Contract law as fairness: a Rawlsian perspective on the position of SMEs in European contract law
Klijnsma, J.G.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

UvA-DARE is a service provided by the library of the University of Amsterdam (http://dare.uva.nl)
10 Unfair terms

10.1 The Unfair Terms Directive and the CESL

In 1993, Directive 93/13/EEC on unfair terms in consumer contracts (Unfair Terms Directive or UTD) was adopted. This directive offers protection against unfair contract terms. Arguably, it is the most important piece of EU consumer protection legislation to date. The original proposal for a Consumer Rights Directive also included a revision of the rules on unfair terms, but this revision was not included in the final version of the CRD. Hence, it is still the Unfair Terms Directive that provides the basis for the harmonization of rules on unfair terms and the type of harmonization is still minimum harmonization (Article 8). As such, the differences between the Unfair Terms Directive and the CESL are much greater than the differences observable between the CRD and the CESL. This is not only due to the fact that the Unfair Terms Directive has remained unchanged since 1993 and much more legal development has taken place as compared to the period since the adoption of the CRD, but maybe more importantly, because the Unfair Terms Directive envisages minimum harmonization while the CESL aims at a uniform set of rules. The Feasibility Study on which the CESL was based contained still many further departures from the current acquis, which the European Commission did not endorse.416 Even though there are some important differences between the Directive and the CESL, the Commission clearly intended the CESL to have a substantively similar test.417

First of all, both the Unfair Terms Directive and the CESL contain two important exclusions from their scope: individually negotiated terms and core terms.418 First, a

---

416 Hesselink and Loos 2012, p. 8. The Committee on Legal Affairs of the European Parliament, however, has proposed to re-introduce a number of proposals made in the Feasibility Study. See Draft Report on the CESL by the Committee on Legal Affairs of 3.5.013, PE510.560, 2011/0284(COD). Currently, these proposed amendments are awaiting a first plenary reading in the European Parliament.

417 This makes it likely, though not entirely certain, that a lot of the case law of the CJEU on the Unfair Terms Directive will also have a bearing on the CESL. Hesselink and Loos 2012, pp. 11-12.

term can only be considered to be unfair if it has not been individually negotiated, which effectively excludes negotiated terms from the unfairness test.\footnote{Loos 2012, pp. 782-786.} A term is considered non-individually negotiated when it has been drafted in advance, and even if one term has been negotiated, this does not imply that other terms have also been individually negotiated. Furthermore, the seller or supplier bears the burden of proof when he claims a standard term has been negotiated (Article 3(2) UTD/Article 7 CESL).\footnote{Schulze (ed.) 2012, pp. 105-108.} Secondly, the main subject matter of the contract and the adequacy of the price are excluded from the unfairness test (‘core terms’), provided the terms are in plain and intelligible language (Article 4(2) UTD/Article 80(2) CESL).\footnote{Micklitz 2010, pp. 363-367.} This in effect makes clear that the unfair terms test does not introduce a \textit{iustum pretium} (just price) doctrine. Under the Unfair Terms Directive, Member States are allowed to extend the unfairness test to include the main subject matter as well. This was expressly confirmed by the CJEU in the \textit{Caja de Madrid} case.\footnote{CJEU 3 June 2010, Case C-484/08 (\textit{Caja de Madrid}), [2010] ECR I-4785.} As the CESL is a freestanding legal instrument, however, such an expansion of scope is not possible.

Article 3 Unfair Terms Directive introduces its main unfairness test. The protection that this test offers is categorical, in the sense that it only applies to unfair terms in contracts between a consumer and a seller or supplier (Article 1).\footnote{CJEU 3 June 2010, Case C-484/08 (\textit{Caja de Madrid}), [2010] ECR I-4785.} Member States are allowed to extend unfair terms protection to other circumstances as well, and some in fact have done so.\footnote{See also Schulte-Nölke, Twigg-Flesner and Ebers (eds) 2008.} It provides that a non-individually negotiated contract term is considered unfair if, contrary to good faith, it causes a significant imbalance in the parties’ rights and obligations, to the detriment of the consumer. Whether a specific term is actually unfair is a matter of interpretation. The CJEU has long taken a cautious approach towards the autonomous interpretation of the general clause contained in Article 3 of the Unfair Terms Directive. In \textit{Freiburger Kommunalbauten} \footnote{ECJ 1 April 2004, Case C-237/02 (\textit{Freiburger Kommunalbauten}), [2004] ERC I-3403. See also Hesselink 2006.}

