



**Universidade do Minho**  
Escola de Direito

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## **Standard terms and Contractual Justice**



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Dissertação de Mestrado  
Mestrado em Direito dos Negócios Europeu e Transnacional

Trabalho efetuado sob a orientação do  
**Professor Nuno Manuel Pinto Oliveira**

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## **Abstract**

This thesis argues for the establishment of a new legal system with regard to contracts of adhesion. Contracts of adhesion are currently the most common form of contracting. However, because they are drafted by economic organizations and imposed on the consumer without any kind of judicial control, these contracts contain tremendously unfair clauses. Finding a new format for this type of contract is urgent. First, they should not be entirely considered in the scope of private law, which regulates relations between individuals. Economic organizations should not, in any way, be treated as individuals. Second, because consumers are, at the outset, in a handicap ratio, their protection matters greatly.

It is, therefore, important to establish a suitable framework for the protection of consumers' interests against the authoritarianism of the economic organizations.

**Keywords:** contracts of adhesion; standard terms; contractual justice; freedom of contract; consent; judicial risks; legal certainty; progress; new legal system.



## **Resumo**

Esta tese tem o objectivo de clarificar a necessidade de um novo sistema legal no que diz respeito aos contratos de adesão. Os contratos de adesão, são hoje em dia, a forma mais vulgar de contratar. No entanto, pelo facto de serem redigidos por organizações económicas e impostos ao consumidor sem qualquer tipo de controlo judicial, estes contratos podem incluir cláusulas injustas.

É por isso urgente uma nova formatação para este tipo de contratos. Em primeiro lugar, não devem ser considerados inteiramente no âmbito de Direito Privado, pois este regula relações entre individuais. As organizações económicas não devem, nem podem, de forma alguma, ser equiparadas a um individual. Em segundo lugar, pelo facto de os consumidores estarem, logo á partida, numa relação de desvantagem, deve ser dada grande relevância á protecção destes.

Importa, por isso, estabelecer um quadro legal adequado para a protecção dos interesses dos consumidores contra o autoritarismo das organizações económicas.

**Palavras-chave:** contratos de adesão; clausulas contratuais gerais; justiça contratual; liberdade contratual; riscos jurídicos; certeza jurídica; progresso; novo sistema legal.





## **Methodology**

The methodology used in this master's thesis research is based on a legal dogmatic descriptive method, particularly in Chapter I and II. The subsequent Chapters (III and IV) are result of a descriptive method followed by a conceptual analysis method. Then, a evaluation method is put in practice to determine whether the current legal system is appropriate for the present reality. Also, a comparative approach is used throughout this thesis.

The Chapter I contains a introduction to contracts of adhesion in general. What is a contract of adhesion, to whom it applies, who enjoy their use, and others, are questions answered in this chapter. Then, Chapter II exposes the opinions of three notorious scholars. Kessler, Rakoff, and Slawson specially address the problem of contracts of adhesion and their impact on the today's society, more precisely the US society. Their perspective is helpful to a full understanding of the practice.

In Chapter III, a case-law analysis describes the state of adhesion' practice in the EU as well as its legal framework. Their fast spread and tricky usage gave rise to many legal problems, which happen until today. The EU and the ECJ consider that contracts of adhesion, which are normally consumer contracts, have some particularities that mislead the consumer, for instance some unfair contract terms. For that reason, the EU has released the Directive 93/13/EEC on Unfair Contract Terms., its enforcement is visible within the case-law analysis.

Lastly, the Chapter IV respects to the Conclusions and Recommendations acquired during this research work, in which a critical analysis is made.



## Table of Contents

<b>Introduction.....</b>	<b>13</b>
<b>CHAPTER I.....</b>	<b>13</b>
1.1. Standard forms or adhesion contracts? .....	17
1.2. Public nature of contracts of adhesion .....	30
1.3. The Basis of Standard Form Contracts.....	31
<b>CHAPTER II.....</b>	<b>35</b>
2.1. Friedrich Kessler.....	36
2.2. Todd Rakoff.....	46
2.2.1. Problem outlines .....	47
2.2.2. A Innovative analysis.....	59
2.2.3. New doctrine's development.....	74
2.2.4. Rakoff's Conclusion .....	91
2.3. W. David Slawson.....	92
2.3.1. Controlling the Lawmaking Power.....	94
2.3.2. Standard's Form Consensual Lawmaking.....	97
2.3.3. Contracts of Adhesion.....	100
2.3.4. Current Judicial Control of Contractual Lawmaking.....	106
2.3.5. Slawson's conclusion.....	106
2.4. Further considerations.....	108
<b>CHAPTER III.....</b>	<b>113</b>
3.1. The Aziz Case.....	114
3.1.1. The Case.....	114
3.1.2. The ECJ's New Approach.....	117
3.1.3. The ECJ as supervisor of unfair terms in Europe.....	120
3.1.4. The ECJ as a social righteous.....	122

3.2. The public interest.....	124
3.3. Private Law’s Constitutional Approach.....	125
3.4. Relation with U.S jurisprudence.....	130
<b>CHAPTER IV .....</b>	<b>133</b>
4.1. The Freedom of Contract.....	134
4.2. The Institutional Power (The Market and the State).....	136
4.3. The call for a multiple system of contract law.....	137
4.4. The public interest in the US and the EU.....	138
4.5. Public interest or Constitutional settlement?.....	141
<b>References .....</b>	<b>143</b>
<b>EU Case-Law .....</b>	<b>145</b>
<b>US Case-Law.....</b>	<b>145</b>

## Introduction

Since the first moment I studied Standard Form Contracts or Contracts of Adhesion, a question always came to my mind: How can such unfairness not be fought?

The most popular type of contract in our time is that of adhesion, especially in consumer transactions. They are preprinted forms containing non-negotiated provisions, that are offered to the consumer on a take-it-or-leave-it basis. The terms are normally presented in fine print, and are drafted by and on behalf of one of the parties to the contract, normally the one with superior bargaining power, that is, business organizations.

With the expansion of the worldwide market, the transactions had to become standardized, or else it would have been impossible to keep the market running. The contracts are standardized for many reasons: first, they are used to supply mass demands for goods and services; second, they are drafted for an infinite number of persons; third, they promote the efficiency of the trade, reducing transaction costs; and fourth, they strengthen the power of the organizations that enjoy their use.

Surely, these contracts are helpful to some extent but they are also deceiving. They are deceiving because the consumer cannot even negotiate. He either accepts or not. If all consumer commercial transactions are made through these contracts what can the consumer choose other than a imposition? This imposition of terms on the consumer is, in fact, the power of “making” law by the organizations. If contracting is a form of lawmaking between two private parties then, if the same contracting is imposed by one of the parties, that party is effectively making law. Moreover, the organizations impose various types of unfair clauses that, for many reasons, the consumer, is not aware of.

Powerful business enterprises distort the principles of contract law to achieve their own goals. For this reason, is my belief that the law regarding contracts of adhesion must be separated from the “ordinary” contract law. The contractual relationship is no longer equal, because one of the parties has much more power than the other. Also, I believe that if organizations are capable of “making” law, they must be subject to any kind of “democratic control”. The consumer is not yet sufficiently protected against the abuses of this practice.

The path to achieving contractual justice is one of determining the appropriate sphere in which contracts of adhesion are contained. They are not contracts *stricto sensu*, so why are they still governed by principles of contract law? More precisely why are they still governed by private law if they have all the characteristics of a “public” contract?

Contracts of adhesion must have the direct intervention of the State. Otherwise organizations will keep imposing all kinds of unfair terms, with no fear of being discovered.

We must take a look at the reality that surrounds us. These days, organizations do not even think about any legal consequences, because the law regarding this problem is full of contradictions. Moreover, they prepare their “contracts” to be close to the threshold of legality, because they have the power and the means to do so. In the other hand, the consumer is facing the “world” alone. He does not have the means, most of the time, for a reasonable defence against these organizations. Besides, he has been deceived in the first place, because, unlike these organizations, he did not have all the information in the beginning of the transaction.

How can this still happen in the twenty-first century? How can the law itself admit such injustice?

In this thesis I will analyse American jurisprudence by comparing decisions taken both in American and European Union courts. Furthermore, I will show that the decisions are beginning to be in accordance with the public law approach to contracts of adhesion

## **CHAPTER I**

### **GENERAL CONSIDERATIONS ABOUT STANDARD FORM CONTRACTS**



Standard form contracts are the type of contracts that are most used in today's modern economy. That is due to the reality of mass production and the consumer economy in which we live. The birth of these contracts was inevitable to keep the market functioning. Mass production leads to mass consumption, and in order to facilitate it, businesses tend to use standard form contracts. Then, what is a standard form contract? Most people have already contracted this way. Opening a bank account, taking out insurance, buying a car, getting the house fixed or even taking a shirt to the laundry are examples of standard contracts. They are essentially consumer contracts that use standardized, non-negotiated terms, usually in pre-printed forms. These contracts may also be known as "boilerplate contracts", "contracts of adhesion" or "take-it-or-leave it" contracts. The terms written in fine print, are drafted by or on behalf of one party to the transaction, normally the party that has more bargaining power. The terms are not even negotiated by the consumer. This standard form contracts also play an important role in the efficiency of mass distribution of goods and services. They reduce costs by eliminating the need of negotiating every detail and this reflects in reduction of prices, from which the all society benefits.

Consumer adhesion standard form contracts and the proliferation of unfair supplier-biased terms are characteristic of the modern day consumer market<sup>1</sup>. Many countries have been enacting legislation that aims at providing a general framework to deal with the possibly unfair terms in these contracts. Examples include in Germany, the Standard Terms Act<sup>2</sup>, in 1976, in Israel the Standard Contract Law, in 1964,<sup>3</sup> in Sweden, the Improper Contract Act, in 1977<sup>4</sup> and in the United Kingdom the Unfair Contract Terms Act, in 1977<sup>5</sup>. Most of them have been rectified by now, this may be because of the implementation of the Unfair Contract Terms

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<sup>1</sup> It is estimated that about 98 per cent of all written contracts made in USA are made on standard forms: see Slawson, "Standard Form Contracts and Democratic Control of Law Making Power" (1971) 84 Harv. L. R. 529. That may not be the case in other countries. Yet, due to the highly internationalized marketing methods used in today's world, it's tempting to believe that Slawson comment is not too far from reality.

<sup>2</sup> See Sandrock, "The Standard terms Act 1976 of West Germany" (1978) 26. Amer. J. Comp. L. 551, Alpa, "Protection of Consumers against Unfair Contract Terms: Legislative Patterns of Controlling Adhesion Contracts in Europe" (1976) 105 Willamette L. R. 267, 274-276.

<sup>3</sup> See Diamond, "The Israeli Standard Contracts Law, 5729-1969" (1965) 14 I.C.L.Q. 1410, Gottschalk, "The Israeli Law on Standard Contracts" (1964) 81 L.Q.R. 32, Hecht, "The Israeli Law on Standard Contracts" (1968) 3 Is. L.R. 586, Comment, "Administrative Regulation of Adhesion Contracts in Israel (1966) 66 Colum. L.Rev. 1341, Lando, "Standard Contract: A Proposal and a Perspective" (1966) 10 Scan. Stud. L. 129, Jacobsen, "The Standard Contracts Law of Israel" (1968) J. B.L. 325, Berg, "The Israeli Standard Contract Law 1964: Judicial Control of Standard Form Contracts" (1979) 28 I. C. L.Q. 560.

<sup>4</sup> See "Consumer Protection and Standard Contracts: The Swedish Experiment in Administrative Control" (1974) 22 Amer. J. Comp. L. 17, Bernitz "Consumer Protection and Standard Contracts" (1973) 17 Scan. Stud. L. 11, Id., "Consumer Protection: Aims, Methods and Trends in Swedish Consumer Law (1976) 20 Scand. Stud. L. 11, King. Consumer Protection Experiments in Sweden (New Jersey: 1974).

<sup>5</sup> See, Treitel, *The Law of Contract (London: 1979)* 179-193, Cheshire and Fifoot, *Law of Contract (London: 1981)* 159-173, Coote, "Unfair Contract Terms Act", (1978) 41 *M.L.R.* 312, Sealey, "Unfair Contract Terms Act 1977" (1978) 37 *C.J.L.* 15, Adams, "An Unfair Look at the Contract Provisions of the Unfair Contract Terms Act, 1977" (1978) 41 *M.L.R.* 703.

Directive by the EU countries, in one side, or, the sign that there is the need to adapt to the new circumstances of the market and law, in the other side. By the same token, in the US the Section 211 of the *Restatement (Second) of Contracts*, entitled “Standardized Agreements” treats contracts of adhesion.

The conceptual base from which most of the legislation derives is the classical theory of contract as bargain resulting from agreement between parties to contracts of adhesion and the conclusion that unfair terms in these contracts result from breakdown in the classical contract bargaining process.

### **1.1. Standard forms or adhesion contracts?**

#### **A. Introduction to the term “contracts of adhesion”**

The term “contract of adhesion” is widely used in the context of contemporary contract’s<sup>6</sup>, though the expression has not yet attained any accurate legal meaning. When referring to these contracts there is the possibility of mistake its significance. For example, the term is sometimes used to mean all standard form contracts. It may also refer to a broad range of contracts where the bargain is absent and, at other times, to refer only to consumer type contracts.

Due to their deceiver meaning, contracts of adhesion must be looked closely at, more specifically, their core characteristics.

Henry Maine was one of the first to note the impact that standard form contracts would have in the future. In 1861, he observed that “the movement of the progressive societies has hitherto been a movement from Status to Contract”<sup>7</sup>.

What Maine meant was that the society was moving away from the stratification based on fixed classes, as with feudalism, and was moving into the much revered “Freedom of Contract Era”, where the people were free to transact with, and become obligated to, whomever they wished.

Nonetheless, just about a century ago, Nathan Isaacs speculated about whether the standard form contract phenomenon would be opposite to that transformation. That is, Isaacs become aware of the possibility that the rising of this type of contracts could lead to the re-

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<sup>6</sup> See, eg., Kessler, "Contracts of Adhesion: Some Thoughts about Freedom of Contract" (1943) *43 Colum. L.R.* 629, Bolgar, "The contract of Adhesion: A Comparison of Theory and Practice" (1972) *20 Amer. J. Comp. L.* 53, Lenhoff, "Contracts of Adhesion and Freedom of Contract" *36 Tul. L.R.* 48, Schuman, "Consumer Credit by Adhesion Contracts" (1962) *Temp. L.Q.* 125, 281

<sup>7</sup> Henry Sumner Maine, *Ancient Law* 170 (Transactions Publishers 2002) (1861)

classification of the contracting masses into two categories: the dominating lords (the corporations using such contracts) and the subservient vassals (the consumers subject to such contracts). Hence, his observation was not totally incorrect as the rise of this standard form contracts revealed the growing disparity in bargaining power between industry and consumers<sup>8</sup>.

The first time that the contract of adhesion was referred to as a transaction type was in 1901, by the French jurist Raymond Saleilles, who identified what he called “*contracts d’adhesion*”<sup>9</sup>. Saleilles stated that these contracts consist of pre-formulated stipulations in which the will of one party dominates the transaction. This dominance lies in relation, not only to a single individual, but also to an entire group of individuals who may at any time wish to participate in such transaction<sup>10</sup>. Some illustrations of this type of contract are collective labour contracts in large industries and railway transportation contracts<sup>11</sup>. Saleilles asserted that these contracts are similar to legislative enactments and should be interpreted “in the interests of the collectivity to which they are addressed... in the sense called for by both good faith and economic relations involved<sup>12</sup>”.

The topic that Saleilles most discussed in differentiating contracts of adhesion from other contracts was the need to adopt a different method of interpretation. According to him, contracts of adhesion differed from ordinary contracts in that the juridical basis of the latter type was not consensus (or consent), but was adhesion to one party’s stipulations. For this reason, Saleilles suggested a diverse interpretation technique.

Then, in 1919, the expression contracts of adhesion entered into the Anglo-American vocabulary, at the hands of Professor Patterson, who embraced the Saleilles thesis. In an article on life insurance contracts, Patterson said that “contract is drawn up by the insurer and the insured, who merely adheres to it, has little choice as to its term”<sup>13</sup>. Patterson, as Saleilles, used this analysis to show why contracts of adhesion should be interpreted differently from ordinary contracts. When classifying a contract as an “adhesion contract”, it means that this contract should be interpreted in a particular method.

Another important contribution in this discussion was made by Friedrich Kessler<sup>14</sup>, who

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<sup>8</sup> See Nathan Isaacs, *The Standardizing of contracts*, 27 Yale L. J. 34 (1917)

<sup>9</sup> See Saleilles, *De La Declaration de Volonte* (1901)

<sup>10</sup> See Patterson, “The Interpretation and Construction of Contracts” (1964) *Colum. L.R.* 833, 856 and Amos and Walton, *Introduction to French Law* (London: 1966) p. 152.

<sup>11</sup> Saleilles, *supra* note 9 at 230.

<sup>12</sup> *Ibid.*

<sup>13</sup> See Patterson, “The Delivery of a Life Insurance Policy” (1919) 33 *Harv. L. R.* 198.

<sup>14</sup> Kessler, *supra* note 6

still has one of the leading articles regarding the contract of adhesion<sup>15</sup>. In it, he broadened the idea of the adhesion contract. For Kessler, the arrival of this type of contracts was inspired by the need to encourage business activity and mass production<sup>16</sup> and is so different from ordinary contracts that totally new legal principles are necessary to regulate these contracts. Kessler wrote:

It is not even profitable to spend the energy of the counsel, the money of clients and the time and analysis of the judges in discussing the problems presented by contracts of adhesion in terms established legal principles and to proclaim that recovery is contrary to the well settled principles of contract law.

It is perceivable that Kessler, more than calling for a different mode of interpretation, also called for a new set of legal principles.

Kessler was quite persistent in referring that the adhesion contract is a distinct, legitimate transaction type which is capable of generating separate legal principles. This led to the curiosity of modern commentators, which started to collect the various distinguishing features between an adhesion contract and an ordinary contract.

One of these commentators was Arthur Lenhoff<sup>17</sup>, which collected some features of the contracts of adhesion and then, enumerated their five main characteristics:

1. The contracts are based on standard forms.
2. They are used to supply mass demands for goods and services.
3. They are drafted, for the public, that is, for an infinite number of persons, rather than a single individual.
4. Their use is entangled with the superior bargaining power of the stipulator which is, to a certain extent, a monopolistic body.
5. The individual customer has no bargaining power; he must either adhere to the contract or refuse the contract all together<sup>18</sup>.

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<sup>15</sup> Leff refers to this article as “the most elegant and powerful discussion of the adhesion contract”: See Leff, “Contracts as Thing” (1970) 19 *Amer. U. L. R.* 131, 142.

<sup>16</sup> “The effect of mass production and mass merchandising is to make all consumer forms standard, and the combined effect of economics and the present law is to make all standard forms unfair. Mass production and mass merchandising work to make all forms standard because nonstandard form is characteristically just as expensive for a seller to make and sell as is a nonstandard tangible product.”: See Slawson, “Standard Form Contracts and Democratic Control of Lawmaking Power” (1971) 84 *Harv. L. R.* 529.

<sup>17</sup> See Lenhoff, *supra* note 6.

<sup>18</sup> *Ibid.* at 481-482

This description, however, doesn't fit perfectly in all these types of contracts. Because of that, it is imperative to clarify some notions. Lenhoff states that adhesion contracts are based on standard forms, but all of the contracts based on standard forms may not mean exactly the same as some commentators tend to incorrectly state. There are some differences between the adhesion contract and another type of standard form contract, namely the commercial standard form contract<sup>19</sup>.

The commercial standard form contract takes place between parties who are engaged in trade, business or commerce and who are of relatively equal bargaining power. There is a case that addresses this issue<sup>20</sup> and which states that: "The clauses of these (contracts) have been settled over the years by negotiations by representatives of the commercial interests involved and have been widely adopted because experience has shown that they facilitate the conduct of the trade..." An example of this sort of contract is standard form building contract.

The adhesion type standard form contract, oppositely, is concluded between parties, of relatively unequal bargaining power, on a standard form produced by, or on behalf of, the party with the stronger bargaining position. In the case referred above, Lord Diplock made a description of these types of contracts, where he held the following:

The terms of this kind of standard form have not been the subject of negotiation representing the interests of the weaker party. They have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others providing similar goods or services, enables him to say: 'If you want these goods or services at all, they are the only terms on which they are obtainable. Take it or leave it'.<sup>21</sup>

This unequal bargaining is possible due to the existence of relative market power by one party to an adhesion contract. Lenhoff was of the opinion that the use of adhesion contracts was implicated with monopoly power. As a matter of fact, he goes too far in this issue when he suggests that the adhesion contracts indicate the absence of competitive markets. It is quite possible for firms in a given industry, finding it economical to use standard form contracts, to refuse to negotiate with purchasers, but nevertheless to have competitive terms in standard forms<sup>22</sup>. Hence, adhesion contracts may be found in workably competitive markets and they do not need to be any monopoly as such to create and maintain an adhesion situation. Though, such a situation can be created where contracts are offered on substantially nearly identical

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<sup>19</sup> See Sales, "Standard Form Contracts" (1953) 16 *M.L.R.* 318.

<sup>20</sup> *Schroeder Music Co. Ltd v. Macaulay* [1974] 3 *All E. R.* 616, 624, per Lord Diplock

<sup>21</sup> *Schroeder Music Co. Ltd v. Macaulay* [1974] 3 *All E. R.* 618, 624, per Lord Diplock

<sup>22</sup> See Posner, *Economic Analysis of Law* (Toronto: 1977)

terms by competitors who dominate the market<sup>23</sup>. When Lenhoff referred the “monopoly power” it must be understood in this former sense.

There is another Lenhoff’s description referring to the adhesion contracting process which deserves attention. He mentions that the weaker party “adheres” to the contract, or else no contract can result. This is not enough to emphasize one of the most distinguishing features of the contract of adhesion, which is that the contract involves a disqualification of the element of bargaining over terms. The contract procedure is much simpler than the classical contract. When using this contracting “via”, the weaker party is presented with a form, where it simply has to sign or not. So, the contracting process is, actually, a co-operative act by the weaker party done in agreement, rather than by way of making an agreement.

## **B. The Genesis and Expansion of Standardized Contracting**

The standardization of contracts can already be found in primitive societies, such as Greco-Roman societies<sup>24</sup>. The conclusion of a contract, the transference and establishment of property rights were usually viewed as sacred acts, where a priest had to be present. Over the years, the priest had collected some of the sacred words spoken at these occasions, which later were given to the public notaries. Until now, most public notaries have had at their disposal books of forms, in which most current legal acts have been standardized.

Another important factor in the development of standard form contracts is the advent of model insurance policies in the 16<sup>th</sup> and 17<sup>th</sup> century. Insurance in the 16<sup>th</sup> century was a rather new institution, unprovided for by Roman law and outside of the scope of the guilds. With the increase of the number of insurance contracts it became worthwhile to cover specific events that rarely arise in the policies. Similarly, the need for standardized clauses was felt. These were grouped in model policies.

Then, in the late 18<sup>th</sup> and the 19<sup>th</sup> centuries, after the decline of the guilds, for example, in France, the state or either the manufactures themselves started to proclaim “codes of factory discipline”. Given that trade unions weren’t allowed, these codes became very one-sided, hence containing extremely onerous clauses. Applying these clauses to the labourer, or not, was up to the manufacturer. In fact, this system proved to function so well that it was also applied to other branches where one party had an economically dominant/superior position, namely sales of

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<sup>23</sup> See, eg., *Henningsen v Bloomfield Motors Inc.* 161A 2d. 69 (1961).

<sup>24</sup> E. H. Hondius, *Standard contracts and adhesion contracts according to Dutch law*, LL.B Leyden 1965, M.C.L. Columbia 1966

goods to consumers, railway transport, water, electricity and gas delivery, and many other services.

In England, the origin of the adhesion contracts return to, at least, the latter part of the 18<sup>th</sup> century, with the expansion of large railway companies<sup>25</sup>. As carriers, these railway companies were not only obliged to carry goods offered to them at a proper and reasonable charge, but were also under a strict liability, especially for any loss of goods entrusted to them<sup>26</sup>. In order to escape this strict liability, the railway companies, through the end of the 18<sup>th</sup> century and increasingly during the 19<sup>th</sup> century, began to post public notices excluding certain types of liability, especially that for loss or for theft<sup>27</sup>. In the *Riley v. Horne* the validity of this clauses was sustained. During this trial, the president of the Court of Common Pleas, Best CJ, observed that the major part of the people who send their goods by carriers were entirely ignorant of what they could do to insure their goods. By 1830, the problem of public notices, which Best CJ noticed, had become grave enough to attract the attention of the English literature. In this year, the Carriers Act was approved. One of its many features was the disallowance of the reliance on public notices, where the goods being carried were worth less than £10, unless the carrier could prove a “special contract”. This requirement of “special contract” was that it had to meet the standard of “justice and policy”, which Best CJ stated in the *Riley v. Horne*. This “special contracts” were the predecessors of the modern adhesion contracts. With the view to prevent the effect of the Carrier Act, railway companies started to constitute “special contracts” with consignors and passengers by giving them tickets or notices containing extremely broad exclusion clauses<sup>28</sup>. This tickets were invented by large railway corporations with the intention of controlling the potential limitless liability. This way they were dealing with large sections of the public, instead of with a restricted number of contractors.

The expansion of the adhesion contract was also marked by the progress of the big enterprises and their need to control liability in a mass market environment. One good example of this were the English quasi-public corporations like the Gas Corporation and the Water Board. This mass suppliers started to use adhesion contracts containing wide exception clauses. Another example were insurance companies, the earliest private companies to use adhesion contracts. It is important to refer that these were companies that also supplied people on a mass

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<sup>25</sup> Atiyah, *The rise and fall of freedom of contract* (Clarendon Press, Oxford: 1979), pp. 555-560.

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

<sup>28</sup> For useful discussion on the use of these tickets see the “ticket cases”, eg., *Parker v. South Eastern Railway* (1877) 2 CPD 416, *Walker v. York and North Midland Ry* (1853) 2 E & B 750, *Harris v. Great Western Ry* (1876) 1 C & B 515, *McManus v. Lancaster & Yorkshire Ry* (1859) 4 Hurlst & N 327

basis. One of the various reasons why the adhesion contracting is so used nowadays is the unstoppable traffic of goods and services that increases from day to day. This made this method of contracting dominant in our days.

When analyzing the background of the contract of adhesion it is understandable that it is used, mainly, to achieve an efficient method of mass contracting. Their use has increased while the trade of goods and services has become more and more standardized, leading to the enlargement of the consumer markets.

We actually could name these contracts, market contracts.

### **C. The social and economic reasons for the endless use of standardized contracts**

#### **I. Social**

During the late nineteenth and early twentieth centuries, the transformation of the contracting process was eased by several changes in the social market conditions<sup>29</sup>. The first important change was the fact that commercial enterprises became aware of the power of standard form contracts to increase their profitability<sup>30</sup>, which made them use the contracts daily. Indeed, if a business is large enough to engage multiple transactions, the most advisable thing it can do to save transaction costs is to use one standard form for all transactions of a kind.

Other change was that, due to the newly high standards of living, many goods and services began to be required. So, in order to acquire these goods it was imperative to enter in a contract<sup>31</sup>. Allied to the contract itself are its legal implications, which have grown at the same speed as its transactions. Hence, the complexity of products became to be a problem in the sense that one transaction may give arise to many problems. In other words, if a product/service has problems, this problems must be prevented or repaired, consumers must have a warranty. This leads to other “problem” which is the substantial growth of the law regarding this problem. This law grows so rapidly that the consumer can’t keep the pace with it. In effect, the average consumer is unformed. So it became implicit to expand some duties, like for example, the duty of good faith and fair dealing in which concerns contractual situations.

An important, if not the most important, key point to this development was the rise of mass commercial communications. Newspapers, magazines, radio, television and more recently

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<sup>29</sup> Slawson, *The New Meaning of Contract: The transformation of contracts law by Standard Forms*, 46 U. PITT. L. REV. 21 (1984)

<sup>30</sup> *Ibid* at 24.

<sup>31</sup> *Ibid*.



the internet, were an important factor for the growing expectations of the consumers. Nowadays, we don't even need to leave our homes to be aware of all kinds of products and their characteristics, which are constantly advertised everywhere. This resulted in: too much consumption, because we are everyday harassed to buy more and more, even if we don't actually need to; and then, due to this exaggerated supply, the creation of exacerbated expectations about the goods we're about to buy, or that we intend to buy.

This vast range of products and its associated legal implications made it nearly impossible to collect all the possible outcomes arising from future transactions. The parties don't want to, or simply are not interested in wasting their time, reading and understanding the contract document. Due to this consumer "passivity", businesses were in a position to take advantage of drafting their own standard forms, which they use to create any legal implications they wish, and as they draft their forms long before they use them, they can predict what are the legal implications that best serve their interests.

Under those circumstances, if a company is capable of drafting its own standard forms, it is also capable of drafting its terms. That's exactly what businesses do, they draft their own forms in order to escape to their possible liability. Thus, the contract terms became more uniform between businesses that deal with the same products or services, which normally are mass production and distribution companies. Moreover, the use of this standard contracts may make both sellers and buyers better off, because it is presumed, in a perfectly functioning market with a complete information, that contracts will contain only efficient terms and the seller's contract terms will benefit buyers as a class<sup>32</sup>. Again, the evident practical importance of the use of standard contracts by sellers or firms is self-protection or minimization of possible risk, as I mentioned earlier, to escape their liability. While drafting their contracts, the firms normally, through their legal offices, will try to prevent others from interfering into the interests of the firms, and will only consider how the firms' businesses interests are to be effectively protected<sup>33</sup>. This is true with respect to firms/businesses of all kinds and sorts: banks, insurance companies, and delivery companies, distribution companies, production companies of all sectors and the list could go on. The most important factor in the rise of adhesion contracts was their efficiency. Hence, how could the market function so well, when it offers so many goods and services, to so many people, in a globalized arena?

To put it other way, the terms are controlled by the stronger party, the business, and this

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<sup>32</sup> Russel Korobkin, *Bounded Rationality, Standard Form Contracts and Unconscionability*, 70 U. CHI. L. REV. 1203, 1208, 1216 (2003)

<sup>33</sup> See Edwin Richards, *Drafting Licenses to Guide Whether Potential Disputes Lie in Contract or Infringement*, 7 COMP. L. REV. & TECH. J. 45 (2003)

terms might relate with, for example, the goods to be delivered, the date of delivery, the identity of the party that bears the risk of an accident during the shipment, or, might also refer to terms that release the seller from its obligation if a strike or a similar events occurs. A hypothetically complete contract would describe all the possible eventualities, but transaction costs, including the cost of negotiating and writing down the terms, renders all contracts incomplete. Coupled with this, the parties choose some terms or avoid others for strategic reasons, in order to exploit superior bargaining power and information asymmetries. Ultimately, parties will rely on custom, trade usage, and, in the end, the courts to fill the terms of the contract. The terms that usually appear in contracts depend on what the parties are trying to accomplish, on their shared understandings about the relevant industry, transaction costs, general characteristics of their interaction such as asymmetric information and unequal bargaining power and its background legal regime. This legal regime respects to what rules of contract law would best serve the parties.

In the meantime started the decline of the individualism in the U.S society. In the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, the dominant view of the society was that it consisted of numerous individuals whose principal relationships with each other were competitive. Life was a struggle in which only the fittest survived<sup>34</sup>. Imagine, for example, a “jungle” in which only the strongest would survive. This means that the people were so suspicious about each other, that they felt the need to control every transaction “point-by-point”. In this atmosphere of thinking, the normal was to consider that any transaction, the one person that could take an advantage, would certainly do it. If a party bound himself to terms he never read or did not understand, this was his choice, and the law, within wide limits, did nothing to excuse him from the risks he had supposedly voluntarily assumed.

People have become more dependent on each other and started to live in a society based on the confidence between individuals. In the contemporary world, there is no time to make each contract a struggle in which one extracts every possible advantage. Nor does anyone today know enough about all the implications of every contracts one makes to understand every advantage one might obtain. The result is that the contracts are made on trust.

