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Save the 'Mittelstand': How German Courts Protect Small and Medium-Sized Enterprises from Unfair Terms

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Abstract: This article discusses the appropriateness of controlling standard terms in business-to-business (B2B) contracts. Using the example of Germany, where the Civil Code explicitly allows the control of B2B standard terms, it finds evidence that courts tend to use this control to favour small and medium-sized enterprises (the Mittelstand) in relation to bigger companies. This approach is questionable. It is suggested here that the rationale of standard terms control is not to compensate for power imbalances, which is the task of other legal institutions, such as competition law. Rather, the goal of such control should be to prevent and correct failing contractual and market mechanisms. It is further argued that clear criteria are required for assessing the fairness of standard terms in B2B relations, which are currently lacking both in German statutory provisions and in case law. Therefore, the article finds that it is not recommendable to emulate the German model on the European level. Before any clear criteria are found, the EU should not engage in the harmonization of B2B standard terms control.

Resumé: Cet article s'interroge sur la pertinence du contrôle des conditions générales des contrats entre professionnels (B2B). En Allemagne, où le Code Civil étend explicitement le contrôle des conditions générales aux contrats B2B, on constate que les tribunaux ont tendance à utiliser ce contrôle pour privilégier les petites et moyennes entreprises (PME) par rapport aux grandes entreprises. Cette approche est discutable. Nous soutenons ici que les conditions générales n'ont pas vocation à compenser les déséquilibres dus aux positions dominantes sur le marché. Cela relève de la compétence d'autres institutions juridiques, comme par exemple du droit de la concurrence. L'objectif du contrôle des conditions générales devrait plutôt prévenir et corriger les défaillances des instruments de marchés ainsi que les mécanismes de conclusions de contrats. A cet effet, il est nécessaire de fixer des critères clairs permettant de juger de la proportionnalité des clauses des conditions générales. Vu que ces dits critères font cependant défaut tant dans la législation que dans la jurisprudence, cet article recommande de ne pas s'inspirer du modèle allemand. Avant que tout critère clair se soit établi, l'UE ne devrait pas s'engager dans l'harmonisation du contrôle des conditions générales dans les contrats B2B.

Zusammenfassung: Der Aufsatz untersucht die Angemessenheit der Kontrolle von Allgemeinen Geschäftsbedingungen (AGB) im unternehmerischen Rechtsverkehr (B2B). Am Beispiel der deutschen Rechtsordnung, die die ABG-Kontrolle auf B2B-Verträge erstreckt, lässt sich beobachten, dass Gerichte dazu tendieren, die von großen gegenüber kleinen und mittleren Unternehmen (KMU) verwendeten

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AGB für unangemessen und unwirksam zu erklären. Dieser besondere Schutz, der dem „Mittelstand" zuteil wird, ist fragwürdig. Unter Berücksichtigung anderer Ansätze wird hier die Ansicht vertreten, dass der AGB-Kontrolle nicht die Kontrolle von Marktungleichgewichten obliegt, welche von anderen Instituten wahrgenommen wird, wie dem Wettbewerbsrecht. Vielmehr soll die AGB-Kontrolle dem Versagen von Vertragsschluss- und Marktmechanismen vorbeugen und ggf. korrigierend entgegenwirken. Für diesen Zweck bedarf es klarer Kriterien, um die Angemessenheit von AGB-Klauseln beurteilen zu können, jedoch mangelt es derzeit sowohl im Gesetz als auch in der Rechtsprechung an ihnen. Im Ergebnis ist daher festzustellen, dass die Zeit noch nicht reif dafür ist, die AGB-Kontrolle im unternehmerischen Rechtsverkehr auf europäischer Ebene zu harmonisieren.

1. A unique feature of German law is the way it regulates standard form contracts. Contrary to the contract law of many other countries, Germany does not limit the scrutiny of standard terms and conditions to business-to-consumer relations (B2C).[1] Instead, it extends the scope of review to business-to-business contracts (B2B),[2] provided that the clauses were not individually negotiated by the parties. This extension is thought to particularly help small and medium-sized enterprises (SME), or the *Mittelstand* in German parlance. Courts in Germany have rendered many decisions branding standard terms in contracts between big companies and *Mittelstand* companies as being unfair towards the latter, and consequently void, so that statutory default rules are applicable.[3] This case law not only stands out from that of European neighbouring countries, but it has also fuelled a heated discussion over the merits of a control of standard terms and conditions in B2B relations and moreover in principle.[4] As a legislative novelty outside Europe, which will be comparatively considered, Australia very recently decided to amend its consumer law to equally protect small businesses against unfair terms (in force from November 2016).[5]

2. Taking a closer look at how terms in B2B contracts are subjected to a fairness control is worthwhile for several reasons. One may first of all debate whether it is indeed desirable and justified to protect small firms against 'big

1 For an overview of unfair terms control in different Member States, see Paolisa Nebbia, *Unfair Contract Terms in European Law: A Study in Comparative and EC Law* (Oxford, Hart 2007) pp 75–82; a country in which unfair terms control historically was also not limited by a particular status of the contractual parties is Italy, see *ibid.*, p 77, and Gino Gorla, 'Standard Conditions and Form Contracts in Italian Law', 11 *American Journal of Comparative Law* 1962, p 1.

2 See s. 310(1) BGB, which will be discussed below, see 1.2.

3 Some illustrative examples will be discussed below, see 1.3.

4 See *infra* 2.

5 Australian Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 No 147 (assented 12 November 2015, www.legislation.gov.au/Details/C2015A00147) – 'An Act to amend legislation to extend unfair contract protect to small business contracts, and for other purposes.' The Act amends both the Australian Securities and Investments Commission Act 2001 and the Competition and Consumer Act 2010, especially its Schedule 2 'Australian Consumer Law'.

business' by second-guessing their agreements. A thorough discussion of this point may elucidate the rationale underlying standard terms control in general, which so far is not completely clear. European law, in particular the Unfair Terms Directive 1993, seems to suggest that the *raison d'être* is consumer protection, which would speak against extending it to B2B contracts. But one could equally try to justify such extended control of contract terms by the need for a more general protection of the 'weaker party', including SMEs, or by the idea of 'contractual justice'. If one accepts that regulating unfair terms is necessary in B2B relations, the next question concerns the appropriate standard of what is 'fair' or 'unfair'. The German discussion may provide some insight, which could be enlightening for other countries and at the European level, since both the legislator and the courts have sought for decades to establish such a standard. Regulating unfair terms in B2B relations is not yet part of EU law but its incorporation has been suggested by the Draft Common Frame of Reference (DCFR)[6] and the Proposal for a Common European Sales Law (CESL).[7] The standards of 'good faith and fair dealing' or 'good commercial practices' that these texts use are inspired by those set out by the German Civil Code (Bürgerliches Gesetzbuch, BGB).[8] The German experience may also shed light on the interpretation and appropriateness of these standards.

3. Consequently, this article is structured as follows: Section 1 provides the economic, social and legal background against which the B2B standard terms control takes place with special focus on SMEs. Section 2 will take a closer look at the reasoning for the voidness of unfair terms. Section 3 provides an analysis of the standards applied by German courts to assess the (un)fairness of standard terms and conditions in B2B contracts. Section 4 concludes with some lessons that can be drawn from the German experience for European law.