\footnotesize{\begin{itemize}
\item \footnote{Loos 2012, pp. 782-786.}
\item \footnote{Schulze (ed.) 2012, pp. 105-108.}
\item \footnote{Micklitz 2010, pp. 363-367.}
\item \footnote{CJEU 3 June 2010, Case C-484/08 (\textit{Caja de Madrid}), [2010] ECR I-4785.}
\item \footnote{See also Schulte-Nölke, Twigg-Flesner and Ebers (eds) 2008.}
\item \footnote{Hesselink 2007b, p. 327.}
\item \footnote{See Schulte-Nölke, Twigg-Flesner and Ebers (eds.) 2008.}
\item \footnote{ECJ 1 April 2004, Case C-237/02 (\textit{Freiburger Kommunalbauten}), [2004] ERC I-3403. See also Hesselink 2006.}
\end{itemize}}
it held that whether a concrete term is unfair depends on the context and national law and hence that this was a matter for national judges to determine. In the recent *Aziz* case\(^4\) the Court, however, moved a step beyond this position. It spelled out further what is meant by ‘significant imbalance’ and ‘contrary to good faith’. With regard to the significant imbalance test, the CJEU holds that this must be assessed by comparing the contract term to national law that would have been applicable had the term not been agreed to by the parties.\(^5\) With regard to the question whether the significant imbalance arises ‘contrary to good faith’, it should be considered whether the seller or supplier, dealing fairly and equitably, could reasonably assume the consumer would have agreed to the term if it had been negotiated.\(^6\) In the end, however, it remains the task of national courts to consider whether an individual term is unfair under the directive. The Unfair Terms Directive itself also gives some further directions as to what should be considered as unfair. Article 4 determines that factors to be taken into account when determining whether or not a term is unfair include the nature of the goods or services, all the circumstances attending the conclusion of the contract and all other terms of the contract. Additionally, the Unfair Terms Directive contains an Annex with an indicative and non-exhaustive list of terms that may be regarded as unfair.

The main unfairness test in contracts between traders and consumers in the CESL is found in Article 83. As mentioned above, the unfairness test for B2C contracts of the CESL is practically identical to the test of the Unfair Terms Directive. The general clause contained in this article determines that a non-individually negotiated term is unfair if it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer, contrary to good faith and fair dealing.\(^7\) The CESL, though, differs in character, as it aims to be a freestanding instrument, i.e. a second regime of national law. Accordingly, this would seem to require the CJEU not to transpose its *Freiburger Kommunalbauten* case law to the

\(^{4}\) CJEU 14 March 2013, Case C-415/11 (*Aziz*).

\(^{5}\) Also known as the *Leitbildfunktion* of default rules, see e.g. Eidenmüller et al. 2011, pp. 1090-1091, 1094-1095.

\(^{6}\) CJEU 14 March 2013, Case C-415/11 (*Aziz*), para. 69.

\(^{7}\) Loos 2012, pp. 788-790.
interpretation of the CESL and instead to give an autonomous interpretation of what is considered unfair under the CESL.431

Furthermore, in comparison to the Unfair Terms Directive, the CESL introduces a black list and a grey list that further determine what is considered or presumed to be unfair in Article 84 and 85 respectively.432 The black list contains a number of terms that are always unfair, such as excluding liability of the trader for death or personal injury through an act or omission by the trader or a term giving the trader the exclusive right to determine the conformity of his performance of the contract. The grey list contains a list of contract terms that are presumed to be unfair, for example clauses for disproportionately high penalties. The Unfair Terms Directive’s annex already provided a non-exhaustive list of terms that was indicative of what can be regarded as unfair, but the two lists in the CESL mark a considerable addition to that. These two lists are not only more extensive, but also different in character. Article 84 introduces for the first time on a European level a list of terms that are always unfair in B2C contracts. Although the CJEU also indicated that some terms are always unfair in its interpretation of the directive, the black list in the CESL provides much more certainty as to which terms always should be considered to be unfair.433 Furthermore, the grey list contains terms that are presumed to be unfair, which is one step further than a mere indication of unfairness. It explicitly places the burden of proving the fairness of a term on the trader.

