Articles

Unfair terms in consumer contracts : towards a European directive

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Introduction

The European Commission is at present considering the publication of a draft directive on unfair contract terms in consumer contracts. This comes at a time, when most European countries have already introduced legislation. This paper is devoted to the question whether such a directive should be issued and if so, what its contents should be. In the paper I shall present the findings based on an analysis of present legislation and legal practice in a number of European countries, which the European Commission has commissioned me to write[2].

The findings may be grouped under three headings. First, I shall try to describe the principal features of some national control systems which on the basis of the last decade's experience seem to have the potential of serving best the general interest (I). Then, I will consider briefly some technical questions which such control systems raise (II). Finally, I shall devote some attention to the possibilities of EC harmonization (III).

Comparing legislation of different countries always has its danger[3]. The Channel still divides Europe in a common law and a civil law area[4]. Travelling from North to South, legislation is increasingly seen as the dominant source of law. Even between countries apparently so similar in legal culture as are the Federal Republic of Germany and the Netherlands, the general contract terms which are in use may vary greatly[5]. Then there is the human element. Enforcement is often entrusted to a limited number of persons. In the absence of an efficient enforcement machinery, the most perfect laws of the world are not worth the paper they have been printed on.

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[2] The Report is published under the title 'Unfair Terms in Consumer Contracts' (Utrecht : Molengraaff Institute for Private Law, Nieuwe Gracht 58, NL 3512 LT Utrecht)

[3] B. Grossfeld, *Macht und Ohnmacht der Rechtsvergleichung*, Tübingen 1984.

[4] See D. Tallon and D. Harris (eds), *Le contrat aujourd'hui : comparaisons franco-anglaises*, Paris 1987.

[5] Other dissimilarities are set out by E. Blankenburg and J.R.A. Verwoerd, The courts as a final resort ? : Some comparisons between the legal cultures of the Netherlands and the Federal Republic of Germany, *Netherlands International Law Review*, 1988, p. 7-28.

I. Towards an efficient control system

1. The need for legislation

There is one major conclusion to be drawn from a survey of European legislation on unfair contract terms. All member countries now either have specific legislation as to unfair contract terms in consumer transactions – in force, as in Denmark, France, the Federal Republic of Germany, the Irish Republic, Italy, Luxemburg, Portugal, Spain, the United Kingdom, or not yet in force, as in the Netherlands –, a government bill pending as it is the case in Belgium, or are at least considering such legislation (Greece). The same applies to most other European countries : Austria, Finland, Norway, Sweden and Switzerland, which now all have specific legislation.

Apparently, the need for legislation is felt everywhere. Even the countries which a decade ago still were opposed to specific legislation (Switzerland) or which had political problems in getting a government bill enacted (the Netherlands) now have joined other countries.

Nor is there any trend towards repeal of this legislation. The wave of deregulation which has been sweeping over parts of Europe in the early 1980's has hardly affected the other trend towards specific legislation (although in the Netherlands it nearly succeeded in killing the bill).

In those countries, where there has been organized opposition against specific legislation, the two main arguments against such legislation usually were that there was no real need for it and that the necessarily wide scope of application would endanger national and international commerce.

As far as the first argument is concerned, it has often been observed that little – if any – empirical evidence supports the need for legislation. It should be added : nor is there much evidence that legislation is not needed. Supporters of legislation and their adversaries have often waged full battles over the question which side should bear the burden of proof. Against the contention that those who propose legislation should prove their case, it has been observed that in this special case the 'legislationalists' only want a return to the law and therefore do not bear the burden of proof. But even if the necessity must be proven, there is sufficient secondary evidence, such as court report, the use of standard form contracts, consumer complaints, that supports the case for legislation.

As for the second argument, it is true that some laws on unfair contract terms deal not only with consumer transactions but also with contracts between two persons or entities who are acting in the exercise of a profession or a trade. Consumer activism sometimes serves as a catalyst to legislative innovations which are not confined to consumers. In other cases, policy reasons require protection not only of consumers but also of small businessmen. In such cases, a legislator runs the risk that the provisions dealing with consumer contracts have to be watered down. Business interest will otherwise proclaim the act a danger to national and especially international commerce.

There is an easy solution to this problem, which may be found in several legislations. It consists in differentiating between the various provisions. Thus the procedural provisions are often limited in scope to consumer transactions. Likewise, the black lists are geared to consumer transactions. Other substantive provisions, however, may well play a limited role in purely commercial transactions as well. The one drawback of this solution is that it makes codification of the whole of consumer law in one single *Code de la consommation* more difficult.

2. Three generations

The legislation on unfair contract terms in consumer transactions may be seen as a set of waves. Among EC member countries, Italy is the only one which belongs to a first generation of jurisdictions which have introduced specific legislation. Italy actually was the pioneer of this wave, which did reach some other countries at the Mediterranean as well as I have described in a Report, which I submitted to the European Commission in 1977[6]. The legislation was inserted in the Civil Code[7] and it focused on individual contracts, not on the use of unfair terms as marketing practice.

A second wave of countries approached the problem from this latter angle and no longer from the individual point of view. This involved setting up a control machinery. Sweden paved the way as a pioneer of the second wave[8].

Meanwhile, Sweden has moved into a third wave, in which the two approaches are combined or at least co-exist. Most member countries of the EC have opted for this solution. The exceptions are Italy and Spain, which are still in the first wave, and France, which finds itself alone in the second wave[9] (Greece belongs to the lost generation).

