STANDARD CONTRACT PROVISIONS AND STANDARD FORM CONTRACTS IN GERMAN LAW

On a visit to the Victoria University of Wellington during 1976 Professor Von Caemmerer addressed the Comparative Law class on the use of standard contract provisions (Allgemeine Geschäeftsbedingungen) and standard form contracts (Formularvertrag) in Germany. The substance of that interesting and informative address is reproduced here.

I THE USE AND PROBLEMS OF THE STANDARD CONTRACT PROVISIONS AND FORM CONTRACTS

1. Area of Applicability

Standard contract provisions and standard form contracts are used extensively in German law and throughout the European continent, and in the Anglo-American legal circle the situation may well be the same. We find them, for example, in the delivery terms of wholesale trade, the purchase and sales conditions of industry, the purchase terms of the motor vehicle industry, the standard form contracts which are applied in financed instalment purchases, the general contract provisions of banks, the bank conditions for checks, the broad insurance conditions in all branches of the insurance industry, the terms of building societies, mortgage conditions, loan conditions, transport and freight forwarding conditions, the forms of home owners associations or tenants associations for apartment purchase and rental contracts, the contract conditions for the rental of motor vehicles and so on.

The court decisions in Germany wavered for a long time on the question of whether a distinction should be drawn between standard terms, to which the contracting parties refer either expressly or implicitly, and standard form contracts, in which a complete set of provisions is incorporated into the contract which is signed by the parties, as for example in rental contracts, instalment purchases, mortgage loans and so on. On a policy basis such a distinction cannot be justified and thus standard contract provisions and forms contracts will now, according to the decisions of the highest federal court (Bundesgerichtshof) be treated equally in all respects.

2. The Functions of Standard Contract Terms and Standard Form Contracts

Standard contract terms and standard form contracts make it possible to establish special rules in which the specific needs of a particular line of business and the special purposes of the parties involved can be taken into account to a far greater degree than is possible in legislation. Mass contracts can in this way be rationalized and the attendant risks can thereby be rendered calculable. A bank can in this way regulate corresponding orders of its customers. For example it can regulate the purchase and sale orders of stocks of its customers so that it need only go to the stock exchange for the final balance. That requires, however, that the purchase and sale orders which it receives from its customers can be executed according to uniform conditions. With insurance contracts a standard form and the ability to calculate risks which are thereby created are substantial prerequisites of insurability.

Furthermore the standardization of transactions through establishment of the terms simplifies the conclusion of the contract. With CIF or FOB transactions or the issuance of letters of credit a simple cable closing of the contract is possible.

Finally the use of forms or the reference to standard terms makes it possible for persons who are not legally trained, to close transactions which are in themselves legally very complicated, for they then only have to complete a form or agree on a few commercial points. The complete contract need not be negotiated.

Without this rationalization and standardization, the closing of bank and insurance transactions, and also many other complicated transactions of foreign trade, by persons who are commercially but not legally trained would be quite unthinkable. The use of standard terms and forms allows, finally, a clear limitation of the agency powers of the involved negotiators who, as a rule, are not authorized to deviate from the standard conditions.

3. Considerations Operating Against Standard Contract Terms and Form Contracts

The application of standard form contracts and standard contract terms is thoroughly justified on the basis of the rationalization and standardization they provide, and because they make possible mass transactions and allow special purposes of particular areas of business to be taken into consideration.

At the same time, however, there are substantial dangers connected with their use. The party who is in a position to draw up the contract terms and to work out the form contracts, creates through this process a not insubstantial inequality in negotiating power. It is possible for him to exclude or limit liabilities which are provided in the law. One may refer by way of example to the so-called "exemption

clauses". The German expression is "Freizeichnungsklauseln." The battle of the courts and the legislators against exemption clauses in bills of lading is famous. Standard terms and forms can further be used to reserve to oneself priority rights and security which go further than the security legislation has provided. Well known, for example, are the liens which the banks have reserved to themselves in their standard terms for all demands arising out of the business relationship with their customers, or the liens in standard conditions of freight forwarders, warehousemen and commercial carriers in land and sea tansport.

