A Law for Big Business and Competent Consumers?

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1. Introduction

Professor Thomas Wilhelmsson has asked whether, were the DCFR to be used as the basis for an Optional Instrument or for a general harmonisation measure, the result would not be a law for big business and competent consumers. This short paper is a reply to Wilhelmsson. I take big business and competent consumers in turn. I end by discussing briefly the difficult question of distributive justice in the law of contract.

2. Use of the DCFR

I should preface my remarks by making two points about the use of the DCFR on which Wilhelmsson's question seems to be predicated.

The first is that I do not envisage any broad harmonising measure in general contract law – or even enormously much wider legislation in the field of consumer law than we already have.¹ It is true that the DCFR is very broad in its coverage, but that reflects its purpose as a toolbox or legislator's guide. One of its functions as

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¹ In the foreseeable future I can envisage European consumer legislation dealing with other kinds of supply of goods contracts besides sales: services contracts, and perhaps insurance contracts.

a toolbox, perhaps the most important of its functions, is to provide definitions of terms that are used in European legislation without being defined there.² The existing *acquis* already employs a very wide range of legal terms and concepts in this way, so the DCFR needs to be broad. Its breadth does not indicate any desire to legislate across the fields that the DCFR covers.

Any Optional Instrument would certainly also be narrower than the DCFR. It might encompass general contract law, consumer contracts and some of the specific contracts to be found in Book IV of the DCFR. I think it will be a long time before the Member States would agree to an optional instrument covering tort, even though under the new Rome II Regulation³ the parties can now choose the law of tort that is to govern their relationship.⁴ But I think that even an Optional Instrument for contracts is a long way off. It is very far from clear that the EU will ever adopt an Optional Instrument. Even if it did, it seems inconceivable that the DCFR would form more than a very preliminary draft, a source of ideas and – again – of definitions and techniques.

But let us assume that the DCFR – or at least the parts dealing with contracts – were to be enacted as an Optional Instrument in the form in which it appears in the Interim Outline Edition, with the commentary that has been delivered to the Commission. Or suppose that the European Commission were to decide on a European Contract Law Directive, under which each Member state were required to harmonise its contract law with the provisions of the DCFR. How would it stack up against Wilhelmsson's comment?

3. A Law for Big Business or for SMEs?

I would argue that the DCFR is very far from being a law just for big business. I assume that big businesses are sophisticated, are making contracts large enough that fees for legal advice are – relative to the deal – not prohibitive and are prepared to accept a fair degree of risk. I would say the DCFR is certainly not for them. Compared to my own law, for example – and particularly compared to the law English lawyers “sell” to foreign parties as the law of choice, when the most protective legislative rules are do not apply⁵ – it contains a great deal of protection for parties.

Rather, I would argue that the DCFR would be much better suited to the needs of SMEs. Ms Diana Wallis MEP has spoken eloquently of the need for better protection for small businesses.⁶ In many countries including my own there is a recognition that small businesses need more protection, for example from unfair standard terms.⁷

² See Beale [1], [2].

³ Regulation (EC) no 864/2007 of the European Parliament and of the Council of 11 July 2007.

⁴ Art. 14.

⁵ Unfair Contract Terms Act 1977 does not apply to contracts that are subject to English Law only because the parties have so chosen: s 27(1).

⁶ E.g. “European contract law and the review of the *acquis*”, delivered at the Austrian Presidency Conference on May 26, 2006. The text is available at http://www.dianawallismep.org.uk/articles/000004/european_contract_law_and_the_review_of_the_acquis.html.

⁷ See the recommendations in *Unfair Terms in Contracts* (Law Commission Report No 292, Scottish Law Commission report No 199, 2005), available from <http://www.lawcom.gov.uk>. The recommendations have been accepted in principle by Government, subject to further evaluation.

SMEs tend to be less sophisticated in terms of legal knowledge, and even knowing when they need legal advice; their contracts usually involve lower values, so that taking legal advice about them is relatively costly; and, I suspect, they are much less able or willing to take risks than are larger businesses. So they may well want quite different things of the law of contract than do larger businesses. I suspect they are prepared to pay the price of some trammelling of freedom, and of some uncertainty as to how the courts will judge matters which are governed by broad standards.

I would argue that the law for B2B contracts that is to be found in the DCFR is in fact well suited to the needs of this group. Let me give some examples.