The decline of individualism has brought up another issue, the collectivism. If people started to be more dependent on each other, this means they are living in a collectivist society. The word society itself means collectivity. Society is regarded as “a large group of people who

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<sup>34</sup> See, e.g., *Lochner v. New York*, 198 U.S. 45 (1905)

live together in an organized way, making decisions about how to do things and sharing the work that needs to be done”. Still, individualism is the one to blame on Free Market Capitalism, which is deeply rooted, historically and culturally in the idea “*Everybody for himself*” that supposedly would lead to the highest common good, according to Adam Smith. The loss of individualism arises when smaller businesses are substituted by larger ones because larger businesses tend to be more administrative, both for their employees and for the people who deal with them, and bureaucracy is averse with individualism. Mass communications are also averse to individualism because they tend to eliminate individual differences and create a mass culture<sup>35</sup>, which is substantially the same for all those whom it includes. The current technique of contracting through standard forms is less individualist than the old one, because it gives to a particular contract a social character. An insurance contract such as burglary, theft and robbery insurance is deemed to provide the rights and duties that are commonly associated with the concept of burglary, theft and robbery insurance in the society which the contract was made. Unless the parties agree differently, which they practically never do (despite what the insurer may say in its standard forms), it is the social meaning that practically always controls. It is the insurance industry as a whole, not just the particular insurer selling the insurance in the case at hand, that has given the insured the meaning of burglary, theft and robbery insurance by the kinds of protection that it has sold over the years under the name burglary, theft and robbery insurance. In addition, both “burglary”, “theft”, “robbery”, and “insurance” are concepts commonly understood to carry certain meanings in our society.

## **II. Economic**

In a mass production economy it is essential to standardize the terms for exchange of goods or services in some method, as the cost of individual negotiation is high. For this reason, many who participate in the market on a regular basis find it worthwhile to standard forms that set out in print the terms upon which the drafter proposes to do business<sup>36</sup>. This empowers them to take advantage of economies of scale in determining the terms that maximize their surplus from the transaction and in drafting the written agreement that embodies those terms.

If standard forms are to economize on negotiation costs, each individual exchange cannot provide the occasion for reopening the terms of bargain. At least, written terms must be regarded as presumptively nonnegotiable, but this presumption may be impossible to surpass.

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<sup>35</sup> Slawson, *supra* note 29 at 29.

<sup>36</sup> Katz, *Your terms or mine? The duty to read the fine print in contracts*, *The RAND Journal of economics*, Vol. 21, no 4 (1990), pp. 519-537

As matter of fact, actual forms contracts often provide that the negotiating agent lacks authority to vary the written terms<sup>37</sup>. Yet, the fact that certain terms are not negotiable doesn't mean that there is no negotiation at all. Generally, in the forms, blank spaces are left to be filled in with essential terms actually dickered, such as price, quantity and price of shipment.

In the event that standard forms are equally understood by both parties, there would be presumably no strong welfare concerns regarding their use, apart from any second-best considerations arising from interactions with other market imperfections such as monopoly. If both sides knew the terms of the contract and bore all costs of negotiation, they would use form contracts whenever the savings in negotiation costs outweighed the advantages of tailoring the bargain to their individual circumstances<sup>38</sup>.

Even though their advantages are many, form contracts have been received by courts and legal scholars with uncertainty and on occasions with suspicion. Partly, this is so because some have assumed that such contracts reflect the presence of market power<sup>39</sup>. The take-it-or-leave-it element that form contracts display with regard to non-dickered terms has been analogized to the power a monopolist has over the price. This is way the form contract have become more popularly known as “contracts of adhesion” and understood as inherently coercive<sup>40</sup>.

The law's hesitation toward form contracts goes beyond the fact that a party faced with a form offer is unable individually to negotiate all terms with the offeror. More important is that contracting parties often purport to accept form offers without knowing and understanding the terms within. This is rationally intelligible, since the cost of reading and considering each term is high, and many of the terms deal with improbable possibilities. Few consumers try to read all the terms of their leases, insurance policies or automobile loan contracts, for instance, though they may occasionally deceive people of doing so in order not to appear unsophisticated. Few of those who do try understand what they read, since terms are often written in fine print, to save on the costs of paper and handling, and are expressed unclearly or in legal or technical

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<sup>37</sup> The aforesaid disclaimers are presumably intended to address the agency problem the drafter of the contract faces with regard to his sales force. For example, since compensation contracts of insurance agents typically give them an incentive to write policies insuring excessively poor risks, the fine print of the insurance application forms commonly provides that the policy is subject to the ultimate approval of the insurer's home office.

<sup>38</sup> *Ibid.* at 520.

<sup>39</sup> Economically addressed, this analogy has been poorly grounded, as Katz stated: “the fact that several firms in an industry include similar terms in their standard forms has been regarded by some courts as *prima facie* evidence of conspiracy or oligopoly. Furthermore, legal commentators have generally assumed incorrectly that sellers with market power will choose non-price terms that are excessively or inefficiently favourable to themselves, by supposed analogy to the effect of market power on price”

<sup>40</sup> See *supra* note 1 and *supra* note 6.

jargon to save on the expenses of drafting. This situation is not confined to the consumer setting. Purchasing agents do not read non-essential terms of price quotation sheets, and sales agents do not read the terms of purchaser's orders, it simply not worth their time and effort to do so, Furthermore, some of the terms of the standard forms are included primarily for purposes of internal organizational control, and only secondarily for their effects on bargain. Most times, even agents of the drafting party are not aware of the content of their own forms.

As Todd Rakoff stated in his "*Contracts of adhesion: An essay in reconstruction*", the standard form contracts are beneficial, if not essential, to the market economy: "Firms create standard form contracts (...) in part to stabilize their external market relationships, and in part to serve the needs of a hierarchical and internally segmented structure".

Form documents promote efficiency within a complex organizational structure. First, the standardization of terms, and of the very forms on which they are recorded, facilitates coordination among departments. The costs of communicating special understandings rise rapidly when one department makes the sale, another delivers the goods, a third handles collections, and a fourth field complaints. Standard terms make it possible to process transactions as a matter of routine: standard forms, with standard blank spaces, makes it possible to locate rapidly whatever deal has been struck on the few customized items. Second, standardization makes possible the efficient use of expensive managerial and legal talent. Standard forms facilitate the diffusion to underlings of management's decisions regarding the risks of the organization is prepared to bear, or make it unnecessary to explain these matters to subordinates at all. Third, the use of form contracts serves as an automatic check on the consequences of the acts of wayward sales personnel. The pressure to produce may attempt salesman to make bargains into which the organization is unwilling to enter; the use of standard form contracts to state the terms of the deal obviates much of the need for, and expense of, internal control and discipline in this regard.<sup>41</sup>

The economists who deal with this issue, call this last situation the agency problem<sup>42</sup>. In firms, agents are inescapably entering into transactions with third parties that will bind their firm. So, how does the firm constrain the ability of agents to serve their own interests? By offering excessive terms of which even their directors will inevitably be unaware. Thereby, it binds both agents and third parties to the (unwaivable) terms in a form contract.

To do business on a scale that benefits everyone would simply be impossible if firms were unable to control the terms their agents could offer to third parties by using form contracts<sup>43</sup>. Since they are so many terms contained in any single contract, the small probability of the term being invoked in some future court case, combined with the relatively low risks of

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<sup>41</sup> Todd D. Rakoff, *Contracts of Adhesion: An essay in Reconstruction*, 96 Harv. L. Rev. 1174 (1983).

<sup>42</sup> See, e.g., Eugene F. Fama, *Agency Problems and Theory of the Firm*, 88 J. Pol. Econ. 288 (1980).

<sup>43</sup> Randy E. Barnett, *Consenting to Form Contracts*, 71 Fordham L. Rev. 627 (2002)

many such contracts, makes it irrational for form-receiving parties to spend time reading, much less understanding, the terms in the forms they sign<sup>44</sup>.

For most consumer transactions, the close reading and comparison needed to make an intelligent choice among alternative forms seems grossly arduous. Moreover, many of the terms concern risks that in any individual transaction are unlikely to eventuate. It is notoriously difficult for most people, who lack legal advice and broad experience concerning the particular transaction type, to appraise these sorts of contingencies. And the standard forms – because they are drafted to be long and complex, even if each term is plainly stated. Once form documents are seen in the context of shopping (rather than bargaining) behavior, it is clear that the near-universal failure of adherents to read and understand the documents they sign cannot be dismissed as mere laziness. In the circumstances, the rational course is to focus on the few terms that are generally well publicized and immediate concern, and to ignore the rest.<sup>45</sup>

As previously stated by Kessler: “The stereotyped contract of today reflects the impersonality of the market”. Hence, the uniformity of terms is useful for businesses due to the fact that they are very influential in the exact calculation of risks. Risks that are difficult to calculate can be excluded altogether. An example that standard forms are the most striking illustrations of successful attempts on the part of business enterprises to select and control risks assumed under a contract, are the ones included in insurance policies.

So, the motivating factor to the use of standard forms is the desire to avoid juridical risks. This was proven by the use of exemption clauses<sup>46</sup>. Warranty clauses, arbitration clauses or exculpatory clauses are examples of that.

As mentioned above, this contracts are typically used by enterprises with strong bargaining power. The weaker party, in the need of goods and services, is frequently not in position to shop around better terms, either because the author of the standard contract has monopoly (natural or artificial) or because all competitors use the same clauses. This contractual intention is nothing more than a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood in an ambiguous manner.

The enterprises use their power to control their risks and impose their will, but they also do that in order to control and regulate the distribution of goods from producer all way down to the ultimate consumer. Hence, enterprises regulate external market relationships through mechanisms that will build up and strength their industrial empires.

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<sup>44</sup> *Ibid.* at 631.

<sup>45</sup> Rakoff, *supra* note 41 at 1226.

<sup>46</sup> This issue will be discussed later.

## **1.2. Public nature of contracts of adhesion**

There is a very important aspect in the contracts of adhesion that commentators, since Saleilles have neglected, which is its public nature. It is clear that contracts serve the public rather than specific individuals. So, the most distinctive aspect of the adhesion contracts, and what characterizes them as a type, is its public nature.

Curiously, this idea of “public contract” was not discussed in any of the leading theories of Contract Law. This may be because it has always been seen as being a private matter that regulated private individuals in their private matters, in which the public has no immediate interest.

Patrick Atiyah, the author of *The Rise and Fall of Freedom of Contract* (an important text on the changes in the concept of freedom of contract), has, however, demonstrated that the private contracting has never been wholly accepted as the only form of contracting<sup>47</sup>. He indicated a number of areas which were legislatively and judicially detached from the area of private contracts and subjected to legal rules which set out guidelines and standards of contracting<sup>48</sup>. In these areas, the individual’s freedom to enter into agreements on whatever terms they wish is taken away from them and the law has established standards which individuals must observe if their contracts in those areas are to have legal effect. This development, that is the removal of vast areas from private contract, was necessary because it is impossible to organize society on the basis of private contracting alone<sup>49</sup>.

Thus, there is an area that is outside of the private sphere of the contract, where the public interest is best served by restrictions and regulations on the individual’s private right of freedom of contract. However, contracts may affect an extensive and indiscriminate range of persons in the society either directly, because people become parties to the contracts, or indirectly, because the operation of the contracts could disturb fundamental social and economic rules. In this sense, an adhesion contract should be understood as being a public contract.

The adhesion contract is used, typically within consumer transactions, as it is observable, and its trace is easy to find: the superior bargaining position of the supplier; the use of pre-drafted standard forms; the absence of real bargain and consent; the non-discrimination between different contracting members of the public, are all signs of a consumer deal.

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<sup>47</sup> Atiyah, *The rise and fall of freedom of contract* (Clarendon Press, Oxford: 1979)

<sup>48</sup> *Ibid.*

<sup>49</sup> See Reiter, “The Control of the Contract Power” (1981) 1 Oxford J. Leg. Stud. 347, 348-349

In fact, another important contribution was made by Professor Rakoff<sup>50</sup> when he described and updated possible attributes of this commercial practice. In his opinion, there were seven characteristics that could show us that we would be in the presence of a standard form contract:

- 1) It is a printed form, containing several clauses;
- 2) It is drafted unilaterally by one of the parties to the agreement, normally a business entity;
- 3) The business engages in many of the same types of transactions on a routine basis;
- 4) The business often presents the form to the consumer on a “take-it-or-leave-it” basis;
- 5) The consumer typically signs the form contract after whatever negotiation occurs;
- 6) The consumer does not engage in many transactions of that type, especially compared to the volume of such transactions engaged in by the business;
- 7) The primary (and only) obligation of the consumer is the payment of the price.

Thus, when comparing Rakoff’s analysis with Lenhoff’s, not many differences are visible. This because the core characteristics are essentially the same, only in different terminology.

The use of standard form contracts shifted the transactional process. Contract law was largely developed around the traditional model, which consisted in the bargaining between two individuals after a period of dickering over terms. Therefore, all of the terms were broadly discussed, negotiated and understood by the contracting parties, which is no longer the case today. Due to this fact, the contract as we used to know it (individually negotiated) should not be regarded as such nowadays. There is a new type of contract (if we can still call it contract) and a new way of contracting.

### **1.3. The Basis of Standard Form Contracts**

Even though standard form contracts are daily used in most of commercial transactions, their “making” is not yet clearly understood. Many contracts law scholars tried to do so, but

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<sup>50</sup> Supra note 41.



none of them, until this day, reached a “general accepted solution”. Arthur Leff, described the U.S law regarding consumer form contracts as “a disaster”. He wrote “the consumer-purchase transaction is still stumbling about, a diagnosed disease seeking a nostrum”<sup>51</sup>. According to some authors, during the years, contract law has died<sup>52</sup> and been resurrected<sup>53</sup>, reconstructed<sup>54</sup> and transformed<sup>55</sup>. Doctrinally, contract law is being reshaped over, and over again: doctrines of adhesion<sup>56</sup>, reasonable expectations and unconscionability have become known. The truth is, the contract itself adapted to this new economic reality, whether one wants to call it adhesion contracts or forms contracts or whatever it may be. The contract law, despite several attempts, has not yet reached, concluded or clarified even one of the paths it has been trying to.

Standard forms, as was mentioned earlier, started to be used in the insurance field. The insurance companies’ support on forms was the declaration of departure from the traditional view of a negotiated contract. Otto Prausnitz, author of *“The Standardization of Commercial Contracts in English and Continental Law”*, the book reviewed by Karl Llewellyn (in which he first detailed his own view of form contracts), acknowledges this departure:

No longer do individuals bargain for this or that provision in the contract ... the control of the wording of those contracts has passed into the hands of the concern, and the drafting into the hands of its legal advisor... In trades affected it is henceforth futile for an individual to attempt any modification, and incorrect for the economist and lawyer to classify or judge such arrangements as standing on an equal footing with individual agreements.<sup>57</sup>

There is a current debate, in which some economists and lawyers continue to associate form contracts with the negotiated, “individual contracts”<sup>58</sup>. Others, instead recognize that consumer form contracts are expected to create special risks and problems<sup>59</sup>. In general, these issues have

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<sup>51</sup> Supra note 15. In 1983, Rakoff continues to refer that “although there is a quite general perception that different law must be applied to contracts of adhesion, there is a little agreement on what principles should control. The currently applicable law is characterized by lack of intelligible doctrine and a lack of consistent results”, see supra note 41.

<sup>52</sup> Grant Gilmore, *The Death of Contract* (1974).

<sup>53</sup> Colin K. Kaufman, *The Resurrection of Contract*, 17 Washburn L. J. 38 (1977)

<sup>54</sup> Rakoff, supra note 41 at 1176.

<sup>55</sup> Slawson, supra note 29.

<sup>56</sup> Supra note 6.

<sup>57</sup> Otto Prausnitz, *The Standardization of Commercial Contracts in English and Continental Law* 11 (1937), at 18 (“It is the freedom of contract theory pushed to its extreme, thus reaching its climax and resulting in fetters to one of the parties concerned.”)

<sup>58</sup> See Richard A. Posner, supra note 22; Stephan J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461-1467; Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 652-655 (1979)

<sup>59</sup> The term “consumer form contract” in this context includes more than merely contracts associated with the purchase of consumer goods and services. Many, though not all, form contracts create similar problems concerning informed assent. The same covers form contracts in relation to agreements between employers and employees as well as between large and small businesses, where the situation indicates to the reasonable contract drafter that the other party has not assented to unread or unexpected terms.

been associated with problematics such as, the unequal bargaining power, the failure to negotiate contract terms, the “take-it-or-leave-it” basis of the transaction and finally, to the fact that unavoidably most terms remain unread.

One of the points in which the form contracts collide with the objective theory of contracts is the presumption of assent. This presumption that, consumers who sign forms contracts are aware of, understand, and assent to the unread, unexpected and un contemplated terms is erroneous. Certainly the drafters of these contracts know not only that their forms will not be read, but also that it is realistic for consumers to sign them unstudied. Any reasonable person should understand that there hasn't been true assent to these terms. Thus, the evidence is that, objectively, the drafter doesn't even expect the consumer to learn the contract terms. If applying the objective theory to consumer form contracts, this would not assume automatically that there is an objective agreement to all terms just because they have been printed and a document has been signed. Rather, it must be determined how a reasonable drafter should have understood the consumer's agreement.

In order to fight this divergences between doctrine and reality, the role of the drafter should be clarified. In other words, it should be find an equilibrium between the drafter and the consumers' interest so that they can both achieve “full” contractual freedom.



## **CHAPTER II**

### **KESSLER, RAKOFF AND SLAWSON'S VIEW ON CONTRACTS OF ADHESION**

#### **PRIVATE OR PUBLIC LAW APPROACH?**

## 2.1. Friedrich Kessler

In the early 40s Kessler changed the view in which contracts were seen by people in general. Saleilles was the first one to introduce the classification of “contracts of adhesion” to the currently mode of contracting, but after him, many others did. Kessler was one of them, and maybe the most remarkable one.

Kessler argued that contracts, as legally known (one in which freedom of contract is at its best) were not the ones that people usually faced in their everyday dealings. The contracts of today were fruit of the development of the market. This development transformed contract. Contract used to be a fair bargain between two individuals, or instead between an individual and a business. The current contracts are used as an instrument of the enterpriser to control, rationally, the possible outcomes of his affairs. And controlling affairs, in this sense means, be aware of the increasing number of transactions and their possible legal consequences.

The problem here is that law cannot follow such rapid transactions, happening in everyday life. Such pace is due to the fact that consumers consume just for consuming. Refraining from doing it, is, actually, almost impossible, because now is mostly a societal issue. Monitoring this transactions, which are infinite and atypical, and also, necessary for the proper functioning of the current economy seems a basic premise of justice.

Unlike other types of law, making a contract requires that both parties have an agreement and understanding of their intentions. This, as Kessler realized, means that “the law of contract has to be of their own making”<sup>60</sup>. This reflects the principle of Freedom of Contract, in which individuals contract, freely and according to their will. Inherent to this thought is the individualist society that we all are part of, and its associated concept of *laissez-faire*.

Thus, contract is seen as a “private affair” rather than a “social institution”. For this reason, it is not the courts’ duty to make contracts for the parties, however, it is a burden of the judicial system to interpret such contracts. For the same token, when a person makes a contract, it supposedly knows the contract in which is entering, and if so, this means that the person is giving an “objective manifestation” of assent. By agreeing is expressing its intention to be bound to such contract. And no such contract, or whatever contract, can prevail if deprived of assent.

In respect to the behaviour of people when entering contract, one must be aware of the fact that, contracts initiate with an offer. This offer, is nothing more than a proposal to buy or

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<sup>60</sup> Kessler, supra note 6.

acquire something, it bounds no one, even because there isn't any obligation to accept or reject such offer. People are free to choose what they want and who they want to contract with. That is the reason for the existence of privity-of contract principle.

The U.S courts insist to declare this contracts enforceable, due to the still present optimistic belief that “a contract is the result of the free bargaining of parties who are brought together by the play of the market and who meet each other on a footing of social and approximate economic equality, there is no danger that freedom of contract will be a threat to the social order as a whole”<sup>61</sup>. Thus, stating that people “meet ... each other on a footing of social and approximate economic equality” is only one way to escape the problem, whereas there is no equality whatsoever in these contracts. It seems easier to deny the problem, because admitting its existence is one step towards change. But when changing implies going against more than established principles of contract law judges seem afraid to go with the flow (this flow being the unstoppable and undeniable change in contracts).

To put it differently, as Kessler argued “courts are hesitant to declare contracts void as against public policy because if there is one thing which more than another public policy requires is that men (...) shall have the liberty of contracting – and their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice”<sup>62</sup>. This would work perfectly some years ago, but when “men” turns into more than an individual, and becomes a powerful economic institution is unquestionable that the situation is not what used to be.

The development of large scale enterprise, accompanied by its mass production and mass distribution lead to the new type of contract which we all use today. This contract is a standardized one. A standardized contract is one means to join similar and consistent rules in an acceptable and proper order, in order to promote efficiency and also functionality of the business in which they are used. In the meantime, these contracts became so used that “once the contents of a contract have been formulated by a business firm they became used in every bargain dealing with the same product or service”<sup>63</sup>. Therefore, the individuality of the parties to contract turned into pattern of contracting. Kessler couldn't have described it better: “the stereotyped contract of today reflects the impersonality of the market”.

The fact is that this contracts are very useful, and once this usefulness was discovered, it is difficult to go back again. It started in the insurance field but it quickly spread to all other

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<sup>61</sup> *Ibid.* at 630.

<sup>62</sup> *Ibid* at 631.

<sup>63</sup> *Ibid.*

fields of large-scale enterprise. First they were used on a national basis, then they also spread to international trade relationships. Labour contracting is also through standard contracts.

But why did the standard contracts became such a usual and desirable practice? The answer lies in the uniformity of terms. Thus, uniformity of terms is the best way to a business enterprise to calculate risks. If an enterprise uses a contract pattern, it can know what to expect from such pattern, because the outcomes will be always similar. To demonstrate, let's take the example of insurance companies and their insurance policies. The insurance business were the first to realize the full importance of the so-called "judicial risks", the danger that a court and their judges may be deceived by "irrational factors" to decide against the powerful defendant. To safeguard their interests, companies started to be very creative in respect to their clauses. This safeguard may be related to the yearning to avoid judicial risks. As matter of fact, the use of warranties clauses in contracts of adhesion is one of the many reasons for their widespread usage. If there is a probability of limiting the remedies to which a buyer has rights, namely excluding his right to claim damages, surely the companies will do so, in order to avoid unforeseen and undesirable costs. The same situation takes place with arbitration clauses in international trade.

As can be seen, standard contracts are means of "excluding and controlling the irrational factor in litigation"<sup>64</sup>.

Another important issue regarding contracts of adhesion is their capability to reduce costs of production and distribution. This reduction will be ultimately returned in low prices and therefore, all society will profit.

Equally important is the fact that the standard form contracts are normally used by enterprises with strong bargaining power. According to Kessler:

The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms, either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses...his contractual intention is but a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood only in a vague way, if at all.<sup>65</sup>

So, this leads us to the conclusion that standardized contracts are often contracts of adhesion, they are "*à prendre ou à laisser*"<sup>66</sup>.

Despite all facts, there still is another one to refer, which is the power of this type of

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<sup>64</sup> *Ibid.* at 632.

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*

contracts to “build up and strengthen business empires”. Actually, these contracts were also used with the end of controlling and regulating the distribution of goods from producer all the way down to the ultimate consumer.

Nevertheless, the economic power of such contracts is “not yet sufficient” for them to be properly regulated. There is a very simple reason for this fact: fear of change. If one were to admit the truth about these contracts, which is that they do not fall in the scope of “normal” contracts, many rules and practices would have to change. The structure of such contracts is increasingly departing from the traditional view on contracts.

It is preferable to keep beneath the surface this weakness of the law system, rather than improving and amending it. The solution found was protecting the weaker party of the contract, the consumer, and still keep “the elementary rules” of the law of contracts untouched. But since this contract problem is different from the “normal” contract problems, this turned into “contradictory and confusing” law regarding standardized contracts. Thus, the law potentialities regarding contracts of adhesion have not yet been fully explored.

A key point of this analysis could be the law in insurance contracts. The courts have the hindrance of only interpreting rather than making contracts for the parties, for this fact they had to count on this advantage of interpreting contracts to protect the policy holder. But, while protecting the policy holder against the roughness of the doctrine, they did not point out plainly that as a matter of public policy an insurance company cannot escape liability just for the fact that it previously focused on an possible expectable event which they labelled as “warranty”. They felt that if they did so, that would hinder the Freedom of Contract. The insurance companies when confronted with the possibility of cutting down their “unfair” warranties, started to create new ones.

This regular creation of warranties in order to circumvent the unconscionable ones turned into uncertainty. The legislature had to step in and so it did. It placed warranties and representations side by side.

Not to mention the situation where there is a “loss without insurance”. Who should bear the risks of such loss? The insurance company or the applicant? There isn’t a consensus among judges, who are not experienced enough with this situation. This loss is caused by “an unreasonable delay on the part of the insurance company in issuing a policy of insurance for which application has been made”<sup>67</sup>. Courts dismissed the possibility of recovery of contract.

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<sup>67</sup> *Ibid* at 634.



The problem is in deciding contrary to a well-established principle of law of contracts contained in the field of which insurance lies. This principle states that:

An application for insurance is a bare offer and therefore imposes no liability upon the insurance company until it is accepted...nor does it afford a basis for any liability by reason of delay in accepting it or the want of care in dealing with it.<sup>68</sup>

Thus, the argument was fortified by the fact that a future promise of action couldn't be supported by consideration, "*no legal benefit moved from the applicant to it by reason of the offer, and any detriment which the applicant suffers is not one which was contemplated by the terms of the offer or its acceptance*". This is a correct line of thought, for the simple fact that the applicant is not bound to accept it and therefore can search for another insurance alternatives, furthermore it is also free to withdraw his offer before the acceptance.

The plea that "recovery of contract would be contrary to the well-established principles of contract law" has encouraged the whole body of legal literature<sup>69</sup>. For this reason, the most part of applications currently have a provision which states that a company cannot be held liable under the application until it is approved by its home office and that a formal policy must be issued and delivered. In addition, generally people are informed, assuming that an implied promise will result in an immediate action is ignoring the reality. As Funk<sup>70</sup> stated:

If a court should hold that a contract to decide expeditiously on the proposal did exist, it is believed that, within a short time, all insurance companies doing business in that jurisdiction would incorporate in their applications stipulations expressly negating such promise.

The curious fact is that though courts agree with this doctrine, most of them still allow recovery, but in a discreet way. The recovery *ex contractu* is seen as impossible, but they still permit recovery *ex delictu*. According to these decisions, the failure of an insurance company to take an immediate action sums to the breach of general duty towards the public to act without unjustified delay on applications for acceptable risks. The courts know that an insurance contract cannot be treated in the same manner as the other contracts. The insurance business has an important role in society, because it insures people from possible future damages. It is expectable that the State, which gave the franchise for such business, has the power to regulate and supervise it.

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<sup>68</sup> *Ibid.*

<sup>69</sup> The term "legal literature" concerns decisions uphold by American Courts

<sup>70</sup> Funk, The Duty of an insurer to act promptly on Applications (1927) 75 U. of PA. L. REV. 207-214

Insurance lies in the idea of securing people, and everyone has, at least, one insurance, if not many more. For the fact that insurance contracts are part of everyone's life, it is in the public interest that application for acceptable risks shall not be unduly delayed.

As stated in *Swentusky v. Prudential Ins. Co.*,:

Public interest more requires that stability of the insurance business which is necessary to guard the great body of persons who enter into relations with it for their own protection and that of those dependent upon them, than it does that certain individuals should be saved the loss which may result by adherence to established legal principles.<sup>71</sup>

But this event doesn't occur only in the field of insurance. Other chartered corporations have similar relations with the public, such as banks, utility companies, and so many others.

The courts' systematic confrontation with insurance cases brought an issue into the light. This issue is, as Kessler realized, "*can the unity of law of contracts be maintained in the face of the increasing use of contracts of adhesion?*"<sup>72</sup>. On the one hand, the courts, both the ones that allow recovery in contract as well the ones that allow recovery in tort, have evidently realized that insurance contracts are contracts of adhesion. For this reason, they try to protect the weaker party against the strictness of common law and against what they consider as abuses of freedom of contract. On the other hand, the courts which deny recovery stick to the conviction that an application for insurance is exactly the same as other offer, and are sure that to build up by trial and error a dual system of contract law will lead to impairment of the security function of all law, since courts are poorly prepared to decide whether and to what extent an insurance contract has compulsory features.

Equally problematic is the task of creating a multiple system of contract law. Not only for the fact that "courts are not commissions", which are capable of exploring all the branches of the problem which come to the dispute, but also because it is very difficult to perceive whether and to what extent a contract is a contract of adhesion.

Even so, there were no signs of inability of the insurance business to adapt itself to the new law made by the courts' decisions permitting recovery. It is understandable to do so, for the fact that "deviations from the standard practice in handling applications which result in loss without insurance, are the exception"<sup>73</sup>.

When one takes a look at the cases allowing recovery, it will understand that the

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<sup>71</sup> *Swentusky v. Prudential Ins. Co.*, 116 Conn. 526-532 (1933)

<sup>72</sup> Kessler, *supra* note 6 at 636

<sup>73</sup> *Ibid* at 637.

reasoning behind them is very creative and useful. The courts, when faced with a standardized contract have the task of ascertaining what were the legitimate expectations of the weaker contracting party when dealing with a stronger party, and to what degree this party appointed reasonable expectations based on an ordinary daily event.

Of course it is a novelty to the courts to redraft the contents of a contract of adhesion even because it is one of their functions. The judge-made law concerning to constructive conditions proves the quite the contrary. It rejects the contention that a contract implied in fact is not different from an express contract, unless the intention of the party is “circumstantially proved”<sup>74</sup>.

In Kessler’s view, adapting the common law of contracts to every individual contract of adhesion is only conceivable if courts become “fully aware of their emotional attitude” in which concerns to Freedom of Contract.

Indeed, Freedom of Contract is the greater barrier to progress, for being a very important topic that the judges tend to avoid. Instead, they rationalize it. For them it is preferable not to sacrifice the legal certainty and the “sound principles” of contract law against the principles of justice and social desirability. One must admit that the feeling of justice and the case law are not synonyms.

The freedom of contract purpose is, thus to give enough space to the parties to adapt the law of contracts to their own interests. So must the common law do regarding to its elasticity, with rule and counterule always in competition. Insomuch as it is possible for the courts to follow the dictates of “social desirability”.

It is a normal exercise of common law to turn ideals into practice. And in doing so, the ideal of certainty must always be balanced against the social calling for change. However, one must bear in mind the possibility of legal certainty being sacrificed for progress.

For instance, discussing the problems presented by contracts of adhesion is a waste of time for judges, since they will always look at it through the spectrum of the “established legal principles”. Also, they will always stress out the fact that recovery is “contrary to the well settled principles of contract law”. What the judges actually want us to think is that the rules regarding formation of contracts are a locked and harmonious structure.

A testament to the ever-evolving process of contract law was the Doctrine of Consideration. This doctrine, full of contradictions and inconsistencies, reacted to the Freedom of Contract, and showed that it can be used to protect a creditor against the risk of economic

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<sup>74</sup> *Ibid.*

duress on his debtor (*Foakes v. Beer*). As matter of fact, the doctrine of consideration has defended “opposed social policies”.

“Even the mere risk of reliance has been regarded sufficient consideration” said Kessler, thus this doctrine gives way to compensate the argument that the applicant of an insurance policy could have withdrawn his application and applied for insurance in a another place.

It’s true that the acceptance of an application is not made by way of silence, for an irrational extent of time, because the standard clause in the application normally advises the applicant that the company will not be held liable until the application has been approved and formal policy sent and delivered.

This clause tries to state two things, one that the application will not be accepted through silence; two, that there is not any implied collateral promise to take prompt action for an acceptable risk. As Kessler said: “*more serious is the argument that an assumption of an implied promise to act promptly is unrealistic because insurance companies, once subjected to such an implied promise, would immediately negate it by express stipulation in the policy*”<sup>75</sup>. The critical issue here doesn’t lie in whether this companies would insert such a clause, but if they could do so without any problem.

