholarship would need to discuss and reach an agreement with respect to some fundamental questions, especially concerning incorporation and the judicial fairness control (see 6. and 8. above).

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