3.1 Unfair Terms

As in PECL⁸ the DCFR provisions on unfair terms which have not been individually negotiated apply to all B2B contracts. This is a significantly more far-reaching provision than is found in the Unidroit *Principles of International Commercial Contracts*,⁹ and certainly more than anything found in English law.¹⁰ It is true that for B2B contracts, the texts do not go quite as far as the PECL text seemed to go. PECL was a copy-out of the Directive on Unfair Terms in Consumer Contracts,¹¹ but applied to all contracts, and perhaps it was not as well-thought through as it might have been.¹² There are two principal differences between the PECL text and the provisions of the DCFR.

The first is that in the DCFR, for B2B contracts a term can be challenged “only if it is a term forming part of standard terms supplied by one party.”¹³ There is good reason for this. A term which is simply one of a set of standard terms is particularly likely to be a problem even in B2B contracts – the other party may not realise that it is there, so that they are taken unfairly by surprise, or they may be met with a blanket refusal by the other party to alter its standard terms. In contrast, the PECL test can (like the Directive on which it is based) be read as allowing an individual term to be challenged if one party insisted on the term, simply because that party had drafted it before the negotiations began. That may be appropriate for consumer contracts, and it is the test that the DCFR applies to them,¹⁴ but the researchers took the view that it would not be appropriate for B2B contracts. Even if the clause has been drawn up by one party in advance, if it has been put forward individually rather than as just one term in a long document, the other party will know it is there. They can then seek to negotiate for a change to it or to other terms. If they can’t get it changed, or can only do so at the cost of some other change, such as a change in the price, which is unacceptable to them – well, tough luck. That’s business.

It is of course true that there are many businesses which would like to be able to attack clauses which the other party has insisted on. When the Law Commission and

⁸) PECL art 4.110.

⁹) 2nd ed, 2004, see art 3.10.

¹⁰) Unfair Contract Terms Act 1977 applies to domestic B2B contracts but it affects only exclusion and limitation of liability clauses and the like, not unfair terms in general.

¹¹) Directive 93/13.

¹²) As the responsible reporter for the validity chapter, I think I may say this.

¹³) II-9:406.

¹⁴) II-9:404.

the Scottish Law Commission proposed to bring all unfair terms in B2B contracts within a PECL-like provision,¹⁵ there was a warm welcome from some sectors – particularly from sub-contractors in the construction and defence sectors – who want to avoid certain risks which the main contractors frequently insist that the subcontractor carries. But the problem was certainly not one of “unfair surprise” – the subcontractors knew about these clauses all too well – nor even that the terms were imposed by the main contractors as an unalterable bloc. The problem was that market conditions made it possible for the main contractors to insist on particular terms they wanted. The Law Commissions concluded that problems like this are not ones that contract law can deal with. Even if the particular term were to be declared invalid, the problem would re-surface in another form. To compensate, the main contractor would impose other risks on the subcontractor or would simply reduce the price it was prepared to pay – and the subcontractor would probably like that even less than the offending clause.¹⁶ In other words, problems of overall market power are not susceptible to solution under unfair terms provisions.

The other difference between PECL article and the DCFR is that the fairness test which applies in B2B contracts is not whether it “significantly disadvantages the consumer, contrary to good faith and fair dealing”¹⁷ but whether it is “of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing”. In the CRT it was thought that there is inevitably a difference between B2B and B2C contracts: what is unfair when used against a consumer may not be unfair when used against another business. The question is how best to make that clear. Should there simply be a single test, as in PECL, with a note in the Comments that it may lead to different results in the two cases? Or should the difference be expressed in the text? After much discussion, the CRT opted for the latter, but on this point no change of substance from PECL is intended.

3.2 Threats and Unfair Exploitation

The provisions on unfair terms are far from the only ones that are protective when compared to many laws, and which are likely to be particularly important for SMEs. There are the provisions on Coercion or Threats¹⁸ and on Unfair Exploitation.¹⁹ It cannot be only in the UK that many of the leading cases on threats – particularly “economic duress” – have involved small businesses that have been put under pressure.²⁰ Some banks who have demanded guarantees have been guilty of exploitation of the kind that under the DCFR will invalidate a contract,²¹ and while it is more com-

¹⁵ Joint Consultation Paper, Unfair Terms in Contracts (LC CP No 166, SLC DP No 119, 2002), Part V. The paper is available at www.lawcom.gov.uk.

¹⁶ See *Unfair Terms in Contracts* (Law Commission Report No 292, Scottish Law Commission report No 199, 2005), also available from <http://www.lawcom.gov.uk>, esp. at paras 5.19–5.20.

¹⁷ Cf. PECL 4:110(1) and DCFR II-9:404, Meaning of “unfair” in contracts between a business and a consumer.

¹⁸ II-7:206.