The first generation often may be described as a codification of existing case-law. In the absence of any legislation, courts have sometimes arrived at similar solutions, which were possible by applying the general clauses of the Civil Codes. In the second wave this is far more difficult. The difference may be illustrated by referring to the two Dutch cable-television cases, both handed down on April 25, 1986[10]. In one case, the Supreme Court anticipated on the introduction of the bill – as it then was – on unfair contract terms ; in the other it refused to do so. The first case involved a substantive law provision, the

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[6] See E.H. Hondius, Unfair Contract Terms : New Control Systems, 26 *American Journal of Comparative Law* 525-549 (1978).

[7] Articles 1341, 1342, 1370 Codice civile. See C.M. Bianca, Condizioni generali di contratto, in *Enciclopedia Giuridica Italiana*, 1986/1987.

[8] See U. Bernitz, *Standardavtalsrätt*, 4th ed, Stockholm 1987.

[9] Although the new Act 88.14 of January 5, 1988 'relative aux actions en Justice des Associations de consommateurs et à l'information des consommateurs' may pave the way towards a Nordic type control system. See a forthcoming article by J. Calais-Auloy in *Dalloz*.

[10] Hoge Raad 25 April 1986, *Nederlandse Jurisprudentie* 1986, 714 (note W.C.L. van der Grinten) and 1987, 742 (note W.H. Heemskerk).

second the procedural right of collective action. In my view, the Supreme Court might as well have anticipated on this particular procedural provision, but I must admit that the powers of a court do have their limitations. Establishing a new court, a consumer ombud, or handing out subsidies to consumers' organizations are activities which would require an even larger legal activism on the part of the judiciary than we know already.

3. Basic features of a control procedure

What then are the basic features of the second wave control systems ? These basic features consist of a two-layer control. On the first level, the consumer interest is represented by an entity, either public or private. This entity engages in negotiations with suppliers or their organizations in order to arrive at agreed contract terms. Two ways may get suppliers and their organizations around the negotiating table : the system of the stick and that of the carrot. The carrot comes later, now first about the stick.

The stick is provided by a court or court-like agency, neutral anyway, which may order a supplier to cease the use of particular contract terms. The stick will rarely have to be used, but the threat that it will must in itself be sufficient to make parties agree to an equitable result.

This is the model which I described as the most ideal one in a 1977 Report. Eleven years later, on the basis of German experiences but also on the basis of my own, I must modify my ideas. Negotiations are not always the appropriate way of dealing with general contract terms. In the Federal Republic of Germany, the VerbraucherSchutzVerein acts just as much as a policeman, looking for contract terms which violate the law. This of course is only possible, when the substantive law is explicit. A mere general clause will not be sufficient. Rather a black list or at least a number of mandatory law provisions are needed to provide the consumer representatives with sufficient back-up to exercise their watch-dog role.

One reason for my diminishing enthusiasm for the negotiation model – although it still appears to be the ideal model – is very down to earth : it costs quite a lot of money. From my own experience, I can give one example. Under the auspices of the Dutch Social and Economic Council's Commission for Consumer Affairs, negotiations on contract terms have been taking place between consumers' organizations and suppliers' organizations as off the 1970'. As president of a working group on repair conditions, I have witnessed how a number of such organizations which all seemed very sincere in their wish to arrive at equitable terms needed eighteen half-day meetings to reach a conclusion. For the four consumers' respresentatives this must have meant at least eighteen full days of work each. Seventy-two days of work for one of hundreds of branches, this one showing willingness and being highly organized, involve a considerable expenditure from all organizations involved. It is not certain whether consumers' organizations can afford this model in the long run.

4. First-level : private organization or governement agency

At the first level, the consumer interest may be represented either by a private consumers' organization or by a government agency (or both). In a 1977 Report I have scrutinized the arguments advanced in favour of government agencies. At the time, there were said to be four such arguments :

(a) a public official has more authority than a private organization,

(b) a public official is more representative for consumers in general than private organizations,

(c) in the Consumer Ombudsman model there can be no fear of quarrels between different private organizations,

(d) the Swedish experience has been quite successful, and

(e) the German experience in the related area of unfair trading practices on the other hand has not been so successful. After an analysis of these arguments, only (a) came out to be somewhat persuasive. I based my argument with regard to (a) on the presumption that only a public official might impose fines and issue cease-and desist orders. This assumption has proven to be unfounded. German experience demonstrates that German consumers' organizations may well require suppliers to sign a declaration to the effect that they shall no longer use specific unfair contract terms and that they shall forfeit a penalty when they violate this undertaking. This procedure reminds one of the undertakings under Part III of the UK Fair Trading Act. Both the public and the private procedures have proven to be highly effective once an unfair contract term has been identified.

As for argument (b), I hope to have refuted this in my 1977 Report by putting the rhetoric question who is more representative for consumers : a public officer who is nominated and fired by government or a private organization with nearly half a million members, such as the Dutch Consumentenbond. I must add, however, that in some countries consumers' organizations have felt less inclined towards negotiations over contract terms than might be expected. The United Kingdom is an example.

Argument (c) does play a role in several member countries : Belgium, France, Spain, However, these countries have all solved this question in their legislation. Limiting the first level rights to those organizations which are represented in the National Consumer Council (Belgian bill on trading practices) is one such solution.