In German law the right of reservation of title by the seller, with all of its so-called extensions and expansions, plays an important role. In the most expansive reservation of title clauses in sales terms the reservation of title is stretched to include the products produced from the delivered goods, and the claims arising out of any further transfer of the delivered goods or the manufactured products. Furthermore, the reservation of title is said not only to secure the claim for the purchase price in the particular transaction, but also all demands of the seller arising out of the continuing business relationship with the buyer.

Finally one often tries in standard contract terms and standard form contracts to include agreements concerning jurisdiction or arbitration clauses which could never be established in individually negotiated contracts.

Thus standard contract terms and form contracts contain within themselves the danger of splitting the law along the lines of particular business areas. Above all, however, they can lead to the establishment of rules which are completely one-sided, and which adversely affect the interests of those who are subjected to them.

The question of whether the problems of standard contract terms and standard form contracts can be controlled is therefore a central question in the protection of contractual autonomy.

II THE LEGISLATIVE MEANS FOR THE REGULATION OF THE PROBLEM

1. The Development of Compulsory or Mandatory Rules

The legislator can counter the abuse of standard contract terms and form contracts by creating broad compulsory laws. In Germany this occured in the 1890's with respect to instalment purchase. The buyer was protected against acceleration clauses, by which a delay in an instalment payment caused the total payment to be due immediately and at the same time gave the seller the right to take back the sold goods. In recent years this protection of instalment buyers has been greatly expanded through the creation of numerous addi-

tional mandatory provisions governing the instalment loan; all under the catchword "consumer protection". Also, transport businesses such as railroads, bus companies and so on cannot exclude or reduce the liability provided by law in their terms of conveyance. And finally, apartment rental laws have been greatly changed through numerous mandatory provisions for the benefit of tenants, and as a result freedom of contract has been substantially restricted.

Until 1908 the law of insurance contracts in Germany was solely one of standard business terms without any legislative rules. Here, there is now an insurance contract law whose provisions are in numerous points not mandatory, but whose protections may nevertheless not be bargained away. In other words, they can be deviated from for the benefit of the insured, but not for the benefit of the insurer.

Famous, finally, are the limits on exemption clauses in bills of lading, which were established in the Hague Rules of 1924.

2. Form Provisions

The further development of mandatory laws is one means which legislators throughout the world will use when they seek to prohibit particular conditions in form contracts and standard contract terms. There are, however, cases in which one does not oppose the contents of specific conditions but one seeks merely to prevent them from being included in standard contract terms and form contracts. The German legislator chose to deal with this problem by means of special form provisions. They provide that other provisions may not be bound up with the affected clauses, the penalty being the nullity of the clause.

This can be best made clear by referring to the example of arbitration clauses. Arbitration clauses are basically permitted by German legislation. The Rules of Civil Procedure demand, however, a particular form which states that:

> Other agreements such as those which refer to arbitration proceedings may not be included in this document.

With this, the inclusion of arbitration clauses in standard contract terms and form contracts, is prevented. It requires that a special written arbitration contract be entered into which is separate from the other agreements. (This applies, however, only for the ordinary citizen. Among businessmen no special form regarding arbitration clauses is provided. That means that arbitration clauses may also be included in standard contract terms. Hamburg importers can thus write into their purchase terms the clause: "Hamburg Friendly Arbitration", with which agreement is reached that the Hamburg Arbitration Court is to be responsible.) In other cases however, it is of the foremost importance that arbitration panels cannot be agreed on in

standard form contracts or standard contract terms. This requirement will guarantee control of standard terms through the regular courts.

3. Anti-Trust Law

a) In Germany important rules concerning the application of standard contract terms are contained in anti-trust law. (Anti-trust law is regulated in the Law Against Restraints on Competition of 1956/1966). The law permits so-called "condition cartels". This form of cartel involves cartel agreements in which the application of standard business and delivery terms is agreed upon. These condition cartels are of great importance for industries in a weak bargaining position such, for example, as the textile finishing industry which weaves, colours or prints fibers or materials produced by large chemical industries; or subcontractors and certain service businesses. Although these cartels are permitted, they must however be reported, and the cartel arrangements are only effective if antitrust officials do not object within three months. In this process the cartel officials listen to the parties which would be affected by the cartel, and this results in negotiations over the contents of the standard contract terms in which a balancing of opposing interests can be brought about.

b) Furthermore the cartel officials may step in against market-dominating businesses on the basis of abusive formulations or application of one-sided formulations of such terms.