Despite all efforts, the technical doctrines made until this day did not offer any solution to the courts. All the technical doctrines that were used in insurance cases denying liability were nothing more than mere rationalizations of “the courts emotional desire to preserve freedom of contract”. As an illustration, one must look at the cases holding the insurance company liable in tort. Even in these cases, the judges “pay tribute to the dogma”, otherwise it wouldn’t be necessary to demonstrate that the plaintiff is not seeking recovery in contract.

Freedom of contract dogma is notably the “hero or villain” in the tragedy of the insurance cases, but it is kept aside, leaving the discussion to consideration or others.

Yet, the tort cases are an indirect test to the claims of the Freedom of Contract Dogma, because as Kessler argued “they keep alive the question whether or not the “received ideas” on freedom of contract [which form the background of the insurance cases] represent a cultural lag”<sup>76</sup>.

After all things considered, what Kessler concludes is that Freedom of Contract has intrinsic to it the idea of individualism. Maybe for the fact that it was conceived in an age where the normal course of deal was made by “small enterprisers, individual merchants and

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<sup>75</sup> *Ibid.* at 639.

<sup>76</sup> *Ibid.* at 640.

independent craftsman”<sup>77</sup>.

Back then, the society had the belief that “*individual and cooperative action left unrestrained in family, church and market would not lessen the freedom and dignity of man but would secure the highest possible social justice*”<sup>78</sup>. In other words, the society strongly believed that there was a natural law, whereby the individual pursuing his own interests was also pursuing the community welfare.

The reason for the moral justification of the freedom of contract is to maintain the “pre-stabilized harmony” of the society’s structure which lies in the idea of free enterprise and perfect competition. Thus, the private autonomy of the contracting parties will work perfectly and its outcome will ultimately benefit the whole society.

The decadence of the “free enterprise system” had as its main reason the shift from competitive capitalism to monopoly. And, as a consequence, the “*meaning of contract*” suffered some mutations.

One must be aware that Freedom of Contract is not applied equally to all people and in the same extent. What happens is quite the contrary. The protection of the uneven distribution of property is an example that the law nothing did to prevent the freedom of contract of being a “one-sided privilege”. The Freedom of contract was just a way found by the society to ensure that no one will interfere with the contracting power of each other.

The most important effect of the Freedom of Contract noticed by Kessler was that it “*enables enterprisers to legislate in a substantially authoritarian manner without using the appearance of authoritarian forms*”<sup>79</sup>. In other words, standard contracts have become an efficient mechanism used by powerful commercial and industrial entities to impose a “*new feudal order of their own making upon a vast host of vassals*”<sup>80</sup>.

It was due to Freedom of Contract, which is one of the most well-founded maxims of our cultural philosophy, that the return back from contract to status was possible.

Conventionally, contract is only classified as group of “operative facts”, with its adjacent consequences. But the natural law philosophers were of different opinion. In their view, freedom of contract was like giving a piece of sovereignty to each member of society. This would allow them to be part of the law making process.

If so, then that means that the State is not the only one holding the law making power.

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<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.*

<sup>79</sup> *Ibid.*

<sup>80</sup> *Ibid.*

The parties, when consenting to a contract are also creating law. The power is divided between the state and the citizens. Believing that capitalism would replace the previous social structure, feudalism, just because “*contract and not status had become chief means of social integration*”<sup>81</sup>, is not, decidedly, the answer. Nor is the natural law philosophers’ theory, which claims that “*the progress in any society towards freedom is to be measured by the extent to which all political relations can be reduced to contract, “the perfect form of obligation”*”<sup>82</sup>.

In the good days of the free enterprise capitalism believing that making a contract was making law was the adage. It did not harm democracy in doing so. Actually it was its reaffirmation. The courts, as community representatives remain silent, in order to maintain their neutrality on behalf of Freedom of Contract. For the natural law theory to be meaningful to us, the pluralistic society as we know it, pressured by powerful groups, would have to deteriorate. On the other side, the dominant doctrine, by stating that contract is only a “set of operative facts”, is preserving “*the illusion that “the law” will protect the public against any abuse of freedom of contract*”<sup>83</sup>.

Until we do not recognize that Freedom of Contract has different meanings depending on the type of contract in which is inserted, change will not arise. Kessler couldn’t have phrased it better: “*...its meaning must change with the social importance of the type of contract and with the degree of monopoly enjoyed by the author of the standardized contract*”.

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<sup>81</sup> *Ibid.* at 641.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.* at 642.

## **2.2. Todd Rakoff**

Since the first moment that Friedrich Kessler named form contracts as “contracts of adhesion”, a scholarly cloud has involved them.

Another very important commentator of this subject was Todd Rakoff. He realized the conflict between theory and practice. He is of the opinion that the form terms contained in this contracts of adhesion should be “presumptively unenforceable”. In addition, Rakoff states that the legal system treats differently contracts of adhesion from “ordinary contracts”<sup>84</sup>. These differences are noticeable in many ways, like for example, separate black-letter rules in the Restatement (Second) of Contracts or the declaration by some judges that these contracts are “special”. Even judges started to see them from another standpoint. Expressions like “unequal bargaining power” triggered the application of a separate body of law, while facts showing “equal bargaining power” were treated by the “ordinary” body of contract law.

It is easily perceivable that these contracts call for a different law, but the problem lies in what principles should control these. The law which is currently applied to them is intelligible and lacks consistency.

It may be Rakoff says “*that contracts of adhesion can be understood only as a collection of disparate deviations from the paradigm of “ordinary” contract law*”<sup>85</sup>, but in the end he realized that maybe the problem is more a structural one. Structural in the way that these contracts only have arisen because of the “*organization and practices of the large, hierarchical firms that set the tone of modern commerce*”<sup>86</sup>. Thus, is due to contracts of adhesion that the relation between such businesses and their customers is much easier than it could be, since contracts of adhesion turn into functional and efficient transactions.

Obviously, such contracts do not fall into the so-called “ordinary” contract law, but neither are they seen as an aggregate of exceptions to that law. There is the invitation to develop a “unified model” but also the invitation to develop the already existing applicable law.

Another important point in Rakoff’s analysis is the fact that this contracts of adhesion (seen as negotiated contracts) are prima facie enforceable as written, what shouldn’t happen since they are not at the same step as the “ordinary” contracts. Rakoff’s view is that “*quite*

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<sup>84</sup> This term “ordinary contracts” is very used by this author to refer to all types of contracts that do not fill the characteristics of contracts of adhesion.

<sup>85</sup> Supra note 41 at 1175.

<sup>86</sup> *Ibid.* at 1176.

*contrary to “ordinary” contract law, the form terms present in contracts of adhesion ought to be considered presumptively (although not absolutely) unenforceable”<sup>87</sup>.*

### **2.2.1. Problem outlines**

#### **A. Model status**

The expression “contract of adhesion” has currently many meanings and therefore needs a better definition and clarification.

The use of standard form documents is not sufficient itself to define it. Neither is the presentation of demands on a take-it-or-leave-it basis. In fact, the problem lies in the combination of these two factors.

Accordingly to Rakoff, there are seven characteristics that show that we’re facing a “contract of adhesion”:

- 1) The document whose legal validity is at issue is a printed form that contains many terms and clearly purports to be a contract;
- 2) The form has been drafted by, or on behalf of, one party to the transaction;
- 3) The drafting party participates in numerous transactions of the type represented by the form and enters into these transactions as a matter of routine;
- 4) The form is presented to the adhering party with the representation that, except perhaps for a few identified items (such as the price term), the drafting party will enter into the transaction only on the terms contained in the document. This representation may be explicit or may be implicit in the situation, but it is understood by the adherent;
- 5) After the parties have dickered over whatever terms are open to bargaining, the document is signed by the adherent;
- 6) The adhering party enters into few transactions of the type represented by the form – a few, at least, in comparison with the drafting party;
- 7) The principal obligation of the adhering party in the transaction considered as a whole is the payment of money.<sup>88</sup>

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<sup>87</sup> *Ibid.* at 1176.

<sup>88</sup> *Ibid.* at 1177.



This model ignores some problems, like for example, the problems that might arise from documents that do not clearly demonstrate to be contractual, such as some “warranties”, eliminated by stipulation. Many examples of commercial practices of the use of form documents also don’t fall inside the model. This model also excludes the issue of the “battle of forms”<sup>89</sup> and also the issue of “industry-wide master forms”, which are viewed as equivalent exchange rules<sup>90</sup>.

Rakoff set aside from the model, intentionally, the structure of the market in which the contract has been made. This due to previous academic opinions that linked the use of contracts of adhesion to the exercise of monopoly power. However, as Rakoff realized, this is not true. Even small firms in competitive markets choose to use their own standard form contracts in their daily business, especially retail stores that extend credit or make time sales.

Hence, even if it is though that in a contract of adhesion most terms are not negotiable, in a competitive market the adherent must have the right to shop around for better terms, or at least, different terms.

Furthermore, there is another feature which is generally connected with the “concept” of contracts of adhesion. It refers to the fact that, normally, the adhering party does not read the standard terms before signing the document and even if it were to read them, probably wouldn’t understand them. As well do the drafting party know this adherents’ behaviour. One evidence of that is how businesses present their form contracts to the customers. Although this is a point to be made when discussing contracts of adhesion, Rakoff left it out the definition. In his opinion, this is only a consequence of the use of contracts of adhesion by our society. They are points that questioned the enforceability of form clauses. Additionally, Rakoff assumes that because contract law is rationalized on the “voluntary assumption of obligation” it cannot be applied in an instinctive and direct manner to contracts of adhesion.

## **B. Scopes of choice**

To presume that form terms are enforceable just to avoid the fact that there is the need to construct a new framework for contracts of adhesion seems fearful. Although it would be hard to govern a countless number of transactions, it will not be impossible. There is the supposition that ordinary contract law “*must form the framework for considering contracts of*

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<sup>89</sup> The case in which each party has drafted a document.

<sup>90</sup> “Their function is to standardize a type of transaction not for a single drafting party, but for all participants in a trade”.

*adhesion ultimately seems to derive from the proposition that all the terms of a transaction must be developed in the same way*<sup>91</sup>. In other words, after despising a whole system of legal control to all terms, and after the parties provide any term, being it whatsoever, then “of necessity” every term provided so must be given the same consideration. The law, in this case has two options: or it follows the agreement of the parties; or it substitutes its own rules. It isn’t allowed to do both.

Although it would be better to pursue the drafting party’s conduct regarding contracts of adhesion, it is obvious that the legal system mustn’t do the same path. The argument from “necessity” totally misreads the so-called “shape” of contract law. Evidently, courts do not create a list of duties from the beginning to the end and call it “contract”, but actually they do not obligate the parties to provide many terms. When someone wants to be bound, they do make enforceable agreements which stipulate no more than core business terms, like price and quantity. Is only when courts/judges become aware of the omission of this type of terms that they inform that “*courts do not make contracts for the parties*”<sup>92</sup>.

The remaining obligations that may arise from a simple agreement will be thus specified and defined by a court. Some of these terms are more seen as tort obligations, some as incidents of special relationships, and some as a matter of procedure. In contrast, others as “constructive conditions of performance or frustration, or the specification of available remedies” are seen as instantly part of the law of contracts. The heart of the matter is that both these, however they are branded, have their implied terms standardized. They are not fruit of the parties’ specific intention, but rather from a series of background rules.

The issue of standardization of implied terms is most noticeable in regulatory statutes that offer terms, or full contracts, automatically applicable when there isn’t any specification by the parties. An illustration of that is the Article 2 of the Uniform Commercial Code, which though not professedly regulatory, is in fact a directory of the implied terms of sale’s contracts. Even terms, caught by case law became standardized.

Courts prefer to treat “judicially provided conditions of performance” as general rules from trade usage, custom, and policy instead of treating them as part of the individual part intent.

Evidently, parties are not obliged to enter in such standardized transactions at all, but as Kessler argues “*beyond that freedom, the parties’ contractual power is now exercised primarily*

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<sup>91</sup> *Ibid.* at 1180.

<sup>92</sup> *Ibid.* at 1181.

*in specifying deviation from the standardized plan rather than in defining the obligation ab initio*”<sup>93</sup>. This reality begs the question of whether there is the necessity of declaring contracts of adhesion enforceable. The form terms normally provide alternatives to terms that the legal system will propose to lay emphasis on simply stated bargains. As matter of fact, most of the terms are used with the aim to relocate clear rules of law that would govern the transaction in another way. The most compelling evidence of these are clauses limiting the time in which a suit can be brought up or, due-on-sale clauses in mortgages.

There is an additional group of form terms that try to specify the rules of law whose application to certain situations is indeterminate. Examples of these are clauses which set time limits on issues that the law would require a “reasonable period of time”, not to mention the endless clauses and forms of force majeure, that try to circumvent the framework of a “flexible legal test of impossibility or frustration”. There are even clauses that try to circumvent an entire body of substantive and procedural law, such as choice-of-law clauses and arbitration agreements.

The clauses which are normally known for raising complications (limitations of warranties, of consequential damages, of liabilities for negligence, and of times for inspecting goods or filling proofs of loss) are included in one or another of the previous clauses.

When a contract fails to define some clauses, like for example the allocation of risks of negligence, no one assumes that this contract is lethally unspecified. For this, there isn’t any reason to believe that these terms should be regarded as enforceable, or even valid just for the fact they are included in a contract of adhesion.

### **C. The traditional dogma**

If one wants to understand the current doctrine regarding contracts of adhesion, it must first take into account the reason why the traditional doctrine had more respect for the drafter’s terms.

The traditional approach may be illustrated by the *Lewis v. Great Western Railway*, which was decided by the Court of Exchequer in 1860. It turned out to be a very important case regarding this. The case refers to an action brought to recover damages for the loss of a parcel. The judge sustained the company’s plea that the plaintiff’s claim was blocked because it was not made within the brief period of time specified on a document that the plaintiff has signed. Lewis had earlier testified that he had listed the consigned items on a form supplied by the

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<sup>93</sup> *Ibid.* at 1182

railroad. He said that he didn't read the paper, and that a person told him to sign the form. Lewis argued that this person didn't even call his attention to the conditions or to read them. The Barons solidly support for the company (despite the argument of the Counsel that "if the plaintiff did not, in fact, consent to enter such a contract, he was not bound").

The Baron Bramwell's speech symbolizes the attitude of the court:

It would be absurd to say that this document, which is partly in writing and partly in print, and which was filled up, signed, and made sensible by the plaintiff, was not binding upon him. A person who signs a paper like this must know that he signs it for some purpose, and when he gives it to the Company must understand that it is to regulate the rights which it explains. I do not say that there may not be cases where a person may sign a paper, and yet be at liberty to say, "I did not mean to be bound by this," as if the party signing were blind, and he was not informed of its contents. But where the party does not pretend that he was deceived, he should never be allowed to set up such a defence.<sup>94</sup>

This view was adopted and repeatedly used during the latter part of the nineteenth century and especially in the first half of the twentieth. It was understood as part of the general law of contracts and applied it to signed form contracts.

Williston exposed this approach on his treatise, which was published in 1920, and that was part of the section 70 of the first *Restatement of Contracts*, published in 1932. It can be said to be the "traditional response to the problem of contracts of adhesion".

Rakoff lists four propositions in which the traditional doctrine is built on:

- 1) The adherent's signature on a document clearly contractual in nature, which he had an opportunity to read, will be taken to signify his assent and thus will provide the basis for enforcing the contract;
- 2) It is legally irrelevant whether the adherent actually read the contents of the document, or understood them, or subjectively assented to them;
- 3) The adherent's assent covers all the terms of the document, and not just the custom-tailored ones or the ones that have been discussed;
- 4) Exceptions to the foregoing principles are narrow. In particular, failure of the drafting party to point out or explain the form terms does not constitute an excuse. Indeed, in the absence of extraordinary circumstances, the adherent can

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<sup>94</sup> 5 H. & N. 867, 157 Eng. Rep. 1427 (ex.1860)

establish an excuse only by showing affirmative participation by the drafting party in causing misunderstanding<sup>95</sup>.

This propositions were visibly formulated through some version of the objective theory of contracts, and indicates that to be held to the terms of a contract, it is not compulsory to have intended to agree with them. One of the flaws of this theory is concerning to this “agreement”. As Rakoff said *“agreement requires communication; communication takes place through a socially determined medium; if there is to be any workable contract law at all it must be possible to base liability not solely on actual agreement, but at least sometimes on the “reasonable”, which is to say the socially specified, meaning of communicative acts<sup>96</sup>”*.

The issue lies in the formulation of the basis of the obligation (for example, the classic case when a contract consists of terms which were agreed upon, in long-distance negotiations, signed and delivered to the other party), which may be made in two ways:

A) To the party which received the document is expected to assume reasonably that the contract was signed with the intention to agree to its terms; the law, then, should protect this “reasonable reliance”;

B) Instead, it can be understood that a signed document is legally binding, except if a “particular ground of excuse” appears.

What, then, is the difference between these two statements? The degree of formality. Rakoff contends that if contract law is grounded in the “voluntary assumption of obligation”, then the second statement must be seen as a *“formalization of the first”*. He then adds that the “objective meaning of a communicative act” is to be set by the presence of a form and of its signature, with no need to ask to the other party if it did assented even.

But when this is applied to contracts of adhesion, the picture changes. The first substantive version of the objective theory simply will not be taught as enforceable, much less comprehensive. In that case, the drafting party can understand the adherent’s signature as a sign of assent to the bargained terms and to the other remaining terms clearly known by the adherent (such as price), however the drafting party is aware that is very unlikely that the adherent have read and understand the form terms.

In Rakoff’s view, to sustain the presumption of enforceability of form terms, one should assume that a party is entitled to trust on a signature as a proof of assent, even if the reliance is

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<sup>95</sup> *Ibid.* at 1185

<sup>96</sup> *Ibid.* at 1186. See also J. Wigmore, *Evidence in Trials in Common Law*, pp. 2415.

not reasonable in some situations. In other words, the traditional treatment demands that the form contract adherents' are to be treated like they have read and understood the document presented to them, notwithstanding that this is not true and that the other party is aware of this latter fact. This may be understood as the "duty to read" (before signing the contract). This duty can be seen as "a refusal to impose any duty on the drafting party to ascertain whether form terms are known and understood"<sup>97</sup>.

The same formal view is taken regarding the traditional rule that "the signed form document represents the entire agreement of the parties regarding matters within its scope". Here comes the Parol Evidence Rule. If this rule is applied in accordance with its Willistonian formulation it will take the possibility of proving that the actual parties agreement was not in conformity with the form document due to including more, fewer, or different terms. The same will happen in the case when a party believing in its form enforcement had no reason to suppose that the other party actually agreed in handling the document as if it were the exclusive statement of the agreement.

Concerning the degree of formality of the rules of law, Rakoff states that they are normally "*underinclusive, over inclusive, or both*"<sup>98</sup>. This "imperfect fit" is acceptable in order to make the law administrable and to implement our concept of equality before the law. If some group of rules is overinclusive, that fact is not enough to consider that this group should be changed. There's always the problem of applying substantive injustice in analysing if a certain rule should be recalled or not.

If one assumes that all or most signed documents were fully consented to and understood, and if, in one particular occasion a document was adhesive, maybe the better option would be to apply a rule, that when signing a document, would result in being bound by it. This was what happened in the *Lewis v. Great Western Railway* case. This is when one realizes the importance of time and social conditions in determining the meaning of rituals and forms. If we look to the current contracts, the most part of them is adhesive.

Hence, Rakoff realized that the environment in which decisions are made changes the "verdict" of these, and that applying "old" doctrines to new realities is definitely not the answer: "*Rigorous application of the traditional doctrines to contracts of adhesion generates*

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<sup>97</sup> *Ibid.* at 1187.

<sup>98</sup> *Ibid.* at 1188. For further discussion see Kennedy, Form and Substance in Private Law Adjudication", 89 Harv. L. Rev., pp. 1685,1689.

*in modern circumstances so many unjust results that it can no longer be justified as the tolerable cost of applying a general system of rules*<sup>99</sup>.

Still, change is difficult to achieve. The traditional view has the solution to the problem of contracts of adhesion, yet, using language and rules that respect to negotiated contracts will not solve any problem at all.

Rakoff calls for a new set of rules regarding contracts of adhesion: “*To depart from the initial presumption that a signed document is enforceable, one must abandon the appearance of theoretical unity and devise a whole set of new and unfamiliar rules for contracts of adhesion*”<sup>100</sup>.

If we keep assuming that contracts of adhesion are prima facie enforceable, then unwanted results will keep appearing.

#### **D. The Modern Doctrine**

##### **I. Different results from same structure**

The modern courts and scholars understood this new reality. Though the current doctrine produces different results from the ones from older cases, it remains knotted to the traditional formulation that once a document is signed it implies a binding contract, and if one wants to support the nonenforcement of its terms it must do it with a plausible cause. The Section 211 of the *Restatement (Second) of Contracts*, entitled “Standardized Agreements”, expresses very well the commitment of the modern doctrine:

- 1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing..., he adopts the writing as an integrated agreement with respect to the terms included in the writing.
- 2) Such writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing.
- 3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement<sup>101</sup>.

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<sup>99</sup> *Ibid.* at 1189. See, e.g. Tobriner & Grodin, The individual and the Public Service Enterprise in the New Industrial State, 55 Calif. L. Rev., pp 1247, 1252 (1967)

<sup>100</sup> *Supra* note 41 at 1190.

<sup>101</sup> Restatement (Second) of Contracts (1979)

In the first two subsections, the traditional doctrine is implicit for the fact that it refers that “signing automatically connotes assent”, that “the adherent has the duty to read” and that the parol evidence rule is applied to form contracts. In contrast, subsection (3) indicates an exception to the general rule that is considerably broader than the traditional excuses for issues such as fraud or induced mistake<sup>102</sup>. This development is evident in the explanatory comment, which declares that: “*reason to believe that the adherent would not knowingly have signed may be inferred from the fact that the term is bizarre or oppressive, from the fact that it eviscerates the nonstandard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction*”<sup>103</sup>.

The same pattern is followed by the case law. It assumes, too, that contracts of adhesion are enforceable.

The California Supreme Court is one of its followers, as it declared that “*a contract of adhesion is fully enforceable according to its terms...unless certain other factors are present, which under established legal rules – legislative or judicial – operate to render it otherwise*”<sup>104</sup>. This means that exceptions are not included in the doctrines of fraud, duress, and mistake. The traditional analysis is being exceeded by more liberal results, though these are only evident when observing the courts’ assumptions. For instance, the *Williams-Thomas Furniture Co.* is considered one of the cases stating the end of the traditional solution, even though the interpretation of such case wasn’t go far enough. This case was a key point in adapting the doctrine of unconscionability by means of providing a way of alleviating the adherents. Still, its origins were found in the traditional approach. As Judge Wright established the law in the following way:

Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence a little real choice, signs a commercially unreasonable contract with a little or no knowledge of its terms, it is hardly likely that his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.<sup>105</sup>

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<sup>102</sup> Supra note 41 at 1191. See Dawson, *Unconscionable Coercion: The German Version*, 89 Harv. L. Rev., pp 1041, 1120 – 1121 (1976)

<sup>103</sup> Restatement (Second) of Contracts § 211 comment f (1979)

<sup>104</sup> *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, pp. 819-20, 623 P.2d 165, 172, 171 Cal. Rptr. 604, 611 (1981). Despite *Graham* did not involve a contract of adhesion, several cases referred to it.

<sup>105</sup> *Walker-Thomas*, 350 F. 2ed pp. 449-50



The first step in the courts' analysis was to conclude that the adherent's signature is not a manifestation of assent neither in the eyes of the adherent nor in the eyes of the drafting party. Rakoff phrased it perfectly: "*the signed document still has force; its terms still cannot be thrown over unless they are "so unfair that enforcement should be withheld"*"<sup>106</sup>. Or as Judge Wright stated, except this terms are unjustly advantageous to the other party. It seems that many terms may be unfair, but not so "unfair that enforcement should be withheld", or that maybe are advantageous for the drafting party, but not "unreasonably" so. But, for the simple fact that the document was signed they are enforceable. The grounds for excuse have been extended, but the enforceability is still presumed.

This is not confined to situations where the doctrine of unconscionability is brought up, since the terms' nature appears to presume enforceability of the document in question.

Similar are cases that regard whether matters of "public interest" are concerned, or whether one of the parties of the transaction had "superior bargaining power"<sup>107</sup>, which are the two most relieving doctrines bearing form contracts.

In the past decades, courts when assessing contracts of adhesion usually applied categories of "public interest" and "superior bargaining power" to a wider group of events that would fit analogously to doctrines of ordinary contract law respecting businesses "affected with public interest" and transactions rotten by "economic duress". An illustration of such expansion is shown after comparing two cases settling the "validity of clauses in form residential leases that attempt to exculpate the landlord from his duty of ordinary care. The referred cases are *O'Callaghan v. Walker & Beckwith Realty Co* were decided in the late 50's and held such clauses valid. On the contrary, in *Henriouille v. Marin Ventures, Inc.*, the clauses were held invalid.

In one hand, in the *Callaghan* case, the judge refused to find an admitted shortage of housing legally relevant: "*the relationship of the landlord and the tenant does not have the monopolistic characteristics that have characterized some other relationships with respect to which exculpatory clauses have been held invalid. There are literally thousands of landlords who are in competition with one another...*"<sup>108</sup>

In the other hand, in the *Henriouille* case, the judge found a "public interest" involved, largely due to the presence of "unequal bargaining strength": "*In a state and local market characterized by a severe shortage of low-cost housing, tenants are likely to be in a poor*

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<sup>106</sup> Supra note 41 at 1192.

<sup>107</sup> See e.g., *Henriouille v. Marin Ventures, Inc.*, 20 Cal. 3d pp. 512, 519, 573 P. 2d 465, 469, 143 Cal Rptr. 247, 251 (1978)

<sup>108</sup> *O'Callaghan*, 15 Ill. 2d, pp. 465, 143 Cal Rptr. 247 (1978)

*position to bargain with landlords.*”<sup>109</sup>. So, the former refers to “superior bargaining power” applicable law, while the latter, more modern, refers to “economic duress” on facts that certainly would not settle such exception if in case of a fully negotiated transaction.

The problem of using doctrines of “public interest” and “superior bargaining power” or even “unconscionability” is that all of them have within themselves the structure from general law from which they come. They are treated as matters of exception or excuse.

It is not easy for an adherent to demonstrate that he signed a form contract, which was presented to him on a take-it-or-leave-it basis, and that such form (its terms in question) diverted from the background rule that the law would imply. What the courts actually tend to do is to declare the enforceability of the form terms in question, rather than determine accurately if there are matters of public interest or disparate bargaining power involved. Thus, courts prefer to presume enforceability of form contracts just to avoid bigger problems.

As Rakoff concluded: “*the present judicial doctrines, although they often provide different results, still ask why an adherent should be allowed to avoid a term of this contract, rather than why the law, as usually enunciated, can fairly described as a softened or decayed form of the traditional solution*”<sup>110</sup>.

## II. Will the structure survive?

This problem has reached such extension that the expansion of exceptions and excuses became a synonym of “renunciation” of the existing rules.

Some courts already admit that the present law concerning contracts of adhesion should demand more than a signature to make even the presumption of enforcement of form terms. But are these cases the norm or the exception? Do they reflect the controlling sense of justice that other courts, without exacerbate conservatism, do not over the counter admit? It is not clearly evident.

Yet, there is the suspicion through judicial intuition that the presumption of enforceability is not vigorous. The more recent cases, in which form terms were substituted, show the courts’ preference towards the adhering party, more than doctrinal statements reveal. And the courts rational sometimes follows the same reasoning. As Rakoff argued: “*the circumstances accepted as sufficient foundation for the application of what is, in form, an exception are sometimes so commonplace that the exception could easily swallow the rule*”<sup>111</sup>.

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<sup>109</sup> *Henriouille*, 20 Cal. 3d pp. 519, 573 P.2d pp. 469, 143 Cal. Rprt pp. 251

<sup>110</sup> *Supra* note 41 at 1195.

<sup>111</sup> *Ibid.* at 1195.

The *Shell Oil Co. v. Marinello* is a good example of a case which presents a matter of “public interest”. This case respected a form clause giving Shell the right to terminate a dealer’s franchise on short notice and without “cause”, the court held the clause invalid as matter of “public interest”. The court stated the following:

That the public is affected in a direct way is beyond question. We live in a motor vehicle age. Supply and distribution of motor vehicle fuels are vital to our economy. In fact the Legislature has specifically concluded that the distribution and sale of motor vehicle fuels within this State is affected with public interest.<sup>112</sup>

Lastly, the courts that do enforce a questioned form clause, normally do not do so instantly, they explain the grounds for enforcement first, and in accordance with the case in point. But reaching a consensus on the fair meaning of the current doctrine is very difficult.

Evidently, there are cases in which enforcing a form term is suitable with the application of background law. Similarly, there are a number of cases that, without exception, enforce form terms in circumstances in which the other option, the legally implied rule, would induce a different decision. In addition, judges do not always treat the exception as a matter of “public interest” or “superior bargaining power”, nor they think that such concepts are infinitely malleable. As a matter of fact, there are cases which support form clauses limiting liability for errors made in publishing classified telephone directories. Such cases rely on the fact that the publishing of “Yellow Pages” (contrary to the white pages directory) is not regulated by the public service business of the telephone company<sup>113</sup>.

The present law applicable to contracts of adhesion is full of contradictions, different methods of analysis, conflicting results and so on. It is increasingly distant from the traditional doctrines, and rules conducting bargained-out agreements, in favour of the adhering party. The remaining question is whether the analysis sustained by traditional approach can still be preserved. Rakoff claims that this is a call for reconsider some fundamental premises. Still, it seems that even if the law is better established, the exceptions to enforceability appear whenever a contract is adhesive, thus questioning if any assumption of the presumptive validity of contracts of adhesion can be supported at all.

Is this reality only an intermediate position of law, due to the tendency of the law to mediate between past history and present reality? Or is this position justified on principle?

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<sup>112</sup> 63 N. J. 402, 307 A.2d 598 (1973), *cert. denied*, 415 U.S. 920 (1974).

<sup>113</sup> See, e.g., *McTighe v. New England Tel. & Tel. Co.*, 216 F.2d 26, 27-28, 30 (2d Cir. 1954)

### **2.2.2. A Innovative analysis**

#### A. Contracts of adhesion as a practice

The domination of the modern economy by business organizations brought a greater use of contracts of adhesion. Enterprises use standard form contracts to steady their external relationships, and also to control their hierarchical and internal structure.

##### 1. *Relation between the Firm and the Market*

The modern business development had many effects in the way firms do business. One of the most remarkable ones was the substitution of market transactions for managerial coordination. This through means of vertical integration, that is, in the production of goods, for example, the trail from raw materials to consumer was largely reduced to require just one, or very few transactions. This practice became most frequent when firms became aware of their ability to reduce transactions, and thus reduce costs, since those are not free. They are not free because it takes money to assemble the significant information, negotiate the deal and then draft the contract. Avoiding outsiders in the marketplace is not a bad idea since they bring uncertainties to the productive process. And uncertainty is not desirable in this situation. The internal administration of the successive stages involved in production and distribution, and internal processing of the unavoidable disputes enables the coordination and predictability, and later, lower costs.

If complete integration is not achievable, it's always possible to resort to franchise arrangements and the like, because normally they fulfil the same aims. Yet, integration has boundaries. The market also concerns to the relation between the firm and the consumer, which are at the end of the economic chain. These firms will also try to dominate the market through reduction of costs of contract formation, hence minimizing uncertainty and legal responsibility for uncertainty and gaining some mastery over the residual disputes.

If we see things through this point of view, standardization is valued, for the reason they reduce transaction costs. However, the possibilities exceed plain standardization since firms can draft their own terms in order to stabilize the incidents from business. For instance, the use of force majeure clauses, liability for consequential damages and short time limits for making claims and filling suit.

In fact, the firm's intention to be free of external restrictions combines with "the professional ethos of the legal draftsman"<sup>114</sup>. Thus, it is the lawyer's duty to safeguard his client

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<sup>114</sup> *Ibid.* at 1222.

from every possible eventuality. Here, the businesses demands are set aside, “the standard applied is the latitude permitted by the law”<sup>115</sup>. In the end, the document becomes hard to understand, even for average businessman.