1. Background in German Economy and Law

1.1. The Special Role of SMEs in Germany

4. SMEs form the backbone of the German economy. They amount to no less than 99.6% of all companies operating in Germany.[9] Ranging from innovative service providers to highly specialized manufacturers, they are often leaders in niche markets at the global level. SMEs employ the majority of Germans workers and

6 Art. II.-9:405 DCFR.

7 Art. 86(1)(b) CESL Draft.

8 See s. 307(1) 1 BGB, which will in detail be addressed below.

9 See Institut für Mittelstandsforschung Bonn, 'Mittelstand im Überblick – Volkswirtschaftliche Bedeutung der KMU', www.ifm-bonn.org/statistiken/mittelstand-im-ueberblick/#accordion=0&tab=0.

about 80% of the trainees.[10] The jobs they create are considered to be particularly safe since they are less subject to the 'hire and fire culture' of big companies. In addition, SMEs are less prone to move to other countries. Though they only produce about a third of the gross domestic product (35.5%), SMEs make very notable contributions to their home cities, for instance by sponsoring cultural or sporting events. In short, they are a pillar of the country's economic and social stability.

For these reasons, it is no wonder that SMEs are the darling of German politics. In any discussion, the argument that a proposed legislative project is against the *Mittelstand* gives rise to virtually insurmountable opposition and a great deal of public indignation.[11] Equally, and perhaps more surprisingly, the size of a company also seems to have an impact on the practice of the judiciary. Courts sometimes happen to favour small companies over 'big business'. Consciously or not, they have incorporated the policy argument into their case law. An area in which this is particularly evident is the control of standard form contracts. In many cases German courts have invalidated contractual stipulations that were imposed by big companies on smaller enterprises. The case law has become so pervasive that SME protection increasingly resembles the protection of consumers. The new legislation in Australia goes even further and explicitly provides SMEs with the same protections as consumers.[12]

5. Many view this development with a great deal of scepticism. German business associations and law firms usually representing big players in the industry have forged an initiative whose major goal is to limit the fairness control of B2B contract terms in the name of the principle of freedom of contract.[13] Against this, associations of smaller enterprises have built up a counter-movement for the defence of the current state of the law, which expressly aims at protecting the *Mittelstand* from unfair terms.[14] The topic is also considerably debated by legal academics. In 2012, the National German Lawyers' Conference adopted a resolution that suggests

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10 At the end of 2013, SMEs employed 59.2% of all German employees and 82% of trainees, see Institut für Mittelstandsforschung Bonn, *ibid.*

11 Many legal bills have been condemned with the verdict being against the Mittelstand ('mittelstandsfeindlich'): from the duty to make tender offers, over the rise of fees for the authorization of prescription drugs, to the EU Tobacco Directive. See for instance 'Eine europaweite Ausschreibung wäre kunden- und mittelstandsfeindlich', www.rhein-erft-spd.de/html/25437/welcome/Eine-europaweite-Ausschreibung-waere-kunden-und-mittelstandsfeindlich.html, 'Arzneimittelzulassung: Gebührenpläne sind mittelstandsfeindlich', www.aerzteblatt.de/archiv/8304; VdR, 'Die neue Europäische Tabakproduktrichtlinie ist überzogen und mittelstandsfeindlich', www.verband-rauchtabak.de/aktuelles/meldung-vom-19-12-2012/.

12 Cf. Australian Small Business and Unfair Contract Terms Act 2015, *supra* n. 5, ss 1–16 and 19–47.

13 Initiative zur Fortentwicklung des AGB-Rechts, www.zvei.org/Downloads/Recht/AGB-Recht-Positionspapier-Endfassung-20110210.pdf.

14 'AGB-Recht nicht antasten – Mittelstand schützen – unfaire Vertragsbedingungen verhindern', www.pro-agb-recht.de.

an overhaul revision of the current regime.[15] Thus, the regulation of unfair terms is *the* hot potato in German business law, even more than the eternally contested co-determination with which companies have learned to live.

1.2. Does Standard Terms Control Apply to B2B Contracts? A Resounding 'Maybe'

6. The German law on unfair terms centres around a general provision, section 307 of the Civil Code, which reads in translation as follows:

> Terms provided by one party in a standard form contract are void if, contrary to the requirements of good faith, they unreasonably put the other party to the contract at a disadvantage.[16]

Already from its inception, when the German Parliament passed the Standard Terms Act 1976 as its precursor,[17] the fairness test laid down in this provision equally applied to B2C and B2B contracts. The request for uniform applicability was motivated by the fact that there had been many decisions by the German Supreme Court (Bundesgerichtshof, BGH) on cases of standard form contracts between businesses that were found to be against 'good faith'.[18] Also, control in B2B context was requested because of the idea that not *every* business could be regarded as having immunity from being put at any disadvantage by standard form contracts.[19]

7. Uniformity of standard terms control does in principal not go beyond the equal application of the general provision quoted above. When looking more closely at the statutory provisions of German standard terms control, one has to be aware that, although their scope of application is limited to the protection of consumers, they have

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15 69th Deutscher Juristentag, Beschlüsse, 2012, p 5 (recommendations IV 1-3 'AGB-Recht im b2b-Bereich'), www.djt.de/fileadmin/downloads/69/120921_djt_69_beschluesse_web_rz.pdf.

16 German wording: 'Bestimmungen in Allgemeinen Geschäftsbedingungen sind unwirksam, wenn sie den Vertragspartner des Verwenders entgegen den Geboten von Treu und Glauben unangemessen benachteiligen.'

17 Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen (AGB-Gesetz), 9 December 1976, *Bundesgesetzblatt* 1976 I 3317. The law entered into force on 1 April 1977.

18 BGH 8 March 1955 – I ZR 109/53, *BGHZ (Entscheidungen des Bundesgerichtshofs in Zivilsachen)* 17, 1 at 3–4; BGH 6 March 1956 – I ZR 154/54, *BGHZ* 20, 164 at 167–168; BGH 29 September 1960 – II ZR 25/59, *BGHZ* 33, 216 at 219; BGH 11 November 1968 – VIII ZR 151/66, *BGHZ* 51, 55 at 60; BGH 4 June 1970 – VII ZR 187/68, *BGHZ* 54, 106 at 109–111; BGH 28 February 1973 – IV ZR 34/71, *BGHZ* 60, 243 at 245–246; BGH 16 April 1973 – VII ZR 140/71, *BGHZ* 60, 353 at 355–356.

19 W. Eith, 'Zum Schutzbedürfnis gegenüber Allgemeinen Geschäftsbedingungen', *Neue Juristische Wochenschrift* 1974, p 16 at 17; H. Kötz, in *Verhandlungen zum 50. Deutschen Juristentag* 1974, pp A65–67; Fritz Nicklisch, 'Zum Anwendungsbereich der Inhaltskontrolle Allgemeiner Geschäftsbedingungen', *Betriebs-Berater* 1974, pp 945–947.

an incidental effect on business relations.[20] Sections 308 and 309 of the Civil Code, which list 24 detailed categories of terms that are void, are at the heart of German unfair terms law. This ensures legal certainty and predictability for contract drafting, but their direct applicability is limited to B2C contracts.[21] This contrasts with the Australian legislation, under which SMEs are treated as if they were consumers.[22] Yet, according to German law, almost all of the specifically void B2C terms must be taken into consideration when assessing 'good faith' and 'reasonableness' as decisive criteria of the fairness test also in B2B relations.[23] On the other hand, when assessing the fairness of B2B terms, it is required that appropriate consideration is given to commercial customs, which serves as a safeguard for the protection of the peculiarities and traditions of business trading.[24] Commercial customs are of high importance in the context of standard terms control when defending specific B2B terms, which would be unquestionably void against consumers. In sum, standard terms control generally applies to B2B contracts, just as it would to B2C contracts, but the applicable tests are modified in order to restrict the control.