4. Governmental Supervision

In other areas also government supervision and approval of standard terms is demanded. The previous experience with such governmental approvals is not, however, encouraging. For example the banks are subject to governmental supervision. The insurance companies are subject to the very strict and thorough supervision of the Supervisory Office for Private Insurance. Nevertheless, bank terms as well as insurance terms contain clauses which in particular cases have proven themselves to be extremely one sided and burdensome for customers.

It is a well-known fact that governmental supervisory officials are inclined to a type of brotherly relationship with the area of business which they supervise. For example, the insurance control office is in a difficult situation when the insurance industry asserts, with respect to a contested clause, that it is required for limitation of risk and that its omission threatens severe financial burdens which would endanger securiy or the calculation of insurance risk. The reason is that in such cases the very same office would be responsible for the problems thereby created. The case law in Germany has therefore always taken the position that the fact that certain terms have been approved by supervisory boards does not hinder courts from overruling such clauses.

III THE TREATMENT OF STANDARD CONTRACT TERMS AND FORM CONTRACTS IN THE CASE LAW

I have already said that German case law, after some vacillation, now handles standard contract terms and form contracts on a substantially equal basis. Drawing the line would in specific cases be difficult. With respect to standard contract terms the special problem that arises is that it is sometimes not clear, whether the parties have made the terms part of the contract. Also the problem of the so-called "battle of forms" arises naturally only with standard contract terms, for with a standard form contract the question of whether it has become part of the contract is answered by the signing of the form by the parties involved. As for the rest, however, the policy situation of standard terms and standard form contracts is substantially the same. Thus it is to be welcomed that the highest German civil court has decided in recent cases on the similar handling of standard contract terms and standard form contracts.

1. Appeals to the Highest Court

The highest courts in France, (the Cour de cassation), and in Germany (the Bundesgerichtshof) deal only with questions of law and not with questions of fact. The construction of contractual agreements is a question of fact, and thus it would normally not be handled by the Bundesgerichtshof or the Cour de cassation. Thus a crucial step was taken by the German Reichsgericht, which was the highest German court from 1879 until 1944, and now likewise by the Bundesgerichtshof, in deciding to handle standard contract terms and form contracts as legal principles to which the parties subject themselves. In this way the appealability (in Germany known as "Revisibilitaet") of standard contract terms is permitted and their control by the highest court is made possible. That was a quite decisive step in gaining control over the problems of standard contract terms and standard form contracts.

2. Basic Principles of Construction

German case law has, in line with countless other legal systems, developed certain principles of construction for standard business terms and standard form contracts which make relief possible in the case of unjust clauses. Included here are the so called "lack of clarity rules". They belong actually to the maxims of decision of the old Roman jurists. If a contract clause is unclear and doubts are left open it will be construed against the party which prepared the rule and which is responsible for its formulation. This provides a certain protection. But it does not prevent business groups protecting themselves against this type of attack by clearly reformulating clauses which have in this way been struck down by the highest courts.

Furthermore the case law provides protection against unexpected or surprising clauses. Realistically, one begins with the proposition that

no businessman reads the full text of either a form contract or standard contract terms. He operates on the assumption that a transaction with a trustworthy partner will operate normally in 99% of the cases and that in the irregular 1% of the cases the courts will provide him with protection. For the sake of this small number of problem cases he cannot endanger the closing of the contract through negotiations over standard terms. Since that is so, a contract partner who has accepted standard terms or forms should at least be protected against clauses which to him are completely unexpected and which in business are not common. Contract clauses which a signatory need not take into consideration are considered as not agreed upon. These maxims, which are continually applied throughout the world, offer, however, only temporary protection and do not help if such a clause is conspicuously printed and is made known through long years of use.