Therefore, standardization is a way to spare and to control market relations, yet is hard to know the reasons why standard form contracts regularly contain terms that are hostile to the adhering party. Also there is no explanation for the use of this contracts on a take-it-or-leave-it basis or for the fact that clients do not contest this demand.

The consumer’s lack of interest to dicker about all but a few terms is reflected by Rakoff in this passage: “A salesman and a buyer of, say a major household appliance will haggle at length over its price and perhaps over whether the sale will be for cash or for credit; yet both will assume that remaining terms will be provided by the seller’s standard form”<sup>116</sup>.

The problem is that, normally, these terms may respect to substantial issues, such as conditions of the buyer’s right of return or the seller’s right of repossession.

## 2. *Relation between the firm and the form*

The institutional dynamic is visible through the use of standard form contracts. Nowadays modern firms are organized by departments and over hierarchies. This is a call for the adoption of standard form contracts.

Within a complex organizational structure, the use of standard form documents foments efficiency and there are some reasons for that: first, the standardization of terms, and also of the forms in which they are contained, simplifies coordination among departments. Inasmuch as they allow to process transactions as a matter of routine; second, the standardization allows the efficient usage of the costly managerial and legal talent; third, the use of such contracts works as an “automatic check” on the outcomes of the actions of errant sales personnel.

Besides, form contracts help to consolidate the organizations internal structure. This happens both in private organizations, as in public bureaucracies since “discretion is power”<sup>117</sup>. It is harder to control subordinates with wider discretion because the standards of performance are less certain.

The hierarchy serves its ends by denying the agent’s authority to alter the terms of the document or requiring that acceptance will happen only if permitted by a superior or the home

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<sup>115</sup> *Ibid.*

<sup>116</sup> *Ibid.*

<sup>117</sup> *Ibid.* at 1223.

office<sup>118</sup>. Rakoff stated clearly the nexus between forms and their informational purpose: “*Apart from their obvious role in litigation, a clause transforming a vague legally implied term (“a reasonable time”) into a precise one (“ten days”) may simultaneously serve to inform subordinates of the decision made by managerial and legal personnel*”<sup>119</sup>.

Even so, enterprises blame the difficulty in pursuing the communicated special needs of the customer to justify their disclaimer of liability for consequential damages.

The take-it-or-leave-it approach is an illustration of the institutional inflexibility. Firms do not want to negotiate individually for two reasons: one, it’s more costly to negotiate in particular; two, it will be more costly, both economically and institutionally, to modify the organizational structure already familiarized with standard terms.

The market control share isn’t in any way linked to the use of contracts of adhesion by firms. Even in the presence of competitive markets, firms will reject the possibility of bargaining their standard terms in matters that usually two individuals would wish to negotiate.

However, that there is another theory that states exactly the opposite. According, the firm’s internal structure is unrelated to the firm’s market behaviour, which includes its contracting practices. The fact that firms refuse to bargain in situations where an individual would do so, must be based on “market power in the usual sense”<sup>120</sup>. This would only be possible if we supposed that the market’s force is so strong and so exact that all the partakers will be obligated to act as individual human beings would.

At the same time, the presence of contracts of adhesion does not mean that competition is absent. Nothing prevents other firms from having different combinations of form terms.

The imperative question here is whether adherents will sufficiently pressure drafting parties, and thus, discipline them, by shopping around for better terms.

### 3. *Relation between the form and the adherent*

Customers are aware of their incapacity to change form terms, and if they do not understand the take-it-or-leave-it basis, the salesman will tell them that he does not have the authority to vary the form. Bargain is not even a possibility, because that means infiltrating in the hierarchical structure of the firm. No one will be willing to haggle, “we cannot make an exception for one customer”, as Rakoff writes, “the language of standardization becomes a

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<sup>118</sup> See Macaulay, *Private Legislation*, pp. 1059.

<sup>119</sup> Rakoff, *supra* note 41 at 1224.

<sup>120</sup> *Ibid.*

moral claim”<sup>121</sup>. In situations involving organizational hierarchies, bargaining is not even expected, or appropriated for a consumer to do so. Yet, shopping is still a possibility, the only actually. The problem is that in most consumer transactions, making a plain choice may be difficult. The consumer must read and compare all the possibilities, and also take attention to terms concerning risks that in any given transaction are improbable to happen.

The standard forms are thus drafted to cover many eventualities and for that reason they are normally long and complex, even in the case that each term is clearly stated. The shopping ability of consumers is, in effect, low. They do not read, or understand the documents. Of course they shop some terms, otherwise they wouldn't be shopping anything at all, but actually they do that within a small “space”. They just concentrate in a few terms, normally the ones that are best-publicized, and ignore the remainder. The ideal customer that reads, understands, and shops carefully does not exist.

Businesses take advantage of this “consumer apathy”, to “sell” new form terms. This may be expensive for the company, for the fact that it has to “underwrite the additional terms and bear the cost of stipulating shopping behaviour”<sup>122</sup>, but in the long-run may be advantageous because these new terms will catch the attention of the consumer, and thus making will acquiring the “thing” in question. The consequence, however, is that, over time, more and more risks will be moved to the adhering party.

The contracts of adhesion are used by drafting parties because they are means to predict and avoid future risks, and also to solidify the internal structure of the company. The adherents' response to this is concentrating on a few terms, rather than reading all the form. The firms, being aware of such practice, also focus on this “few terms”, thus competing in their regard. The company's incentive is, like Rakoff stated, to “save whatever they can with defensive form terms and employ the savings to compete with respect to the shopped terms”<sup>123</sup>. The competition just makes the problem even bigger.

Llewellyn realized that, as time goes by, the contracting through standard forms tends to be more seller-protective than customer-protective, and this occurs in whole lines of trade, since the bottom to the top industries.

Maybe the answer is in the “business reputation”, consumers could choose according to the firm that seems more reliable.

The reality is that the adherent cannot do anything to ameliorate his position. Through

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<sup>121</sup> *Ibid.* at 1225.

<sup>122</sup> *Ibid.* at 1227.

<sup>123</sup> *Ibid.* at 1227.

an ordinary law point of view, the adherents' flaw to read and understand the documents is the main problem regarding the use of contracts of adhesion. On a fuller view, this failure demonstrates the persuasive and complex nature of the institutional practice. Thus, the internal rigidity of the firm will hinder a well-informed adherent to object to any form term, even if he attempts to start a bargain and menaces that he will make his deal elsewhere, the business will not care. Moreover, if the adherent reads one form, that does not mean that he has read or shopped many others, or that he would find that rationale to do so.

Rakoff realized that consumers are nowadays dominated by economic organizations, as he wrote in this passage: *"The consumer's experience of modern commercial life is one not of freedom in the full sense posited by traditional contract law, but rather one of submission to organizational domination, leavened by the ability to choose the organization by which he will be dominated"*<sup>124</sup>.

#### 4. *The Form's Power*

The use of contracts of adhesion is not just a result of the exercise of monopoly power, or a consequence of mass production and mass distribution, but rather, as a circumstance related to the "specific organizational form in which mass production and distribution"<sup>125</sup> most typically arise in our society. There isn't any other way to explain all the critical features: the standardization of documents in many economic sectors for a huge number of transactions, the use and acceptance of form contracts on a take-it-or-leave-it basis, the adherents' fault to read and understand the documents they sign, and the forms' trend to become more and more protective of the drafting party.

This is the only theory that links the standard form contracting practice with the business history of the past century, in other words, the development of large business enterprises and the replacement of management for bargaining, in the market.

With this in mind, the use of contracts of adhesion, which is legally held, must be seen as "an institution that itself generates and allocates power – not market power in the traditional sense, but power nonetheless"<sup>126</sup>. Thus, the use of standard form contracts, if legally enforceable, is translated into freedom from legal limitations and ability to control market relationships. If one wants to accept this practice, it has also to accept this consequence.

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<sup>124</sup> *Ibid.* at 1229.

<sup>125</sup> *Ibid.* at 1229.

<sup>126</sup> *Ibid.* at 1229.



## B. Appraisal of the Practice

Any simple agreement between a customer and a commercial entity will consist in the terms typically haggled or shopped, the remaining terms will be implied. If the same happens in the case of a signed form, it's the legal systems' duty to decide whether and to what extent to apply the drafter's form terms rather than use the law's implied terms.

### 1. *The conception and dissemination of wealth*

The existence of contracts of adhesion in competitive markets shows that the costs saved by switching risks to the consumer through form terms, may be ultimately reimbursed to the consumer per lower prices or more beneficial terms vis-à-vis the few matters that are still bargained or shopped. The legal system should, before enforcing a contract, check its fairness, in the sense that equal values are being traded. The consumer lack of information concerning to some terms impedes him to make some pre-judgement of what is, in fact, fair, since is not absolutely conscious of all terms. Even in this situation, Rakoff believes that "firms are not making extraordinary returns, and accordingly, that customers are getting a fair deal, even in ignorance"<sup>127</sup>. Moreover, he considers that "it does not seem that contracts of adhesion raise any unique legal issues regarding the distribution of wealth between sellers and consumers"<sup>128</sup>.

Doctrines such as economic duress or unconscionability are keener on distributional issues though. Yet, it is not expectable that competitive market forces will yield forms that will optimally and effectively please consumer demand or that are wanted in some broad sense. The market is not interested and has no idea of what consumers' preferences are.

Supposing that the legal system, before enforcing a contract, tries to ascertain whether the stipulated allocation of risks are reasonable enough to oversee the possible perils of a transaction, the presence of competition will not provide the required guarantee. Again, the consumers' lack of information will preclude the resort to the argument that parties can deem by themselves how should risks be distributed, or which party should support the insuring cost against such contingencies. The same applies in respect to the question whether the trade values are equivalent. Yet, here, competition is not a substitute. If one assume that some risks are better absorbed by the drafting party, even if that rises the price, the competition in this context will have a worse outcome, since it leans towards "degradation of any adherent-protective

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<sup>127</sup> *Ibid.* at 1230.

<sup>128</sup> *Ibid.* at. 1230.

provisions of the contract”<sup>129</sup>.

Having said that, Rakoff asks why one still relates the enforcement of standard form contracts to an overall gain in economic welfare. Llewelyn’s argument, that contracts of adhesion ameliorate the legal system’s allocation of risks and liabilities through the judgment of commercial experts, fails to realize that forms are not drafted from such a “professional and interest-free point of view”<sup>130</sup>. Also the proposition that form contracts are translate into huge cost savings fails to perceive that the alternative is not to “the bargaining-out of every deal but rather the use of standardized yet legally implied terms”<sup>131</sup>. It seems that Llewelyn’s aim was to be supported by the Williston’s statement that enforcement of signed documents “rests upon the fundamental principle of the security of business transactions”<sup>132</sup>. This assertion would have implicit two propositions. One is that the form documents have a “useful economic purpose”, for the fact that they specify a particular transaction and its general rules of law. In other words, the consumer knows that, generally, the reasonable time is “ten days”. However, this assertion has some flaws. In first place, the firm may not adhere to the set line that its forms stipulate, and being so, if the adherent consults the form will be deceived. Second, if the dispute goes to court, “the intermittent yet time-honoured” practice of the judiciary to ignore what seem clear form terms, or to read them against their meaning, really weakens the position.

In second place, the prerogative with basis on “the security of business transactions” continues by stating that if people want to become aware of the terms of a transaction they can do so by exploring the written document, concluding then that is important to keep such peoples’ trust. This does not mean that by signing the document, the seller or the consumer would become more certain that they are supported by the law. We must remember that one of this parties is a “segmented and differentiated firm”, in order to perceive that traditional rules assure to the members of the organization, not to the salesman, that the document states the transaction, regardless of what the salesman knew, said or reasonably thought. The internal firms’ reliance is the one reliance which is being protected. Thus, the aim of the doctrine is to authenticate the form as means of internal communication.

Therefore, form documents should be held enforceable for the fact they facilitate the communication and discipline within a firm, aid to modify their obligations to risks suitable to their business structure and lead to overall welfare as a result of their organizational efficiency.

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<sup>129</sup> *Ibid.* at 1231.

<sup>130</sup> *Ibid.* at 1232.

<sup>131</sup> *Ibid.* at 1232.

<sup>132</sup> S. Williston, *A Treatise on the Law of Contracts* § 37-49 (W. Jaeger 3d. 1957).

Still, what is the nexus between institutional factors and substantiation for enforcement of form contracts? This argument does not explain the claim. Not only are the form terms not justifiable because of the firms' structure, but also the drafting party, taking advantage of its position, often attempts to avoid its legal responsibilities for reasons that have nothing to do with internal efficiency.

Even on the assumption that the use of form contracts increases the "efficient operation of the organization"<sup>133</sup> and even on the assumption that this gain is repaid to customers through lower prices, there isn't, according to Rakoff, any guarantee that there has been a general gain in social welfare. The sending of risks and responsibilities to the adhering party has its costs, such as the transactions costs of arranging insurance or handling an uninsured risk that occurs. This may be the reason why the liability is first placed in the side of the drafting party. The draftsman will always bear in mind the size these costs may have, or whether these costs go beyond the costs involved in having firms covering the same risks. Thus, denying the obligation, saves the draftsman's client, the firm and money. This suggests that the legal system, in creating legally implied rules, should consider the institutional costs supported by firms when adapting to the different responsibilities, but yet, it does not clarify why to give deference to the drafting party's terms.

If standardized terms can be legally implied, this means that mass distribution is not dependent of contracts of adhesion. These contracts if applied in a competitive market may not generate a large redistribution of wealth to the drafting parties, yet any gain in social welfare due to their use and enforcement will be relatively modest. The drafting party will be not capable of measuring if any possible gain compensates the costs of attaining it. Analysing the standard form contract use as an issue of production or distribution of wealth will not be the answer, because this does not explain the presumption of enforceability.

## 2. *Power and Freedom Line-up*

### a) *Freedom of Contract*

Contract Law is one means of freedom embedded in our society. Enforcing contracts of adhesion definitely releases the drafting party from legal restrictions, but at the same time the exploitation of such freedom leads to the imposition of terms on adherents.

The demand for contractual freedom was part of the historic movement related with the modern market economy growth that with the governments' help, substituted the social order,

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<sup>133</sup> Rakoff, supra note 41 at 1234.

which was organized by status and full of customary restraints on the power to contract. In the past decades, the meaning of freedom of contract has been largely discussed. Thus, Contract Law, and other fields of private law, have been seen as suitable to “prevent social coercion in the now-established market economy. The state’s help is no longer essential to wipe the remains of former legal orders. In Rakoff’s opinion, the Freedom of Contract “now consists in the absence of government meddling except when a substantial public policy justifies the intervention...it is defined in terms of the separation of the market and the state, private and public law; at its fullest reach, it is the doctrine of *laissez faire*”<sup>134</sup>.

According to Courts’ statements, denying the enforcement of a contract of adhesion obstructs the Freedom of Contract. Similarly, they perceive the drafting party as an individual. But, supposedly, Freedom of Contract means uncoerced choice, as the Courts realize, that is, its link to the human being, its development, its individualization, its fulfilment by doing so.

However, none of these human values is visible by enforcing the organization’s form. The standard form is a representation of the organization’s needs and dynamics. It is incorrect to conceive that contracts of adhesion are the “extension and fulfilment of the will of an individual entrepreneur”<sup>135</sup>. Furthermore, it is unsuccessful to claim that this contracts are the “cooperative expression of the freedom of all or most of the individuals who comprise the organization”<sup>136</sup>. But, the commercial organizations evidently do not participate, even because who designs the forms are very few people, typically lawyers. Thus, the contracts of adhesion derive from the matrix of organizational hierarchy, their enforcement nothing has to do with “freedom of contract”.

It is no longer feasible to see the Freedom of Contract as the opposition between an individual and state due to our industrialized, organized and institutionalized society. Clearly, institutions other than the state can and do control the individual within the context of private law as typically designed. The threat is visible in many fields of economic life, for instance, in the labour relationship in modern industry, where such a domination exists. To recognize the elimination of such domination is as much an achievement of liberty as is the limitation of governmental control.

In Rakoff’s view, the courts should claim that enforcing standard form terms harms the freedom of the adhering party, since this terms are inflicted on the transaction in a way that no individual adherent can impede. The biggest aim of this contracts, is thus, to guarantee that the

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<sup>134</sup> *Ibid.* at 1236. See, e.g., *Coppage v. Kansas*, 236 U.S. 1, 12-21 (1915); *Adair v. United States*, 208 U.S. 161, 172-76 (1908).

<sup>135</sup> *Ibid.*

<sup>136</sup> *Ibid.*

drafting party will succeed in case of dispute. This is how big companies “legislate in a substantially authoritarian manner without using the appearance of authoritarian forms”<sup>137</sup>, as Kessler well realized.

The solution may be a term imposed by the adhering party, individually or as a class, rather than one imposed by the drafting party. Yet, the solution must be given by law, not by the drafter or the adherent. The judges, legislators, and administrative officials are impartial as opposed to the drafter. They have a broader view of the common good, and they are subject to political control. Thus the government has legitimacy, and should frame general applicable rules of law. The same cannot be said to the draftsman.

The courts should determine if the enforceability of a contract of adhesion is because “the adherent makes a sufficient claim based on public policy” or “simple fairness to override the drafting party’s claim based on the value of free choice”<sup>138</sup>. However, framing the issue in such manner is not correct, because individual freedom bears the prerogative of the adhering party not to have the drafter’s terms imposed on him. With this in mind, such terms ought to be totally unenforceable. Yet, this is not enough to assert this proposition, for the fact that individual liberty relates not only to individual human growth and achievement, but also on the preservation of a democratic society. If this democratic society is dependent on business firms, and if such firms are dependent on standard forms, maybe the enforcement of such is defensible.

#### *b) Conservancy of Civic Freedom*

Our society’s composition is based on individuals related to one another across markets and over the state, thus each citizen “faces the state naked”<sup>139</sup>. One of the first to realize that was Hobbes, in its *Leviathan*<sup>140</sup>.

During the twentieth century, totalitarian governments became real, with its means of mass organization, mass communication and mass terror. The legal protection of individual rights is not sufficient in face of such a reality. The citizen, even with the protection of his personal property, has no such power. According to Tocqueville’s theory, in the modern context, freedom must be achievable through the maintenance of organized and overlapping intermediate institutions, both civil and political<sup>141</sup>. Rakoff is of the opinion that “one of the

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<sup>137</sup> Kessler, supra note 6 at 640.

<sup>138</sup> Rakoff, supra note 41 at 1238.

<sup>139</sup> *Ibid.*

<sup>140</sup> T. Hobbes, *Leviathan* chs. 20, 22 (London 1651).

<sup>141</sup> A. De Toqueville, *Democracy in America* 509 (J. Mayer ed. 1969) (1<sup>st</sup> ed. Paris, 1840)

defining characteristics of modern totalitarian regimes is the absorption by the state of formerly independent loci of organized social power”<sup>142</sup>.

The courts’ willingness to enforce form documents supports the autonomy of intermediate institutions. Other illustrations of such support are the hesitancy to impose constitutional procedural requirements on nongovernmental entities; the readiness to accept arbitration as a compulsory method of settling disputes; and the allowance of opportunities to incorporate on rather minimal terms.

On the word of Rakoff “these instances bear witness to our sense that if we bring social structure too directly within the ken of the law, we will end up specifying the structure by law in a way that undermines the ability to manifold centers of power to thwart the possibly threatening designs of government”<sup>143</sup>.

This argument suggests that there is, leastwise, some liberty interest existent in the enforcement of contracts of adhesion. The argument’s point is that the power of intermediate entities ought not to be structured as an extragovernmental authority delegation, provided that this power is extra governmental, it will not serve its established intention. Also this argument has a limited range. The controversy is that standard form contracts should be upheld with the view to promote firms as instruments leading to civic freedom, which clearly is not such an impressive argument as the traditional claim that these contracts represent the direct expression of individual freedom. Business firms don’t look alike to the types of voluntary organizations held by law. Yet, participatory groups strengthen the independence by providing joint action in an uncoercive atmosphere. The opposite argument is that contracts of adhesion were created by business firms that could be seen as participatory, and they impose rules on adherents, who cannot opine on them.

It is preferable to have mini-authoritarianisms of many separate institutions for the evasion of the totalitarianism of the monolith.

Is a system of independent commercial institutions the solution? Maybe federalism and separated constitutional powers have broken the power of our society that we think that the only option is the existence of nongovernmental counterbalances. Is the preservation of business firms’ independence related to the legal institution of enforceable form contracts? Probably it would be easier that firms adjust themselves to a general requirement of only using terms implied by law. In the event that the rest of the legal powers remained constant, we could

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<sup>142</sup> Supra note 41 at 1239. See also, C. Friedrich & Z. Brzezinski, *Totalitarian Dictatorship and autocracy* 22 (2d ed. 1965)

<sup>143</sup> *Ibid.*

conclude that firms are able to adjust, without any problem, to the complete nonenforceability of form terms. This would be a major change for firms, not just functionally, but also socially, to lose their power to draft enforceable form documents. This would be visible within a whole legal and social framework. As Rakoff stated “the degree of abstraction and assumption necessary to demonstrate that our fragmented governmental structure is by itself a sufficient protection against tyranny seems greater still”<sup>144</sup>. This line of argument is valid only justifies in part, the unusefulness enforcement of the analysis’ terms is still objectionable. Since contracts of adhesion normally protect the drafting party, even in the perspective of the firms’ needs, it is not understandable why some form terms are viewed as important for the maintenance of the business firms’ institutional strength. Further, the enforcement of form terms is only one of the methods that the legal system use to preserve the role of intermediate organizations.

The underlying theory cannot go far. It isn’t visible in the routine. The enforcement of a particular form term or set of terms had to be greatly desirable. It is not sufficient to allege that the use of form terms save firms money for the reason that price terms (which are not characteristically abusive of adherents) are adapted to account for the legal responsibilities.

In case it can be substantiated that the enforcement of a particular set of terms make the firms able to start new businesses and deals, and therefore contributing to the “functioning of a business as a social force independent of governmental control”, maybe the enforcement is acceptable.

This is something that involves ordering the power and freedom’s society, with this in mind, a general rule that contracts of adhesion are presumed enforceable cannot be sustained.

Concerning this, Rakoff wrote “the inevitable infringement of adherents’ individual freedom that results from the rule leads one to suggest that form terms should never be enforced. But that suggestion must be tempered by the possibility that such enforcement will in some circumstances contribute significantly to the maintenance of civic freedom”<sup>145</sup>. The rule must be to justify the enforceability any form term. In the case that it deviates from the background rule, reasons should be shown for that.

### *c) Extra problem of fairness*

There is the need to address an extra problem before we conclude that the assumption of unenforceability is correct. One of the analysis states that when a contract of adhesion is tied

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<sup>144</sup> *Ibid.* at 1241.

<sup>145</sup> *Ibid.* at 1243.

to monopoly power, is assumed that the adherent is paying for more favourable terms than actually he got. Being so, the substitution of background law for severe form terms can be seen as a “restoration of the overall equivalence of the exchange”<sup>146</sup>. On the contrary, the proposed theory, calls into question, form terms within price-competitive markets. That is, the enforcement of terms would be foreclosed even in the case that the drafting party reduced the price to give back to the adherents the costs saved by moving some risks and obligations. The courts are not able to adapt the price term along with the form terms, and thus creating a significant disparity of consideration, which offers a good argument for enforcing written form terms. Maybe the question should be raised considering the possibility of unequal values being exchanged.

In the light of this question, it is necessary to recall that form terms are drafted by someone that is presumed to be sensible to the mandates of the legal system, for that reason, firms review forms or readjust prices, thus filling some legal requirements. This does not respect to prospective legislation or administrative regulation or even, the traditional claim to “freedom of contract”. Here the issue respects to retroactive unfairness, which emerges in the circumstance there is adjudication. Is not even the adoption of a whole new framework that is at stake, because according to the modern view, judges should not be impeded of enunciating new principle of law. Also, the attentive draftsman should have now realized that the presumption of enforceability is in decay.

The framework developed by Rakoff in this article is one that “raises the possibility that judges using it will, in some systematic way, be imposing on drafting parties obligations or risks that these parties were not paid to bear”<sup>147</sup>. According to his proposal, a set of legally supplied terms should exist, in order to provide a test, or to be an alternative to the drafter’s form terms. The problem is that these “supplied terms” may turn out to be ambiguous in some situations. Being hand to hand with uncertainty is normal nowadays. Yet, this uncertainty could be withdrawn if the drafter didn’t pass beyond the acceptable boundaries. Sometimes it may seem worth to keep the firms’ position as potential motivators of new businesses, however, this means imposing large uncompensated liabilities in a party that is trying to adapt background rules to new circumstances. Generally though, the judicial submission of background terms instead of form terms should not be dependent on the fact that the adherent paid for more than he got. This would be translated into risk free terms. Due to current form terms’ depreciation,

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<sup>146</sup> *Ibid.* at 1243.

<sup>147</sup> *Ibid.* at 1244.



judges will sometimes prefer to shift risks without compensation, because this will keep draftsman from surpassing acceptable limits. The law has already done this in the past. The case law regarding non-competition pacts has lots of examples in which courts have set aside broad clauses instead of redraft them. In both cases, one party has received a benefit for which he had never haggled<sup>148</sup>. The exact same method is used in other fields of law, for instance, regarding patents' coverage, if the request for coverage is wider than it should be, the patent's protection may be lost.

Therefore, as Rakoff wrote "there is ample authority and sound reason for the conclusion that courts need not be inhibited from refusing to enforce form terms by the imbalance created in the particular transaction before them"<sup>149</sup>.

#### *d) Principles of choice*

When the presumption of enforceability is inverted and the burden of affirmative justification is put in the drafting party, the shape of the analysis derives substantially. The courts are already reaching decisions which are more adherent-protective, however, such results are not according to the current doctrine. Through the proposed framework, courts with same opinions would no longer be repressed by the idea that they are transgressing basic principles of legal rationality or justice. This analysis refollows the reasoning of statutory or administrative stipulation of issues that would otherwise be handled by standard form contracts. These are not "regulatory", in an effort of requiring special justification because contrary to the general rule, instead such enactments could be seen as simple exercises of the governmental power of making law. Actually, the one thing that calls for justification is the practice of making statutory terms subject to alteration by what seems an agreement of the parties, but instead is a contract of adhesion. As Rakoff realized "although there may be circumstances in which counterprinciples do justify the enforcement of form terms, such instances are now the exception, not the rule"<sup>150</sup>. Rakoff then formulates partial principles revealed by relevant typical situations.

The principles are:

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<sup>148</sup> See, e.g., *Rector-Phillips-Morse, Inc. v. Vroman*, 253 Ark. 750, 489 S.W. 2d 1 (1973); *Jenkins v. Jenkins Irrigation Inc.*, 244 Ga. 95, 259 S. E. 2d 47 (1979).

<sup>149</sup> Rakoff, *supra* note 41 at 1245.

<sup>150</sup> *Ibid.* at 1246.

“1) The deepest issues raised by the use of contracts of adhesion are the potential infringement on the freedom of adhering parties and the possible need to maintain the social independence of drafting parties.

2) The danger of upholding the authoritarian relationship between the drafting party and the adherent is a danger different in kind from the risk that the terms of the transaction, overall, represent an unfair exchange of values, and is less likely to be cured by competition. Indeed, there is a very real possibility that the drafting parties will attempt to capitalize on any legal toleration of form contracting. Terms that greatly exacerbate the authoritarian nature of the relationship have little claim to enforcement.

3) The law can provide terms alternative to those appearing on the form. The drafting party’s standardized terms are not demonstrably better than the law’s and cannot be justified by arguments based on presumed consumer preference manifested in the marketplace. The parallel legally implied terms provide an appropriate reference point for judging the quality of the form terms.

4) A drafting party’s terms may represent a sound judgment about how the risks and responsibilities of a trade or line of endeavour ought to best to be apportioned. Given the dynamics both of drafting and of using form contracts, however, there is no reason to think this will routinely be true. It is better to treat whatever expert judgment is embedded in form terms as possible evidence of what the legally implied terms should be, rather than as an independent basis for enforcement of the documents.

5) That nonenforcement will cost the drafting party money is not a positive ground for enforcing form terms. Firms can compensate for such costs by increasing the price term, which is also the term most accessible to the adherent. If, however, the ability to specify particular form terms (or form terms in particular circumstances) can be shown to contribute substantially, in ways not readily compensable in money, to maintaining organizations as independent social actors, a cognizable claim to enforcement will have been made.

6) The drafter’s work product may deviate substantially from the practice of the drafting organization. A drafting party can hardly claim that it will lose its independence if it cannot enjoy legal rights more protective than its ordinary commercial practice of the organization may well be in order.

7) Whatever value organizational independence has is a general consideration that goes to the structure of society as a whole. To uphold that value, it is not necessary to legitimate form terms of a particular drafting party that are substantially less

favourable to the adherent than are the practices of other comparable organizations. A comparison of the form document with general trade practice may therefore also appropriate.”<sup>151</sup>

### **2.2.3. New doctrine’s development**

#### A. The Regular Concerns

The first question arising here is whether the present analysis is sufficiently developed to create law, in the practical meaning. Is it possible to implement a framework for decision through legal institutions, such as courts, without harm? Rakoff tries to show that, both substantive and procedural tasks imposed by the new approach are not more difficult than those which are currently acceptable. The second question is concerning to the results adopted by the generated law. How are such results compared with the current adopted propositions and its stipulated consequences? It is known that contracts of adhesion cover a wide range of economic life, for that trying to identify all the possible results is almost an impossible job. Rakoff studied, instead, “several typical, widely adjudicated fact patterns” to show that actual consequences are better understood in this sense, than in courts expressed rationales.

##### 1) *The Basic Classification*

In any given case, the legal matters arising must be previously classified. In this present situation should the facts be included in the contracts of adhesion category? The analysis bottom line here is the presence or absence of the seven aspects that all together define the model situation. Since actual cases rarely correspond to postulated ideal-types, the appropriate conduct to have in marginal cases is an extensive reflection of the whole social practice. This is not different from the categorization that already takes place in other fields of law.

The present law has a problem of categorization for the fact that it considers the contract of adhesion as a separate legal issue. Yet, the analysis of cases treated according to this approach will be considerably larger than the one recognised in the doctrinal lines, which emerge from incorrect and restrictive understanding of the matter. For instance, contrary to many judicial propositions, the suggested analysis demonstrates that finding “gross inequality of bargaining power” should not be understood as a requisite to prove the existence of a contract of adhesion.

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<sup>151</sup> *Ibid.* at 1248.

In other words, “the practice of standard form contracting is not based on the exercise of pre-existing market power”<sup>152</sup>.

The issue is actually whether one party is capable of drafting form contracts and use them in a way that configures the dynamic here studied. The test, as Rakoff realized is “the presence of the correlative social roles of drafting party and adherent as we have been using those terms”.

## 2) *Separation between Visible and Invisible Terms*

This study revealed that only some of the terms included in a contract of adhesion are seen as undesirable. For that reason, a distinction between terms that are typically harmless and terms that normally are abusive (even in a competitive market) must be done. The validity of the first set of terms can be treated according to the “ordinary rules of contract law”; the validity of the latter can be treated according to the principle that such terms should not be enforced without positive reasoning.

Rakoff says that, the visible and invisible terms must be separated. The visible terms are the ones that are bargained, while the invisible terms are all the rest. It is not a correct reasoning to consider that the terms offered in a take-or-leave-it basis are the invisible ones. The visible terms also include the ones shopped by a large amount of adherents. Being so, the visible terms of a standard form contract are normally those that set up the entire explicit contents of a simple ordinary contract, being the price term the paradigmatic example.

Yet, the task of distinguishing both types of terms is not easy. Even though the bargained terms are not difficult to identify in a concrete case, identifying the shopped ones is much harder. Here there is no question if the adherent effectively shopped such terms or not, for the fact that, only when adherents generally read, understand and shop for alternative terms do the dangers associated with invisible terms vanish. For that, courts should look at the adherents’ practices as a class<sup>153</sup>. It may seem a hard task, but the common law standards concerning social practices show the exactly opposite. There is not such thing as “reasonable men”, “reasonable reliance” or “reasonable disclosure”. Actually, the traditional rules applicable to form contracts are subordinated on such knowledge. Developing and applying “a customary shopper” standard is a problem that must have a legal resolution. The current ordinary practice must be appreciated, not according to courtroom evidence, but according to what is expected to be a

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<sup>152</sup> *Ibid.* at 1249. See also, *Henriouille v. Marin Ventures, Inc.*, 20 Cal. 3d 512, 518, 573 P. ed 465, 468, 143 Cal. Rptr. 247, 250 (1978); *Jones v. Dressel*, 40 Colo. App. 459, 462, 582 P. 2d 1057, 1059 (1978).