1.3. Evidence of 'Mittelstand' Favouritism in the Case Law

8. A selection of cases will serve to illustrate how the *Mittelstand* has been protected against unfair terms in the last decade. Courts do not always protect SMEs in an obvious manner but sometimes rather discreetly when dealing with a case of a big company against a SME. The judiciary has hidden behind legalistic motives, such as the nature of a contract or its essential terms.

A first demonstrative example is a decision by the Supreme Court of 2008, concerning the case of costs for renovation of a tailor's shop.[25] The tailor, a small entrepreneur, had rented the premises from a bigger company that set the terms and conditions. *Inter alia*, the tenant was obliged to pay a fixed percentage of the costs for renovation when the tenancy ended, and the longer the shop had not been renovated, the higher the graded percentage (for instance, 40% of the renovation costs after two years of tenancy). Imposing this duty on the tenant deviates from the default statutory rule that the landlord has to maintain the property.[26] The Supreme Court had, in a different case of a consumer-tenant, held that such a clause requesting contribution to renovation costs based on a *rigid* timetable was unfair and completely void.[27] In the case of the tailor, the Supreme Court applied this precedent because the status of the

20 On this incidental effect see *infra* 3.2.

21 S. 310(1) BGB, first sentence.

22 Australian Small Business and Unfair Contract Terms Act 2015, *supra* n. 5, ss 1–16 and 19–47.

23 S. 310(1) BGB, second sentence, first half. There is the single exception that the ban of late payment terms also directly applies to B2B contracts.

24 S. 310(1) BGB, second sentence, second half.

25 BGH 8 October 2008 – XII ZR 84/06, *BGHZ* 178, 158.

26 S. 535(1) BGB.

27 BGH 23 June 2004 – VIII ZR 361/03, *Neue Juristische Wochenschrift* 2004, 2586–2587.

tenant would not make any difference to the unfairness of the term. The judgment delivered by the court of first instance had explicitly highlighted that the tenant was an SME.[28] Although the Supreme Court did not mention this fact, it seems that its reasoning might be influenced by this background information.[29] One can hardly imagine that it would have annulled the term as unfair if it had been used between two big companies.

9. The extension of consumer protection to the *Mittelstand* can also be illustrated by a number of cases that concern additional banking fees for services which have already been remunerated. German banks used to charge their customers – consumers and businesses alike – a fee of 1–2% for minor tasks they carried out when required for the duly execution of a paid service. For instance, customers were charged an additional 'handling fee' when a credit loan was given to them, for which they were already made to pay interest to the bank on a recurring basis. The fees were set out in the standard terms and conditions of the banks. This practice initially received judicial approval by the Supreme Court in the 1980s.[30] Its view was recently reversed when, owing to internal organizational changes of the Court for jurisdiction over banking law, the Supreme Court held clauses for additional fees in standard terms and conditions void – with regard to loan contracts with consumers.[31] Such fees would be inconsistent with the statutory concept of loan contracts since the Civil Code provides for interest as the sole remuneration for the lent money.[32] Deviating from this statutory concept by the bank's standardized terms and conditions would, the Court reasoned, put consumers at a significant disadvantage, for there is no additionally payable service by the bank when 'handling' the loan.[33]

Left without any guidance as to the application of this leading decision to professional customers, especially to SMEs, various German courts of lower instances had to deal with the question of whether such banking fees should also be held unfair in B2B standard form contracts. The majority of the courts, carefully weighing up the arguments for both sides, ruled in favour of the professional customers where the cases concerned SMEs.[34] They argued that customers of either private or professional

28 LG [Landgericht] Düsseldorf, 18 November 2005 – 15 O 143/05, para. 22 (accessible via the Juris online database).

29 BGH 8 October 2008 – XII ZR 84/06, *BGHZ* 178, (158) 167, para. 24.

30 BGH 2 July 1981 – III ZR 8/80, *BGHZ* 81, 124 at 126–128.

31 BGH 13 May 2014 – XI ZR 405/12, *BGHZ* 201, 168 at 173–204; BGH 13 May 2014 – XI ZR 170/13, *Betriebs-Berater* 2014, 1866 at 1868–1875.

32 S. 488(1) BGB. Cf. BGH 21 April 2009 – XI ZR 78/08, *BGHZ* 180, 257 at 265–266, para. 21.

33 Recently, the Supreme Court only took a different view with regard to distinguishable cases where private banks acted as intermediaries and legitimately charged the borrowers for handing out loans based on a government scheme; see BGH 16 February 2016 – XI ZR 454/14, *Neue Juristische Wochenschrift* 2016, 1875 at 1876–1878, paras 18–48.

34 LG Chemnitz, 13 June 2014 – 7 O 28/13, paras 27–29 (Juris); LG Magdeburg, 13 August 2015 – 11 O 1887/14 (689), *Zeitschrift für Bank- und Kapitalmarktrecht* 2016, 159 at 160–161, para. 37; LG Neuruppin, 24 September 2015 – 5 O 66/15, paras 25–34, and 17 February 16 – 5 O 9/15,

background would be equally affected by the deviation from the statutory concept of loan contracts and that the relevant sections of the Civil Code do not exclusively apply to consumers. Moreover, the courts took the view that a different assessment of the unfairness of the terms would not be justified by a general situational superiority of SMEs compared to consumers when negotiating a loan contract with their bank. The vast majority of professional customers of banks are, considering the large numbers mentioned above, SMEs. The courts argued that these would usually find themselves in an equally dependent position for credit loans as consumers. The dependence of SMEs might be even greater because, on the one hand, businesses would require debt financing in order to be successfully and competitively run. On the other hand, SMEs would not have a corresponding greater expertise and bargaining power compared to consumers. This would be most obvious in the case of debt financing for the purchase of business premises as a very expensive, but typically one-off purchase, which start-up SMEs do without any experience.[35] The courts found that even once the business is set up and running, each individual SME could not bargain with a bank like the few large enterprises could in order to dictate their borrowing conditions. SMEs would have to take the terms and price offered by the bank with little or no choice. Therefore, the courts concluded, additional fee clauses would be unfair terms against SMEs.

10. This evidence of *Mittelstand* favouritism has to be seen in context of judgments of the opposite opinion.[36] Their main reasoning for refusing special protection to SMEs focuses on commercial customs in B2B relations, making use of the Civil Code's provision which provides for appropriate consideration of commercial customs when evaluating the fairness of standard terms and conditions between businesses.[37] However, it is not perfectly clear from those other judgments on which grounds such commercial customs should be assumed. The mere fact that clauses for additional fees had been frequently used in standard terms and conditions, or the fact that businesses generally take out loans more often than consumers, do not satisfy the test for the assumption of a particular commercial custom. It would at least be necessary that separate clauses were developed for the B2B context.[38] The clauses at hand, however, have been equally used by banks against consumers, which

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paras 36–39 (both Juris); LG Düsseldorf, 18 December 2015 – 10 O 517/14, paras 48–49 (Juris); AG Stuttgart, 24 June 2015 – 1 C 1137/15, para. 17 (Juris).

35 LG Chemnitz, *supra* n. 35, paras 27–29.

36 LG Cottbus, 18 June 2015 – 2 O 27/15, paras 27–28 (Juris); LG Neubrandenburg, 30 June 2015 – 4 O 55/15, paras 44–58 (Juris); LG Leipzig, 16 July 2015 – 7 O 3450/14, paras 37–39 (Juris).