Besides a material unfairness test, both the Unfair Terms Directive and the CESL contain a duty of transparency. In the Unfair Terms Directive, Article 5 establishes such a duty. It requires that terms must always be drafted in plain and intelligible language. Furthermore, when there is doubt about the meaning of a term that term should be interpreted according to the contra proferentem doctrine, which means here that the interpretation most favourable to the consumer must prevail. The same duty

431 See also Loos 2012, pp. 792-793.
432 Interestingly enough, here the requirement that terms are not individually negotiated is not mentioned explicitly, but given the structure of the chapter this seems to have been unintentional. Whether it was indeed unintentional, however, remains uncertain.
433 See e.g. the Océano-case and subsequent decisions with regard to jurisdiction clauses; Schulze (ed.) 2012, p. 387.
is found in the CESL under Article 82 in combination with Article 64 CESL, however with a slight difference. Whereas the CESL limits the duty of transparency to non-individually negotiated terms, the Unfair Terms Directive formally extends it to all contract terms.434

Furthermore, the effects of unfair terms are regulated. An unfair term is not binding on the consumer, but the contract will continue to exist if it can continue to do so without the term in question (Article 6 UTD/Article 79 CESL). What it means for a term to be ‘not binding on the consumer’ with regard to the Unfair Terms Directive and what it requires of national courts has been subject of a series of cases before the CJEU. In its groundbreaking Océano judgment435 the court held that the aims of the directive would not be fulfilled if it was required that the consumer himself had to contest the unfairness of a contract term.436 Accordingly, it is up to national courts to test contract terms, ex officio, for unfairness, where they have the legal and factual elements necessary for such a test.437 This ex officio test also applies to cases in second instance where the validity of the contract term has not been raised in the appeal.438 A further question that arose was whether or not national courts were allowed to reduce or replace an unfair term with a less unfavourable one.439 In Banco Español de Crédito440 the CJEU determined that allowing that would also undermine the goals of the directive and hence that so-called geltungserhaltende Reduktion, or ‘validity of the contract maintaining reduction’, is not allowed under the Unfair Terms Directive.441 The underlying idea is that if the only consequence of having such a term in the contract was that it would be reduced, companies would be tempted to simply leave

434 Albeit restricted to contract terms in writing (which in turn is a requirement not found in the CESL). The practical consequence of this requirement seems relatively minimal though and it is also unclear whether it was actually the intention of the directive to cover negotiated terms or whether it is simply an obscurity in drafting. See Schulte-Nölke, Twigg-Flesner and Ebers (eds.) 2008, p. 413.
436 This was especially true in the case of unfair jurisdictional clauses where the consumer often would not (be able to) show up and hence could not dispute the validity of the term.
438 CJEU 30 May 2013, Case C-397/11 (Jőrôs v. Aegon).
439 E.g. the reduction of a penalty clause.
440 CJEU 14 June 2012, Case C-618/10 (Banco Español de Crédito).
441 See Rott 2012.
such unfair terms in the contract, knowing that at worst these will be modified to the extent necessary.\textsuperscript{442}

Finally, and importantly, the CESL contains a completely new section compared to the Unfair Terms Directive on unfair terms in contracts between traders (Chapter 8, Section 3 CESL). Article 86 CESL determines that a contract term in a B2B contract is unfair if it forms part of non-individually negotiated terms and is of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing. Article 86(2) CESL outlines a number of considerations to be taken into account to determine the unfairness of a contract term: the nature of what is to be provided, the circumstances prevailing during the conclusion of the contract, the other contract terms and terms of other contracts on which the contract depends.

That brings us to the differences between consumers and SMEs with regard to unfair terms protection. Similarly to the situation with pre-contractual information duties and rights of withdrawal, the comparison between consumers and SMEs under the current \textit{acquis} is rather straightforward, as there is simply no unfair terms protection for SMEs at the EU level.\textsuperscript{443} Matters are more complex under the CESL, as it contains a section on unfair terms in B2B relations. As the CESL is primarily applicable to situations where at least one party is an SME, this comes down to (also) unfair terms protection for SMEs.\textsuperscript{444} There are, however, important differences between the unfairness test for consumers and the test for SMEs.

There are a number of ways in which the Article 86 test for SMEs differs from the B2C contracts test. The general Article 83 test determines that a term between a trader and a consumer is unfair if it causes a significant imbalance to the detriment of the consumer, contrary to good faith. The criterion of ‘grossly deviating from good commercial practice’ that is used in Article 86 is derived from Directive 2011/7/EU (the Late Payment Directive), which in turn was based on the DCFR (interim outline

\textsuperscript{442} Presumably this case law can be extended also to the CESL, see Hesselink and Loos 2012.

\textsuperscript{443} Again, save for some unfair commercial practices regulation.