<sup>153</sup> Restatement (Second) of Contracts § 211 (1) (1979)

“reasonable practice”. The answer is in everyday experience. While unusual facts can be seen as evidence, there isn’t no fear of oversimplified or intensive categorization. The problem may appear in situations in which shopping practices are quickly shifting, maybe due to advertising. The main aim of proving that terms is invisible is to make such term more probable to be binding.

The “customary shopper” is dependent on the type of market in which it is included. For instance, when adherents are businesses it is more likely that more terms will be visible. We may think that doctrines of adhesion are just for consumers, but the present law does not state that only consumers, and never businesses can benefit from the new doctrines that temper the traditional rules<sup>154</sup>. There are opinions that relief should be denied to commercial adherents, different from the broad principle. Instead, they consider that the adherent “was represented by a person likely to be knowledgeable about what types of documents used or the problems likely to arise, or that the deal was sufficiently large to make it worthwhile for the adhering party to become knowledgeable concerning the particular clause at issue”<sup>155</sup>. Therefore, commercial parties with greater expertise, and more interested in individual deals, can be expected to shop or bargain more terms.

According to the “customary shopper” notion, it is a normal adherents’ behaviour to shop only some of the terms of an expected transaction. This is contrary to the imposition of the “duty to read”. Sometimes, in order to show that a term is adhesive, it’s proved that no other drafting party in a similar industry offers a more favourable corresponding term. The aim is to show what would occur if the adherent had shopped for a better deal. In the case, the term is considered unreasonable to shop, the doctrine imposes on the adherent, hypothetical consequences of what would have been unreasonable behaviour. This only makes sense if we assume that the use of contracts of adhesion creates problems simply when connected with an independent distortion of the marketplace.

By the same token, courts make a mistake when they treat a contract mainly constituted of form terms as they would treat a negotiated deal, just for the fact that one of the terms was haggled. The presence of a single negotiated term, normally a visible one such as price, indicates that the drafting party does not own crushing economic power. On the contrary, the institutional process makes it probable and rational that shopping or bargaining in respect to little terms of the deal will coincide with the imposition of invisible terms for the rest of the

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<sup>154</sup> Examples of businesses treated as adherents: *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264 (E.D. Mich. 1976), *Weaver V. American Oil Co.*, 257 Ind. 458, 276 N. E. 2d 144 (1971), *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W. 2d 169 (Iowa 1975).

<sup>155</sup> Rakoff, *supra* note 41 at 1253.

transaction.

Thus, the division into visible and invisible form terms is possible. Such partition is valuable because it gives to the law a better correspondence with the institutional origins of form contracting than do the “monopoly power” or “superior bargaining power” doctrines.

### 3) *Selection of the Transaction Type*

Even though there might be some difficulties in specifying the limits between visible and invisible terms in certain situations, this consideration does not undermine the basic division. However, there is one case which is important to address. For economic purposes and judicial process needs, the items needed to fill the set of visible terms must be gathered in more or less integral packages. To identify few packages would be inappropriate to the many lines of trade in which contracts of adhesion are used. To identify many packages leads to the problem of which one should be employed in a particular case. Llewellyn had knowledge of this issue, but tried to soften it by comprising “the broad type of transaction” as one situation where actual assent was given. It would be more precise, in many markets, to consider the selection as one on the edge between visible and invisible. As Rakoff realized “shoppers often do not think in terms of legal categories of any subtlety, and the drafter’s stipulation of a legally defined transaction type will be, in a strict sense, an invisible term. But the core substance of the legal type may be very near the boundary of visibility”<sup>156</sup>.

Actually, it seems possible to have “legally stipulated rules of preference” to the several alternative transaction types. An illustration of this is presented by the Article 2 of the Uniform Commercial Code, which specifies as a bottom line that sales of goods are presumed to be sales for payment on tender of delivery<sup>157</sup>. These are essential as “filler terms”.

If the drafting party’s choice of transaction type is visible, that choice must be justified. This because, due to the level of generality, both options may be fair or reasonable. The risk lies in the more specific terms used to fill the chosen type. This will turn out to be easier to courts. Being so, judges can make a detailed comparison of the drafter’s terms with the legally implied features of a certain type, with no need of reconstructing the entire relationship. However, due to the huge number of lines of business, this will produce similar problems of application even in a sophisticated scheme. In case they apply such scheme generally, the businesses would tend to reduce their initiative to create new lines of business or new practices

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<sup>156</sup> *Ibid.* at 1256.

<sup>157</sup> U. C. C. § 2-511 (1977).

for already existing deals.

Equally, if the transaction chosen is within the borderline area, business firms should be allowed to decide what broad type of business they intent to prosecute, though this line of though doesn't explain deference to the drafter's specifications of the details by which the type is to be concretized.

Given this points, Rakoff concludes that "the proper standards governing the selection of transaction type are not far different in structure from the present law concerning contracts of adhesion generally"<sup>158</sup>.

#### 4) *The Judge's preparation the Invisible Terms.*

The major part of terms stipulated by the drafting party will be invisible, thus unenforceable according to this analysis. In such cases, background law should be applied. Yet, the courts cannot evaluate that a term should be upheld, without considering how the case would be without the form clause. That is, before judging invisible terms, the background law and its concrete application to the case must be known. It will be a legal system's routine task to build the implied term applicable to a precise situation of a specific type of transaction. The constructing materials for this would be case law principles, statutory and administrative sources, and adequate custom and practice. As Rakoff wrote "in many situations, the basic outline of the implied term already exists in the law, either in the form of a generally applicable norm or as a term routinely added to simple negotiated transactions of a given type"<sup>159</sup>. In such circumstances, the only necessity is to apply the rule to the concrete situations, putting aside the presence of a form term on point. In fact, the form terms already come decoded and in accordance with certain transactions.

The continuous reference to the background law, might lead one to think that this will increase the possibility of litigation, both to the judiciary and the parties, which probably won't be valuable. Deciding based on the presumption of validity of form terms seems the best choice, in order to save review into precedent, or resorting to trade usage and commercial concrete situations. Additionally, it seems easier to proceed the rule of enforceability of a form than applying the rule of law. If so, the present proposal will intensify the resort to trial. These protests just make sense if contrasted with the strict application of the Willistonian rule concerning standard form contracts. The present law has moved from this approach already.

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<sup>158</sup> Rakoff, *supra* note 41 at 1258.

<sup>159</sup> *Ibid.*

Thus, the existing law has the tendency to apply alleviating doctrines into a large number of cases. Yet, the additional burden seems minimal. For instance, when the unconscionability doctrine is applied, it already considers the commercial practice and the legally relevant context, in accordance with the general approach required by the Uniform Commercial Code, in issues of its domain. In this respect, Rakoff said, “similarly, the courts can hardly hope to determine whether a form term is “very unfair” without having at least some idea of what result background law would stipulate”<sup>160</sup>.

The suggested method would change the actual practice in two ways. In the first place, if determining the legally implied term was necessary to assess the drafter’s work, and not as piece of the alleviating doctrine, the burden of proof on issues such as commercial usage would naturally move to the drafting party. In second place, judges would have to accurately determinate the background rule at stake and its application to facts, more than is required under the actual practice. This would meant that further investigation into unusual commercial practices and usages is needed, because this matter hasn’t yet been fully explored. Nevertheless, the judges can always resort to mechanisms used in case of insufficient information: they can decide a case based on the record presented, and they can decide by applying burdens of production or persuasion.

The proposed regime lacks practical meaning of change. The real effect, said Rakoff, “would be to convert issues than now must be raised by the adherent – and that are thus often not raised – into issues to be pressed by the drafting party, the side more likely to have the necessary resources and incentives”<sup>161</sup>. Also, if in the presence of a more coherently body of law, the people’s incentive to litigate would reduce. The present system seems to efficiently discourage litigation and also fails in its promise to ease the worst features of contracts of adhesion. Such efficiency only emerges due to the adherents’ failure to state their legitimate legal strifes.

In the case the background law reaches the same result the form term does shall render its decision based on the legally implied rule only and treat the form terms as irrelevant. Exclusive trust in the background law has two symbolic purposes: first, the enforcement of an invisible term, even when explained, signifies the approval on imposing terms on the adherents. In case the rules provided by governmental authority reach the same result, such approval shouldn’t be considered. Second, the approach followed in litigated cases becomes the

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<sup>160</sup> *Ibid.* at 1259.

<sup>161</sup> *Ibid.* at 1260.



foundation on which many cases will be abandoned, settled, or mediated. In Rakoff's words, "the judicial nod of the drafting party's "freedom of contract" is not harmless, even if nothing in the case turns on it"<sup>162</sup>. The existing law abounds with general statements supporting form draftsman, which seem to be overstated.

If the form term is different from the legally implied term in a way that would change the result of the case, then it is possible that the decision rests only on the background law. The rules of law sometimes are beyond reach, even in the most bargained contract. Grossly negligent behaviour is one these, for instance<sup>163</sup>. When someone tries to circumvent such norms they are considered "void as against public policy". Currently, an example of such cases is the "due-on-sale" clauses in mortgages void as unreasonable restraints on alienation.

According to Rakoff, the use of contracts of adhesion embodies a different social institution "not adequately encapsulated by the difference between "public" and "private" contract"<sup>164</sup>, and we must surpass these normally applicable concepts. This is, in case a certain background rule may fluctuate from a dickered term does not indicate that it can be changed by a form. Therefore, it is not enough to evaluate solely the degree of importance of the substantive rule in comparison to the strength of negotiated agreement. The contracts of adhesion freedom issue must also be addressed.

### B. *Rule on the Invisible Terms*

In order to produce accurate judgements concerning some classes of invisible terms, Rakoff applied his principles of decision to usual fact patterns. He starts by stating that his analysis developed "a general proposition that invisible terms should be presumed unenforceable"<sup>165</sup>, and that if one wants to enforce them, it must justify it properly.

For his test Rakoff chosen three sets of problems which are quite common in the case law, and that raise issues concerning to the form contracting practice.

#### 1) *Controlling the Institution*

The reason to enforce contracts of adhesion is not a matter of general right, instead it concerns the achievement of particular social purposes. But, if the law accepts any imposition on adherents by drafting parties, the firms will be tempted to impose even further. They do so with the intention of gaining more power over the adherents, power that may be valuable, even

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<sup>162</sup> *Ibid.*

<sup>163</sup> Restatement (First) of Contracts § 575 (1932); Restatement (Second) of Contracts § 195 (1981).

<sup>164</sup> Rakoff, *supra* note 41 at 1261.

<sup>165</sup> *Ibid.* at 1262.

commercially. This power may go beyond the rights contained in the terms. Explaining the degree of authoritarianism implicit to the use of contracts of adhesion is not an easy task. It's not permissible to admit the use of such clauses to terrify adherents. If the legal system wants to enforce such clauses, it must control the abuses of the practice. Hence, courts should not support terms which aim to increase the power of the drafting party. However, overcoming the problems is not impossible. In an analogous situation, concerning bargained-out contracts, the courts considered themselves competent to separate legitimate commercial aims from "in terrorem" ones when splitting liquidated damages clauses and penalty clauses<sup>166</sup>. This became an easier task due to the availability of background rules of law to set up the bottom line for consideration of legitimate purposes. The same analysis can be used within the suggested framework. Actually, this view is more persuasive than the existing doctrine, thus showing the yearning to protect adherents, visible through many settled cases. The *Williams v. Walker-Thomas Furniture Co.*, a case concerning the analysis of a cross-collateral clause, is a good example of such practice. In a time-purchase contract for ordinary household goods, the draftsman provided that any payment would be protected against all outstanding accounts. According to Judge Wright, the effect of such provision was to "keep the balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated"<sup>167</sup>.

However, the court upheld the written document. The appellate court returned the case, to understand if this matter was resolved through the unconscionability though, adding that the clause had the possibility of being unfair, and thus recommended an investigation into the commercial practice for purposes of fairness determination. Another important effect was the fact that the seller could follow the purchaser steps. Equally, cases which laid down clauses in gas-station franchise-and-lease agreements allowing lessor oil companies to terminate at will or on very short notice are seen as obstacles to the use of termination menaces with the single intention of disciplining leases.

So, as Rakoff wrote "any contractual option given to one party is in some sense a weapon that can be invoked against the other. When such powers are stipulated in form clauses solely or predominantly for their values as weapons, however, they ought not to be enforced"<sup>168</sup>.

Besides that, there are form terms drafted only for ordinary commercial purposes. For instance, the class of terms that prevents adherents the resort to courts. The reason for enforcing such clauses is that these clauses serve an important commercial purpose, such as making the

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<sup>166</sup> See e.g., *Priebe & Sons v. United States*, 332 U.S. 407, 413 (1947).

<sup>167</sup> *Supra* note 41 at 1263. See *Walker-Thomas*, 350 F. 2d at 447.

<sup>168</sup> *Ibid.* at 1964.

debt collection cheaper, which would otherwise make the cost credit to increase. This is not merely a question of helping the drafting parties making money, if so, this purposed could be served by enhancing the visible price term. Also, onerous terms aren't justified because of the consumer preference for lower prices, since the institutional dynamic doesn't explain why adherents concentrate exclusively on the visible terms. Then the question arising is whether legal institutions are capable of processing a huge number of small disputes. This, raises questions more easily handled by official authorities than by form draftsman. In Rakoff's words, "whatever their commercial utility when bargained for, and regardless of how often they appear in negotiated contracts, clauses that limit or burden the recourse adherents may have to legal remedies are nothing less oppressive when imposed as a part of a contract of adhesion"<sup>169</sup>. There is a huge body of case law distinguishing clauses of this kind in negotiated commercial agreements from formally identical terms contained in contracts of adhesion. The former was upheld, but the latter didn't.

The same problems are raised by arbitration clauses in form contracts, although they seem an attractive method of resolving small commercial disputes. This clauses not only designate the form of proceeding but also the arbitral body as well. According to Rakoff, "unlike commercial arbitration between members in the same trade, in which knowledgeable panels may well be deemed fair by both sides, the lack of obvious common interests or shared trade practices between firms and consumers makes it very difficult to develop appropriate tribunals for their disputes"<sup>170</sup>. The more visible effect is, actually, the adherents' barring to courts. Judges are starting to abandon the presumption of enforceability while searching for a more adherent protective doctrine. If the law follows this path, maybe is more advisable to the consumer to resort to judicial judgment. The courts noticed this problem and several recent cases held that arbitration clauses, when contained in contracts of adhesion, should be held unenforceable<sup>171</sup>.

Therefore, terms that may be though as enforceable if included in negotiated agreements, should not be given the same reasoning if included in a contract of adhesion. This because they just intensify the authoritarian relationship implied in the use of such contracts. Some case law reaches these results, while other keeps tied to the existing doctrinal formulations.

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<sup>169</sup> *Ibid.*

<sup>170</sup> *Ibid.* at 1265.

<sup>171</sup> See e.g., *Wheeler v. St. Joseph Hosp.*, 63 Cal App. 3d 345, 133 Cal Rprt. 775 (1976); *Board of Educ. v. W. Harley Miller, Inc.*, 236 S. E. 2d 439, 447 (W. Va. 1977)

## 2) *Measuring the relevance of Organizational Structure*

It is already known that the use of contracts of adhesion helps the firm's organizational structure to develop. This is due to their capability to: "reduce the effort required to organize internal hierarchy and maintain communications among divisions; (to) minimize the need to delegate authority; to control subordinates' use of any authority that is delegated"<sup>172</sup>. Although the enforcement of form contracts promotes the strength of some forms of organizational hierarchy, that is not enough to justify the level of imposition on adherents that enforcement involves. Indeed, there is no reason to believe that any particular organizational pattern will lead to "a gain in efficiency for society as a whole once the effects on all parties are considered"<sup>173</sup>. Also, the instrumental value of firms in providing alternative place for social initiative and power does not depend on the preservation of any particular organizational form<sup>174</sup>.

Some might say that is important to reserve to the firms some power to determine their own structure, but that also is not sufficient to impose the costs of maintain such structure on a non-member of the firm who can do anything more than adhere to its specified transactions. This point of view is well illustrated by the courts' use of the "doctrine of reasonable expectations" in cases regarding "conditional binding receipts issued by salesman of life and disability insurance". In these transactions, the proposed insured fills an insurance application, gives to the agent a check which covers the initial premium, and receives a receipt.

This receipt establishes that no coverage, even if only temporary, will be in force until some conditions are met. Then, when all the conditions are met insurance will be provided effective as of the date of the application and initial payment. Here, the agent may tell the applicant to make a medical examination, but he can also say nothing. He may also tell the applicant that temporary binding insurance is from the time of initial payment. Normally, these applications (or receipts) generally claim that no agent is allowed to vary the terms of the printed documents. The problem arises when the applicant dies before one of the conditions precedent to coverage has happened, and thus, the condition doesn't occur and the company rejects any responsibility. Courts haven't yet reached a consensus concerning this outcome. In one side, there is considerable authority for demanding fulfilment of all the conditions, even in the case an agent states that coverage will be in force after the payment of the first premium, at least, if

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<sup>172</sup> Rakoff, *supra* note 41 at 1266.

<sup>173</sup> *Ibid.*

<sup>174</sup> *Ibid.*

the receipt states clearly that the agent has no power to vary its terms. These cases follow the traditional reasoning of form contracts. Rakoff's view on this is that "the doctrinal formulation used by at least some of these courts reveals that they are rather consciously upholding the efforts of insurance companies to protect the hierarchical structure of their sales organizations, for the courts also state that oral representations by someone sufficiently high in the company's organization to be a "general agent" rather than a mere "soliciting agent" (a salesman) will take effect despite the parol evidence rule or broad form statements limiting authority"<sup>175</sup>

On the other side, two recent suitcases have requested the insurance company to handle the financial results of its scheme of organization. These courts stated that a temporary insurance policy is shaped simply by acceptance of the first premium payment. If the insurance company wants to evade this outcome, it must not only plainly draft a receipt stating the conditions precedent, but also, its agents must notify the applicant of the conditions in clear language. The argument used in both cases was that the applicant has a "reasonable expectation" that insurance is immediately in force after the payment of the premium. Here there is no "duty to read" documents, and certainly, the use of complex policy provisions presses applicants to trust on the agent's oral representations. In the case the salesman rests silent about the issue, the court's reasoning is that the insured's expectations will make him to misinterpret the meaning of the receipt. Under the proposed analysis, both cases reached the desired result. This kind of insurance contract are, without a doubt, contracts of adhesion. This conditions which companies normally rely on are evidently invisible terms.

Rakoff poses the following problem: "when an applicant has, without fraud, satisfied an agent that he is likely to be an insurable risk, and he has paid the initial premium on a policy that is ultimately to be dated from the date of application, how should the law – not the draftsman – allocate the risk that he will die before the insurance company completes its investigation of the application? In fashioning the applicable background rule, the court should of course consider what the applicant might reasonably expect; but just as relevant is the courts' own sense of what is fair"<sup>176</sup>. Accordingly, the proposition that "the public has the right to expect that they will receive something of comparable value in return for the premium paid"<sup>177</sup> seems an appropriate one. Another possible argument is one that states that performances which start immediately are better, or other that asserts that is not normal to attempt to prove that a

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<sup>175</sup> *Ibid.* at 1268.

<sup>176</sup> *Ibid.* at 1269.

<sup>177</sup> *Collister v. Nationwide Life Ins. Co.*, 479 Pa. 579, 594, 388 A. 2d 1354, 1353 (1978).

dead man would have been found insurable if his death had not been known<sup>178</sup> - this examples may be seen as judicial sense of what is right. In this type of transaction, the legally implied terms should state that the applicant has acquired a temporary contract of insurance that will be in force until the company reaches a concrete decision, or it accepts or it rejects the policy. But, is there any basist to substitute the form terms for the legally implied ones? If the firm is allowed to protect its hierarchical structure, at the adhering party cost, then the law should require the firm to plainly states the coverage conditions on its form documents whereas is free of any obligation to control its salesman's representations. This is the view embraced by the courts that sustain a written conditional receipt as long as it states that agents have no power to vary its terms. However, that is not yet a justification for sustaining the enforceability of invisible terms, in order to maintain the firm's chosen organizational structure. However, this argument is not a good one, for the fact that if the company wanted to protect itself, it could do it through price raise. In case an agent misrepresent the firm, is the company that should borne the consequences, not the insured individuals. Even if they merely remain silent, the form conditions should not be applied, because there isn't any basic presumption in favour of using legally implied terms. This cases support the idea that the written terms only should be enforced if agents properly disclose "the highly conditional nature of the temporary coverage". Thus, this cases' conclusion alters the relationship between insurance companies and their agents. If firms want to their terms to stick, they must discipline their agents. If they don't want to have such responsibility they can accept the consequent liabilities or stop writing such insurance altogether. These seem proper approaches, contrary to the more traditional ones which permitted companies to shift the costs of discipline to adherents.

This trend was generally adopted by courts in rather different contexts. The best example of such movement is the line of cases developed under the section 20(II) of the Interstate Commerce Act. The referred section provided that "interstate carriers subject to the Act were generally liable for full actual loss, damage, or injury to property transported, notwithstanding any attempt to limit liability"<sup>179</sup>. However, "it excepted traffic for which the carrier maintained approved tariffs providing for rates dependent upon the value declared in writing by the shipper or agreed upon in writing as the released value of the property, in which case such declaration or agreement shall...limit liability"<sup>180</sup>. That is, the statute provided a background rule and also "freedom of contract", because it allowed varying the rule by

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<sup>178</sup> See *Allen v. Metropolitan Life Ins. Co.*, 44 N.J. 294, 300, 208 A. 2d 638, 645 (1965).

<sup>179</sup> Rakoff, *supra* note 41 at 1272.

<sup>180</sup> *Id.*, *see also* 49 U.S.C. § 20(II) (1976).

agreement. Then, in 1920, the Supreme Court stated that the value would be considered to have been “declared in writing by the shipper or agreed upon in writing and the statutory prerequisite for limiting the carrier’s liability would thus be satisfied, if the carrier handed the shipper a receipt stating the valuation on which the rates were based and advising the shipper of the opportunity to declare, and pay for, a higher value”<sup>181</sup>. In other words, the burden of avoiding form terms, thus by choosing the statutory choice, befell on the adherent. This is just one example of the contracts of adhesion problems. In this respect Rakoff wrote: “The dynamics of contracting by standard form – the desire of organizations to deal with standard risks, the desire not to have sales agents making variant contracts, explaining form terms, or valuing goods, and perhaps the desire to compete primarily by price – lead the drafting party to stipulate a low price alternative. When damage occurs, is the shipper to be held to this limit? Or will the legal system refuse to let the carrier rely on an invisible term that stipulates a rule contrary to one established by statute?”<sup>182</sup> The traditional approach to standard forms, coupled with the exchange equality belief, was employed by the 1920’s law which upheld the form term. Some modern cases follow the same path<sup>183</sup>.

Nonetheless, the most recent settled cases deviate from the traditional analysis in three considerable ways: 1) “situations in which the shipper either knew of and exercised the available choice or was such an experienced shipper that it ought reasonably to have known”<sup>184</sup>. In this case, courts normally decide according to the traditional law, thus enforcing the shipper’s choice, not automatically but rather through the demonstration that the form term was visible; 2) “courts presented with a document that the shipper signed without inserting any special valuation nevertheless hold the carrier responsible for assurances made by its agent that were contrary to the form terms, and find for the shipper for true amount of the loss”<sup>185</sup>. Here the courts substantiated their decision on declarations that did not contain enough fraud or misrepresentation to invalidate or vary any signed contract below traditional doctrines; 3) “the carrier cannot merely recite in a form document the existence of choice and direct its agents to be silent, but rather bears an affirmative obligation (if it wishes to limit its liability) to have its agents explain to the shipper the alternatives involved”<sup>186</sup>.

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<sup>181</sup> *Ibid*

<sup>182</sup> *Ibid.* at 1273.

<sup>183</sup> See e.g., *Rocky Ford Moving Vans, Inc v. United States*, 501 F. 2d 1369 (8<sup>th</sup> Cir. 1974); *Foremost Ins. Co. v. National Trailer Convoy, Inc.*, 370 So 2d 1258 (La. Ct. App. 1979).

<sup>184</sup> Rakoff, *supra* note 41 at 1273.

<sup>185</sup> *Ibid.* at 1274.

<sup>186</sup> *Ibid.*

This cases may be compared to the ones involving binding receipts issued by insurance agents if one identifies that the doctrine of “reasonable expectations” applicable to insurance cases, is only one path of asserting the conflict between the law’s terms and the drafter’s.

However, the modern law under section 20(II) is not justifiable only through the statutory provision that “the shipper will receive less than full protection only if an agreed-upon writing limits liability”<sup>187</sup>. The same statute has been in force since courts widely recognised the efficacy of signed forms. This case show, in effect, that there is another attitude concerning the responsibility of an organization for its agents’ representations and silences. This change is much more sensible to issues regarding the authoritarian power of adhesive forms, and is much more averse to the fact that form terms are a substitute for internal organizational disciplines

### *3) The Influence on the Commercial Practice*

The use of standard form contracts is connected, normally, with the drafter’s tendency to write terms which are more favourable to the business than its own practice. Thus, the firm attains the discretion to follow or disregard its practice in any given circumstance. If the dispute goes to trial, the result is the adherent begging for relief whose cost is none. The division between contractual terms and actual practice was litigated directly in respect to disclosure provisions of the Truth in Lending Act not yet rewritten as they would after. This act demanded that some creditors included in their visible disclosure statements “the default, delinquency, or similar charges payable in the event of late payments”<sup>188</sup>. Cases discussed in numerous courts posed the question whether, under this language, “the creditor had to list its right to demand accelerated payment of the principal upon a debtor’s default and the method by which interest would be computed in case of such acceleration”<sup>189</sup>. The Board’s staff interpreted the governing law not to demand disclosure of any acceleration right per se, and also not to demand disclosure of any policy concerning applicable finance charges, except when such policy varied from the one used with respect to voluntary prepayment (mandatorily disclosed).

Once the same issue reached the Supreme Court in *Ford Motor Credit Co. v. Milhollin*<sup>190</sup>, the court upheld the agency’s view. Thus, under the agency’s interpretation, the creditor must include in the disclosure statement only its actual policy concerning to finance

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<sup>187</sup> *Ibid.*

<sup>188</sup> 15 U. S. C. §§ 1638 (a) (7) (1976) (amended 1980).

<sup>189</sup> Rakoff, *supra* note 41 at 1275. See also, e.g., *Croysdale v. Franklin Sav. Ass’n*, 601 F. 2d 1340 (7<sup>th</sup> Cir. 1979); *Milhollin v. Ford Motor Credit Co.*, 588 F. 2d 753 (9<sup>th</sup> Cir. 1978), *rev’d*, 444 U.S. 555 (1980).

<sup>190</sup> 444 U. S. 555 (1980).



charges as it was a different specification from the full extent of rights granted on the contract signed by the debtor. Here, the courts of appeal didn't reach a consensus. However, the Supreme Court upheld the agency's position again. The Court's reasoning was that "if the creditor genuinely changed its policy after the transaction had been entered, the creditor might well be entitled to enforce the previously unexercised, and therefore, not "disclosed" rights lurking in the contract". In the *Milhollin* case, the court expressly assumes that debtors will read and understand at most the disclosure statement, which implicitly suggests that the contract terms will be invisible. This proposition seems contrary to the enterprise's practice since it states that invisible terms that diverge from the disclosed policies may also be enforceable. Here, not only the invisible terms were diverting from the creditor's practice, but also the adherent was explicitly invited to trust on such practice. But this is not the discussion's central point. Thus, according to Rakoff, the central point is that "the domination implicit in the use of adhesive terms is not counterbalanced by any plausible claim that the substance of the form term is necessary for enterprise independence; the enterprises own practice negates that claim"<sup>191</sup>. Actually, the only relevant claim possible to make here is the power to free its practices from legal challenge, power which cannot be established, because it's a consequence of the "evil we want to avoid"<sup>192</sup>

Equally important is the presence of form terms correspondent to firm's practice, particularly when such firm's practice is consistent with the general trade practice too. As Rakoff stated "the courts have the power to adopt and enforce rules of law contrary both to customary practice and to form terms embodying that practice. Both the source of the uniformity of practice and strength of the contrary social policy are relevant to such decisions", then he adds, "what is less obvious, but also true, is that the existence of uniform trade practice can provide a valid reason to sustain related form terms, because in some circumstances rejection of the terms would present a serious threat to enterprise independence"<sup>193</sup>.

This situation often happens in adjudication. Here, it's the legal system's duty to judge after the fact whether to accept the already-established trade practices, contained in the form clauses. The influence of trade custom at the time of judicial decision-making is well illustrated in cases regarding whether mortgages must pay interest on escrow payments made to cover upcoming taxes, associated to mortgaged property. The banks' practice of demanding advanced payment of taxes started at the time of 1930s default and its commercial aim was to escape the

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<sup>191</sup> Rakoff, *supra* note 41 at 1277.

<sup>192</sup> *Ibid.*

<sup>193</sup> *Ibid.* at 1278. See e.g., *Henningsen v. Bloomfield Motors, Inc.*, 32 N. J. 358, 161 A. 2d 69 (1960)

accumulation of liens against the property which would be previous to the mortgagee's. The mortgage mechanism usually requires monthly payments to cover taxes, but remains silent about the issue of compensation for funds' use. It is a standard bank practice since 1930 to recollect the profits earned on the float between the mortgagor's payment and the tax collector's bill. For this, many mortgagors filled up a judicial process to recover interest on profit. Courts frequently decided that drafter's silence had the purpose of letting the bank avoid payment. Other courts were of the opinion that the desired result was it to be a contract of adhesion invisible term. Yet, most decisions denied the mortgagor's claim<sup>194</sup>. Concerning this issue, Justice Braucher in the *Carpenter v. Suffolk Franklin Savings Bank*<sup>195</sup> wrote:

No doubt the contracts between the plaintiffs and the bank were "adhesion" contracts, but we are not prepared to hold that they are unconscionable in the aspects here in issue. Customers who adhere to standardized contractual terms ordinarily "understand that they assenting to the terms not read or not understood, subject to such limitations as the law may impose"... the enrichment of the bank may have been unjust in some sense. Apparently, the Legislature thought so when it enacted G. L. c. 183 § 61... [Prospectively requiring interest payments on sums held in escrow under residential mortgages]. But most of the unjust enrichment, if any, enriched the bank's depositors at the time. The plaintiffs do not suggest that those depositors should now disgorge their excess returns. Thus a judgement of restitution would ultimately result in a transfer of funds from present and future depositors to compensate for excess payments to past depositors. Doubtless for this reason the Legislature enacted its reform with an effective date over two years after enactment. We do not think we should go further in disrupting legitimate expectations than the Legislature was willing to go.<sup>196</sup>

In other words, this argument states that even in the case standard terms are "not read or not understood", the invisible terms of a contract of adhesion are presumed enforceable and that if an adherent wants to avoid the contract, it must show that the terms are "unconscionable". Also, it states that even if the term apparently makes the contract unjust in some way, it must be sufficiently unfair to meet the applicable test. If this eventually settled the issue, the similar terms would be viable for the future and for the past. But concerning this even Justice Braucher seems to identify this framework as inappropriate, and lacking. He explains his decision on other grounds arising from the retroactive imposition of burdens.

The *Carpenter* case, instead, achieves the proper outcome. Here, the matter of retroactivity was analysed as the core problem. When considering a contract of adhesion, the invisible term must be in accordance with a certain background term, properly determined for such end. In one side, advanced payments in the course of a normal bargain wouldn't require the recipient to pay interest. In the other side, the escrow payments' purpose is to create a fund

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<sup>194</sup> See, *Gibson v. First Fed. Sav. & Loan Ass'n*, 504 F. 2d 826 (6<sup>th</sup> Circ. 1974); *Umdenstock v. American Mortgage & Inv. Co.*, 495 F. 2d 589 (10<sup>th</sup> Circ. 1974); *Brooks v. Valley Nat'l Bank*, 113 Ariz. 169, 548 P.2d 1166 (1976).