37 S. 310(1) BGB, second sentence, second half.

38 BGH 25 November 1993 – VII ZR 17/93, *Neue Juristische Wochenschrift* 1994, 659 at 660, with reference to s. 346 HGB.

contradicts any assumption of their purposeful development for contracts among businesses in order to establish a commercial custom.[39]

11. Finally, moving on to another type of standard terms and to the area of logistics, protection against long payment periods was granted by a court to a small haulier who was a subcontractor of a bigger haulage company and claimed payment.[40] The standard terms and conditions of the big company contained a clause that payment to the subcontractor was due not earlier than three months after the invoice is received, which significantly deviates from the statutory default rule in the German Commercial Code (Handelsgesetzbuch, HGB), according to which payment is due immediately upon delivery.[41] The court held the clause to be unfair, and it based its decision on the statutory ban of standard terms and conditions which provide for inordinately long time periods for satisfying payment obligations towards a contractor.[42] Different to all the other statutorily enumerated bans of unfair terms, which only directly apply to B2C contracts, this ban directly applies to B2B relations, too.[43] The ban originates from the Late Payment in Commercial Transactions Directive 2011/7/EU, which provides a maximum of 60 days for payment unless there is an express and fair agreement between the parties.[44] Due dates of 90 days, as in the case in question, would especially be unfair towards SMEs, the court argued. Such late payment would put them at a severe disadvantage, considering that they are obliged to perform in advance. They have to bear all costs for the actual shipment (and have no security for payment later), which could in sum endanger their economic survival.

12. The aforementioned examples of case law should not lead to the conclusion that courts would without exception tend to be very generous to the *Mittelstand*. To give an instructive example, B2B standard terms control was not applied by the Higher Regional Court of Berlin in a case concerning a group of building contractors.[45] The reasoning is particularly interesting: the court noted that while each of the group members was an SME, when acting together they would be as

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39 J. Koch, 'Bearbeitungsentgelte im Kreditgeschäft – ein Blick nach vorn', 70 *Zeitschrift für Wirtschafts- und Bankrecht* 2016, p 717 at 720–721. Insofar it is self-contradictory when terms used against consumers and business alike are found to be justified due to allegedly existing commercial customs, see for instance LG Wiesbaden, 12 June 2015 – 2 O 298/14, para. 28 (Juris).

40 AG Mannheim, 22 July 2015 – 10 C 169/15, *Betriebs-Berater* 2015, 2515.

41 S. 420(1) HGB.

42 S. 308(1a) BGB.

43 *Argumentum e contrario* s. 310(1) BGB, first sentence.

44 Directive 2011/7/EU on combating late payment in commercial transactions, data.europa.eu/eli/dir/2011/7/oj = *OJ* 2011 L 48/1, Art. 3(5). The German legislator explicitly incorporated this rule in s. 271a(1) BGB. S. 308(1a) BGB is a permissible addition since the Directive only sets minimum standards, Art. 12(3).

45 KG [Kammergericht] Berlin, 10 September 2012 – 23 U 161/11, *Neue Zeitschrift für Baurecht und Vergaberecht* 2012, 766 at 768.

competent and capable as a big company. It would be justified to expose them to higher risks, which can, for instance, arise from standard terms and conditions used against them. So, at first sight, this decision seems to disfavour SMEs. However, it only does so under the exceptional circumstance that they have united power equal to a big company. The very fact that the court compared the group of SMEs to a big company demonstrates that in its view standard terms control would not apply to big companies but is intended to favour the *Mittelstand*.

2. B2B Contracts as the Litmus Test for Standard Terms Control

13. At the core of the debate about the German case law is the question of whether it is justified to rectify or annul standard terms in contracts between professionals. The answer to this question may shed some light on the justification of standard terms control in general. Paradoxically, the rationale for controlling standard terms even in B2C relations has never been fully clarified.

2.1. The Open Rationale of the EU Unfair Terms Directive

14. One apparent justification for reviewing standard terms is consumer protection. At first sight, this idea seems to be buttressed by EU law. The Unfair Terms Directive specifically mentions the protection of consumers as its main goal, and its scope is expressly limited to contracts concluded between a seller or supplier and a consumer.[46] The meaning of this restriction is, however, subject to debate. Some interpret it as evidence that the Directive is based on the consumer protection model.[47] Others have stressed that the limited scope of the Directive is simply due to the limited scope of the harmonization endeavour and thus any conclusion about the need for standard terms control in B2B relations cannot be assumed.[48]

15. An intermediate approach is perhaps more helpful. It is true that the Unfair Terms Directive is targeted at consumer protection, yet this begs the question why the consumer needs protection specifically against standard terms. Consumers are

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46 See Directive 93/13/EEC on unfair terms in consumer contracts, data.europa.eu/eli/dir/1993/13/oj = *OJ* 1993 L 95/29, Preamble and Art. 1(1).

47 See e.g. Thomas Wilhelmsson, 'Various Approaches to Unfair Terms and Their Background Philosophies', 14 *Jur. Int'l* 2008, p 51 at 54 (stating that 'as the directive was prepared solely with consumer relationships as its object of regulation, the content of the directive appears to be a good example of the consumer protection model').

48 M.W. Hesselink, 'Unfair Terms in Contracts between Businesses', in Reiner Schulze & Jules Stuyck (eds), *Towards a European Contract Law* (München, Sellier European Law Publishers 2011), p 131 (stressing that the Directive 'simply does not affect business to business contracts and, thus, is neutral on the issue of unfair terms control in business relationships').

never holistically privileged against businesses independently of the circumstances. Rather, their protection is only provided for where they face special challenges and are particularly vulnerable, for instance due to a peculiar situation in which they conclude an agreement or with regard to a uniquely complex type of contract.[49] In order to establish whether SMEs merit protection in the same way, it is necessary to inquire more deeply about the particular challenges that consumers are facing when confronted with standard terms.

2.2. Failure of Contract and Market Mechanisms

16. Disparities in contracting situations are a particular challenge for the 'weaker party' to the contract, who typically is a consumer but can fathomably also be a SME. Most of the reasons cited for the necessity of standard terms control refer to failures in the process of contracting, which are believed to equally apply to consumers and to businesses of the *Mittelstand.*

17. A frequently presented argument is information asymmetry.[50] A party imposing a standard term on the other party to the contract usually knows this term and its legal effects better than the other side. It also has sufficient incentives to invest in the drafting and analysis, given that it is usually a 'repeat player', which offers the same terms to many customers. The consumer, on the other hand, mostly engages in one-off, low value transactions, which make it inefficient to study the terms of a contract. In addition, he or she may suffer from time-constraints: often the consumer must decide quickly and cannot afford reading the voluminous contractual conditions. These problems are compounded by intellectual dispositions. Consumers might not be able to process a large amount of information contained in standard terms, and they may also lack the necessary knowledge to assess their legal effects.[51]

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49 For a detailed analysis of 'Consumer Concepts in Community Law' see Economic law, consumer interests, and EU integration N. Reich & H. Micklitz, in Reich, Micklitz, Rott and Tonner (eds), *European Consumer Law* (Cambridge/Antwerpen: Intersentia, 2nd edn 2014), paras 1.36–1.36a. The Australian legislation highlights the specific vulnerability of SMEs as an important reason to equally protect them like consumers; see Parliament of the Commonwealth of Australia (House of Representatives), *Explanatory Memorandum: Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015*, www.legislation.gov.au/Details/C2015B00109/5e119258-6273-49d1-8335-ed49708d47b1, p 7, no. 1.2.

50 N. Reich & H. Micklitz, see *supra* n. 50, para. 1.36; M.W. Hesselink, *supra* n. 49ss, pp 136–138; Michael G. Faure & Hanneke A. Luth, 'Behavioural Economics in Unfair Contract Terms: Cautions and Considerations', 34 *J. Consumer Pol'y* 2011, p 337 at 340.