¹⁹ II-7:207.

²⁰ E.g. *D & C Builders v Rees* [1966] 2 Q.B. 617. I should add that larger businesses are also sometimes victimised, e.g. in *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd* [1979] Q.B. 705.

²¹ E.g. *Crédit Lyonnais Bank Nederland NV v Burch* [1997] 1 All E.R. 144. The problem is not confined to the UK: see BGH, 12 March 1981.

mon for the exploited guarantor to be a private individual, it is certainly possible to envisage the same sort of thing happening to a small businessman or woman.

3.3 Pre-Contractual Information

There is a general duty on provision of pre-contractual information²² which at least on the face of it goes much further than English law, which has no general duty of this kind. Admittedly this pre-contractual information duty is not as strong for B2B contracts as for consumer contracts. For B2B cases, the test is whether the failure to provide the information would deviate from good commercial practice. Again this is primarily an attempt to mark the point that businesses are expected to make their own enquiries to a much greater extent than are consumers. Somewhat similarly, after detailed discussion at a workshop with stakeholders, the CRT took the view that a business should not automatically assume that the seller would accept responsibility for everything stated by or on behalf of a producer. A business buyer can be expected to ask its contracting party to confirm or deny the statement. And I do not accept the suggestion that there is any lack of coherence between this general rule and the more demanding standards applied in the Book on Long-Term Contracts.²³ First, it is widely accepted that many franchise and similar contracts are closely analogous to consumer contracts because they are often concluded between very sophisticated franchisors or manufacturers on the one side and “Mom and Pop” operations on the other. Moreover, the fact that the contract is a long-term one which requires the franchisor to make considerable transaction-specific investments makes it all the more important that the franchisor or distributor has full information at the outset. For many of them, getting experience for the future by from their mistakes on the first contract is simply not an option.

Thus my argument is that the provisions of the DCFR are actually much better suited to SMEs than they are to big business.

4. “Competent Consumers”

There may be more justification in the criticism that the DCFR assumes that it is normally enough to give consumers information; they can then be expected to act on that information. Likewise, when they have agreed something explicitly, the law should be slow to let them disavow it later. Thus, for example, the articles on unfair terms in consumer contracts apply only to terms which were not individually negotiated.

This was an issue which divided the CRT. Some argued that the number of cases in which a consumer can negotiate effectively over a non-core term are so few that it would better to apply the fairness test even to terms that have been negotiated, as is done in many Member States.²⁴ Others, mindful perhaps of the original task of the Acquis Group, to restate the principles of the existing Acquis, or concerned to maintain the symbolic importance of holding parties to what they have expressly agreed

²² II.–3:101: Duty to disclose information about goods and services.

²³ E. g. IV.E.–2:101: Pre-contractual information duty.

²⁴ See the *EC Consumer Law Compendium* (ed. H Schulte-Nölke, 2007), Part 3 C.III.3.b. This has also been recommended for the UK: see the Law Commissions’ report on Unfair Contract Terms. The Report has been accepted in principle by the Government.

to, preferred to restrict the text to terms which have not been individually negotiated. This is obviously a matter of policy on which the legislator will have the last word; and so a compromise was agreed by which the words “which has not been individually negotiated” are placed in [...].²⁵

5. Lésion

What is not to be found in the DCFR is any mechanism for ensuring that, even in the absence of some sort of procedural irregularity, a party may escape a contract on the ground that the exchange is an unfair one – for example, that the price is far higher than the market price for the item. A reference by Professor Wilhelmsson to Commutative Justice suggested that he would like to see something on these lines. Thus should we have an article dealing with *lésion*, in addition to the article on Unfair Exploitation,²⁶ which applies where one party deliberately takes unfair advantage of, for example, the other’s ignorance or needs (“qualified *lésion*”).

I think there are good reasons for not including an article on *lésion*. First, it does not seem to represent the common core. But I have to admit that there are European precedents for such provisions. There are the rather traditional rules on *lésion*, still found, for example, in French and Austrian law, though they are subject to severe restrictions. Section 36 of the Nordic Contracts Act might cover excessive prices. Also I understand that several countries have implemented the Unfair Terms in Consumer Contracts Directive without the clause preventing a review of the adequacy of the price.²⁷

What I do not know is how far such provisions are used in practice or, to put the question another way, to what extent simple overcharging – overcharging without the kind of overreaching which amount to unfair exploitation – is really a problem within the EU. My guess is that it is less of a problem in Western Europe, where it is relatively easy to find out the value of major items such as used cars or to get valuations of real property, than it may be in the newer Member States, where these valuation services may not yet have developed. Perhaps we should include something on these lines. It is my suspicion, however, that problems of simple overcharging are better solved by improving information about prices than by legal rules on *lésion*.