<sup>195</sup> 370 Mass. 314, 346 N.E. 2d pp. 892 (1976).

<sup>196</sup> *Id.* pp. 326-27, 346 N. E. 2d pp. 900.

for payment over third party which aim is protecting the bank's collateral. According to Justice Braucher, the Massachusetts' background rule implied an obligation to pay, because he understands it to treat the legislative enactment which requires interest to be paid in the future as a measure of background norm's maintenance, not as something opposed to it. Being so, the form term conflicts with the background rule.

Nevertheless, the drafting party can attempt to demonstrate the prevalence of the document. The background rule, thought opposite to the form document, could not be perceived as such, because there wasn't yet concrete legislation on the question. Similarly the consideration of policy was not a basis for this result. As Rakoff stated "the industry's determination of what was proper, although wrong, was not reasonable"<sup>197</sup>. In fact, the form term was in accordance with the bank's practice and the bank's industry. If any wide rule always sustained a draftsman's product while the background rule was ambiguous, such rule must not be upheld. In circumstances where the draftsman's determination was not seen as unreasonable, and the adopted term was in accordance with the whole line of trade practice, more conclusions should be drawn. It is possible to demand that the establishment of a new industry, or a new practice should not be done until legal rules governing its conduct had been set by a governmental authority. But that would harm the separate intermediate organizations' support. According to Rakoff "if enterprises are to go forward as independent sources of social practice, they will have to invent new solutions to legal problems... if firms are to establish new practices, some legal force must be accorded to the very fact of that establishment"<sup>198</sup>.

When a form term is not in accordance with the practice of the drafting party, so that only one argument to enforce the term is stated, the term should not be given deference. Also, if the drafting party's practice is much more severe compared to other firms in the same situation, deference is not justified. However, if the form term document represents the organization and trade practice, consideration for the transactions already placed must be given. Thus, Rakoff realized that "when new legislation administrative rulemaking, or even prospective announcement of judge-made law is at issue, the general rule for invisible terms incorporating trade practice should not differ from the general rule for invisible terms as a whole. Trade practice should be adopted whenever it is sufficiently sound to be enforced as background rule, but not otherwise"<sup>199</sup>. In Rakoff's opinion, his framework is adequate to

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<sup>197</sup> Rakoff, *supra* note 41 at 1281

<sup>198</sup> *Ibid.* at 1281-82.

<sup>199</sup> *Ibid.* at 1282.

address this problem. It can be used both to sustain the nonenforcement of form terms and to establish appropriate, limited grounds for enforcement.

#### **2.2.4. Rakoff's Conclusion**

Contract law is a social interaction system. It is based on wide generalizations about how social elements act and react with each other, and how institutional forces govern such relations. The circumstances in which contracts of adhesion are used is disconnected with the ordinary contract law generalizations, thus not properly defining how the parties are situated. For this, there is a call for a new legal structure, an entirely new body of law. In order to do so, an analysis of thought with experience must be done. The three types of situations discussed in this article do not consume all the contracts of adhesion case law. Also, not all the possible outcomes are predictable yet. Rakoff wrote, “The need for that reconstruction, based on an open recognition that contracts of adhesion represent a different social practice from “ordinary contracts”<sup>200</sup>, is the essential point”. For that, it is the judges and legislatures’ duty to create this new legal structure. They must not be afraid of leaving the ordinary contracts bonds, once and for all.

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<sup>200</sup> *Ibid.* at 1284.

### **2.3. W. David Slawson**

Professor David Slawson is a highly recognized scholar whose aim was to discover all the accuracies of contracts of adhesion, particularly its new method of contracting. Slawson wrote many articles on this matter, the most remarkable ones were the “Standard Form Contract and Democratic Control of Lawmaking Power” and “The new meaning of contracts: the transformation of contracts law by standard forms”. He is also one of the co-founders of the doctrine of “reasonable expectations”.

In 1971, Slawson wrote an article concerning Standard forms and Democratic Control of Lawmaking Power. Here, he started from the premise that “all contracting is law making”<sup>201</sup>. Yet, firstly he introduced the problem in a very practical way. In his opinion, the standard form contracts are predominant in all mundane transactions, for instance, all individuals have, at least, once in their life (and once is an exception) contracted this way. The contracting method envisioned by earlier scholars, as an individual participation of both parties in an agreement, is now only a historical mark. Actually, the standard form contracts impose privately made law that respects the major part of law to which we are bound. This lawmaking means the imposition of officially enforceable duties or the creation or restriction of officially enforceable rights.

As Slawson phrased it “the predominance of standard form terms is the best evidence of their necessity. They are characteristic of a mass production society and an integral part of it. They provide information and enforce order”<sup>202</sup>. A good example are the automobile insurance policies, which inform the policy holder how to behave in case of accidents or other such events. Services such as insurance are vital to our life, that is why there is some reason to make them available at a reasonable cost. In order to do so, they must be standardized and mass-produced like other goods and services in a business economy. The order could be settled by drafted rules (laws in the traditional sense) even because our society seems better organized, if some lawmaking power is decentralized. Therefore, the inclination is to let the economy be ruled by private parties, and its translation is private control through standard form.

According to Slawson, if there is a huge amount of law made through standard form contract, at least it should be made in a democratic manner, that is, the agreement must respect both parties wills. The contract in the traditional sense is democratic because it respects both parties agreement. Unlike these contracts, the standard form contracts are not democratic. They are not democratic even because most of the times, the consumer doesn’t read the form, or if

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<sup>201</sup> Slawson, *supra* note 1 at 530.

<sup>202</sup> *Ibid.*

he reads, it does it after being bound to its terms. The few that read it, are not sufficiently powerful to vary its terms. In Slawson's words "the form may be a part of an offer which the consumer has no reasonable alternative but to accept"<sup>203</sup>. This overpowering standard forms have a nefarious effect in our economy. The major consequence of mass production and mass merchandising is making all consumer forms standard. This economic effect allied with our present law has the tendency of making all standard forms unfair. It is preferable to sell a standard form than a nonstandard one, because the latter is normally "just as expensive to make and sell as a nonstandard tangible product". For this reason, sellers prefer not to offer nonstandard products or to demand a higher price for them. If this nonstandard negotiation were to take place, the buyer would have to pay expensive lawyer fees and also the seller's extra costs. Moreover, the practice of negotiating a nonstandard contract could be attained more easily and less expensively in other ways, even if there were some benefits given by the seller.

Another important aspect of the use of such forms is to achieve economies of mass production and mass merchandising. If their use is under the present system, the most probable outcome is that these forms are unfair. If they are not, someone is likely to be losing money. An unfair form has not the effect of detaining sales, because the seller is always free to arrange his prices. The law also is not a threat for this unfair forms. A user of an unfair form also isn't much of a threat because the terms, normally unfair, are the ones providing protection for contingencies that probably won't occur. And in the event such contingency happens, the consumer is not in a position to compare the form he submitted with other forms, and if he does, he'll see that most of them are "similar". As Slawson writes "an unfair form thus normally constitutes a costless benefit which a seller refuses at his peril. If he fails to take advantage of it, his competitors will. Competitive pressures have worked so long and so thoroughly to make standard forms unfair that we no longer even notice the unfairness"<sup>204</sup>.

Attempting to make the law of contract fair and legitimate through the insistence that a standard form to be enforceable must also be an uncoerced and informed agreement, is idealistic. It is impossible, in our modern life, to require that each time we contract, we do it in a complicated way, through minor agreements. Instead, we are presented with standardized contracts given by tolerated monopolies, in which the power of contract is the power of one party to impose whatever terms he likes on the other.

Similarly, it would be idealistic to give courts competence and power to rewrite standard

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<sup>203</sup> *Ibid.*

<sup>204</sup> *Ibid.* at 531.

form contracts. Such a scenario would lead to the undoing of standard forms, because courts would have wide discretion to alter terms of the contract and this would harm the already achieved order by imposing central and inflexible control.

The answer, according to Slawson, is to create a “set of legal principles which reconcile the interests of the issuers in setting such terms as they wish on an agreement and of the consumer in having his reasonable expectations fulfilled”<sup>205</sup>. Slawson believes that an “administrative law of contracts” is the path to follow. The contracting parties no longer believe in the private law solution made to govern them. In such a situation all the terms would be known. That’s not the case anymore. Nowadays contracting parties agree to some part of the contract, normally a tiny one, and the remaining features are left to the seller to decide. So, they delegate power to the seller to decide their “not-viewed terms”<sup>206</sup>. Thus, Administrative law view is an attempt to maintain the unilateral or “delegated” cases of agency lawmaking consistent with the legislative purpose, made in the public interest.

### **2.3.1. Controlling the Lawmaking Power**

#### A) Standard’s control

The Courts have a twofold role in the lawmaking process. They can make law themselves or review law made by others. The method to do so is according to standards. The law must be in accordance with standards. This standards respect to other laws of the jurisdiction, essentially the ones of upper rank, the so-called “authoritative standards”. There also are “non-authoritative standards” which are reasons, principles or considerations without legal authority within the jurisdiction, but that possess more generality than the reviewed law, and which follow the public interest.

For instance, a court follows an authoritative standard when it rules in accordance with the decisions of a higher court of its jurisdiction. On the contrary, a Court follows a non-authoritative standard when it chooses to refer to decisions of courts of equal or lower rank or of other jurisdictions. It is a normal process to resort to applicable authoritative standards to resolve disputes. It may also resort to non-authoritative standards, when the law was not made democratically. For example, it is not a requirement to justify statutes by reference to non-authoritative standards, in the same manner that is not required to the parties of a contract to

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<sup>205</sup> *Ibid.* at 532.

<sup>206</sup> This would be Rakoff’s invisible terms.

justify their contract by reference to non-authoritative standards, this due to the fact that the contracting process is democratic. The contract terms are consented and thus binding only to the contracting parties.

The requirement of having a rule in conformity with non-authoritative standards will improve the law and will make it democratic regardless of its nondemocratic roots. One of the court's functions while reviewing is to determine whether such standards are in the public interest, even because they must be so. Besides, conforming law to standards has not only the purpose of showing that the law is democratic and in the public interest, it is also to make it so. It makes the law democratic, because it subjects the law to democratic control. Thus, conforming a law to standards increases its susceptibility to change, for the fact that standards are usually much simpler than the laws which are made to follow to them.

The standards' conformity also eases control, because such standards are made in accordance with factors which we consider pertinent. They also may serve as warning for future events, because even if one instance of agency lawmaking only affects some, the most general standards may justify more than one instance, thus many similar instances which will affect a large number of persons.

This conformity to standards is normally enforced, in the case it is enforced, by judicial review, which is the perfect test to assure that such standards will be truthful and precise.

## B) Private consent

The consent of the parties is what gives legitimacy to the privately made law, which controls our society. The lawmaking power is delegated to private individuals by the laws of contract such as collective bargaining, incorporation, partnership or private association. Some courts would perceive such lawmaking as unconstitutional, since it is not supposed to delegate such power in private parties at all. Justifying that privately made laws are subject to democratic control is not sufficient. Hence, the Supreme Court decided that the Section 3 of the National Industrial Recovery Act was unconstitutional because it delegated to privates the power to draft by themselves "codes of fair competition", which weren't substantially checked by any public authority, even though they would be void if they weren't democratically adopted and enforced<sup>207</sup>.

Another important problem may arise when a law is democratically enacted by one

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<sup>207</sup> *Schechter v. United States*, 295 U.S. 495, 522-23 (1935).



group that affects other groups who weren't able to participate in its making. Here too, there must be a justification by reference to standards. The same reasoning applies to statutes, as Slawson wrote:

A corporation is deemed to have consented to the laws of the state of its incorporation to the same extent as if it were a voting citizen, but the laws of other states can affect its activities only insofar as, among other things, they comply with the standards of the Interstate Commerce Clause<sup>208</sup>.

### C) Conformance of Private Lawmaking to Standards

When the lawmaking is consensual there aren't any serious effects. The problem is when such lawmaking is not consensual. If one is subjected to private laws which he has not consented, there must be some kind of protection, that probably only judicial review can offer. The problem is that, while private law-making is not recognized as official law making, judicial review can do nothing about it. If one private person makes law for another without his consent - for instance through a standard form, which the major part of people doesn't even read - it should be subjected to judicial review by the same authority that held its enforcement.

In Slawson's opinion there might be two types of recipients of form contracts. In the first type, the recipient of the standard form has, in some way, manifested its consent to the related transaction. Of course, some of the terms are unknown by the customer, but others are known. That is sufficient to consider that the recipient has consented to some parts of the contract, which are considered to be the authoritative standard to which the other parts of the contract must in conformance with. There might be also authoritative standards from the public law. Yet, just as in Administrative Law, conformity with appropriate standards "would not be a part of the enforcing party's prima facie case"<sup>209</sup> The second type refers to recipients which agreement is adhesive, that is, coerced to the extent that it no longer expresses its consent. In this case, the recipient's agreement has no legitimacy to the standard form, and the form, if it is to stay, must be in conformity with the applicable authoritative standards in public law (if there is any) and also in conformity with non-authoritative standards in the public interest.

The situation seems similar, however, between the two types, however there is a big difference which is that "the authoritative standard consisting of the recipient's *non-adhesive* manifested agreement is lacking"<sup>210</sup>.

Sometimes, only some parts of the agreement are adhesive, for that reason Slawson

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<sup>208</sup> Slawson, *supra* note 1 at 537. See e. g., *Crutcher v. Kentucky*, 141 U. S. 47 (1891).

<sup>209</sup> *Ibid.* at 539.

<sup>210</sup> *Ibid.*

writes that the second type of treatment should be given to those, whereas the non-adhesive parts should be treated by the first type.

### **2.3.2. Standard's Form Consensual Lawmaking**

A) A description of contract that meets the requests of democratic consent

Slawson starts by stating that the enforcement of a standard form lies on the presumption that it is a contract. He wrote:

Since a contract is in theory the agreement of the parties to it, and since an agreement which is uncoerced expresses the consent of each person making it, the assumption upon which standard forms are commonly enforced carries with the conclusion that the law of which they consist is legitimate.<sup>211</sup>

The Courts have given little importance to how these consents are attained. Yet, many standards forms which no one reasonably reads or understands are commonly treated as contracts. For instance, there are some contracts placing “warranties” on packaged consumer items inside the box, where they won’t be seen by the consumer until he opens the box at his house. Here, the consent doesn’t seem too democratic.

If the necessary consent is obtained through this means, it cannot be said that a standard form is a contract. In Slawson’s view “since the recipient is ignorant of its terms or even its existence until after he has consummated the transaction, it cannot possibly be the manifestation of its consent, and if we were to condition its contractual status upon a later manifestation of whether, and to what extent, it conformed to his manifested consent, we would end with a law of contract which defined standard forms as partly contracts and partially not”<sup>212</sup>.

The best path may be to follow the administrative law, which in this case would be more practical. In administrative law, the only expressions of legislature are named “statutes” and if they do not clash with constitutional law (the highest authoritative standards) they are unquestionably enforced. The remaining documents, such as rules, regulations or rulings are named as something else, and are enforced only in the case they are in accordance to the applicable statutes or other standards.

Thus, if the administrative language was applicable to contracts it would be a sort of

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<sup>211</sup> *Ibid.* at 539.

<sup>212</sup> *Ibid.* at 541.

“manifestation or statute of a private legislature made up by parties, which would include in its terms, expressed or implied, a delegation of power to one or both of them to make more subordinate law”<sup>213</sup>. If so, contract law would meet the democratic consent requirement by means of the parties’ manifestation of mutual assent to one another.

The consensual theory of contract clearly does not demand “actual subjective consent” to make a contract binding. It is not sufficient for the parties to act either verbally or non-verbally in order to give each other the reasonable expectation that they understand the meaning which both tend to manifest. And there is always the possibility that one of them gives an unintended manifestation which ultimately will lead to unwarranted contracts. Because all of us have unmanifested thoughts. As Slawson stated “this position rests upon the assumption that the sole legitimate basis for the law of contract is the parties’ consent, but the position would be no different if any other reasonable basis were adopted instead”<sup>214</sup>.

Similarly, contractual liability is based on the reliance of the promisee on a promise, the so-called promissory estoppel. This means that if one wants to enforce a promise on the grounds that he relied on it, he must prove that his reliance was reasonable, which is to say that the promisor made the promise upon which he relied. Thus, he cannot enforce more than what he promised, or in other words, to what he manifested his consent.

#### *B) Are Standard Forms contracts?*

Slawson’s conclusion on this is that standard forms aren’t contracts. As he wrote “they cannot reasonably be regarded as the manifested consent of their recipient because an issuer could not reasonably expect that a recipient would read and understand them”<sup>215</sup>. It cannot be said that reasonable expectations are determined by what the form states, instead it is the way how the transaction is conducted that matters, therefore the seller has no grounds for “asserting that he relied to his detriment on manifestations of mutual assent”<sup>216</sup>. The situation here is that the seller has no interest in his forms being fully read, even because if he wanted, he could bring the adverse terms of his forms to consumer’s attention by the same manner in which he advertises his product’s desirable characteristics.

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<sup>213</sup> *Ibid.* at 542.

<sup>214</sup> *Ibid.* at 543.

<sup>215</sup> *Ibid.* at 544.

<sup>216</sup> *Ibid.*

### C) Identifying the contract

The contract, in this context, *is* the standard form itself. There might be cases where a transaction involves one or two forms, but even so, is only lightly more complicated. The form received by the recipient is then the contract, and the other must be in accordance with the standard it establishes. Automobile sales practices make for a good illustration. First they have a shorter order form describing the kinds and amounts insured, which is the contract, and then they have the insurance policy itself, which is only delivered after accepted. These are two separate forms where only one is a contract.

Another good example that might help to determine the content of the contract is the law of sales. In this case, normally the contractual terms impose no obligations on the purchaser other than the payment. They only confer rights or assume or deny liabilities, subject to conditions. Slawson gave the example of the airline ticket: “[it] confers the right to ride a particular airline to a particular destination at a particular time, subject to the holder’s appearing at the airport sufficiently in advance of departure time. The purchaser does not promise to appear at the airport or to take that or any other airplane. All the promises except the promise to pay emanate from the issuer of the form”<sup>217</sup>. Nowadays consumers do not contract, instead they “buy promises” as they buy products. The price of the product is therefore the only consideration for the promise.

Standard form contracts generally have attached to them an implied warranty of fitness for intended purpose, which serves the function of the original contract, implied from the conduct of both parties, to which the standard form must be in accordance with, if valid. In the case a form “is not subject to such implied warranty, it must be a part of the contract and thus itself an expression of what the recipient can reasonably expect”<sup>218</sup>.

### C) Economic benefits

If the suggestions given by Slawson were applied, competition among forms would be more in the consumers’ interest. If some sellers’ forms were censured due to their failure to find a sanction in a buyer’s actual or implied agreement, sellers would be obliged to show the adverse parts of their forms. Being so, buyers would have enough information to make a proper

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<sup>217</sup> *Ibid.* at 546.

<sup>218</sup> *Ibid.* at 547.

selection of forms, according to their advantages. Thus, sellers would feel the competitive pressure to make the forms in the consumers' interest. Competition reaches even the warranties, since warranties are one of the features to which the buyer pays more attention. As Slawson stated "if only a few consumers out of every hundred used their newly gained understanding of the differences among competing forms as a basis for choice, the effect would be sufficient to force issuers to improve their forms at all... since forms are standardized, a change intended to benefit the few who discriminated between forms would work to the benefit of all"<sup>219</sup>.

### **2.3.3. Contracts of Adhesion**

#### **A) Coercion and Consent**

According to Slawson "a contract which one party makes because he is coerced in this "total" sense is what we shall mean by a contract of adhesion"<sup>220</sup>. The presence of a standard form does not imply that the contract is adhesive in the same manner that its absence does not mean that the contract is not adhesive. If we look through the democratic theory of contract perspective, it seems to be no reason to enforce contracts of adhesion. The private law legitimacy of contract is obtained over the consent and manifestation of the parties' agreement. If these are coerced, they cannot be considered consent. Thus, since the standards of the supposed contract are coerced, hence invalid, "the legitimacy of the transaction must be judged by other standards"<sup>221</sup>. Such standards might be available in statutes or in the common law or they may be provided, subject to endorsement by a court, by the creator of the private law himself.

So, in order to deny the enforcement of a contract because it is adhesive, a judgment of both parties must be made. There might be situations where one of the parties has no option but entering the contract, in this case, this party must prove that he had no reasonable choice, thus resisting to the contract's enforcement. On the contrary, the other party wants to hold the enforcement because he illegitimately constricted the options of the first party. The Common Law path shows that generally this judgment is done separately, except when there is the necessity of both being together. For instance, in early cases concerning contractual responsibility, the party looking for excuse had to show that the other party subjected him to "duress", which normally just applies to conducts of violence or of threat of violence. In

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<sup>219</sup> *Ibid.* at 548-48.

<sup>220</sup> *Ibid.* at 549.

<sup>221</sup> *Ibid.* at 550.

contrast, the most recent cases<sup>222</sup> highlight the loss of options by the party avoiding enforcement, but they fail to note that this loss would not excuse contractual liability if it were accompanied by standards that define legitimacy.

Another extreme perspective is the one that considers contracts of adhesion as non-representative of the exercise of legitimate power because they do not fulfil the characteristic purpose of contract law. Maybe, but is also true that this contracts provide more flexibility and individual fit than any other social ordering, since any individual person can participate in the creation of rules that ultimately will govern himself, by negotiation, compromise and bargain. Moreover, in the same way that is capable of flexibility and fitting, it is also capable of properly organizing the functioning of a corporation, thus another beneficial end of standardization. In fact, standardized contracts maintain the cost of writing, performing and enforcing them within tolerable limits.

Equally important is the fact that some contracts because containing standard terms (which are not dickered) are seen as contracts of adhesion. The act of bargaining, thus negotiating, is the one from which derives the legitimacy. Accordingly, if a contract has standard terms and dickered terms, it only should be given enforcement to the last. As we know, dickering is not easy nowadays. And this difficulty comes from the seller's lack of authority to bargain its terms. Even in the past, it was not a requisite to dicker to close a contract.

Another extreme position is the one that considers that courts should never refuse enforcement on the sole grounds of adhesion, unless there is a statute stating so. The flaw here is that "never refuse" is too much. Even if there was a statute, there would always be situations where courts would have to refuse enforcement. As Slawson realized "a person who possesses the power to impose adhesive contracts on another possesses the power to make the law for him without his consent. Neither a legislature nor a court can constitutionally allow that power to exist in private hands except when appropriate safeguards are present, including a right to judicial review"<sup>223</sup>.

## B) Principles of Adhesion appliance

There might be some means through which private law-making becomes legitimate. Most of the contracts made currently are contracts of adhesion, and fortunately they are

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<sup>222</sup> See e.g., *Thompson Crane & Trucking Co. v. Eyman*

<sup>223</sup> Slawson, *supra* note 1 at 553.

considered legitimate and thus enforced. Otherwise it would be very difficult to maintain the order. These contracts commonly appear in competitive markets, which balance supply and demand at a “market price”, “below which no buyer can hope to buy and above which no seller can hope to sell”<sup>224</sup>. If one is in need of an essential good which is commercialized through adhesive terms, he has no reasonable choice but to buy it, and if he does, he has no other choice than accepting its price, and the other terms established by the market. Therefore, if there aren’t any external influences affecting the market, its lawmaking is legitimate. According to Slawson “society has decided through its legitimate democratic processes that it wants those prices and terms imposed because theory teaches that they tend toward an optimum allocation of resources and are an incentive to efficacy. This decision serves as a standard of legitimacy, and since the contract is within this standard, it is legitimate and should be enforced”<sup>225</sup>.

However, in contracts which public utilities with legal monopolies need to provide their services such legitimacy shouldn’t be so easy. In this situation, if a user cannot do without the service, any contract he enters is a contract of adhesion. Here, the enforcement should be dependent on the existence of legitimate exercise of the lawmaking power in the contract or in a particular term involved. The imposition of conditions or rules in the contract are effectively regulations which were imposed by the utility as if it were an administrative agency. These rules or conditions should meet the utilities’ legal authority standards, being them express or implied.

There are many monopolistic entities, privately owned or operated organizations, which use contracts of adhesion, such as unions, professional organizations, private schools and clubs. In the event that these organizations are not democratic, it seems plausible that judicially created standards should be applied to them. Since members of these organizations may not have chosen to enter or aren’t capable of structuring the organization in their best needs, this organization will only operate legitimately if its activities are in conformity with broader standards created to work the public interest.

However, if the organization is an adhesive, democratically operated one, the relationship with its members is more complex. Here, we assume that the member had no reasonable choice but to join, and that his participation in the democratic governance of the organization is the only foundation for asserting that he individually consented to its rules. Issues raised by the possible inequality between members are solved by corporation law, labour law and the law of professional organizations and private associations. The model adopted by

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<sup>224</sup> *Ibid.* at 554.

<sup>225</sup> *Ibid.*

each of them is a constitutional democratic government, containing a combination of majority rule and individual rights. The application of the model is not dependent on the organizations' features. It is not required for these organizations to be "quasi-public" or even an arm of the state, to be fully protected by the constitution. Rather, they concentrate on their members' characterization as being adhesive. But, as Slawson realized "since the individual as not consented to his treatment by joining or remaining in the organization, the law of the organization as applied to him as no legitimate basis other than its possible justification through his opportunity for democratic participation or its conformance to judicially acceptable standards"<sup>226</sup>.

Thus, it is a well-established common law principle that "a contract cannot be imposed upon a person against his will by an offer which purports to make his failure to do something he would not ordinarily do into a manifestation of his acceptance"<sup>227</sup>. For instance, a person cannot be bound to a contract for the simple fact that it requires that unless he replies to a letter, he will become a member. Of course he can fail to reply and still not become a member. People give importance to not being bothered in the pursuit for contractual activity. Yet, there are many situations in which someone might advantage of this to impose additional insignificant terms, which may be onerous.

People didn't stop going to theatres for the fact that a signing behind the ticket means exclusion of liability for injury from fire, riot, or building defect. These kind of contracts may be called "contracts of imposition" and should be perceived as partially adhesive and enforced only to the extent that their adhesive terms can show to be in conformity with the public interest standards.

### C) Adhesion Principles to Administered Industries – Complementing the Antitrust Laws

One of the most important contexts to acknowledge the potential application of principles of adhesion is the private unregulated industry. Generally, terms for sale are set by competition or regulation whereas others are "administered". These administered terms either conform to no standards at all or only to standards that lack the implicit approval of the public. In fact, the industry may establish its own standards, which aren't publically controlled. There isn't any evidence of public approval of such standards or of how they shall be in the first place.

The judicial review of industrially administered terms has not been simple for Courts.

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<sup>226</sup> *Ibid.* at 555.

<sup>227</sup> *Ibid.* See also Restatement of Contracts §§ 72-75 (1932). This statement of principle is by Justice Holmes in *Hobbes v. Massasoit Whip Co.*, 158 Mass. 194, 197, 33 N.E. 495, 495 (1893).



Many cases, such as the *United States v. Trenton Potteries Co.* or the *United States v. Socony-Vacuum Oil Co.* showed that the members of industry conspired with each other, in order to set prices. In such cases, the defendants argued that their conduct was not prohibited by the Sherman Antitrust Act, because the set prices were not “unfair” or “unreasonable”. The Supreme rejected this defence due to its incapability to review prices in day-to-day basis and also due to fact that antitrust laws state that prices should be set by competition, and not by “reasonability”.

It might be possible that Courts have some difficulty in administering prices on a day-to-day basis, but they are capable of reviewing terms of sale. Just as Slawson realized “there is no obvious reason... why a court is not competent to review the terms which an industry set for the warranties on its products, if the terms could be shown to have been set administratively”<sup>228</sup>. According to Slawson, “a court is usually competent to review administered terms, if three requirements are met: there must be available standards which the court can apply; the standards must be easily derived; and the standards must retain their relevance long enough to be usable”<sup>229</sup>. Thus, the existence of standards is needed because is the only way in which courts obtain legitimate power to make law in a democratic society.

The worst barriers to judicial review of prices come from the failure to meet the second and third conditions. For instance, the supply and demand standard exists even if there isn’t any “pure” market mechanism to enforce it, but “the time and effort that would be required to find, collect, and assess the market data necessary to compute a market price in the absence of a market mechanism that does it all automatically are usually too great for the standard to be usable”<sup>230</sup>. Different from these are the insurance coverage contracts that can easily be reviewed by the courts.

Therefore, the appropriate standards to review terms of an industry should be made in accordance with the purposes of that industry and its products or services. Again, this industry standards should serve the public interest as if its products or services were provided to achieve that goal. In Slawson’s opinion “the court would have to ask, in effect, what would a reasonable buyer under the circumstances have chosen to buy had he the range of choice which the industry-imposed adhesion had denied him?”<sup>231</sup>. Actually, these standards could turn into valuable analogies, as happens with standards restricting the contractual freedom of physicians,

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<sup>228</sup> Slawson, *supra* note 1 at 558.

<sup>229</sup> *Ibid.*

<sup>230</sup> *Ibid.* at 559.

<sup>231</sup> *Ibid.* at 560.

lawyers, accountants or other professionals. Indeed, business historic may be a rich basis for relevant standards.

The issue here is that industries should be subjected to some kind of control, being public or private, monopolistic or not because of the fact that they might limit the liberty of others by possessing lawmaking power that affects the public (which has no effective control). For instance, telephone companies, electric utilities and water companies, although privately owned, have been subjected to regulation. We should perceive that these principles should also apply to administered industries, without needing to convert them into public utilities, “since the industries can always avoid judicial control to the exact extent they choose to compete”<sup>232</sup>.

#### **2.3.4. Current Judicial Control of Contractual Lawmaking**

In Slawson opinion, if its principles were to be applied, that would mean that issuers would have to design contracts in the consumers’ interest if they wanted them to be enforceable. Of course, this does not mean that Courts, currently, enforce all standard forms. As matter of fact, the Uniform Commercial Code gives the courts power to ignore “unconscionable” terms contained in a contract. Even without any statute, courts frequently “construe” or disregard written contractual terms in order to reach a result which they believe equitable.

The *Ferguson* case was concerning an insurance policy for theft. Here, the insurance company tried to excuse its liability, but the Court held that the provisions exempting liability were contrary to the public policy of Kansas, and did not give effect to it. This case shows the uncertainty faced by authors of standard form contracts. On one side, courts try to enforce all terms contained in standard forms because they see them as contracts. However, in many situations, courts would have to invalidate or “construe” what they contemplate as an unfair term. And unfair terms keep popping up.

For the fact that, seemingly, all standard forms will be enforceable, issuers are stimulated to make their forms unfair. The judiciary hasn’t yet found manner to restrict the overreaching of issuers. Thus, the only methods available to protect recipients are the “unconscionability” and the “judicial construction”. However, such methods don’t seem too accurate. Judicial construction, for instance, has no regard to the words to be construed, and the construction is carried with no sense of reality. Courts weren’t there at the time of the contract.

They do not know if the recipient have read the contract (which probably he didn’t), and they construe terms in accordance with the context they think to be fair. Unconscionability, on

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<sup>232</sup> *Ibid.* at 561.

the other side, allows a court to depart from a claim where the wording of the form have dictated the result and expose the real grounds of decision, but these grounds haven't been yet properly defined, or at least, there isn't any correct guidance on it.

All this principles and methods are means to achieve the same ends. For that, terms which seem unfair and thus fail to conform to the contract or to the standards shown to be in the public interest should be refused enforcement. Whereas terms that show to be in conformity would not be regarded as unfair.

According to some commentators, the Subsection (2) of section 2-302 of the Code, adds some procedural protection, for the fact that is an additional "opportunity to present evidence". Yet, when the issue is unconscionability, much more must be borne in mind. When a court is presented with an unconscionability claim it should scrutinise the factors of assent, unfair surprise, notice, disparity of bargaining power and substantive unfairness. Because these factors might be unrelated, the best thing to do is to examine each one of them separately and according to its factual setting. By the same token, one harsh clause might overbalance with a huge number of other clauses that are generous. The recipient might not be aware that the contingency contained in the harsh clause is more likely to happen than any other generous clause. Because of this, a claim of unconscionability of any clause causes a consideration, and a factual full hearing on, all of them.