51 The lack of knowledge of the consumer has been cited by the ECJ as one of the reasons for unfair terms control, see ECJ, 27 June 2000, Joined Cases C-240/98 to C-244/98, *Océano Grupo Editorial and Salvat Editores*, ECLI:EU:C:2000:346, para. 25.

18. Another reason given for controlling standard terms is unequal bargaining power.[52] Even where a consumer takes the time to read the conditions and is capable of understanding their meaning, it will be impossible to negotiate different terms. In everyday life, businesses impose their standard rules on a take-it-or-leave-it basis.[53] A single customer will be unable to convince them to change these rules. As the contracting parties are not on an equal footing, any meaningful negotiation about the terms is not realistic. Thus, the fundamental paradigm of contract law breaks down.

19. These reasons for standard terms control are supplemented by insights from behavioural economics.[54] Experience shows that individuals tend to accept contract conditions without paying attention to their content. One thought is that they have trust in the assumption that any grossly unfair term will be invalidated by the courts anyway. Behavioural economics calls this 'rational apathy', i.e. the fact that one side does not care about what it signs, relying instead on other mechanisms to protect its rights.[55]

20. It is important to note that the described defects on the side of the consumer are not always present to the same extent. To take just one example, the consumer may be a lawyer well versed in legal language, prepared to carefully read the conditions, and with strong bargaining power because he or she can easily reject the offer in favour of a rival bid. As this example illustrates, failures in the contract and market mechanisms are *not always* present when consumers contract with businesses. Rather, unfair terms law targets the *typical* situation that exists in B2C relations.

21. Against this background, it is questionable whether the same reasons for standard terms control also apply to B2B relations, especially to contracts between big firms and SMEs. In a thoughtful article, Martijn Hesselink has suggested that they would.[56] This statement is correct insofar as information asymmetries, unequal bargaining power and behavioural biases may also be present in relations between professionals. A small business may, for instance, be unable to afford an in-house legal department or the continuous service of a big law firm; its bargaining power may be weak; and its directors may suffer from the same behavioural defects as consumers, i.e. they do not read terms and conditions.[57] Yet it is also true that all these defects are *less likely* to occur with SMEs than with consumers. In other

52 The unequal bargaining power has been stressed by the ECJ as a rationale for unfair terms control, see ECJ, ibid. See also M.W. Hesselink, *supra* n. 49, pp 132–134.

53 See also Parliament of the Commonwealth of Australia, *supra* n. 50, p 7, no. 1.2.

54 See in particular M.G. Faure & H.A. Luth, *supra* n. 51.

55 *Ibid.*, p 340.

56 M.W. Hesselink, *supra* n. 49.

57 See also Parliament of the Commonwealth of Australia, *supra* n. 50, p 7, no. 1.4

words, the same level of typicality that exists in B2C contracts may not apply to B2B relations. The legally uneducated but very astute company owner, who is prepared and able to skim through the conditions of its contracting partner, springs to mind. One could also imagine a small supplier as a contractor that has tremendous bargaining power because it delivers key components to a big business.[58] This anecdotal evidence does not completely reverse the case for the necessity of standard terms control in B2B relations. It merely shows that the reasons cited for consumer relations do not apply with the same force.

2.3. Justice and Broader Societal Policies

22. It is sometimes argued that regulating unfair terms could also serve purposes other than correcting failures in contract and market mechanisms. Maintaining 'commutative justice' could be regarded as a different justifying rationale, i.e. striving for an equal balance between the rights and obligations of the parties.[59] Another rationale could be 'distributive justice', i.e. contributing to a 'fairer distribution of resources between the rich and the poor'.[60] It is furthermore suggested that controlling contractual terms could also serve more general policies, such as preserving the 'ethos of the market',[61] achieving gender equality, fighting against discrimination, and even protecting the environment.[62]

The rationales cited apply not only to standard terms and conditions, but with equal strength to all sorts of contractual provisions, whether individually negotiated or not. While it is true that legislators and courts may focus on them, it remains unclear why the control should be specifically targeted at standard terms. In this sense, the rationales cited cannot explain why standard terms are subject to special review for (un)fairness. They must therefore be set aside as justifications for regulating unfair terms. Otherwise, standard terms control would turn into excessive contractual control.

2.4. 'Fighting Big Business'?

23. The history of German standard terms control supports a different rationale as to why unfair standard terms can equally be excluded in B2B contracts. It is the restriction of market power of big businesses that was the original motive for which

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58 In the Australian Legislative Explanatory Memorandum it is also highlighted that SMEs engaged in high-value transactions can be expected to undertake appropriate due diligence, see Parliament of the Commonwealth of Australia, *supra* n. 50, p 8, no. 1.7.

59 T. Wilhelmsson, *supra* n. 48, p 52.

60 M.W. Hesselink, *supra* n. 49, pp 134–136; T. Wilhelmsson, *supra* n. 48, p 52.

61 M.W. Hesselink, *supra* n. 49, pp 142–143.

62 T. Wilhelmsson, *supra* n. 48, pp 52–53.

unfair terms review was introduced into German law, and in some ways it continues to be an underlying theme in the case law until this day.

When the Reichsgericht, the former German Supreme Court, first clamped down on standard terms in the transport business in the 19th century, it argued that the companies who used them enjoyed a dominant position in the market.[63] The court held that they 'abused' this position by imposing their terms on other parties, which would be tantamount to a transaction contra *bonos mores*.[64] This precedent was later referred to by the Federal Supreme Court, which merely based standard terms control on the comprehensive provision of the Civil Code that 'contracts have to be fulfilled in accordance with the requirements of good faith'.[65]

During the 1930s the Ordoliberal school of thought provided a theoretical corroboration and intellectual justification for the position taken in the case law.[66] Its main proponents, Walter Eucken and Franz Böhm, fretted about the market power of big companies as being as much of a threat to freedom as that of an over-reaching state. They particularly criticized standard terms and conditions, which had become widespread. In his inaugural lecture at the University of Freiburg in 1933, the Ordoliberal scholar, Professor Hans Großmann-Doerth took issue with what he called the 'self-made law of the economy'.[67] He suggested that the state should take 'control' over this new type of law.[68] Since the goal was to quash the power of big companies, this 'control' would also have applied to their contracts with SMEs.

24. In 1976, about half a century later, the German legislator introduced the Standard Terms Act mentioned above. This was one of the earliest legislative acts in this field in the world.[69] The Act referred to the positive effects of contractual standards in terms of rationalization and simplification, but also highlighted that

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63 See RG 11 February 1888, *RGZ (Entscheidungen des Reichsgerichts in Zivilsachen)* 20, 115 at 117; RG 8 January 1906, *RGZ* 62, 264 at 266; RG 15 May 1920, *RGZ* 99, 107 at 108–110; RG 1 October 1921, *RGZ* 102, 396 at 397; RG 26 October 1921, *RGZ* 103, 82 at 84.

64 'Gute Sitten' in the sense of s. 138(1) BGB.

65 S. 242 BGB. For case law references see n. 19.

66 For a concise introduction into German ordoliberalism, *see* Mathias Siems & Gerhard Schnyder, 'Ordoliberal Lessons for Economic Stability: Different Kinds of Regulation, Not More Regulation', 27 *Governance* 2014, p 377.