\textsuperscript{444} I am leaving aside here the situation where an SME provides the terms to a larger company and instead will focus exclusively on the SME as the receiver of terms (see also Chapter 6).
(and is meant to be more permissive to the supplier of a term than the significant imbalance test of Article 83.445

Article 86(2) CESL outlines a number of considerations to be taken into account to determine the unfairness of a contract term: the nature of what is to be provided, the circumstances prevailing during the conclusion of the contract, the other contract terms and terms of other contracts on which the contract depends. These are identical to the criteria outlined in Article 83(2) CESL, except that the latter includes a transparency test. The transparency test refers to the duty of transparency as formulated in Article 82, which requires traders to draft and communicate contract terms in plain and intelligible language. This duty is expressly only applicable to consumer contracts and not to contracts with SMEs.446 Related are the rules on interpretation of contract terms. Article 64 provides a mandatory contra proferentem rule in favour of consumers with regard to all contract terms. Article 65 also provides for such a rule of interpretation for non-consumer cases, but this rule is not mandatory and only applies to non-individually negotiated terms.

Another element of the substantive unfairness test that differs between section 2 and section 3 of Chapter 8 CESL is the lack of a grey list and a black list. The two lists included in Articles 84 and 85 indicate a number of absolutely unfair terms (black list) and a number of presumed unfair terms (grey list). These lists are significantly more extensive than the list found in the Unfair Terms Directive.447 Such lists have so-called Indizwirkung for trader-to-trader contracting in a number of Member States, e.g. Germany and the Netherlands.448 This means that the black and grey lists terms can be indicative of what is to be considered unfair under the more general open norm, which (in those countries) applies also to B2B situations. However, this Indizwirkung is not mentioned in the factors that are to be considered under Article 86(2) CESL. Accordingly, this presents another way in which the test for SMEs differs from that for consumers.

445 DCFR notes p. 642.
446 Unlike to the duty of transparency as formulated in Book II.-9:402 DCFR.
447 Loos 2012, pp. 790-792. Which also only had an “indicative” - not quite presumptive - value.
Chapter 10

The last element in which the unfairness test for SMEs differs is in the ‘not-individually-negotiated’-requirement. In principle, terms that are individually negotiated are excluded from the unfairness test. However, where Article 83 CESL determines that a term that is not individually negotiated can be tested, Article 86 CESL determines that a term that forms part of not individually negotiated terms can be tested. This might be read as to imply that as soon as one of the terms of the contract has been individually negotiated, all the other terms are excluded from the unfairness test. As it is not even necessary that the negotiations are successful this seems to set a harsher standard for SMEs.449 Finally, there is a difference concerning the duty to raise awareness of not individually negotiated terms as specified in Article 70 CESL. This article determines that such terms may only be invoked if the party supplying them took reasonable steps to draw the other party’s attention to the terms. Article 70(2) CESL determines explicitly that for consumer contracts this is not the case if the terms are merely mentioned in the contract itself. This explicit mention seems to imply a contrario, that in contracts between an SME and another business such a mention might be sufficient to comply with the duty to raise awareness.

10.2 Underlying rationales

One of the main tactics stronger contracting parties can employ to exploit their counterparties is through the use of unfavourable contract terms. Weaker party protection rules – and more specifically the rules on unfair terms protection – aim at correcting these problems.450 In a vast majority of sales contracts, for example, consumers agree to standard terms they have neither read nor understood. Unfair terms protection in contract law is an important mechanism to combat such exploitation and hence help weaker parties. This is explicitly the case on the EU level.

449 Loos 2012, pp. 784-786.
450 Hesselink 2011b, p. 132.
The Court of Justice of the European Union has made clear in a line of cases that the policing of unfair terms under the Unfair Terms Directive is based on the relative weakness of consumers.\textsuperscript{451} Already in its \textit{Océano}-case the Court stated that:

“The system of protection introduced by the Directive is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge. This leads to the consumer agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of the terms.”\textsuperscript{452}

This reasoning was confirmed and expanded in a number of decisions and is now well-established case law.\textsuperscript{453}

This is embedded in a more general paradigm of weaker party protection that has developed in European contract law.\textsuperscript{454} As the \textit{Océano}-case states, the weakness of the consumer relative to the supplier of the terms is located primarily in his lack of bargaining power and lack of information.\textsuperscript{455} Consumers are powerless when bargaining with traders because of their economic position and hence will not be able to influence the contract terms.\textsuperscript{456} In other words, a product typically is offered on a take-it-or-leave-it basis with regard to the contractual terms. This allows businesses to impose unfair terms.