To argument (d) I opposed the Danish experience in my 1977 Report. Meanwhile, the picture of a successful Swedish control system and an unsuccessfull Danish one needs some reframing. The Danes appear to have become more adept in handling contract terms, whereas the Swedish model has lost some of its initial momentum. In 1977, I already predicted that the meager

experience with German control of trading practices did not indicate that in the contract terms area results would be similarly disappointing (e). My argument was that there is a basic difference between unilateral trading practices and bilateral contract terms. Negotiations of the latter have a lasting result ; unilateral trading practices agreements only deal with past practices – they do not warrant that suppliers will behave better in future. This black-and-white view needs some readjustment, especially since experience in the Federal Republic of Germany shows that the watchman model has been more prevalent than I had anticipated. The watchman model is more geared to unilateral trading practices, which brings it more in line with control of other trading practices.

An element which has grown more important since 1977, is the growing disenchantment with public agencies in general in a number of member countries. Deregulation and privatisation have become watchwords all over the EC. Concluding, we may therefore say that in the presence of strong consumer' organizations with a willingness to negotiate or police contract terms, it is preferable to entrust control to such organizations. In the absence of strong organizations or a willingness to act on their part, public officials should be entrusted with first-level control. A case might also be made for maintaining public agencies, which have shown to be effective in the control of contract terms, such as the UK Office of Fair Trading (which would however already qualify on the grounds of an absence of willingness to act on the part of UK consumers' organizations).

In case of harmonization of control systems in member countries, the various consumer environments and infrastructures should be taken into account. An important element in this is that although control of contract terms is an important task, it is by no means a task which requires massive investment and it therefore seems inappropriate to establish new institutions merely for this matter.

5. Second level : board or court

A basic element of the control system envisaged in this paper, is that at a second level a court or a board may issue cease – and – desist orders directed against the use of unfair contract terms. A number of countries have established special tribunals or boards for this purpose. Others have entrusted this power to the ordinary courts or to one specific ordinary court. In my 1977 Report, I showed a preference for the latter model. Although I maintain this preference, it must be admitted that there are no major discrepancies between the two systems. Discrepancies especially in the case-law between second level control boards and the ordinary courts cannot be discerned. The Supreme Civil Courts have the power to supervise this.

I maintain my argument that it is not necessary to appoint lay members on a board or court dealing with contract terms. Contracts belong to the daily case-load of judges, who need no special expertise in this matter from outsiders. In the previous paragraph, I pointed out that establishing a special public official

board merely for the purpose of controlling unfair contract terms might be too heavy a measure. Likewise, it may be argued that the establishment of a special board only with the task of controlling unfair contract terms at the second level appears to be unnecessary.

Our conclusion therefore is that on the second level, entrusting control to the ordinary courts seems preferable. However, entrusting control to special boards or courts which have been established for other purposes is an alternative. The main thing is that there be a second-level board or court.

6. Sanctions

The division of responsibilities in the two-level control model is that the major sanction of first-level control agencies or organizations consists of an application for a sanction to be awarded by a second level control board or court. The major sanction of such court or board is a cease-and-desist order directed against further use of the unfair contract terms concerned.

In practice, first-level agencies or organizations seem to be well served when they possess two subsidiary sanctions : one aimed at making suppliers submit a copy of their general contract terms, one obtaining from suppliers a declaration that they will cease to use specific contract terms and that a penalty will be forfeited in case of infringement. The latter system has been effective in the United Kingdom and particularly in the Federal Republic of Germany.

As for the second-level board or court, sanctions to be applied may be distinguished along several lines. First, a distinction may be made with regard to the person or entity against whom the sanction will be applied. The main parties concerned are the one which employs contract terms, the one which has drafted contract terms and the one which has recommended or prescribed the use of contract terms. The publisher of contract terms as well as intermediaries may also be envisaged. The nature of the sanction may be a cease-and-desist order, an order to revoke a recommendation or to refrain from recommending them in future, as well as subsidiary sanctions such as posting or publication of the decision. At the basis of the decision will be the declaration that a specific contract term or combination for such terms is to be considered unfair. This declaration may be retro-active or apply only to the future. Finally, the cease-and-desist order may envisage just the one contract term at issue or may be worded more broadly in order to encompass similar contract terms as well.

What to do if a cease-and-desist order is violated ? Most member countries make it possible for a first-level organization or agency to request that in such case a penalty is forfeited either to the organization or agency concerned or to the State. In the latter case, there is not much difference with a criminal procedure. In this regard, the member countries of the EC have widely differing legal cultures. A majority of countries seems to be in favour of decriminalization, but it might be argued that such decriminalization should not be imposed from above.

7. General clause

As I mentioned in the previous paragraph, any cease-and-desist order will depart from the conclusion that a contract term or combination of such terms is unfair. How to arrive at that conclusion ? In theory, several possibilities seem to present themselves to legislators : they may enact mandatory legislation on specific contracts, they may outlaw specific contract terms and they may lay down in their legislation a general clause. Denmark, the Federal Republic of Germany, Luxemburg, Portugal and to some extent the Irish Republic and the United Kingdom have opted for the general clause. Belgium, Italy and to some extent France until 1988 have refused to do so. As Italian caselaw shows, it is not a good idea to provide merely for a black list of specific clauses which are outlawed. New distribution techniques or suppliers' inventiveness lead to the introduction of new contract terms which fall outside the scope of the black list. Moreover, black lists often provide only a minimum level of consumer protection and German experience shows that the use of a general clause may raise that level.