67 Hans Großmann-Doerth, 'Selbstgeschaffenes Recht der Wirtschaft und staatliches Recht', reprinted in Uwe Blaurock, Nils Goldschmidt & Alexander Hollerbach (eds), *Das selbstgeschaffene Recht der Wirtschaft* (Tübingen: Mohr Siebeck 2005), pp 77 et seq. It bears mentioning that the speech is heavily tainted by Nazi thinking and language. While the ordoliberals generally tended to be opposed to national socialist thinking, the role of Großmann-Doerth is more ambiguous, see Alexander Hollerbach, 'Hans Großmann-Doerth im Kontext der Freiburger Rechts- und Staatswissenschaftlichen Fakultät', *ibid.*, pp 19 et seq.

68 Großmann-Doerth, *supra* n. 68, p 92.

69 Other early legislations were the Arts 1341–1342, 1370 Italian Codice civile of 1942, the Israeli Standards Contract Law of 1964 and the Swedish Law on Unfair Terms of 1971.

some enterprises would abuse them to improve their own legal position at the cost of their contracting partners.[70]

Noticeably, the Act did not connect this criticism to the dominant market position of the drafters of standard terms. It wisely departed on this point from the rationale suggested by the Ordoliberal school for controlling those terms. The Act was already in its initial version not limited to contracts with consumers but also applied to those concluded between businesses,[71] and the German government justified this wide scope with reference to the principle of good faith, which would likewise apply to commercial relationships.[72] At the same time, however, it was highlighted in the Bill that consumer protection against unfair contractual terms was of greater political importance.[73] It also considered that there was a need for more flexibility in commercial relationships due to commercial customs and the 'usually greater commercial experience' of the parties involved.[74]

2.5. Lessons from the German Experience

25. The history of German law demonstrates that standard terms control should not be justified by the idea of restricting the market power of some players. In fact, in a modern and legalist economic system, dominant market positions and their abuse are taken care of by competition law. It can do so better, from a legal institutions viewpoint, because it provides the appropriate tools for analysing market structure and the power of each of the players. In contrast, contract lawyers would have to rely on mere guessing, or rules of thumb, in order to know who is the dominant party to a transaction.

The aim of regulating unfair terms should be to restore failing contractual and market mechanisms, not to even out differences in market power between contractual partners. While less typical, such failures may not only exist in B2C but also in B2B relations. Hence, there are good arguments to amplify the standard terms control to B2B relations. Yet this extension must be very carefully done, and courts should not use standard terms control in order to actively restructure market imbalances. In order to ensure such a proportionate and purposeful standard terms control, it is necessary to focus on the tests which underlie the control and to examine to what extent they actually differ in B2C and B2B context.

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70 See Federal Government, 'Entwurf eines Gesetzes zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen (AGB-Gesetz)', Bundestags-Drucksache (Parliament Documentation) 7/3919, p 9.

71 Only s. 24 of the Act exempted contracts with merchants from the application of some of the Act's provisions. It followed that the other provisions apply to them.

72 Bundestags-Drucksache 7/3919, p 14.

73 *Ibid.*

74 *Ibid.*

3. Testing the Fairness of Standard Terms

3.1. The Initial Threshold: Not Individually Negotiated Clauses

26. It is first necessary to clarify how the concept of a 'standard term' is defined in German law on unfair terms in order to fully grasp its importance. Since this is an issue of scope, which is at the borderline between contractual freedom and state control, the statutory law is particularly strict on the definition. It characterizes standard terms as 'pre-formulated', or not individually negotiated, in section 305 (1) of the Civil Code,[75] which resembles the respective scope of the Unfair Terms Directive.[76]

Lately, it can be observed that German courts increasingly tend to extend their review of contractual terms beyond this restrictive definition. In a decision of 2012, the Supreme Court extended the scope of the pre-formulated test so that it even applies to terms which had been the subject of debate between the parties.[77] In the underlying case, a waste management company had suggested a standard form contract to a customer, which contained, inter alia, a 'bring-or-pay clause' by which the customer would be obliged to pay a fee in the event that it would not deliver a certain amount of waste. As a result of the customer's objection against this and other clauses, the waste management company only suggested a change of the contract duration and other terms, but did not touch the 'bring-or-pay clause'. The parties eventually signed the contract, which still included the unchanged 'bring-or-pay clause'. The court held that the clause was subject to standard terms control because it had been pre-formulated in the sense of the Civil Code. In its view, this characterization was not altered by the fact that the customer had initially objected to the clause and finally accepted it. The party who introduces terms which it formulated in advance must, according to the court, make an 'express and serious' declaration that it is prepared to negotiate each of them, and the relevant clause has to be 'a matter of debate' between the parties so that the contractual partner-to-be is given 'a real chance' to influence it.[78]

This standard is very high and businesses have sought 'innovative' ways to satisfy (or circumvent) it. In a case decided in 2014, two businesses had included an express clause in the contract that the contractual clauses had been subject to individual negotiation. The parties had even drafted a negotiation protocol in which they stated that the clauses had been 'subject to extensive and serious

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75 'Standard terms and conditions are contract terms which are pre-formulated for a multitude of contracts, and set by one party to the contract when entering into the contract. (...) Where the contractual terms were individually negotiated by the parties they shall not be treated as standard terms and conditions.'

76 Art. 3(1) Directive 1993/13/EEC on unfair terms in consumer contracts data.europa.eu/eli/dir/1993/13/oj = *OJ* 1993 L 95/29.

77 BGH 22 November 2012 - VII ZR 222/12, *Neue Juristische Wochenschrift* 2013, 856.

78 *Ibid.*, para. 10.

debate'. Yet the Supreme Court held such clauses as being without any effect.[79] It reasoned that the parties could not exclude the judicial control as to whether terms had been freely negotiated by a mere contractual statement. This would be incompatible with the mandatory nature of standard terms control.[80]

27. The threshold of standard terms control has therefore been set relatively low by the Supreme Court. It has practically become impossible to avoid the judicial review due to a decision of January 2016.[81] In this case, one party recommended the standard terms of a third party to the other contracting party. In an accompanying letter, it asked the other party to communicate 'any comment or wishes for change'. In the eyes of the Supreme Court this did not impede standard terms control. It said the party who set the terms had failed to offer the contractual partner a real opportunity to propose an alternative text with an effective chance to succeed in negotiations.[82] The fact that it was fully prepared to accept the other side's wishes for changes did not suffice in the opinion of the judges.[83]

In sum, any clause that is introduced by one of the parties is considered to be 'pre-formulated' by the German courts.[84] The scope of review is therefore frighteningly wide. It is hardly possible to escape it.

3.2. The Indicative Effect of Consumer Protection Law ('Indizwirkung')

28. German standard terms control has an even stronger impact on businesses due to the fact that German courts consult consumer protection law for *prima facie* assessment of standard terms, even in B2B context. In sections 308 and 309 of the Civil Code, as already mentioned above, there are 24 categories of terms that are void against consumers.[85] This list has an 'indicative effect' to the extent that the enumerated terms are presumably unfair in relations between businesses, unless there is a particular reason which would exceptionally refute this presumption.[86] In other words, as far as the values embodied in consumer protection law are transferrable to businesses, they have to be considered when assessing the fairness of B2B terms.[87]

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79 BGH 20 March 2014 – VII ZR 248/13, *BGHZ* 200, 326 para. 27.

80 *Ibid.*, paras 29–30.

81 BGH 20 January 2016 – VIII ZR 26/15 *Neue Juristische Wochenschrift* 2016, 1230.

82 *Ibid.*, para. 30.

83 *Ibid.*, para. 31.