Slawson's opinion is that "if the principles derived here are to be treated separately from unconscionability, nothing they take into account should be taken into account for the same purpose again under the name of unconscionability. Unconscionability, therefore, should be concerned solely with the possible unenforceability of a writing against a party who had consented to it"<sup>233</sup>.

### **2.3.5. Slawson's Conclusion**

According to Slawson, contract law is one means by which a private law democratic system allied with a competitive economy achieves the consumers' interests, and thus, the public interest as a whole.

However, this contracts are made in a quite strange atmosphere and for that, some factors should be taken into account. These contracts are made at a speedy pace, becoming almost impossible to be aware of all terms. Also, normally they are promptly accepted because

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<sup>233</sup> *Ibid.* pp. 565.

one of the parties has not really an alternative other than accepting the terms the other party sets. It should then be perceived that a contract only includes those terms which a party is reasonable expected to understand. For that reason, fast contracts are simple, just like their contents, in order to be easily understood by the recipients or otherwise they won't be considered contracts at all. Forms which are not seen as contracts can nevertheless be enforced, if its terms are in conformity with the standards contained in the contract or if they are in accordance with judicially imposed public standards. Another important factor is that consent does not give any legitimacy to contracts of adhesion, since manifestations which are known to be the product of adhesion do not express consent.

Thus, contracts of adhesion achieve their legitimacy from the ability of justification by reference to the same public standards as are required to sustain those parts of every standard form which cannot be supported by reference to an actual contract.

Slawson tie up loose ends with the assertion that:

There being no private consent to support a contract of adhesion, its legitimacy rests entirely on its compliance with standards in the public interest. The individual who is subject to the obligations imposed by standard form thus gains the assurance that the rules to which he is subject have received his consent either directly or through their conforming to higher public laws and standards made and enforced by the public institutions that legitimately govern him.<sup>234</sup>

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<sup>234</sup> *Ibid.* at 566.

#### **2.4. Further considerations**

Kessler, Rakoff and Slawson had divergent points, but all of them perceived that contracts of adhesion are a public affair. They had the belief that someday, an entire body of law would be born to remedy the failures so far experienced.

Kessler, for instance, recognized that the concepts of contract law are not motionless, but emphasised the fact that people still look at law concepts as static. People still make that religious separation between the public and the private, without even thinking that today they mix. Regarding contract law, we still adopt the private perspective as if the contract relationship remained unchanged to this day, when in fact the opposite happens. The contract is no longer between two equal individuals instead it is one individual versus an institution: what Kessler called a “contract of adhesion”. However, people have the tendency to generalize. While contract law is largely seen as a private issue, the public law administration law is seen as purely public, since is the state’s duty to govern it. They do so, because it is socially acceptable and practicable to place people that are “equal” on one side, and institutions, in the other. However, everyone fails to recognize that private businesses are taking advantage of this widespread inertia. People cannot remain clawed to the traditional legal concepts just out of the fear of change. Change will be difficult but pleasurable. If people separate individuals and institutions and if the market is perceived as an institution, should it not be governed by public law, or at least controlled by it? The problem is that everything related to contracts remains in the private sphere, as if contracts were still made on an equal footing. They are not. More than that they are made in an unfair manner, so that firms obtain the maximum profit. Even more, they are made by informed people, namely lawyers, so that they will remain legally enforceable. Kessler was the only author that perceived the shift in the institutional power. The exchanges can no longer be held in reserve to individuals, they are now, mainly made through powerful economic organizations, that are at the level of the State. The contract is no longer a private issue, it is rather public and institutional. In this context, the *laissez-faire* doctrine just does not make sense anymore.

As well as it does not make sense to talk about freedom of contract, if it is purely a private right. In fact, is due to freedom of contract in the context of contracts of adhesion that many problems arise. This principle, that it is also a right, implies that people voluntarily accept their contractual obligations. In other words, they have consented to the contract. From this principle arises another principle called private autonomy, which, in this context, enables enterprises and businesses to draft their own contracts. Therefore Freedom of Contract implies

a double discourse. On the one hand,, it calls for “voluntary consent” of the parties, and on the other , it lets a powerful organization draft a contract that will be delivered to a person that only has to sign or agree to it to be bound to its terms. If the contract is already made without any negotiation, just the simple delivery of the form contract, how can “consent” be voluntarily given? Worst, how can a signature or a simple act of acceptance be perceived as consent, when consent implies negotiation? Freedom of Contract, as Kessler realized, should be balanced with the social importance of the type of contract. In this context, this freedom cannot be treated as if it were in the context of an ordinary contract, since it is visible that it is not fairly distributed to all members of the society. This was the reason why Kessler said that “freedom of contract enables enterprises to legislate in a substantially authoritarian manner without using the appearance of authoritarian forms”<sup>235</sup>. That, in other words means, making effective law, which is not subject to any “democratic control”. We should recall what Slawson argued, that most of the law’s production gains legitimacy through the parties consent while most standard forms do not. In the cases where such legitimacy does not exist they should not be even legal. To be supported, standard form contracts must pass through a judicial control and review as is typically done for other types of lawmaking “not directly validated by democratic process”. In other words, contracts of adhesion or standard form contracts, because they are not supervised or controlled, must be subject to some kind of control to ensure the consumer’s protection. Law is being made and applied to consumers without any sort of higher control. The contracts of adhesion fall totally neither within the private sphere nor within the public one. Their basis and foundations are private, but their lawmaking is public, because applied to many individuals.

Since they make law to individuals, in the same manner as the legislature does, they must be subject to public law scrutiny. The use of standard forms by organizations results in a high degree of authority for the same. If we let them continue to use them, this authority will increase even more. The democratic control is urgent. In Rakoff’s words, “if the legal system wants to enforce such clauses, it must control the abuses of the practice”<sup>236</sup>. According to Slawson, the best path to control a standardized contract is through standards applied within a administrative law of contracts framework. This framework would have two types of standards: the authoritative standards, according to the higher court of the jurisdiction; and non-authoritative standards, referring to “reasons, principles, or considerations possessing no legal authority within the jurisdiction but of greater generality than the law being reviewed and

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<sup>235</sup> Kessler, *supra* note 6 at 640

<sup>236</sup> Rakoff, *supra* note 41 at 1262.

serving to demonstrate that it is in the public interest”. Then, when confronted with unfair standard contracts judges could “identify, select and apply the correct standards for reviewing form terms in the same manner they use such standards to create common law”<sup>237</sup>. Slawson believes in giving some partial lawmaking power to the drafter, in the sense that is the adherent who delegates the power to fill the form terms to the drafting party. Being so, is the private parties’ duty to decide where the public interest lies, because this power was legally delegated to them. However, this solution seems way too general, lawmaking legitimacy is dependent on many factors. In Slawson’s words, “there being no private consent to support a contract of adhesion, its legitimacy rests entirely on its compliance with the standards in the public interest”<sup>238</sup>.

Another issue that Kessler refers is the monopolistic situation that might be enjoyed by the author of the contract, which years later was discredited by Rakoff. There seems to be no relation between the use of standard form contracts and businesses with monopoly power. Even small companies today use these contracts. These days, due to the development of the global economy, contracts of adhesion or standard form contracts are needed to keep the market going. They are needed in order to promote the market efficiency and, as some argue<sup>239</sup>, to lower costs to the consumer. Also, contracts of adhesion foster the development of the organizational structure of an economic organization, for the fact that they organize the internal hierarchy and minimize the need to delegate authority. However, this is not a plausible reason for the level of imposition on consumers that the enforcement involves.

But then, other questions come to mind. Why is the enforcement of form terms *prima facie* valid? Slawson accepts and upholds the idea that standard form contracts are presumably enforceable because lawmaking is socially better accepted if decentralized. In other words, the lawmaking power should be divided, and not totally condensed in the hands of the state. Rakoff, in the other side, is of the opinion that form terms contained in contracts of adhesion should be presumptively unenforceable. Rakoff focuses his analysis on the separation between contracts of adhesion and other type of ordinary contracts, and it seems the best option. Also, he separates the form terms in visible (normally the price term) and invisible (all the others). The visible terms are normally bargained whereas the invisible are not. However, setting the boundaries between visible and invisible is not an easy task. Promoting the nonenforceability

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<sup>237</sup> Slawson, *supra* note 1 at 558-60.

<sup>238</sup> *Ibid.* at 566.

<sup>239</sup> M. R. Patterson, “Standardization of Standard-Form Contracts: Competition and Contract Implications”, *Wm. & Mary L. Rev.*, 2010

of form terms may lead to an increase in litigation, both for the judiciary and the parties, because there will be a continuous reference to the background law. Conversely, deciding on the basis of enforceability seems the best choice in order to save review into precedent, or resort to trade usage. Also, it seems easier to keep the rule of enforceability of a form than applying the rule of law.

On the whole, the three authors agree that contracts of adhesion lack democratic control. They are used to achieve the highest outcome possible for the organizations, with no mercy for the consumers. They make law and they force us to accept it because there is no other way to resort other than the market itself. For the fact that contracts of adhesion are made to the public, but governed by private principles, at least in some extent they must be governed by public law. A hybrid between public and private law, would be a good option, since these contracts are, before being contracts of adhesion, public contracts. Why is private contracting the only accepted form of contracting? It is not fair, and not even viable. It is hard to admit but the fear of disturbing the social and economic “equilibrium” is bigger than the fear of losing social justice.





**CHAPTER III**

**THE AZIZ CASE**

**PUBLIC INTEREST OR PRIVATE CONSTITUTIONALIZATION?**

### **3.1. The Aziz Case**

The Aziz case is a good example of how the European Courts are dealing with contracts of adhesion. These contracts are regulated by the Directive 93/13/EEC, concerning unfair terms in consumer contracts and seem to be more consumer-protective than the Common Law regulation on the issue. In the EU the clauses are largely unenforceable against consumers, for example through the Directive “indicative list of unfair terms” that together with further EU developments tightened the “presumptive” unfairness. Also, there are cases where the terms are *per se* unfair, the ones contained in the “black list”. By contrast, the US jurisdiction considers contracts of adhesion “presumptively” enforceable. Thus, the US judges resort to the doctrine of unconscionability or to the doctrine of public interest to demonstrate that a contract is unfair, therefore, nonenforceable.

In Europe, the Aziz case was a major contribution towards the doctrine of public interest in contracts of adhesion. The Courts no longer look at this contractual relationship as if it were strictly private and equal. Instead, Courts prefer to treat the consumer as a weaker party in the transaction, and thus, giving it more protective measures. Moreover, it opened the door to the debate concerning the constitutionalization of private law.

The Aziz case dates back to 2011, and deals with the interpretation of the Directive 93/13/EEC concerning the validity of certain terms of a mortgage loan agreement entered by Mr. Aziz and Caixa d’Estalvis de Catalunya.

#### **3.1.1. The case**

On 19 July of 2007 Mr. Aziz signed a mortgage loan contract with Caixa D’ Estalvis Tarragona (currently Caixa D’Estalvis Catalan, Tarragona i Manresa, Catalunyaacaixa)<sup>240</sup>. The information sheet given by Caixa D’ Estalvis Tarragona was signed by the applicant Mr. Aziz and it specified that the property that would be subject to the mortgage loan was his family home, in which he had lived since 2003. Mr. Aziz was married and had other two family members living with him. He was a specialized worker in machinery, engineering and mechanics. He worked in the same company, as a permanent employee since 2006, and had a fixed monthly income of 1.341,67 Euros. Mr. Aziz was a Moroccan national who had continuously worked in Spain in various professions since December 1993. The lent capital

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240 ECJ, Case C-415/11, Mohamed Aziz [2013] ECR I-nyr.

was a total of 138.000 Euros. Its reimbursement had to be made in 33 years, through 396 monthly installments which began on 1 August 2007. The last installment was due on 31 July 2040. Each monthly installment, including the initial interest rate would be 701, 40 Euros.

In its clause 6, the loan agreement established an annual default interest of 18,75%, automatically actionable on unpaid amounts, without the need for any notice, or claim by the creditor. Besides that, clause 6 conferred on Catalunyaacaixa the right to demand the entirety of the loan in the event that any of the terms agreed expired without the debtor having fulfilled his obligation to pay part of the capital or interest on the loan. Lastly, in the clause 15 of that agreement concerning to the agreement on determination of the amount due, was stipulated that Catalunyaacaixa had the possibility to resort to foreclosure to collect the debt, but it could also directly submit an appropriate settlement to determine the amount claimed. Mr. Aziz frequently paid the monthly instalments from July 2007 to May 2008, but he ceased paying as of June 2008. Given this default, on 28 October 2008 Catalunyaacaixa went to a notary in order to obtain a certificate which determined the amount of debt owned by Mr. Aziz. The value of the debt was 139.764.76 Euros, a result of the unpaid monthly instalments, including contractual and default interest.

After an unsuccessful attempt to contact Mr. Aziz to pay, on 11 March 2009, Catalunyaacaixa brought an enforcement procedure against him before the Court of First Instance No. 5 in Martorell. The main claim was for 139.674,02 Euros, but it also claimed 90, 74 Euros for due interests and 41.902,21 Euros for other interests and costs. Mr. Aziz failed to appear, and on 15 December 2009, that Court ordered enforcement to the procedure which resulted in an order of execution issued by the Court on 15 December 2009. A demand for payment was also sent to Mr. Aziz, who did not respond or oppose the order. For that reason, a public auction was held on 20 July 2010 to proceed with the sale of the property. No bids were made. Consequently, in accordance with Article 698 of the Spanish Civil Procedure Law, the Court of First Instance no. 5 of Martorell required the sale of property at 50% of its real value. The Court indicated 20 January 2011 as the date on which the property transfer had to occur. As a result, Mr. Aziz was expelled from his house. However, shortly before this occurrence, on 11 January 2011, Mr. Aziz applied to the Juzgado de lo Mercantil No. 3 de Barcelona for a declaration seeking the annulment of clause 15 of the mortgage loan agreement, on the grounds that it was unfair. That would also mean that the enforcement proceedings would be annulled. This Court expressed some doubts concerning the conformity of Spanish Law with the legal framework established by the Directive. As a result, the Court stayed in the proceedings and referred to the ECJ the following questions for a preliminary ruling:

- 1) Whether the system of judicial decisions on mortgaged or pledged property pursuant to Article 695 et seq. of the Spanish Code of Civil Procedure, imposes limits regarding the consumer's grounds of objection, which involves, both formally and substantively, a clear obstacle to the consumer's exercise of rights of action or judicial remedies of such a kind which guarantees an effective protection of his rights, might be considered a clear restraint to the consumer's protection?<sup>241</sup>
  
- 2) How is to be understood the concept of disproportion with regard to:
  - a) The use of acceleration clauses in contracts lasting a considerable time – 33 years in this case– for incidents of default happening within a limited specific period;
  - b) The fixing of default interest rates – in this case superior to 18% - which are not consistent with the criteria for determining default interest in other consumer contracts (consumer credit), which, in other types of consumer contracts, might be considered as unfair, and which, in contracts relating to immovable property, are not subject to any clear legal limit, even where they are applied not only to the instalments that have already been required but also to the totality of those that have become required due to the result of the clause of acceleration;
  - c) The unilateral imposition by the lender of mechanisms for the calculation and determination of variable interest – both ordinary and default interest – which are connected to the possibility of mortgage enforcement and do not allow a debtor who is subject to enforcement to object to the quantification of the debt in the enforcement proceedings themselves but instead require him to resort to declaratory proceedings in which a final decision will not be given before enforcement has been completed or, at least, the debtor will have lost the property mortgaged or charged by way of guarantee – a matter of great relevance when the loan is sought for the purchase of a house and enforcement implies the eviction from the property?

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<sup>241</sup> According to the Spanish Constitutional Court the procedure laid down in article 698 of the Civil Procedure Code complies with article 24 of the Constitution, which establishes the right to the effective remedy.

### 3.1.2. The ECJ's new approach

In the Aziz case, the ECJ accompanied by the Advocate General, investigated three terms at the very center of Spanish mortgage contracts. The ECJ went far in its direction towards what is “correct” and “fair” in the interpretation of what is “disproportionate”. In fact, what the ECJ is doing is measuring and weighing the fairness of contract terms to a degree of detail which usually only is found at the level of national courts’ appeals.

#### A) Assessment of standard contract terms

The three contract terms presented by Caixabank have, in effect, reinforced its position: 1) through the acceleration clause – in case of default by the debtor in respect of just one of the total of 396 monthly payments, the borrowing bank may automatically call in the totality of the loan; 2) through the interest default clause – if the borrower fails to pay, without the need for a notice or reminder at all, he must pay default interests of 18,75% on the sum of capital due; 3) through unilateral determination of the amount owed - for the enforcement proceedings the lender may unilaterally determine the balance of the loan and can thus autonomously generate an important condition for the conduct of the simplified mortgage enforcement proceedings. The ECJ based on the arguments of the Advocate General in the assessment of the acceleration clause as well as of the default interest clause, but took a different view with regard to assessment of the unilateral determination.

Both Advocate General and the ECJ pointed out the significance of the obligation to pay instalments which then has to be balanced against reasons which prevented the consumer from performing properly as well as the procedural remedies provided under national law to redress the potential misconduct. The Advocate General and the ECJ only disagreed on the assessment of the acceleration clause. While the Advocate General makes a sharp reference under the requirement of good faith to the expectations of the consumer, the ECJ remained completely silent about it. Implicitly, both are aware that losing the home and having the risk to be evicted is a serious threat that cannot be so easily overcome by the single non-payment of a loan’s instalment.

As regards to the assessment of the default interest clause, the ECJ agrees with Advocate General in using point 1. e) of the indicative list<sup>242</sup> to interpret and understand the default

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<sup>242</sup> Annex to the UCTD.

interest clause, but both thoroughly investigate the purpose which “may be lawfully pursued by default interest under national law and whether it constitutes, for example, merely a flat-rate amount to cover damage caused by default or is also intended to encourage the parties to observe the agreement”<sup>243</sup>. The reference to national rules on default interests is not the only basis of the assessment, but might also be the limit to European consumer law. The Advocate General and the ECJ both recognize that the regulation of default interest depends of the national legal cultures. Yet, this is a rather bizarre reference in a market which is dominated by global standards and an ever stronger effort to create a European capital market. It is a way of defence for Member States who may feel tempted to camouflage a consumer unfriendly regulation of default interests by reference to the respective national legal culture. Unlike the Advocate General who limits herself to weighing the different interests involved, the ECJ applies the proportionality rule in private law relationships.

The reasoning behind the unilateral determination of the amount owed has a notable difference between the Advocate General and the ECJ. The Advocate General emphasises the key function of that clause for the enforcement proceedings. Without such a unilateral determination of the amount, Caixa bank would not be capable of initiating the mortgage enforcement proceedings, but would first have to go to court and ask for a determination of its claim. The difference is evident. If Caixa bank is capable of unilaterally determining the amount owed, it can count on a prompt enforcement procedure which cuts the borrower off from the any potential reference to the fairness of the standard form contract. If not so, the borrower may pose the fairness test before the Court which has to determine the amount owed. The ECJ, different from the Advocate General, and without mentioning to the Opinion, underlines point 1 q) from the UCTD Annex (preventing the consumer’s right to a legal remedy) as a point of reference. Thus, the reference to the national rules remains the cottier, just like the link of the term to the procedural consequences occurring from the separation between the declaratory and the enforcement proceedings do. However, the Advocate General does not vacillate to add guidance to a possible interpretation of the respective national legal rules and she is quite forthright of the criteria the national court must take in consideration in its final assessment.

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<sup>243</sup> Aziz Opinion, para 86.

## B) Veiled constitutionalization in *Aziz*?

The constitutionalization of European private law is one of the most studied subjects of private law. Normally, the thought is that private law constitutionalization permits for a “better” and more “just” solutions, for instance, to protect the weaker party, the worker, the migrant, the tenant, the private investor and the consumer<sup>244</sup>. *Mohamed Aziz* gives a new tier to the constitutionalization of private law debate. It is hidden because the advocate general and the ECJ do not even refer the Charter of Fundamental Rights, despite the fact that “the right of housing” is provided by Article 43 (3):

In order to combat social exclusion and poverty, the Union recognises and respects the right to social and housing assistance so as to ensure a decent existence for all those who lack sufficient resources, in accordance with the rules laid down by Union Law and national laws and practices.

In the event that Advocate General or the ECJ were to make a direct reference to it, Article 43 of the Charter would be seen as a principle, rather than a right, and if so, that would cause a discussion about social inclusion and poverty. Moreover, the ECJ would have to investigate the extent to which other fundamental rights could be used to give housing a profounder constitutional dimension. Legislation does not address this issue, even the new Mortgage Credit Directive does not mention Article 43 of the Charter.

Yet the fact of not referring Article 43 does not mean that both the Advocate General and the ECJ were not aware of the constitutional dimension behind this case. In fact, both Advocate General and the ECJ gave a constitutional dimension to their arguments. The closest to constitutional reasoning is contained in the Opinion of Advocate General, when she underlines the consequences of the interplay between contract law and national proceedings. The ECJ agrees and confirms this point, but enhances an even tougher constitutional element in stressing the whole purpose for which the credit has been granted: housing as the creation of a family’s home<sup>245</sup>. The reasons for such an undercover approach might be also found in the attitude of the Spanish Constitutional Court which had corroborate the constitutionality of the Spanish enforcement proceedings<sup>246</sup>. If the ECJ addressed the issue of constitutionalization in an open way, the contract terms in *Aziz* would have forced the ECJ to initiate a constitutional

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<sup>244</sup>Hugh Collins, *The Constitutionalization of European Private Law as a path to social justice?* In H. W. Micklitz, *The many faces of Social Justice in European Private Law*, 2011, 115, now Reic, *General Principles of EU Civil Law*, 2014, who identifies the protection of the weaker party as a general principle of European Civil Law.

<sup>245</sup>ECJ, Case C-415/11, *Mohamed Aziz* [2013] at 33.

<sup>246</sup>See the discussion of the Spanish background to *Aziz*, in Iglésias Sánchez, “Unfair terms in mortgage loans: A suitable way to protect housing in times of economic crisis? *Aziz v. Catalunya Caixa*”.



dialogue with the Spanish Constitutional Court. The fact is that ECJ is fully aware of the citizenship dimension of consumer rights as demonstrated in *Asbeek*, where it underlined the “essential needs” of the consumer/tenant to access housing<sup>247</sup>. The reason why ECJ refrained from openly addressing the constitutionalization was the risk of turning each and every private law conflict into a constitutional conflict. It is preferable to ECJ to keep its low profile, even if it is not satisfactory. It would be more convincing if the ECJ had clearly addressed the advantages and disadvantages, the possibilities and boundaries of the constitutionalization of private law.

### 3.1.3. The ECJ as supervisor of unfair terms

The adoption of the Directive 93/13/EEC on unfair terms in consumer contracts brought up the increasing importance of European private law. The ECJ was afraid to be considered the court of last resort to examine standard contract terms in Europe. For that reason, the ECJ created new avenues for consumer protection.

#### A) The procedural innovation – *ex officio doctrine and injunctive relief*

The ECJ created a new path and introduced a procedural remedy into the European Consumer Law. It created the *ex officio* obligation of the national judge to examine the legality of standard terms. The ECJ made a reference to some cases, such as *Pannon*<sup>248</sup>, *Asturcom*<sup>249</sup>, *Pénzügyi*<sup>250</sup>, *Photovost*<sup>251</sup>, *Invitel*<sup>252</sup>, *Banco Español de Crédito*<sup>253</sup>, *Banif*<sup>254</sup> and *Asbeek Brusse*<sup>255</sup> to confirm and develop more sophisticated criteria for this new procedural remedy. Until now, the ECJ had imposed an obligation on the national judge in an order for payment procedure (*Banco Español*<sup>256</sup>) and in *inter partes* proceedings where the consumer opposed to the order of payment (*Pénzügyi*<sup>257</sup>). In the *Invitel*, the ECJ stretched the *ex officio* doctrine to

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<sup>247</sup> Case C-488/11, *D.F. Asbeek Brusse at al v. Jahani*, judgment of 30 May 2013, nyr, para 32.

<sup>248</sup> ECJ, Case C-243/08, *Pannon* [2009] ECR I-4713.

<sup>249</sup> ECJ, Case C-40/08, *Asturcom* [2009] ECR I-9579.

<sup>250</sup> ECJ, Case C-137/08, *Pénzügyi* [2010] ECR I-10847

<sup>251</sup> ECJ, Case C-76/19, *Pohotovost’ s.r.o.* [2010] ECR I-11557.

<sup>252</sup> ECJ, Case C-472/10, *Invitel* [2012] ECR I-nyr.

<sup>253</sup> ECJ, Case C-618/10, *Banco Español de Crédito* [2012] ECR I-nyr.

<sup>254</sup> ECJ, Case C-472/11, *Banif Plus Bank* [2013] ECR I-nyr.

<sup>255</sup> ECJ, Case C-488/11, *Asbeek Brusse* [2013] ECR I-nyr.

<sup>256</sup> *Supra* note 253, at 42 and 43.

<sup>257</sup> *Supra* note 250 at 56.

the action for an injunction. By doing so, it connected the individual and collective remedy. What is yet to decide is the degree to which the *ex officio* doctrine can be lengthened, beyond the scope of the unfair contract terms directive, to all the EU rules which provide for mandatory level of protection, not just in consumer law, but also in labour law, anti-discrimination law, environmental law, in sum, whatever the EU sets binding standards.

In *Mohamed Aziz*, the referring Spanish Court did not ask the ECJ whether the court inquiring into the enforcement proceedings must also evaluate themselves “the effectiveness of individual contractual terms which have effects on enforcement”. In fact, neither did the Advocate General. Also, the ECJ did not explain the role and function of *ex officio* doctrine in this case. Conversely, the Advocate General reasoned from the principle of effectiveness the need to grant *interim relief* to protect the rights of over-indebted consumers against the devastating effects of the separation between the declaratory and the enforcement proceedings. The ECJ upheld its position in *Unibet*<sup>258</sup>. This was how the ECJ introduced a new procedural remedy that unites the enforcement proceedings and the declaratory proceedings. The procedural autonomy of Member States, so much emphasized did not meet the effectiveness test. Here, Advocate General Kokott built a connection between the rights granted under the Directive 93/13/EEC and the necessity to provide for appropriate protection within national procedural law<sup>259</sup>.

In other words, the total separation of the two proceedings makes it impracticable for the consumer to raise in the enforcement proceedings the question of whether the underlying contractual terms are in compliance with the requirements of Directive 93/13/EEC. In this way, procedure and substance remain interlinked. If not for Directive 93/13/EEC, the ECJ would never have the opportunity to investigate in a deeper way the procedural law of Spain.

Therefore, the *interim relief* would have to be granted in those situations where the European substantive and national procedural law would damage the effective and equivalent protection of substantive EU law. If so, this would mean that an important gap would be closed in the protection of collective rights of consumers.

As far as the developments in the field of remedies to the *ex officio* doctrine, the ECJ has already started to lay autonomous procedural consumer law. Regardless of its feasibility and legality under the existing law, the extension of the *ex officio* doctrine would put even heavier weight on national judges, on their obligations and their commitment to the protection

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<sup>258</sup> ECJ, Case C-415/11, *Mohamed Aziz* [2013] at 59. See also ECJ, Case C-432/05 *Unibet* [2007] ECR I-2271 at 77.

<sup>259</sup> Opinion of the AG Kokott in Case C-415/11, *Mohamed Aziz* [2013] at 46.

of collective interests of consumers. The ones who are for the public interest litigation, rely on the Courts to promote particular and normally socially mistreated policies, such as environmental protection, anti-discrimination and consumer protections applauding such judicial activism from the ECJ to the national courts. Still, the fervour for the ECJ's commitment in social policy is rather outbalanced by the unwillingness of the national courts to follow the ECJ's interpretation of the *ex officio* doctrine.

## B) Guide for the interpretation of European Private Law

Is it sufficient to provide national default rules as as guidance for the interpretation of good faith and significant imbalance in European contract law? Is the only standard reference made by the ECJ in its judgments is “*it is for the national court to decide on the basis of the facts of the case...*” enough to overcome the problem that there are no European default rules. Maybe is the role and function of the Draft Common Frame of Reference to set default rules, or is it the ECJ reference to “general principles of civil law” the path to close the gap?

Or is the European Court of Justice's ambition to gradually take over the substantive control and to establish the standards of fairness across whole the Europe? The Directive 93/13/EEC, technically only sets minimum standards. Is the ECJ establishing the limit for minimum justice? And where are the national courts in relation to all this? Are they mere agents of ECJ, like in the RWE<sup>260</sup>, or are they refraining from resorting to ECJ as the former House of Lords did twice in the field of contract terms?

In *Mohamed Aziz*, the guidance to national courts was strengthened, on the one hand by upgrading the function of the indicative list<sup>261</sup>, and in the other hand, by engaging in a European interpretation of good faith, significant imbalance and disproportion

### 3.1.4. The ECJ as a social righteous

There are lots of cases that resemble *Mohamed Aziz* all across the Europe. It is the ECJ's duty, as a court of last resort, to assure to the citizens of Member States the protection that sometimes lacks in their own national judicial systems. *Mohamed Aziz* was a “test case”, in which the ECJ was faced with the social and societal dimension of the current economic crisis. Often, neither the national governments nor other political actors at the European level offer a solution to this problem. In order to surpass the crisis, and to prevent banks from going

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<sup>260</sup> ECJ, Case C-92/11, *RWE, Vertrieb* [2013] ECR I-nyr.

<sup>261</sup> AG Kokott at 84, ECJ at 74 and 75.

bankrupt, politicians around Europe seem to have ignored the effects of the crisis on citizens in their existence as human beings.

It is not a novelty to rely on ECJ to redress social and societal deficiencies of the national and European legal orders. Yet, there is a major difference between all the public interest litigation which has reached the ECJ and *Mohamed Aziz* – the extension of the conflict. This is not a one Member State conflict, it concerns all. In addition, this conflict is inserted into a crisis that stirs the foundation of the European legal order as such. In such a harsh political atmosphere, the ECJ has the responsibility to provide guidance to the solution of a conflict with extreme and societal reach for Spain and beyond Spain. Thus, over-indebted consumers can now read the judgment carefully and refer it to upcoming cases to the ECJ. This will push the Court harder and harder, particularly, if national courts and national political actors are not prepared to respond and to remedy discrepancies in national laws and national procedures.

Moreover, the *Aziz* case reveals the flaws of opening up markets for mortgage credits to low-income consumers in the EU without creating possible safeguards at the European level against the potential risks of private household debts for the economy at large. This could be done, for instance, through an appropriate European mechanism on mortgage foreclosure.

The political elite seems to regard the loss of homes simply as collateral damage. For that reason, the ECJ should act like a guardian of social justice who corrects the failures and disinterests of such elite.

As an illustration, we should remember the positions held by the Spanish Government and the European Commission. Both favoured the interests of Caixa over *Mohamed Aziz*. The Spanish government attempted everything to challenge the admissibility of the reference, often with suspicious foundations. It has argued that the questions which had been referred were “irrelevant” for the mortgage enforcement proceedings<sup>262</sup>. By the same token, the European Commission had no problem in stressing the legality of the acceleration clause to protect the interests of the lender and efficient enforcement proceedings<sup>263</sup>.

Is this a parallel between the ECJ and the Warren Court in the US? The Warren Court opened the door for class actions in the field of consumer protection for which the famous Federal Rule 23 had not been created in the beginning. Thus, this is a path for public interest debate. The question is whether the European Union is floating in direction to the public interest

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<sup>262</sup> ECJ, Case C-415/11, *Mohamed Aziz* [2013] at 33.

<sup>263</sup> *Ibid.* at 34.

litigation? Or is it, instead, taking into account Constitutional values in private law relationships? Perhaps both.

### **3.2. The public interest**

The public interest debate started in the 1960s during the U.S social turmoil and it quickly spread to other jurisdictions, namely the EU. The problem is that, over the years, lawyers and other legal actors became allies of great corporations and have neglected their obligation to use their powers for the protection of people. The public interests has been ignored too many times.