8. Black lists

Most legislators have backed up their general clause – if any – with a list of contract terms which are considered to be unfair. This may be a rebuttable or an unrebuttable presumption. This technique appears to have been quite effective. It provides the draftspersons of standard contract terms with a better idea of what the legislator has in mind than a mere general clause. It also provides consumers' organizations or public officials with a check-list of what will be considered unfair in any case. In the watchman model, such a check-list is a near-must.

An alternative to a black list is mandatory legislation for specific contracts. However, it should be borne in mind that such legislation will not cover specific contract terms which are used in other contracts. From a purely efficiency point of view, black lists therefore seem to be necessary.

9. Civil law effects

In theory it is possible that unfair contract terms legislation focuses only on the use of such terms as a trading practice and that sanctions have no civil law effect as to contracts concluded on the basis unfair contract terms.

This appears to be a highly dissatisfactory model. Not only will individual consumers feel hurt in their sense of justice when contract terms which have been held to be unfair may still be invoked at against them. It also will deprive official first-level consumer representatives from helpful allies. It is true that I have argued earlier that consumers in the traditional judicial control system will usually come too late, that the access to the judiciary is limited and that the decisions are of too concrete a level, but this argument was only made in order to prove that new additional control systems are necessary, not to prove that the traditional model should be abolished.

The major sanction to be applied on the individual level is that the contract term concerned may be held null and void upon the demand of the consumer. Normally, this should not have as a consequence that the whole contract be held void, since that would give suppliers a free hand to introduce unfair contract terms and would refrain consumers from invoking the unfairness.

French experience shows that it is very important that a law on unfair contract terms may be applied directly by the courts, without the necessity of previous intervention by a commission or – especially – government.

10. Incorporation of contract terms

The very first legislation on unfair contract terms of the present EC member countries, the Italian Civil Code of 1942, was based on the assumption that adhering parties should be informed as to the contents of the contract terms. Once the adhering party was informed, he would naturally refrain from entering into an unfair contract. The assumption, as we have seen, has proven to be wrong. Modern legislation instead focuses on the contents of contract terms. This is very apparent in the Explanatory Memorandum to the Dutch Law on Standard Contract Terms. The Dutch government here explicitly states that since the Act introduces a far-reaching control of the contents of standard contract terms, control of their incorporation into the contract need not be as strict.

On the other hand, many recent acts, as does the Dutch Law, still contain some provisions on the incorporation of standard contract terms. Several arguments may be advanced in favour of such provisions. First, the incorporation of standard contract terms into individual contracts has always led to conflicts. General contract law does not provide a ready-made answer to such conflicts. It is therefore better to lay down a number of basic rules in the law. Second, even if the Italian solution should be rejected as the general answer to the problems raised by the use of unfair contract terms, there is no doubt that in a number of cases better information of consumers is very helpful. Incorporation provisions therefore, although not necessary as a general clause, are quite helpful in legislation on standard contract terms.

11. Construction and interpretation

Several Acts on unfair contract terms now in force contain rules as to the construction or interpretation of such terms. These rules are the *contra proferentem* rule and the prevalence of individually negotiated terms over standard contract terms. The contra proferentem rule has been laid down, among others, in German (par. 5 AGB-Gesetz), Italian (art. 1370 Civil Code) and Portuguese legislation (art. 11). In the jurisdictions where no such rule has been laid down in legislation, it has usually been adopted by the courts. The same applies to the prevalence of individually negotiated terms. This rule has been laid down, among others, in par. 4 of the German AGB-Gesetz.

This raises the question, whether the two construction rules should be codified.

Are they not so self-evident, that the legislator can refrain from enacting them ? A preliminary question, however, is whether the two rules are useful at all.

The *contra proferentem* rule has in the past often been used by the courts to arrive at equitable solutions. As a last resort, when no other ways seemed left, standard terms were maliciously construed so as to become ambiguous in order that the court could find against the supplier and in favour of the consumer. A classic example of such construction is the English (non-consumer) case *Szymanowski v Beck* (1923 1 KB 457, in which the clause 'goods shall be deemed to be in conformity with the contract' was held not to prevent a claim that the rolls of cotton had a length of 188 yards instead of the 200 yards convened upon. This claim was held not to regard 'goods delivered' but rather the cotton had not been delivered. This 'solution' – although to be applauded in the short run – should be rejected as a long term solution. Lord Denning has described the ensuing situation in his last case, *George Mitchell (Westerhall) Ltd v Finney Lock Seeds Ltd*[11], in the following words :

'(courts) still had before them the idol 'freedom of contract'. They still knelt down and worshipped it, but they concealed under their cloaks a secret weapon. They used it to stab the idol in the back. This weapon was called 'the true construction of the contract''.