3. Open Control of the Contents of Standard Contract Terms and Form Contracts by the Courts

Real help against questionable clauses is, however, only possible when the controlling case law decides on open control of the contents of standard contract terms and standard form contracts. The German case law has taken this step, whereas the case law in France and in Switzerland, for example, has been unable to decide on it.

According to the German Civil Code, the borders of freedom of contract lie in compulsory law and in good morals. Contracts which infringe a legislative prohibition and contract provisions through which compulsory law would be infringed are void (¶134BGB). The second border is based on good morals (¶138BGB). Thus contract which are contrary to public policy and good morals are declared void by the law. So long, however, as a contract does not infringe either of these two external limitations it is basically effective and enforcable.

The courts naturally have, however, a certain reluctance to accuse businessmen of behaviour contrary to good morals on the basis of their use of certain standard term clauses. Not every clause which relieves one from liability and not every agreement on extensive security can simply be considered as contrary to good morals. The Reichsgericht had attempted, with respect to many standard terms, to help by using the assumption of abuse of monopoly power. That was, however, not the proper standpoint. Certainly there are in the law concerning standard terms monopoly situations. But improper clauses have also been used where such monopoly situations do not exist or in any case could not be proved.

The German Bundesgerichtshof here took an important step in 1956 with a fundamental decision. It distinguished between freely negotiated individual contracts on the one hand and the use of standard form contracts on the other hand. The borders of contractual freedom established in the law apply to freely negotiated contracts in which both contracting parties have approximately equal bargaining

power. Here it is viewed as correct to allow the parties to freely divert from the non-mandatory statutory norms.

The situation is, however, different with respect to standard contract terms and standard form contracts. These are conditions which a party must accept without being able to change them in the course of negotiation, and for them other borders must be establisher. Whoever establishes one-sided terms which are to be applicable in many cases and to many persons is in a position similar to that of a legislator and must therefore create a balanced rule which takes into consideration the interests of all parties concerned. The old formula of "good faith" (¶242BGB) which stems from the bona fide contracts of the old roman law demands that the contract conditions be fair, balanced and appropriate, that is, that they correspond to good faith. The courts thus take it on themselves to check the balance and fairness of standard provisions and standard form contract provisions which are to be applied. That makes it possible for the courts to exclude all such terms which seem to them to be too one-sided, even if they cannot be claimed to be contrary to mandatory law and good morals.

This type of control of the contents of such terms, which was developed by the German Bundesgerichtshof, at first only gradually established itself in the case law of the lower courts. Today, however, it is quite generally applied. Moreover, it has led to a situation where exemption clauses which go too far have noticeably diminished, especially in insurance contracts, in the standard terms of brokers, in the liability provisions of service and transport companies, and in commercial sales conditions.

The standard which the German case law here applies is somewhat similar to that which the American UCC section 2-302 intends to apply, when it declines to allow unconscionable contracts or an unconscionable clause of a contract to be enforced.

An example may clarify why and how the German case law distinguishes between a freely negotiated single contract and contracts with standard contract terms:

A private person who sells his auto to an acquaintance may operate in such an individual contract on the old principle of caveat emptor and agree with the buyer that all liability for defects is to be excluded. That is permitted under German sales law, except when the seller fraudently conceals something from the buyer (¶476BGB).

On the other hand, however, the automobile manufacturer or dealer may not go so far in his sales terms according to the case law. He can *limit* his liability by providing that the buyer shall be limited to demanding subsequent improvement and that the seller shall be liable only for direct damages to the car itself and not for indirect damages which the buyer suffers. But the sales terms may not leave the buyer *without rights*. And when subsequent improvement is not possible or

when it is not reasonable, because such improvements have become repeatedly necessary due to new defects, the statutory rules are revived in spite of the contractual limitation of liabilty, and the buyer can give back the auto and demand the return of his money.