Furthermore, an information asymmetry between the consumer and the business with regard to the contractual terms is often readily observable.\textsuperscript{457} The business is a repeat player with regard to its own standard terms while the consumer often

\textsuperscript{451} Schillig 2008, pp. 338-339.
\textsuperscript{453} ECJ 26 October 2006, Case C-168/05 (\textit{Mostaza Claro}), [2006] ECR I-10421, para. 25), ECJ 6 October 2009, Case C-40/08 (\textit{Asturcom Telecomunicaciones}), [2009] ECR I-9579, para. 29), CJEU 14 June 2012, Case C-618/10 (\textit{Banco Español de Crédito}), para. 39) and most recently CJEU 14 March 2013, Case C-415/11 (\textit{Aziz}).
\textsuperscript{454} Hondius 2004, pp. 245-246.
\textsuperscript{455} Lando 2006, p. 827.
\textsuperscript{456} Mazeaud 2011, p. 126.
\textsuperscript{457} Lando 2006, pp. 830-831.
contracts for a certain product infrequently. The effect is enhanced by the weakness in bargaining position, because if the consumer cannot exert influence on the contract terms anyway, it is more likely he will not attempt to gather more information. This leads to a market failure that unfair terms protection aims to correct.\footnote{Rösler 2009, p. 742.} The market for standard terms effectively amounts to a market for lemons.\footnote{Made famous by Akerlof 1970, with regard to second hand cars, but the same applies here. See e.g. Schillig 2008, pp. 340-343.} In most cases it is rational for a buyer to not fully read or comprehend the standard terms of the supplier. The cost of doing so is often high, as terms tend to be lengthy and difficult to understand, while the rewards are often low, as the terms do not pertain to the core of the contract and are often non-negotiable.\footnote{Hesselink 2011b, pp. 136-139.} The fact that buyers lack comprehensive knowledge of standard terms means that the supplier cannot compete with competitors on the quality of such terms.\footnote{Eidenmüller et al. 2011, p. 1087.} A competitive market then actually forces a race to the bottom with regard to the quality of standard terms, leading to a quality of terms that neither party is happy with.\footnote{Bar-Gill 2012, pp. 24-25.} In this way, information asymmetry can lead to a market failure with regard to standard contract terms. Unfair terms protection can be seen as a regulatory intervention to correct this market failure. Requiring terms to be at the very minimum of a certain quality prevents the quality of terms from dropping below the threshold needed for a market to exist.

### 10.3 Are the differences between consumers and SMEs justified?

As we have seen above, SMEs are in a less favourable position than consumers with regard to unfair terms protection. Even though Member States are allowed to extend the scope of the Unfair Terms Directive to SMEs, the directive itself offers no protection whatsoever. The CESL extends unfair terms control to SMEs, but that test is more permissive in important respects. Hence, the reoccurring question is whether such harsher treatment for certain SMEs compared to consumers can be justified by...
the underlying rationales of unfair terms protection, given the need for categorical weaker party protection in contract law as fairness.

As protection against unfair terms is often considered to be the paradigmatic case of weaker party protection, the arguments here relate closely to those discussed in Chapter 7.4. The main underlying rationales of weaker party protection relate to the inequality of bargaining power and information asymmetry with regard to standard terms. Just like a consumer, an SME will typically lack the bargaining power to influence the terms a large business will impose. The Commission already recognized this in its 2003 Action Plan when it stated, “SMEs often have to accept their co-contractor’s standard terms and the law of the latter as the applicable law due to their weaker negotiating power.”\(^463\) Accordingly, this offers no ground for distinguishing between consumers and SMEs or for the more permissive test in the CESL.

The same can be observed with regard to information asymmetry in unfair terms.\(^464\) Small companies often operate at a similar information disadvantage as consumers, especially in the case of atypical contracts. A large company is able to hire lawyers to inspect and weigh the terms of the other party, but this will typically be impossible for SMEs. On top of that, when an SME knows it will be bound by the other party’s terms anyway, this reduces the incentive to inspect these terms in the first place. As observed in the consumer case, this can lead to a market for lemons with regard to contractual terms, as larger businesses are not able to compete on better terms in their dealings with SMEs. This makes one of the main differences between consumers and SMEs in the CESL – the lack of a duty of transparency in B2SME contracts – especially unjustified.

In Part I, I argued that contract law as fairness creates a normative case for categorical weaker party protection. Unfair terms control is arguably the most important legal mechanism of weaker party protection. Hence, good reasons would be needed to exclude SMEs from the category that receives such protection especially when it comes to unfair terms control. The discussion of the underlying rationales

\(^{464}\) Eidenmüller et al 2011, p. 1092.
specific to unfair terms control shows that differentiating between consumers and SMEs in this matter is not justified. Accordingly, from a Rawlsian perspective the denial of unfair terms protection to SMEs is unjust.