In 1938, Karl Llewellyn, draftsman of the Uniform Commercial Code, already argued that the difficulty with construction as a means to police standard form contracts :

'. . . is threefold. First, since they all rest on the admission that the clauses in question are permissible in purpose and content, they invite the draftman to (return) to the attack. Give him time, and he will make the grade. Second, since they do not face the issue, they fail to accumulate either experience or authority in the needed direction : that of marking out for any given type of transaction what the minimum decencies are which a court will insist upon as essential to an enforceable bargain of a given type, or as bein inherent in a bargain of that type. Third, since they purport to construe, and do not really construe, nor are intended to, but are instead tools of intentional and creative misconstruction, they seriously embarrass later efforts of true construction, later efforts to get at the truth of those wholly legitimate contracts and clauses which call for their meaning to be got at instead of avoided. The net effect is unnecessary confusion and unpredictability . . . Govert tools are never reliable tools'[12].

Similar observations have been made by scores of other writers. European legislators of the second and third wave have never seriously considered construction of standard contract terms a means to police the content.

This does not imply that the contra proferentem rule is not useful at all. In many situations, standard terms are ambiguous, for instance because they are not

[11] (1983) QB 284 (CA) at 297, (1983) All ER 108, at 113-114.
[12] 52 *Harvard Law Review* 700, 702-703.

suited to the individual contract into which they have been incorporated or because the draftsman has made a mistake. In both cases, it is equitable that any ambiguity should be construed against the person who incorporated the clause into the contract, viz. who drafted the term. Not only is this fair in the individual case, it may also have a preventive effect.

The usefulness of the contra preferentem rule does not automatically imply that it should be codified. In the Netherlands, the legislature has explicitly refused to incorporate any construction rules in the New Civil Code's Book 6 on obligations in general. The government argued that there is no need for such rules in the Civil Code, since it is difficult to draft any hard and fast rules and since those rules which may be drafted will be self-evident to the courts. The latter argument would be convincing if a Civil Code were to address courts only. Since the idea of codification, at least in my view, is rather directed towards the citizen, the question whether or not a rule is self-evident to the citizen, rather than to the court, should be the criterion. As a rapid poll of the men and women in the street will demonstrate, the self-evidence of the contra proferentem rule for the ordinary citizen is a myth. It therefore seems advisable to codify this rule of construction.

12. Construction of standard terms : prevalence of individually negotiated terms

The German AGB-Gesetz also contains the construction rule that individually negotiated terms prevail over standard contract terms (par. 4). Like the contra proferentem rule, this rule of construction is well known in other jurisdictions, where it has been developed by case law. Again, two questions may be raised : is the rule useful, and should it be codified.

If standard contract terms are to remain, in general, a useful tool for the parties to the contract and not to become master over the parties, then their dependent role should be stressed. They are what the parties have agreed expressly. It seems useful to have a rule of construction in this regard.

This may be demonstrated by the gaining of influence of American-style merger clauses or entire agreement clauses.

Although most European courts are well aware of these maxims, one should not forget that legislation shall also seek to reach the citizen. It still seems very useful to codify the above-mentioned maxim, as long at it has not become self-evident.

II. Technical questions

13. Keeping up with new developments

Succesfull businessmen are imaginative people. When a specific clause has been forbidden by law, they will often find a way out. An exemption clause may be reformulated as an exclusion clause. A price index clause may be remodeled a

price reduction clause. In both examples, commercial interests will probably prevent the businessman from opting for the alternatives mentioned. He may offer a TV-set as a defective TV-set, thereby removing the need for an exemption clause. And he may offer the Mercedes car to be delivered within three months at 110 % of the price he had in mind, and then offer the buyer a 10 % deduction, when the factory does not raise its prices meanwhile. Both actions would be commercially self-destructive and will therefore not often be undertaken.

What will happen in practice, is that newcomers to the market, consulting new lawyers, may find novel ways to circumcede a black list. Inspiration may sometimes be drawn from foreign examples. The supplier himself may be a subsidiary, asked to employ the general contract terms of the mother company. New clauses may also be the result of changes in legislation, in technology or in social and cultural patterns.

Anyway, a black list of clauses wich are considered unfair, may soon become incomplete. The Italian and the Israeli examples demonstrate that this is not only theory. It may therefore be advisable to add to the law a mechanism which makes it possible to change the law by decree. Governments usually are not very eager to make use of such mechanisms, however. Still, entrusting other bodies with the power to change black lists – the Supreme Court for instance – does not seem a good solution either, being incompatible with the division of powers. The best options therefore seem to be the introduction of a broadly worded general clause and reporting the ensuing case-law on a broad front, as well as a regular updating of the law by the legislature.

14. Scope of application

Two basic questions have so far been raised by every country which has considered introducing legislation on unfair contract terms. First, should legislation be limited to standard contract terms or be extended to all contract terms. Second, should (small) businessmen be included among those who are by the law.

The first question has so far been answered in quite different ways. Once again, it is useful to introduce the division between contract law and trading practices law. Under fair trade acts, private organizations or public entities may initiate an abstract control of contract terms. It is not necessary for the law to say expressly that only standard contract terms may be controlled. An organization would be very stupid to act against a contract term which is used only once and which does not appear to be used in the near future. The scarce resources of the first-level control agent will direct his activities towards contract terms which are of some importance. In considering the (un)fairness of this trading practice, a second-level control board may or may not attach importance to the fact that the terms in question are or are not standard contract terms.
As far as (individual) contract law is concerned, the situation is different. Here, the various laws differ very much. Some are highly sophisticated, making a

large number of distinctions. Others, such as the various variations of the Scandinavian general clause, do not make any distinction at all.