This debate has its most challenging element in the analysis of the definition of public interest as distinct from an individual or collective interest. For instance, concerning standard form contracts against consumers, those supporting enforcement generally speak of freedom of contract in a market society and trust on the consumer's consent as the main reason for enforcement. On other hand, those who do not agree with enforcement usually argue that the consumer does not consent in a meaningful way and that, even with consent, enforcement of some or all of the form terms would be unjust or unfair. Both arguments have considerable weight, but each of them is rights-based, that is, limited to the rights of one party of the contract. Even if these arguments relate to many sellers issuing form contracts and to millions of consumers against whom they might be enforced, this does not mean an argument of public interest. Of course, the sellers' advocates would argue that, ultimately, all the society is benefitting with its enforcement and the consumers would make the same assertion about nonenforcement. However, each of them would be speaking of the combination of individual results, not a different collective interest that should be borne in mind when determining an appropriate legal policy.

Although this may be true, other arguments are based on the public interest notion. The definition of public interest is based on the concern about the positive and negative effects of a policy on most of the people of the society, including those whose individual interests are not directly implicated by a given transaction or activity. For instance, concerning to standard form contracts, the public interest might include factors different from freedom of contract or an unjust result for the consumer party.

There are many concerns in the context of form contracts. One of them, might be called the "secondary effects". Considering the consumer's advocate argument that courts should be

more ready than they have been to strike down unreasonable and oppressive contract terms. One feature of that assertion would be the benefit to the consumers thus saved from the enforcement of such terms. Another feature would be the assertion that judicial activism would serve the public interest by arming the sellers' lawyers with utensils to convince their customers to draft form contracts in a fairer way.

Being so, all the society will benefit by giving everyone more self-assurance in entering into form contracts and forming a universal sense of fairness in the market place. Different from these arguments are the individual rights arguments that rest upon costs and benefits to the society rather than arguments about real consent or normative beliefs about fairness.

The disappearance of the public interest is due to the fact that many legal fields have been privatized by the presumption that benefits and costs concerned in a given activity are limited to the private parties who are individually interested in the outcome. This is true, but just half-true. Let us recall *Mohamed Aziz*, a case that was simply an example of many more, concerning to over-indebted consumers. When one of the parties has much more power than the other, normally it takes advantage of that. In the *Mohamed Aziz* it was the banks, all across the Europe, that took advantage of low income consumers to profit and assure their (market) position. Being so, if one reality respects many people, namely people with low or no power to react, that situation must be resolved according to the public interest. We must consider also the society in which we live in. That society is full of interest group influence and legislator self-interest. The people have become a mere number. For that, the belief must be to protect the weaker party that is also the public in general. It is true that is hard to connect public interest factors with particular legal rules. What tends to happen is that legislators often rely on the courts to have such factors in mind coupled with the structure of a statutory system as a whole when creating a rule.

The main problem of public interest is that normally is viewed more as an exception than as a rule, for that it sometimes lacks the protection needed to the consumers.

Yet, this is just one of the possible paths to follow to achieve the largest consumer protection.

### **3.3. Private Law's Constitutional Approach**

The public interest is, no doubt the core element of the consumer protection issue. The way to address it may change, but its basis remains the same. As far as standard form contracts, *Mohamed Aziz* introduced a new element already known in other cases: the possibility of

introduction of constitutional values or norms in the private law sphere<sup>264</sup>.

Should private law and constitutional law be interconnected in the new European multi-level system? Should the private law be conformed with constitutional principles?

The constitutional law has intrinsic to it a “protective function of the State” or a “positive obligation of the state”<sup>265</sup>. The development of private law in accordance with constitutional values is the constitutional law’s duty, and also of the courts in applying it. The approach taken (before) separates the private law from the constitutional law, instead of thinking of it as an interrelationship. Thus, the relationship between both should be one in which dialogue takes place. This is a consequence of the extreme formalism of law, to separate two fields that, in reality, complement each other. For that reason, judges should be instructed to open-up private law to the power of the constitutional norms. The values contained in such norms are embodied and are constitutive of the very forms of social ordering. Adjudication is a prominent possibility because it may spell out those values and encourage the autonomous self-regulation. As Gerstenberg writes “the role of the courts in developing constitutional norms within private law is not one of absorbing into themselves the entire task of re-writing the entire background rules of private law. Rather, the role of courts can be seen as one of providing ‘deontologic side-constraints’ for the autonomous self-regulation of comprehensive social spheres that carry out their own internal logic and integrity”<sup>266</sup>.

The main problems with this approach lie in the influence of “higher law” (human rights norms and constitutional norms) on the “ground-rules” of private law and also the related question of the role of adjudication in “constitutionalising” private law, that is the judicial awareness of constitutional norms within the private law in the broader context of liberal democracy. In this sense, one should start by asking why there is so much resistance to the idea that a private party may invoke fundamental rights against another party that is not the State. If it is recognized that fundamental rights are more than just legal guarantees for protecting the freedom of the individual against excesses of political power than there is no reason for that to happen. They are also “objective elements of the constitution”, or objective principles that aim to safeguard the “fair value” of rights, even in the sphere of individual relations. Supporters of the view that fundamental rights’ scope should be limited to the dimension of correcting imbalances between the excesses of state power and individual liberty claim that only like this can legal implications remain predictable. If there were an extension of fundamental rights to

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<sup>264</sup> See e.g. Court of Human Rights, Case *Appleby and Others v. United Kingdom* (Application no. 44306/98 [2003]).

<sup>265</sup> Oliver Gerstenberg, *Private Law and the New European Constitutional Settlement*, *European Law Journal*, 2004, at 766.

<sup>266</sup> *Ibid.* at 767.

private (non-state) actors, then that will require courts to “balance” competing fundamental rights. The same would not happen in disputes between the individual and the state (because the state does not bear rights). Thus, the courts are not prepared to bear out this burden, in the absence of detailed and specific legislative guidance. Gerstenberg’s view<sup>267</sup> on the extension of fundamental rights between and among private (non-state) actors features three points: 1) it will result in a threat to private law’s libertarian core of private autonomy, by placing the private actors under the same duties as public bodies acting in the public interest; 2) it will cause a judicial usurpation of legislative prerogatives in determining the limits of spheres of private autonomy, by displacing or overriding the policy choices of statutory legislator; and 3) it will replace the authority to interpret private law’s core concepts such as property, contract, tort from ordinary courts to constitutional (and generalist) courts, what will ultimately result in an superfluous and redundant private law. These three points support the belief that courts give priority to the legislature in changing private law when the shifting point is the efficacy of human rights within private law; and also the belief that is the ordinary court’s duty to administer the background rules of private law.

The idea of constitutionalization of private law seems “eye-catching” but presents us a dilemma. On the one hand, if fundamental rights are seen as protected interests then what constitutionally matters is the threat itself to these interests, regardless of its provenance. It is not important whether the threat comes from a state action or a private action. On the other hand, because of the concerns with liberal autonomy and judicial awareness of constitutional norms in need of balance, there is resistance against the collapse of the separation between constitutional law and private law, for the concerns that notions of value and magnitude are boundless or without a logical endpoint. Gerstenberg’s larger point is that subjecting the ground rules of private law to constitutional norms does not eliminate, but enables choice, autonomy, and experimentalism<sup>268</sup>.

Constitutional rights establish a border between the state and the society nearby a sphere of individual sovereignty and integrity of the the person. In addition, constitutional rights serve as a collective self-restriction by rejecting certain irresolvable contentious and emotionally charged issues from the public agenda. On the contrary, the relationships between private individuals remain outside the normal range of constitutionalism, because they are governed by private law as conceptually different group, which aims to its own coherence. Surely, private

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<sup>267</sup> *Ibid* at 769.

<sup>268</sup> *Ibid.* at 770.



law must be in accordance with the constitution, because it is the *Grundenorm* of any State. But this does not mean that constitutional norms may be inserted into private relationships. However, Gerstenberg's view is one where:

Private law and relationships between individuals do not remain outside the range of constitutional law, but are always already determined by underlying constitutional values such as fairness and democracy...and also all the rules and standards of private law must, perversely and without exception, be interpreted in the light of those values.<sup>269</sup>

He then adds that the horizontal private relationships should, rather than being excluded from the constitution, be a "*continuum*" of the same. Also, he is of the opinion that the separation between adjudication and legislation collapses for the fact that if constitutional rights have a binding effect on private individuals, and if constitution law has an immediate impact on private law, then constitutional courts (adjudication) become meaningless. Thus adjudication must harmonize or construct transitory orders between highly abstract and open-ended principles, in a continuous review process. But the collapse between the separation of legislation and adjudication brings up the earlier concerns: first, private autonomy is threatened; second, the private law becomes superfluous.

As illustration, one shall take a look to the *Lueth* case. Lueth, a Jewish president of the Hamburg Press Club was known for criticizing Harlan, a producer of antisemitic films and one of the most influential film directors of the Third Reich. Lueth called upon distributors, cinema-owners and the public to boycott Harlan's new movie. The film's producer and distributor sought an injunction in the ordinary private law courts to force Lueth to remove his call for a boycott. Lueth was ordered to abstain from calling a boycott in the future on pain of facing fine or imprisonment. The ordinary courts' interpretation of BGB 826 was that any call for a boycott *ipso facto* violates the same rule, because that is clearly what the rules states and means to say. Here, the conflict was between property interests and free-speech values. The Constitutional Court attempted to explain that "the fundamental rights granted by the German *Grundgesetz*, such as freedom of expression, were not only 'subjective rights' of individual addressed (as barriers) against the state, but also, and at the same time, 'objective principles for the whole legal and social order'"<sup>270</sup>. Hence, the *Lueth* case questioned (in the German legal context) the view that constitutional law governed only the 'making' of private law, but not the interpretation or application of private law. In other words, the influence of constitutional law on private law does not come to an end with the 'making' of private law, but rather extends to

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<sup>269</sup> *Ibid.* at 771-72

<sup>270</sup> *Ibid.* at 773.

its interpretation. Moreover, the Constitutional Court stated that the influence of constitutional norms on private law must be ‘mediated’ by the interpretation of the private law itself. This was then known as *indirect application*. Therefore, it emphasized that the litigation, even in the presence of constitutional norms, remains on the grounds of private law and that the balancing between competing constitutional values takes place within the private law framework and that it is the private law’s task to build a fair balance when rights such as property rights and freedom of expression clash. Being so, the private law legislator maintains its role.

The problem of “balancing” the constitutional rights is one of reconciliation with the supremacy of the Constitution. But one cannot have it both ways – both constitutional supremacy and idea that the impact of the constitution on private law is subordinated upon private law itself as a self-sufficient self-programming.

The idea of *indirect application* opened up a debate. For instance, Aharon Barak<sup>271</sup> supports a model that he calls “strengthened indirect application”. This model has two particularities. First, individual’s rights such as the right to property are rights of the private individual concerning both the government and other individuals. Second, the limitation and narrowing of right due to the regard for the other’s right must be evaluated within the particular normative framework of private law. In Barak’s opinion, private law is the “geometric location” for formulating remedies for an infringement by one private individual on the constitutional right of another individual. The party must find its remedy within its framework of private law. To the extent that private law does not, despite the violation of a constitutional remedy, grant an appropriate remedy, private law must be revised to provide the remedy as needed. This model is different from the traditional indirect application that would deny the remedy in the cases in which the private law does not contain the legal tools and institutions for the absorption of constitutional values. Also, it differs from the traditional model because it does not ignore the existing private law and does not create a type of constitutional private law that exists side by side with regular private law.

This approach to European Private Law has implications on the future of the European Union itself. European scholars have pointed the necessity for an alignment between the principles of social justice in European contract law and the constitutional principles already recognized in Europe. Yet, this issue remains controversial.

In *Mohamed Aziz*, the ECJ deliberately avoided the issue of Constitutionalization of

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<sup>271</sup> See A. Barak, “Constitutional Human Rights and Private Law”, in D. Friedmann and D. Barak-Erez (eds), *Human Rights in Private Law* (Hart Publishing, 2001)

European Private Law since it did not openly address the relationship between the Charter of Fundamental Rights and European private law, whereas in other cases it is obvious that the ECJ is creating constitutionalised private law as a safety net. Yet, in this case the ECJ kept a low profile, due to the fear of turning every private law conflict into a constitutional conflict. One must admit the importance, in *Mohamed Aziz*, of the Article 43 of the Charter, “the right to housing”, since Aziz was evicted from his family home. It is necessary to define Article 43 of the Charter as a principle rather than as a right. The ECJ avoids the issue, but adds that the overall purpose for which the credit was granted was the creation of a family home<sup>272</sup>.

It is only a matter of time before the ECJ engages into “constitutionalised European Private Law”, with a solid set of rules that will bind not only the Member States and challenge their national law private systems, but also the private parties to a contract. However, the problem lies in the unwillingness of some Member-States to adapt their national law to the European standards. Contract law for its complexity is a field rather untouchable. It is, undoubtedly, the law field with more harmonization difficulties.

### **3.4. Relation with U.S jurisprudence**

The private law approach is not sufficiently “fair” in which concerns to contracts of adhesion. It is obvious that this contracts are, most of the times, unfair for the consumers. For that, more protection must be granted. The only one who is in a position to fight this powerful economic corporations is the State. The State has two options: or it continues to regulate the issue as if it were private, by regulations containing safeguards to the consumer (as the EU does); or, once and for all, admits the public nature of contracts of adhesion. Slawson’s administrative view on contracts may be a good option, because it would result in an effective control of standard terms by means of judicial review. This judicial review could be made according to the principle of proportionality, a very public principle. Actually, proportionality is one of the most important grounds for judicial review. It has been a ground for many years and has evolved from the concept of unreasonableness. The concept of proportionality has been developed more as a general principle of law by the judges over the years. This doctrine of proportionality is well established and is a broad concept in the European administrative law. Why not forget the traditional doctrine of contracts and govern contracts of adhesion in an administrative manner? It seems the best method of having some sort of judicial control over

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<sup>272</sup> ECJ, Case C- 415/11, *Mohamed Aziz* [2013] at 33.

this contracts. The proportionality doctrine is applied in other fields of law, for instance, constitutional law. It is a very effective control mechanism because it entails a three-part test: 1) is the measure suitable to achieve a legitimate aim?; 2) is the measure necessary to achieve that aim or are less restrictive means available?; and 3) does the measure have an excessive effect on the applicant's interests?. The general principle of proportionality therefore requires that a measure is both appropriate and necessary, Therefore, the general principle of European Union law of proportionality is often considered to be the most far-reaching ground of judicial review and of particular importance in public law cases.

If one wants contracts of adhesion to be subject to some kind of public control, the administrative view coupled with an assesement based on the principle of proportionality could achieve better outcomes than the ones reached through the doctrine of unconscionability or through the doctrine of public interest, or also through the EU “doctrine” of presumptive nonenforcement. However, this would mean shifting the principles of “private contracting” to “administrative contracting”. The American scholars that addressed the problematic of contracts of adhesion as a matter of public interest, namely Kessler, Rakoff and Slawson would probably accept this view of reviewing standard terms through the principle of proportionality.



## **CHAPTER IV**

### **FINAL CONCLUSIONS AND RECOMENDATIONS**

#### **4.1. The Freedom of Contract**

Freedom of contract is one of the most discussed issues regarding contracts of adhesion. As the name refers, it is the freedom of individuals or groups to contract with whoever they want. This freedom is one of the bases upon which the law is founded. The liberty of people to make arrangements or agreements, according to their intents and wills.

This principle plays a huge role in the acceptance of contracts of adhesion for many reasons. First, the whole idea of contracts of adhesion is only possible due to the existence of such liberty. Without it, it would not be possible for a business to contract in such an authoritarian manner. Second, for the fact that is its purpose to give room to parties to adapt the law to their own interests, businesses do it in their favour, by establishing harsh clauses to their customers (who will not find a better option in their close competitors). Third, the freedom of contract lies in the absence of governmental interference (except when public policy justifies its intervention). In other words, Freedom of Contract separates the state and the market, the private and the public. As Kessler writes “the law of contract has to be of their own making”<sup>273</sup>, to provide for individuals the fairer solution in the attainment of their own interests.

The problem is that, Freedom of Contract is not a concept as static as previously thought. Over the years, Freedom of Contract has changed its meaning just as contract itself is not what it used to be. Contract was perceived as the result of free bargaining between two individuals, who meet each other on a relation of approximate economic equality. This contracting manifested their consent because it was individually negotiated and properly dickered. In our days, due to the economic reality that lies in the capitalistic structure of society, contracts are not a “meeting of minds” anymore.

According to Rakoff, Freedom of Contract means uncoerced choice linked to the human being, its development, its individualization, its fulfilment, in doing so – none of these values is visible by enforcing the organization’s form<sup>274</sup>. Thus, seeing the organization as an individual is the first error. An organization is an institution, with power, information, and means to achieve its goals. Of course, an organization should have power to contract, but due to its prime position in many fields, its freedom of contract must be “moderated”. It is misleading to consider an individual which normally is an average person in need of the products or services offered by these organizations on an equal footing with the same. The organizations do not even actively participate in the deal, they simply provide the product or service.

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<sup>273</sup> Kessler, supra note 6 at 629.

<sup>274</sup> Rakoff, supra note 41 at 1236.

The Freedom of Contract is one of the barriers to progress. Not the Freedom of Contract itself, but the perception given to it. The Courts, judges and legal actors across the world do not accept the fact that the Freedom of Contract must be redefined, instead of being rationalized. This principle does not fit the reality anymore because there is not any contract equality. The contractual relationship is currently composed by two parts, in which one is the consumer and the other is an unreachable organization that imposes its terms in a take-it-or-leave-it basis. The consumer has no Freedom of Contract other than choosing the best alternative to its purchase. On the other hand, the organization has the Freedom of Contract to do whatever it wants, for instance drafting unfair contracts, which most times even the governments upheld. And all this is possible due to its privileged power, given by a society whose roots are embedded in money, profit, risk and speculation. The Government cannot subsist without the organizations' support, because they are responsible in many ways for the progress of our society. Maybe that is why they are so many times benefited at the expense of the rest of community. Freedom of Contract is not equally applied to all the people, and even further, what actually occurs is quite the contrary. The Freedom of Contract is currently a "one-sided privilege"<sup>275</sup> that only a few enjoy, namely organizations, corporations, etc.

In effect, Freedom of Contract, that so-well established principle of law, it is to blame for all inertness of evolution. Is it preferable to maintain the "prestabilized harmony" of the society structure and the legal certainty rather than battle for social justice? It is due to that Freedom that we people are losing ours? The problem rests with the fact that the contractual parties are completely separated. Kessler claims that Freedom of Contract "enables enterprisers to legislate in a substantially authoritarian manner without using the appearance of authoritarian forms"<sup>276</sup>. In other words, is due to Freedom of Contract along with Private Autonomy that the organizations are capable of making contracts that impose their terms, obligations and duties. They are effectively making law. People are not in a fair position anymore, because they, on the contrary of organizations, cannot impose any terms. Is this fair? To permit an unfair relationship right from the beginning?

Freedom of Contract does not exist anymore. Perhaps there are some remnants in other contractual relationships. But when Contracts of Adhesion are at stake, it simply vanished. Freedom of Contract requires that the contracting parties voluntarily assume the contractual obligations. In this context, they do it but not "voluntarily", they are almost forced to do so.

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<sup>275</sup> Kessler, *supra* note 6 at 640

<sup>276</sup> *Ibid.*



There might be two options to solve this problem concerning Freedom of Contract:

One, the whole redefinition of the contractual relationship, or at least the separation of this new type of contracting from the other types of contracts. That is, creating a whole new body of law regarding to Contracts of Adhesion or Standard Form Contracts. Since the current concepts do not fit the reality anymore.

Two, withdraw some of this Freedom of Contract to organizations. Since shifting seems too difficult, maybe the solution is to limit the drafting of contracts by companies. Regular inspections of this companies coupled with regulation on the matter could be a start. Besides that, harsh fines should be administered to non-compliant companies. The fines must be so severe than the companies themselves would be more frightened to pay them than of losing the revenue that would be available if they did not comply.

#### **4.2. The Institutional Power (The Market and the State)**

The institutional power is the power held by entities like governments (the state) and corporations (the market) to control people and direct their behaviour. Entities with institutional power, and their agents, have the official authority or ability to decide what “is best” for the whole society. Institutional power exists in situations where authority has been socially approved and accepted as legitimate. Corporations or companies have a considerable power over our lives, as well as the State. As far as lawmaking power for instance, it is considered that its holder *sui generis* is the State. However, that is not true, the state is not the only holding the lawmaking power, the parties when consenting to a contract are also creating law – the power is divided by the State and the citizens. In this context, when an individual is entering into a contract, which is a standard form contract, its consent is sufficient to create law. The problem is that such consent is empty. The consumer, most of the times, does not even read the whole contract, he accepts the “visible terms” as Rakoff stated, which may be the price and others. The remaining terms, the “invisible” ones, are usually the most problematic ones. Thus, this lawmaking power is “given” to the market by consumers through their “empty” consent. But why is that? Is it because consumers want to do so? Or is it a consequence of their necessity for something that only the Market has access to? Namely services or products? Probably the second option. Actually there are institutions, other than the State and the Market that control the individual within the context of private law, for instance labour relationship in the modern industry, “where such domination is as much an achievement of liberty as is the limitation of

governmental control”<sup>277</sup>.

Therefore, the State has the power because it is perceived as a “coordinator” of the whole society, whereas the market has power because of (consumers’) contracts. If the parties of a contract are creating law by consenting to it, and if a contract is only made with consent, then the market, as the party holding more power, is imposing law, through contracts and the consumer is legitimizing it through its consent. They are socially accepting this law. Unintentionally, the consumers are giving the Market power, but that is because they do not have other option than to do so. Otherwise, they will live apart from the others. How can someone currently live without the aid of the Market?

Given these points, the holders of power in our society are the State and the Market. This is only possible due to the consumers’ consent on the contracts they enter. This strengthens the Market power, their organization and their structure to the limit were they can be also called an institution.

#### **4.3. The call for a multiple system of contract law**

It is more than obvious that the current system does not respond to the needs of contract law, more particularly the needs resulting from the use of standard form contracts. It is true that the contract law has grown substantially in the past decades, but even so, it is not adequately prepared. Plenty of doctrines have risen in the hope of solving this problem, but unfortunately none of them properly addressed the issue. While there are some helpful doctrines, but yet incomplete, others are completely lacking a senseful explanation. As Rakoff argued standard contracts call for a different law, but the problem lies in the principles applicable to them<sup>278</sup>. Also Kessler called for a different set of legal principles. The time has come for us to part from the doctrinal moorings and to begin to see things in a more practical way. One thing is Contract as such. Another are contracts of adhesion. The basis of the situation may be the same (an exchange or a transaction) but the path made is another. One is civilized, and respectful of all the elder principles of contract law, another takes advantage of the same principles through use and abuse to achieve the better possible outcome. The judges and other legal actors have to recognize that they are different realities. Ordinary contracts are still adequate to the principles. Contracts of adhesion distort the same principles. For instance in which respects to Freedom of

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<sup>277</sup> Rakoff, *supra* note 41 at 1237.

<sup>278</sup> *Ibid* at 1175.

Contract, this Freedom is no longer perfectly shared by the two parties. Instead, one of them, normally businesses that issue this forms has much more freedom because imposes whatever terms it want. The customer is deprived of his freedom by “allowing” the imposition of the same terms. For that, much more protection must be given to the consumers, and the businesses in other side, must be highly controlled. The contract as contract of adhesion must be fully separated from the ordinary contract. Its principles, proceedings and rules. The principles, as we know them, at least must be adapted. But the impasse lies in this “adaption”. It is very difficult to redraft everything all again. The most advisable thing to do is adapt. There are many ideas of adaption, one of them being the Slawson’s idea of an “administrative law of contracts”. For him, the solution was the creation of a “set of legal principles which reconcile the interests of the issuers in setting such terms as they wish on an agreement and of the consumer in having his reasonable expectations fulfilled”. Thus, administrative law’s view is an attempt to maintain the unilateral or “delegated” cases of agency lawmaking consistent with the legislative purpose, made in the public interest. This public law approach is difficult to implement, but its outcomes would be fairer than the ones achieved in the private law. The Contract must remain in the private sphere, but in a field or area of contract different from the “ordinary” contracts”. In the same manner that a marriage is a contract, but with another name, so must be contracts of adhesion, dettached from regular contracts. I agree with Rakoff when he says that there is a need for reconstruction (or adaption). As he writes “the need for that reconstruction, based on an open recognition that contracts of adhesion represent a different social practice from “ordinary contracts”, is the essential point”<sup>279</sup>. However, I believe that the State has to intervene in the fairness control. For that, it is the judges and legislatures’ duty to create this new legal structure. More than creating this legal structure, they must respect the rights of the consumers as a matter of public interest. These are not “individual” contracts. They cover the public in general. For that, consumers must be treated as a collective group, rather than an individual making a single transaction in a regular day of his life. We as consumers are obliged to “contract” that way.

#### **4.4. The public interest in the US and the EU**

The public interest issue has become a common bond between two completely different legal systems. In the US, the common law legislation treats standard form contracts like any

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<sup>279</sup> Rakoff, supra note 41 at 1284

other contract, with the proviso that there are exceptional rules for unfair situations. The Courts in the US interpret form contracts *contra proferentem*, that is, the interpretation is against the drafter. The party who provided the wording must prove that its contract is fair. The rules applicable to standard form contracts are contained in the Uniform Commercial Code, more particularly in the section 211 of the American Law Institute's Restatement (Second) of Contracts<sup>280</sup>.

The US doctrine and jurisprudence distinguish between regular form contracts and contracts of adhesion. The contracts are subject to special scrutiny if they are found to be contracts of adhesion. According to Slawson "a contract which one party makes because he is coerced in this "total" sense is what we shall mean by a contract of adhesion"<sup>281</sup>. For that reason, this contracts have a special treatment which is more severe. One article on the issue was largely influential on the decisions taken by many courts in the US. That article is *The Delivery of a Life-Insurance Policy* written by Patterson in 1919. The majority of American Courts has adopted this view, especially after the Supreme Court of California endorsed the adhesion analysis. The American Courts seem to be moving towards more consumer-protective measures, because they are aware that businesses are in a much better position than the consumers. The Courts do not uphold form contracts, without first challenging its fairness, if it has been called into question in the first place. They are concerned about the consequences that this contracts might have in the society, so they now discern them as a matter of general public interest. This contracts must be fair to the needs of the whole society. The public interest doctrine is more viewed as a relief doctrine, but I think it is one of the better recourses to achieve the greater justice possible. It is mainly founded on the idea that one of the parties has "superior bargaining power". In fact, many cases were decided according to this idea. For instance, in the *Henriouille* case, the judge found a public interest involved, mostly due to the presence of "unequal bargaining strength", he said "*in a state and local market characterized by a severe shortage of low-cost housing, tenants are likely to be in a poor position to bargain with landlords*"<sup>282</sup>. This case also denoted the "economic duress" felt in this transactions. In a fully negotiated transaction, the "superior bargaining power" and the "economic duress" would not take place. This two factors harm the consumer in a considerable manner. Another important

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<sup>280</sup> The same provides that "Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement". This section has an influential though non-binding force in courts.

<sup>281</sup> Slawson, *supra* note 1 at 549

<sup>282</sup> *Henriouille*, 20 Cal. 3d pp. 519, 573 P. 2d pp. 469, 143 Cal. Rptr pp. 251.

case founded on matters of public interest was the *Shell Oil Co v. Marinello*. This case respected to a form clause giving Shell the right to terminate a dealer's franchise on short notice and without "cause". The court held the clause invalid as matter of public interest and admitted that "the public is affected in a direct way beyond question...the distribution and sale of motor vehicle fuels within this State is affected with public interest"<sup>283</sup>. Therefore, according to the US jurisprudence, for a standard form contract to be fair it must be in accordance with the public interest.

In the EU, the situation is similar, but its approach is different. The EU law spreads to all the Member-States through the imposition of Directives that then are transposed to each Members' national law. They are binding but subject to some adaptations. With regard to contract law, this transposition is much more difficult, due to the differences between contract law rules in each member state. Initially, the EU was centered on an "internal market approach", where the consumer was not seen so much as a weak person in need of protection against the meanderings of the market but as a an active partner who should be encouraged to use the enlarged potentials of cross-border shopping. Over the years, the approach has changed substantially to focus on a "consumer rights". The consumer policy is now one of the EU's priorities we can see in Article 153 of the EC Treaty which states the following:

"To promote consumer information and to protect their economic interests, for example by creating minimum standards on pre-contractual information in direct and distance selling, by increasing freedom of choice through rights of withdrawal, by establishing rules on the transparency and fairness of pre-formulated terms and guarantees, and by ensuring quality standards through mandatory rules on compensation and warranties"

This approach became more obvious when the ECJ, in its famous tobacco-advertising judgement of 5 October 2000 decided to substantially limit the rather loose use of the internal market power for consumer protection legislation<sup>284</sup>. This discussion incited a deep debate among European legal scholars about whether there is a genuine EU competence in contract law in general and in consumer law in particular.

Thus, the Directives concerning consumer law have a protective purpose as also as the ECJ with its inspiration on a "pro-consumer attitude". The contract law directives do not have a "horizontal direct effect", that is they cannot create by themselves obligations against private parties, but they may nevertheless be used as a source for a "directive conforming interpretation" of national law, including in the pronouncements of the ECJ.

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<sup>283</sup> 63 N. J. 402, 307 A.2d 598 (1973).

<sup>284</sup> *Federal Republic of Germany v European Parliament and Council of the European Union* [2000] ECR I-8419

The Directive with more impact in the standard form contracts is the Directive 93/13/EEC on Unfair Contract Terms. This Directive is only concerned with “not individually negotiated terms”, for instance, terms within a consumer contract, which according to Article 3 (2) have been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract. Also, the Directive’s unfairness test has been tightened to combine the reference to “good faith” as in the German Tradition, and the “imbalance in the parties’ rights and obligations” as in French Law, per Article 3(1). There is no reference to the concept of “legitimate expectations”, otherwise used in EU law. Besides that, the Directive contains an Annex with an indicative, yet non-exhaustive, list of terms which may be regarded as unfair, Article 3 (3).

This Directive has not brought many changes to Member States contract law other than improving the consumer’s position on the market. However, with the Court’s insistence on the protective ambit of Directive 93/13/EEC, the judge is now able to raise *ex officio* the potential unfairness of the form clauses. Also, he must interpret and apply his national law in conformity with the Community Law.

Thus, this protection has the goal of reducing the disparities felt in the relation between consumers and businesses. Due to the fact that the consumers are practically the public, protecting them is acting according to the public interest. In *Mohamed Aziz*, the ECJ faced the social and societal dimension of the current economic crisis. This crisis reached many people across the Europe, and it was the ECJ’s duty to provide a solution for the problem of over-indebted consumers. They did it by protecting them against the powerful institutions, namely banks that took advantage of the situation to inhumanly enrich themselves.

Far from everything that divides the US and the EU system, there are also some resemblances, specifically the public interest view that consumers ought to be protected more than the influential and powerful economic corporations. The consumers must be protected, but the economic entities must also feel some pressure to act in a fair and reasonable way, in a win-win perspective for both parties. The negotiation and posterior acceptance of the contract must be just. And it must be for both parties. The solution is to balance the inequality between both.

#### **4.5. Public interest or Constitutional settlement?**

In the context of contracts of adhesion or standard form contracts, the main objective of both the public interest doctrine and the constitutionalization of private law is the protection of

the consumer.

The question then is whether is preferable to resort to doctrines of public interest or to the constitutional settlement. The public interest doctrine is a relief doctrine, based on the general interest of the public. The problem is that this doctrine depends on a high number of individuals harmed by the same “evil”.

The constitutional settlement, on the contrary, would have constitutional principles inserted on private relationships.

However, one must admit that the principles guiding the public interest may be very similar to the constitutional principles. After all, they are the highest principles in any given society. Constitutional values have intrinsic to them principles such as fairness and democracy. It is obvious that the rules of private law are themselves interpreted in the light of this same principles. The only difference is that the constitutional settlement would permit this values, or rights to be also binding on individuals, and not only used by them against the State.

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