Wilhelmsson also mentioned “social force majeure” – the notion that the law should make allowances for consumers unable to perform their contracts because of catastrophes such as illness or loss of employment. Again some of us will have sympathy for such arguments. In any case, this criticism may be wide of the mark or simply premature. It is principally in contracts involving the consumer in a long-term commitment where social force majeure is a real problem – contracts such as tenancy agreements and, above all, consumer credit contracts.²⁸ Tenancy agreements

²⁵) II.–9: 404: Meaning of “unfair” in contracts between a business and a consumer.

²⁶) II.–7:207: Unfair exploitation.

²⁷) See the *EC Consumer Law Compendium*, Part 3 C.IV.2.

²⁸) I would include in this category finance leases and hire-purchase agreements. Arguably social force majeure in such contracts might have been dealt with in the Book on Leasing, but much leasing is short-term. It seems more logical to treat finance leases and hire-purchase agreements as forms of consumer credit agreement, with the vendor providing the credit instead of a bank, and therefore to treat them in the Book on Credit Agreements.

are outside the direct application of the DCFR. The Book on Credit Agreements is still under construction.

6. Contract and Distributive Justice

This example raises, very directly, a very difficult topic: to what extent do we want to use the law of contract as a tool for redistribution? If consumers who enter a long-term contract and then lose their job are to be excused from performing – or even if they are merely to be allowed extra time in which to pay – someone has to bear the cost. In the first instance the cost will of course fall on the lender, but it will not remain there. Over time it will be passed back to borrowers generally in the form of higher charges for credit. That may be an acceptable form of loss-spreading, but we need to recognise it for what it is: a form of compulsory social insurance. The alternative is for the individual to take out an individual “income protection” policy. This is frequently done in the UK. It is true that these policies do not have a good name but that seems to be due to mis-selling rather than anything inherently wrong with the idea. Overall, individual insurance may be more costly than the “social insurance” that the doctrine of social force majeure would provide, but the cost is more likely to be borne by those who create the risk, by taking on loans that they can only afford to repay if their job remains secure. There is a clear political choice to be made here, and I suspect there would be very different views even among today’s audience.

Perhaps we would not mind paying a little extra on our bank loans to help our fellow citizens who have the bad luck to lose their jobs or become incapacitated. But let me give another example which, to my mind, shows why we may not want to tackle distributive questions because of the limits of what contract law can achieve. The UK’s Office of Fair Trading, which is one of the bodies enabled to challenge the use of unfair terms in consumer contracts, has brought an action against eight major banks. The OFT is challenging the “default charges” which the banks, through their terms and conditions, impose on those who overdraw their accounts without the bank’s prior agreement. In addition to charging interest on the overdraft, the banks usually charge a substantial fee, say £25.²⁹ It is said that the banks make very substantial profits from these fees. There have been very interesting arguments as to whether the terms are “core terms”, whether they are in “plain intelligible language” and more generally whether or not they are fair. Judgment has now been delivered on the preliminary point about core terms. To cut a long story short, the terms in question are not exempt as core terms.³⁰

What is interesting from the distributive point of view is what will happen if the banks lose the case. They will not simply accept a cut in their profits. Informed analysts say that it will almost certainly mean the end of the “free banking” enjoyed by those customers who manage to keep their accounts in credit, or have to foresight to arrange an overdraft in advance to cover accidental overspends. Thus rather than the

²⁹ This is the fee charged by HSBC Bank plc. However there are some restrictions. There will not be any charge for overdrawal by less than £10 or for the first overdrawal in a six-month period; and the fee will not exceed the amount by which the account is overdrawn.

³⁰ *OFT v Abbey National plc* [2008] EWHC 875 (Comm). For more background see <http://news.bbc.co.uk/1/hi/business/7218582.stm> (and links from that site).

costs falling on those who overdraw, they will fall on all customers – and in this situation the costs will not be small. Whether you view the redistribution that would result as socially desirable may depend on whether you think most of those who overdraw are the victims of bad luck, so that the current system imposes its costs on those who can least afford to pay – or that most of them are simply feckless. But what contract law cannot do is reduce the very high profits being made, one way or another, by the banks. Only price controls that extend to every aspect of the terms and conditions, or possibly competition law, could do that. So Wilhelmsson must forgive us if we view his wish to introduce aims of improving distributive justice through contract law as something of a forlorn hope.

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