It has often been observed that modern text-writers make it easy to make standard contract terms appear as individual terms. This may be one of the explanations of the decreasing importance of the issue discussed here. Several legislators have expressed concern over the possible use of unfair contract terms legislation as a modern iustum pretium doctrine, enabling the courts to determine what is a reasonable price. These legislators have sought to codify this concern by excluding from the Act's scope of application the essentials of the contract (see for example article 6.5.2A.1 of the Dutch Act). Others, instead, have expressly extended the reasonableness test to prices.

When one analyses the various laws in this regard, there appears to be a connection with the existence of black lists. Once a legislation provides a black list of clauses considered to be unfair, without any discretion for the court, the only way out is an individual contract. Such legislatures have usually adopted for a limitation of their Act's scope of application to standard contract terms. Earlier, I have argued for the introduction of black lists. It seems consistent with this view, to argue for a limitation of the legislation's civil law provisions to standard contract terms. A similar limitation is not necessary for the marketing practices control, but neither can it do much harm.

The second question – who should benefit from the protection – is more difficult to answer. An easy way out is the answer that this issue falls outside the scope of the Report. In order not to take up too much space, I would rather refer to the German law, which seems to have struck a wise compromise, by extending the scope of application of some provisions to all contracts, and confining that of other provisions to consumer contracts.

Why should (small) businessmen be protected by law ?

Small businessmen often suffer as much from unfair contract terms as do consumers. Some legislators have therefore sought to include small businessmen in new consumer protection legislation. In some jurisdictions, most notably in several Canadian provinces, legislation protecting a specific category of small businessmen (farmers) against unfair contract terms has even preceded consumer protection in this regard.

A number of obvious arguments may be advanced in favour of protecting small businessmen. There also is a number of counterarguments. Even a small businessman is not a one-shotter ; he rather will have some experience in looking after his own interests. An important argument against an extension of legislation to small businessmen rests in the problem of defining the category. How to look for smallness ? By taking the number of employees as a yardstick ? Or assets or sales ? Or should a more formal criterion be used, such as compulsory registration with a Chamber of Commerce ? Finally, one should also look at the other side of the medal. A consequence of extending consumer protection to small businessmen may be that a small businessman who has

concluded a contract with another small businessman should not be surprised when the other party invokes a measure of consumer protection.

Leaving it up to the courts to decide whether or not to apply consumer protection legislation to small businessmen by way of analogy also has its drawbacks, however. This may be illustrated by a Danish case involving a farmer[13]. In 1973, the farmer had taken out a hailstorm insurance on the then usual condition that the contract was not to be terminated before 1983. The insurance company thereafter switched to a policy of one-year contracts without any increase in premium. When the farmer learned about the policy switch, he cancelled his insurance as of 1979. The company did not accept the cancellation and sued the farmer for the following year's premium. In court, the farmer maintained that he was not a businessman to be compared with the insurance company where the insurance conditions were involved. He asked for analogous application of section 14 of the Consumer Contracts Act, which provides for a maximum binding period for other contracts than insurance, or for application of section 36 of the Contracts Act.

The Court of Appeal found for the farmer : pursuant to section 36 of the Contracts Act, the Court set aside the contractual provision of irrevocability for ten years. Instead, a binding period of one year was fixed in accordance with the principles of section 14 (1) of the Consumer Contracts Act. One justice dissented and voted in favour of the insurance company[14]. In the Supreme Court, the vote also was split. Three justices voted for upholding the Court of Appeal's decision. The majority of four, however, set aside the lower court's decision. According to the majority, the farmer as a policy-holder could not be considered to be nor could he be deemed comparable with a consumer. As a consequence, the Court did not find sufficient reasons to set aside the ten-year irrevocability clause in the insurance terms[15].

This case illustrates the need which may be felt for extending the legislation's scope of application, at least partially, to small businessmen. When I use the word partially, I have in mind the German solution as mentioned above. I do not have in mind the Dutch Act's article 10, which seeks to protect the 'squeezed' small businessman ; squeezed that is between protection of the other party by consumer protection measures at one end and by harsh sales conditions at the other. This seems to be a situation which may also be dealt with by a general clause and which does not justify a separate provision, which in itself is not easy to understand.

15. Public and private law

When young men – and in the future possibly young women – are drafted for military service, a contract is not the term which one would use to qualify the relation between State and drafter. But what about a psychiatric patient

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[13] Madsen, *Scandinavian Studies in Law* 1984, p. 83, 92.
[14] *Ugeskrift for Retvœsen*, 1980, p. 917.
[15] *Ugeskrift for Retvœsen*, 1980, p. 176.

involuntarily enrolled in a public hospital ? Or a student in a state university ? The number of examples may be extended endlessly. In this paper, I can only point to the issue. 'Unfair contract terms' have to do with contract, and what is contract and what not may vary from country to country.

Especially in the area of what the French call 'administrative contract', the views are at variance. Somewhat similar is the problem discussed in the next paragraph, whether or not public entities and their contract terms – or their functionally similar bye-laws or regulations – should be subjected to control under unfair contract terms legislation.