84 This result corresponds to the explicit presumption set out in s. 27(1) of the Australian Consumer Law (Schedule 2 of the Competition and Consumer Act 2010), which reads: 'If a party to a proceeding alleges that a contract is a standard form contract, it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.'

85 See *supra* 1.2.

86 BGH 8 March 1984 – VII ZR 349/82, *BGHZ* 90, 273 at 278.

87 BGH 19 September 2007 – VIII ZR 141/06, *BGHZ* 174, 1 at 4.

A typical and illustrative B2B case that was decided by the Supreme Court concerned a car merchant who tried to contract out of *any* liability by its standard sales terms.[88] Another merchant purchased a used car, which turned out to be much older and to have a significantly higher mileage than contractually supposed, and so the buyer claimed damages. The standard term set by the seller providing for absolute non-warranty would have prevented the claim, but it was held unfair and void by the court. The court referred to the indicative effect of section 309(7) of the Civil Code, which bans non-warranty terms against consumers that include personal injury damages and damages caused by gross negligence. This ban would, according to the court, be transferrable to businesses, because this absolute non-warranty clause would put them at a disadvantage equal to that of consumers.

29. The presumption that the terms would equally be unfair vis-à-vis businesses can only be refuted by objective circumstances that require a distinct treatment of standard terms in commercial context. However, courts have generally been very hesitant to accept such refutation; they widely apply standard terms control on a similar basis in B2C and B2B relations.

From a holistic perspective of B2B standard terms control in judicial practice, the indicative effect is an inappropriate trigger for rendering void the terms, which are only banned against consumers, in a standard form contract between businesses. This result denotes excessive standard terms control in B2B relations without practical need or jurisprudential backing. Where standard terms and conditions do legitimately deviate from default rules, they should not be condemned for contradicting consumer protection law in the business context. Nevertheless, it is important with regard to B2B contracts to examine in which cases standard terms may actually legitimately deviate from statutory default rules.

3.3. The Basic Contractual Construction ('Leitbild des Vertrags') and the Essential Duties ('Kardinalpflichten')

30. German law regulating unfair terms is largely led by critical examination of deviation from statutory default rules. Such deviation through standard termsis restricted, or permitted only to a very limited extent. This may, at first sight, seem quite surprising, but it is the result of the fact that German law indirectly sets the default rules as the model for all contracts. Section 307(2) of the Civil Code provides the test applicable to deviation through standards terms which were set by one party,[89] and an unreasonable disadvantage is said to exist in two situations.

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88 *Ibid.*, pp 5-6.

89 'Standard terms are, if in doubt, considered to unreasonably put the other party to the contract at disadvantage if they

(1) are not compatible with essential principles of the statutory provision from which they deviate, or

31. First, where a term is 'not compatible with the essential principles of the statutory provision from which it deviates',[90] it is considered to violate the 'Leitbild' (literally 'guiding image') or basic construction of the contract. The 'Leitbild' is composed of the intrinsic statutory rules on a certain type of contract as it is laid down by the black-letter law of obligations, codified in the Second Book of the German Civil Code. These rules serve as a model for assessing the fairness of standard contract terms. The practical application of this assessment can be illustrated by recalling the example of the renovation clauses, which were mentioned above in the case of the tailor.[91] In fact, numerous rental contracts for real estate are based on model contract forms consisting of standard terms prepared by landlords' associations, which oblige the tenant to periodically renovate the property. To the surprise of many, the Supreme Court declared these standard terms void in a series of decisions starting in 2004.[92] The court based the voidness on the contradiction to the statutory 'Leitbild' of tenancies, stressing that the clauses deviate from the statutory rule according to which improvements and repairs are the duty of the landlord.[93] It did not matter for this purpose that this rule is not mandatory and can be altered by an agreement between the parties. In the case of the tailor discussed in detail above, it is notable that the Supreme Court rejected the idea that a professional tenant would be in less need of protection than a consumer renting for private purposes.[94]

32. The second situation in which standard terms are supposedly unfair is where they 'limit essential rights or duties inherent in the nature of the contract so that the contractual objective is jeopardized'.[95] This restriction is specifically designed for contractual relations not covered by statutory provisions.[96] Examples are situations which are not addressed in the Civil Code, such as bank service agreements, factoring, or franchising. One party to the contract cannot, by imposing its standard terms on the other party, contract out of essential duties. These duties have been labelled 'Kardinalpflichten' (literally: cardinal duties) by the courts,[97] and their exclusion in standard terms is void. The practical impact can conveniently be

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(2) limit essential duties or duties inherent in the nature of the contract to such an extent that the contractual objective is jeopardized.'

90 S. 307(2)(1) BGB.

91 See *supra* text to n. 26.

92 See *supra* n. 28.

93 S. 535(1)(2) BGB, which reads: 'The landlord has to surrender the rented property to the tenant in suitable condition according to the contract, and has to maintain it in this condition during the tenancy period.'

94 BGH, *supra* n. 28, para. 24.

95 S. 307(2)(2) BGB.

96 See Wurmnest, in *Münchener Kommentar zum BGB* (München: CH Beck, 6th edn 2012), § 307 BGB, para. 70.

97 BGH 3 March 1988 – X ZR 54/86, *BGHZ* 103, 316 at 322.

illustrated by way of example: An acquiring company processing credit card payments (such as VISA) had entered into an agreement with a computer retail shop. The standard terms of their agreement for credit card payments transferred the risk of any abuse to the retail shop regardless of any negligence whatsoever on its part. The Supreme Court declared this clause void because the acquirer would normally have to bear the cost of credit card abuse by customers itself since it benefits from the commission for each credit card payment; to exclude this liability at the expense of the retail shop would be a one-sided shift of risk, which could not be upheld.[98]

33. The problem with both tests set out by section 307(2) is their rigidity. In essence, legislative rules that are simply designed to be a modifiable default set of rules are elevated to almost mandatory rules, which can no longer be changed by standard terms. In many cases this means that statutory rules cannot be changed at all due to the fact that it would be impractical or impossible to *individually* negotiate their contractual amendment. This is especially true because courts tend to extend the scope of their review of standard terms by treating them as if they were not individually negotiated.[99]

The default rules of the Civil Code could often be regarded as a crude reflection of contractual justice. The legislator enacted them in the belief that the parties can adapt them to their individual situation. That this contractual freedom remains is of great significance for commercial relations, where it is often expedient to distribute risk and costs in a different fashion than in relations between individuals or in B2C relations. If a 'contractual model' is looked for, it would therefore be better to rely on specific default rules for contracts between professionals. Such rules are even rarely set out in the Commercial Code, which generally relies on the freedom of the parties to design contracts according to their needs. The result is a prevalence of default rules of the Civil Code as the only model of contract law from the perspective of unfair terms control. Insofar as rules that apply to B2C relations are used as the model, commercial parties lose lots of their much needed flexibility.

34. Even worse is the result produced by the second test (deviation from 'Kardinalpflichten') in the case of the absence of any statutory rules. In this case, the courts rely on their own conception as to the nature and the purpose of the contract. They are thus supplanting the agreement between the parties with what they find to be necessary and just. Yet, they often lack the knowledge of the specific trade in question that would enable them to rationally substitute the parties' decision (and to actually change the agreement to the better!). This second-

98 BGH 16 April 2002 – XI ZR 375/00, *BGHZ* 150, 286 at 296–297.

99 See *supra* 3.1. for this problem.

guessing is therefore not recommended to overcome potential contract and market failures in B2B relations.