The German case law also developed another important approach to control of the contents of exempton clauses in standard terms and form contracts. Such exemption clauses are ineffective if they would cause a contractual promise to be practically without effect. In the leading case of 1968, which has been followed widely, the following factual situation was presented. A seller had delivered cealing tiles to a buyer and, at the same time, a glue which was guaranteed to be appropriate to cause the tiles to adhere to the roof. The latter was not, however, the case. The tiles which had been glued to the ceiling fell and caused substantial damage and repair costs. The seller declined to pay compensation because his sales terms contained the following clause:

> "In the case of established defects the buyer can only claim a replacement delivery. Claims for compensation for damages as a result of the use of the goods are excluded."

Through such a clause, and similarly through agreements which limit the buyers right to price reduction or return of the goods, the buyer, who here purchased the glue on the basis of the promise, is left without any rights. Exclusions of liability which make a contractual promise practically meaningless are thus declared ineffectual by the German case law. This has a certain relationship to the doctrine of fundamental breach developed in the English case law. It goes, however, further than the English case law, for in the German case law the clauses limiting liability have been declared ineffectual in the face of clear and doubt-free language, whereas the English courts have as yet, if I read them correctly, not been able to reach this point.

Also in German law cases of the so-called "battle of forms" are becoming increasingly important. Both contracting parties attempt to establish their contract terms as the basis of the closing of the contract. The seller refers to his sales terms and the buyer to his purchase terms. The rules of the two contractual forms are diametrically opposed to each other. A clear agreement as to which terms should apply has not been reached. Nevertheless the contract is performed.

Since the parties have in practice carried out the contract, it would be inappropriate to declare the entire contract ineffective on the basis of lack of agreement. The parties have operated on the supposition that it should be carried out. Only an agreement on the standard terms is lacking. The courts have for a long time attempted to explain in individual cases who has the last word in his demands for the establishment of his own terms. That is generally pure coincidence and does not lead to appropriate solutions. Today one takes the following position: if a clear agreement concerning the applicable standard terms is not reached, the contract is established but the non-

mandatory statutory law applies, possibly modified by such provisions of the standard terms which in the relevant area of business are normally used in contracts of this kind.

For the described control of the content of standard trade terms, for the establishment of the precedence of individually given promises in the face of clauses which limit liability, and for an appropriate solution of the problem of the battle of forms, it is of great importance that the regular courts be in a position to decide these cases, and that they be not replaced by arbitration panels. The limitations which the German legislator provided for arbitration clauses in standard trade terms here prove themselves to be extremely important. It is to be seriously considered whether the legislature should not extend it also to contracts among businessmen.

IV REFORM LEGISLATION

Building on the described development of the German case law the German legislature intends at present to create a statute for the regulation of standard contract terms which should also apply to standard form contracts. The draft attempts in substance to codify the principles which the case law of the Bundesgerichtshof has developed. The basic rule of the draft law is to read:

> "Provision in standard contract terms are ineffective, if they do not balance the interests of the parties according to the rules of good faith."

The principles of the balancing of interests which are contained in the legislative rules should serve to establish a standard even where they are not mandatory.

Furthermore, clauses are to be ineffective where substantial rights or duties which derive from the nature of the contract are so limited as to endanger achievement of the purpose of the contract.

The draft law further enumerates a catalogue of clauses, culled from observation of the practical operation of such clauses, which in case of doubt will be assumed to be impermissible. Thus the party who wants to use a clause of this type has the duty to demonstrate that it involves a fair and necessary provision for the protection of justified interests.

A further catalogue of clauses which would be permitted in individual contracts would simply be impermissible in standard contract terms. On the specific, naturally, there is still substantial controversy over these catalogues of clauses. I personally tend to believe that courts are in a better position than the legislature to decide which clauses are inappropriate.

An important success of the case law as well as of the reform efforts of the legislature is that at present in Germany numerous standard terms are being subjected to review. The private banks have,

as of January 1976, subjected their extensive standard terms which had been applied for more than a generation, to a fundamental revision which should serve the interests of their customers.

Another means which one uses is that of bringing two market positions together and trying by way of compromise to work out model contracts which could be applied by the parties. Thus at the moment — with, incidentally, the aid of the Federal Ministry of Justice — a model contract for the renting of apartments is being worked out which should balance the interests of owners and tenants. No one is forced to use this model contract but it is hoped that in general it will be used.

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