16. Public entities and private suppliers

Whenever suppliers and consumers haggle over unfair contract terms legislation, there is one issue which will unite them. The general contract terms used by public entities, such as public utilities, transit authorities, the Post Office, cable television companies, etc. are generally perceived to be worse than those of private suppliers. It is therefore to be welcomed that public entities are no longer considered to be sacrosanct, as far as their contract terms are concerned. In the first half of this century, the State was usually thought of as a single entity. It was considered improper that one entity would control the acts of another entity. This control should be exercised by Parliament, or by the Town Council or Provincial Council in the case of local public entities.

This, of course, is mainly theory. Public utilities will often be considered as means of earning money for the public entity. Exemption clauses and all the other well-known devices may raise profits. It is only in recent times that public entities have grown aware of the consumer movement and show themselves willing to listen to consumer grievances.

Does this changing attitude justify legislative exemptions ? In my view, this is not the case. Either their general contract terms are fair and balanced. In such case, they have nothing to fear from the new control methods. Or the terms are unfair, in which case an exemption no longer is justified.

In accordance with this view, public entities generally will have to comply with modern legislation on unfair contract terms. Only in some cases have legislatures been forced to make exceptions for some branches. This usually reflects the power of the various ministries involved.

One reason to be very careful with these exceptions, is that what may be a public entity today may well be a private enterprise tomorrow, or vice-versa. After the post-war nationalization movement, present-day 'privatisation' turns many a government enterprise into a private company.

17. Other exceptions

Public entities – and the ministries which supervise them – are not the only advocates for exceptions to the application of unfair contract terms legislation

to all consumer contracts. Other branches of trade which have sought recognition as not being in need of control include banking and insurance, the construction industry and transport. The arguments advanced in favour of exceptions usually are either that legislative or administrative control have already been introduced in this particular branch or that the aims of legislation – bilateral standard contracts – have been met. Thus, insurance conditions are usually subject to prior administrative approval, transport legislation is often mandatory and standard contracts in the construction industry are indeed often bilateral because the administration – this time in its quality of principal – is in the position to serve as a true countervailing power (or more than that) to large construction companies.

In a 1977 Report, I have minutely described administrative control of insurance conditions and its history. Since 1977, the number of countries which exercise such control has grown larger because of a European directive. Still, I would maintain that exceptions based on the argument of past legislation and administrative control should not be allowed. As with the public entities one may argue that either the administrative control applies the same standards as does the unfair contract terms legislation – in which case banks, construction companies, insurance companies and transport corporations should have no fear – or it does not, in which case an exception is not justified.

One may suspect that often the control exercised by for instance the insurance control boards is not adequate. Such control usually has the function, very important from a consumer point of view, of maintaining the liquidity and solvability of the insurance companies. Contract terms contain many clauses which are not typical for the insurance contract and which may therefore better be subjected to a general control by the courts.

Allowing no exceptions to the various specific branches does not mean that existing control systems in these branches should all be abolished. Since these systems usually have other functions beside the protection of individual consumers, a conclusion to do away with them should be carefully considered.
In many countries, a Restrictive Practices Board, Monopolies Commission, or however it may be called, exercises control over general contract terms by way of anti-trust measures. Does the existence of such a control warrant the granting of exceptions? Although control of monopolistic activities and of contract terms have occasionaly been entrusted to the same Office – in the United Kingdom they still are -, still the two should not be equated completely. The introduction of standard contract terms in a particular branch may well be in the consumer interest, since he will be in a better position to compare essentials : price, quality, after-sales service. At the same time, such concerted action may constitute a danger from another perspective. The cooperation of suppliers may be extended to price and quality, in which case the restrictive trade policies legislation must of course be applied. It therefore seems clear that the two types of control should be exercised separately and that they should not interfere with one another.

There is one type of exceptions which does seem justified. Many legislators have made an exception for labour contracts, some for rent contracts for housing. In both cases, control has often a long-standing tradition. Extensive mandatory legislation has been enacted, organizations of the weaker parties (trade unions) act as countervailing power, Parliament takes an active interest in the contracts in these areas. Also, the types of conflicts often differ considerably from the ordinary types of consumer conflicts. One may even doubt whether one may speak of consumers in this case. Unfair contract terms legislation which exempts, wholly or partially, employment contracts and/or rent contracts is therefore quite justified.

18. National and international scope

Most laws on unfair contract terms now contain provisions, which seek to prevent suppliers from circumventing consumer protection by inserting choice of law clauses. The usual technique is that of a *règle d'application immédiate*, which requires a national court to apply national consumer protection legislation, no matter which national law is applicable. Of course, foreign court may not feel bound by such rules and forum shopping may be the result.

Rules such as these may once have seemed necessary to protect national consumers from the unilateral contract terms of foreign barbarians. Now that all West-European countries have enacted or are on the verge of enacting legislation on unfair contract terms, the idea of being an island of consumer protection in a sea of barbarians no longer holds true.

Also, one should notice that a legislature's attitude towards international commercial transactions has often been just as radical, but then in a reverse direction. Thus, under article 13 of the Dutch Act, international commercial contracts are not governed at all by the Act. This radical division of the law in consumer transactions and commercial transactions calls for demarcation problems. It therefore may be submitted that radical consumer protection measures through devices such as the *règle d'application immédiate* have had their time. Now that the law as to unfair contract terms is providing for a higher level of consumer protection in all member countries of the EC, tight border controls become obsolete. The ordinary conflicts rules can take over. Perhaps not completely. It cannot be denied that legal cultures are still different in the European countries. In order to protect consumers from unexpected culture shocks, it may be necessary to retain the prohibition of choice of law clauses in general contract terms, which is in force in several countries.