3.4. The Corrective Function of Commercial Customs

35. Turning away from statutory models and restrictions, contractual partners in B2B context frequently rely on special commercial customs such as manners and traditions. In order to accommodate these specialities within B2B standard terms control, German law requires courts to take well-established commercial customs and trade uses into account when assessing the fairness of standard terms and conditions.[100] This is to compensate for the indirect application (indicative effect) of consumer protection law to B2B standard terms control.[101]

It is generally claimed that the assessment of whether a standard term is unfair in B2B context has to focus on issues which are particularly relevant to businesses, and commercial customs would serve as an appropriate tool in this regard. For instance, businesses have a strong interest in transactions being carried out quickly and smoothly; standard terms are often drafted in order to facilitate this aim. More importantly, every party to the contract is, unlike in case of a consumer, expected to take reasonable care of their own risk, which arises from the transaction; prices and insurance ought to be arranged accordingly.[102]

36. Although in theory commercial customs are highly valued in B2B standard terms control by providing for their consideration when assessing the fairness of preformulated terms between businesses, this cannot solve the general problem of appropriate integration of commercial circumstances. Simply, it cannot work for the purpose of adjusting standard terms control to B2B relations. On the one hand, where a commercial custom is well established, such as among timber merchants,[103] this custom is observed by the merchants anyway, and there is no need for them to draft any (doubtful) contract term restating something obvious. The courts follow the customs in accordance with the German Commercial Code.[104] In reality, courts are rarely confronted with standard terms that are based on commercial customs and that would fail the fairness test, which is nonetheless said to apply.[105] On the other hand, with regard to the Civil Code, courts seldom recognize commercial customs in favour of business terms at all.[106] In fact, it appears that they

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100 S. 310(1) BGB, second sentence, second half.

101 See *supra* 3.2.

102 See WURMNEST, *supra* n. 97, p 80.

103 Cf. 'Tegernseer Gebräuche'.

104 S. 346 HGB.

105 J. BASEDOW, 'Handelsbräuche und AGB-Gesetz', 150 *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* 1986, p 469 at 490.

106 Cf K. LENKAITIS & S. LÖWISCH, 'Zur Inhaltskontrolle von AGB im unternehmerischen Geschäftsverkehr', *Zeitschrift für Wirtschaftsrecht* 2009, p 441 at 442.

are far happier to accept the extension of consumer protection law to B2B relations than they are willing to grant businesses their own undisturbed domain. In the Civil Code it would have been preferable to provide for consideration of the necessary flexibility of commercial business and the correspondingly greater importance of freedom of contract, which would entail considerable freedom from standard terms control.

37. A suitable criterion, which could fulfil the corrective function, should refer to what is usual practice for the respective line of business. Where both professional parties to a standard form contract belong to the same line of business, as is regularly the case, it can be assumed that they are equally familiar with trade practices and conditions. Consequently, there is little or no need for protecting either side against the other's terms, and B2B standard terms control should step back. However, where occasionally a professional customer enters into a procurement contract that falls outside its main business area, it seems reasonably justified to grant some protection based on these specific B2B circumstances. As an example, one could think of a car manufacturer purchasing a specialized software for its accounting unit and in this context accepts the standard licence agreement of the software distributor. In such a case, it is justified to control the terms of the software licence agreement.

4. Conclusions and Lessons for European Law

38. Germany has not found the magic touchstone by which unfairness of standard terms in commercial relationships can be tested. Hardly any B2B standard form contract can nowadays avoid judicial scrutiny in Germany. Decades of dialogue between the legislator and the courts have produced rigid case law that often extends B2C rules to B2B contracts and does not appropriately consider commercial customs as a corrective feature. That is the reason why calls for reform are now commonplace.[107] Companies that are not happy with this *status quo* in German law take practical steps to evade it by submitting their agreements, even in domestic contracts of German firms with German clients, to a foreign law, preferably that of Switzerland or England.[108] Commercial parties deem the law to be so unsatisfactory that they are increasingly looking for the escape route than a way forward. By means of regulatory competition, Germany may eventually be forced to adapt its standards to that of other countries, and this would mean to bring down the rigidity

107 See the references ns 14–15.

108 In a poll among experts such as lawyers, 35.2% declared that they have 'occasionally' witnessed a choice of a foreign law in domestic German transactions, see Lars Leuschner, 'AGB-Recht für Verträge zwischen Unternehmen', research report commissioned by the German Federal Ministry of Justice and Consumer Protection, 30 September 2014, p 199, www.bmjv.de/SharedDocs/Artikel/DE/2015/02092015_AGB_Recht.html. In the same poll, 4.5% of big enterprises stated that they 'always' select foreign law for domestic transactions in order to avoid the applicability of German law, see *ibid.*, p 278. On the chosen laws see *ibid.*, p 200.

to a reasonable level. The German experience should however not be understood as a chilling reminder of standard terms control in B2B relations. It serves as a healthy reminder that such control should supplement failing contractual and market mechanisms but it should not be extensively applied as long as the criteria of fairness for this purpose are unclear.

39. These findings are worth considering in law-making at the European level in two regards.

First, criteria such as 'good faith and fair dealing' or 'good commercial practices' have been suggested by the DCFR[109] and the CESL Proposal[110] for regulating unfair terms in B2B contracts but they are too vague because they give courts lots of discretion. In the absence of more precise guidance, for instance by the European Court of Justice, which has refused to provide clarification of what is 'unfair' in the case *Freiburger Kommunalbauten*,[111] courts in the EU will assess those terms very differently. Using such terms would thus only result in feigning of harmonization of the law of the Member States. In reality, businesses could not rely on legal certainty and predictability.

Secondly, though it might initially seem to help in limiting the criticized vagueness, it is inadvisable to base B2B standard terms control on the difference in size between the contracting enterprises. Taking care of such market imbalances is the exclusive domain of competition law. It disposes of bespoke tools for this purpose, especially through control of the behaviour of market-dominating firms. The abuse of a dominant position—especially by imposing unfair trading conditions—is explicitly prohibited in the EU.[112] In terms of assessing market structures, the advantage of competition law over contractual terms control is that it is much more specialized, i.e. competition law has developed a much more sophisticated standard to fight imbalances in the market. Not only does it provide ample jurisprudence which sets out when unfair trading conditions are imposed, it also features a refined definition to assess when a firm has a 'dominant position' in a market. In comparison, the standards that have been developed in B2B standard terms control seem to be relatively blunt. 'Good faith' is a very open-ended and imprecise standard. At the same time, protecting 'small' against 'big' companies by means of contract law would involve a large measure of arbitrariness if one looks at the definition suggested for SMEs.[113] It is impossible to

109 Art. II.-9:405 DCFR.

110 Art. 86(1)(b) CESL Draft.

111 ECJ, 1 April 2004, Case C-237/02, ECLI:EU:C:2004:209.

112 Art. 102(a) TFEU.

113 See for example the definition in Art. 7(2) CESL Draft. The Australian reform provides for the following test: SMEs are companies with not more than 20 employees, and the upfront price according to the (standard form) contract they entered into does not exceed AUD $ 300,000 (or $ 1,000,000 for a duration of one year); Australian Small Business and Unfair Contract Terms Act 2015, *supra* n. 5, ss 8 and 31.

derive the necessity of protection of a small company from the number of its employees or its annual turnover.

40. Before extending unfair terms review to business contracts, it is thus necessary to find a more precise standard of what is 'unfair' in B2B relations. This article suggests mainly focusing standard terms control on prevention and correction of failing contract and market mechanisms. For this purpose, clear criteria are required for assessing when such failures typically exist. As long as no progress is made in this regard, the EU should refrain from harmonizing the control of standard terms and conditions in commercial contracts. Member States which plan to introduce such a control should carefully think about their standards.