19. Place of legislation

For countries with a codified system of law, the question arises where to store the provisions on unfair contract terms. Legislation in this regard may be divided in two groups of rules : those dealing with unfair contract terms on the individual (contract) level and those dealing with the use of unfair contract terms as a trade practice. In accordance with this division, the common law countries and the Scandinavian countries have divided their unfair contract

terms legislation over two distinct types of laws : Civil Code type laws and trading practices laws. Theoretically, this seems to be the most appropriate way of dealing with unfair contract terms from a legislative point of view.

The disadvantage of divisions is that the various parts may grow apart, especially so when they must be interpreted by dissimilar courts. Some countries have therefore preferred enacting a single Act on unfair contract terms in particular or on consumer protection in general. The disadvantages of such a policy is that the Civil Code and other traditional legislation may now become obsolete. The Germans have generally deplored the fact that their AGB-Gesetz, for pratical reasons, could not be integrated in their civil code. This has even led to a movement to reintegrate all civil law in the civil code. Little after the AGB-Gesetz came into force, the German Ministry of Justice asked a number of mainly academics to submit proposals as to a revision of the Law of Obligations. One of the reports which resulted deals with consumer relations in general[16].

At present, only a small part of all the ideas has been taken up by the Ministry, which has charged a commission to convert these into a draft bill.

In the Netherlands, the substantive provisions on unfair contract terms have been incorporated into the (New) Civil Code. The same applies to the procedural provisions, but here we should take into consideration that the Netherlands are among the few countries which do not have an all embracing Fair Trading Act.

III. Europe's role

20. Introduction

Ever since the preliminary Programme for Consumer Protection (1976), unfair contract terms have been high on the list of priorities to be dealt with by the European Community[17]. In the same year a Memorandum and a set of Articles for a directive (Documents ENV/381/76 and ENV/384/76) were presented which were discussed with government experts. In 1979 the Commission postponed further work on a directive (*OJ* C 291 of November 10, 1980, p. 35). In 1984 the Commission then published a document on unfair contract terms (*Bulletin EC* 1984 Supp. 1/84), which provides for two ways of action. First, a directive should harmonize the laws of the member states and further the protection of consumers. Secondly, the EC should stimulate negotiations between organizations, under the auspices of a public control body. In 1987, a new set of draft articles was brought into circulation.

The draft articles will not be dealt with in this paper, nor will their basis in the EC Treaty be discussed. The constitutionality of Community measures of

[16] Madsen, *Scandinavian Studies in Law* 1984, p. 83, 92.
[17] H.P. Westermann. *Verbraucherschutz*, vol. III, p. 1-122.

consumer protection has sufficiently been discussed at the occasion of the preparation of the directive on products liability.
Rather, I will briefly make some observations regarding the need for the EC measures which are now being discussed.

21. Towards a directive

First, it will appear from the previous paragraphs in this paper, that I now welcome an EC directive on unfair contract terms. Legislation in this regard varies very much within the European Community and the same applies to practice. This endangers free competition of goods and services between member states.

An EC directive would also force those member states who are still considering the introduction of legislation or of adequate legislation to make that last step which is necessary for such legislation to come into force.

22. Towards negotiations

As for the other part of the EC's draft proposals, I am more sceptical. I am also sympathetic towards these proposals, since they are in line with what I have advocated in a 1977 Report. The scepticism stems from the fact that experience with guided negotiations so far is mixed.

In several countries such negotiations have indeed taken place. The Dutch New Civil Code, the French Calais-Auloy Report, the original Luxemburg bill – they all seek to promote such negotiations and to provide for instruments to declare the resulting contract terms binding as of law.

But one may not close one's eyes to the fact that negotiations have often not led to a result, that they are very costly and time-consuming and that the necessary prerequisites, such as a sufficient level of organization on both sides, are not always there.

In the absence of clear-cut results, and with the possibility that new legislation will provide the useful stick behind the door, the Commission seems well advised to promote further experiments in this regard, possibly even at an EC level.

23. Varying national contract law : a time-bomb ?

Perhaps unfairly I have kept one difficult question for the end. Contract terms either confirm, 'codify' existing law, or deviate from it. Usually the latter is the case. Unfair contract terms legislation seeks to limit the possibilities of deviation from existing law ; « codification' of existing law usually presents little danger. Harmonization of unfair contract terms legislation in the EC therefore means harmonization of the limitations to deviate from existing contract law. These limitations may well be completely uniform, but does this mean that the situation in the various countries will be the same?

No, this is not the case. When the possibilities to deviate from existing law are limited, what remains is . . . existing law. And as we well know, existing contract law in the EC is far from uniform.

Although this argument may appear convincing at first sight, there are some flaws. First, not all provisions in unfair contract terms legislation are purely negative. Some lay down exactly to what standards a contract term should conform in order to be considered fair. Such provisions, when harmonized in the member countries, may in fact bring about harmonization of contract law, or some measure. Second, the said legislation usually provides for rules on the incorporation of contract terms, their construction and interpretation, collective action, etc., which may well be harmonized.

Still, the message is clear. The harmonization of the law as to unfair contract terms is but one step in the direction of a harmonized contract law. Harmonization of substantive law may well be the next step.