MANDATORY CONTRACT LAW: FUNCTIONS AND PRINCIPLES IN LIGHT OF THE PROPOSAL FOR A DIRECTIVE ON CONSUMER RIGHTS

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Abstract

Starting from the theoretical underpinnings of contract law, mandatory rules should be the exception. In the reality of current European legislation, mandatory law is not the exception but the rule. The obvious explanation is that the EU has focussed on consumer law, i.e. on the regulation of transactions between a business and a consumer. In a B-to-C relationship, the consumer is perceived as the weaker party which requires protection against the more powerful business.

The following article tries to dismantle the assumptions that consumers are weak and that the 'weakness' of consumers forms the normative basis for the body of Directives we now have before us. The *Draft Proposal of a Directive on Consumer Rights* is used as an object for analyses from the perspectives of comparative law and economic reasoning. The argument is that, while there are important areas where mandatory law is justified, the card of mandatory law has been overplayed in important respects. In particular, the petrification of the law of sales that began with the *Directive on Consumer Sales and Guarantees* seems to be unjustified. Within a system that allows for court control over standard contract terms, the need for mandatory law is negligible. Where court control over standard terms is perceived not to be sufficient, 'options' should be used instead of mandatory law. While options preserve party autonomy, they do limit freedom of choice to a set of immutable alternatives. And in doing so, they reconcile party autonomy with legal certainty.

1 Introduction

Contract law is generally thought to be based on the principle of party autonomy. The moral justification for the principle of party autonomy may be derived from any theory that embraces the value of individual freedom. For a Kantian, party autonomy is a consequence of the principle of treating persons not as objects but as subjects, and not as means but as ends.[1] Utilitarian theories do not start from ethical principles, but from the objective to maximise happiness.[2] It follows easily that the maximisation of the happiness of the greatest number of subjects turns on the advancement of individual happiness. Even though one may conceive a utilitarian theory that entrusts the maximisation of individual happiness to a benevolent dictator, the moral yardstick remains an individualistic one. From the premise that it is individual well-being that counts in the moral universe, it is but a short step to the notion of party autonomy. In all likelihood, individuals themselves know best what makes them happy or contributes to their well-being. Therefore, they should be allowed to take the pursuit of happiness into their own hands and to make the choices they think are best for them. As will be explained later, this is exactly the point of view to which neoclassical economics subscribes,[3] regardless of whether or not it qualifies as a special case of utilitarianism.[4]

Given that there is something of an overlapping consensus regarding the normative justification of party autonomy, it is surprising that, in reality, party autonomy is on the

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[1] I. Kant, *Grundlegung zur Metaphysik der Sitten*, Akademie-Edition (1785) at 429.

[2] J. Bentham, *Introduction to the Principles of Morals and Legislation* (1789); H. Sidgwick, *The Methods of Ethics* (1907, 7th ed.) at 413.

[3] See section 3 below.

[4] On this issue, see R.A. Posner, 'Utilitarianism, Economics, and Legal Theory' (1979) 8 *J. Legal Stud.* 103; R.M. Dworkin, 'Is Wealth a Value?' (1980) 9 *J. Legal Stud.* 191, 215 ff.; J.L. Coleman, 'Efficiency,

retreat. During the 1960s and 1970s it was believed that the principle of party autonomy was unhelpful in organising modern societies. The proclamation of the 'death of contract' was not merely meant as a diagnosis, but as an affirmation of a new paradigm in private law that would supersede the outdated institutions of ancient times. Today, the 'death of contract' movement seems to be dead itself.[5] With the demise of socialism, market economies that rely on the aggregation of individual choices through the market appeared to be left without a serious alternative. Contracts are an indispensable cog in the market mechanism. Without a functioning law of contract, parties would be unable to engage in transactions or they would have to take costly measures of self-protection against the opportunistic behaviour of their counterpart. In summary, voluntary agreements, and the body of law enabling and protecting them, are indispensable institutions for a market economy.

2 The Domain of Consumer Law

In spite of this finding, the legislation of the European Union in the area of contract law is almost exclusively in the mode of mandatory rules. The many directives dealing with consumer contracts regulate various aspects of contract formation or even the substantive terms of commercial agreements. These rules are optional for the consumer in the sense that she may agree contractual provisions more favourable to her.[6] For the other side, the business enterprise contracting with the consumer, they are mandatory in the sense that the business entity must not derogate from the statutory provisions to the detriment of the consumer.[7] As the choice for mandatory rules operates only unilaterally, one may call this mode of legislation 'unilaterally mandatory'.

Today, consumer law is firmly established, as evidenced by the Proposal for a Directive on Consumer Rights. After decades of piecemeal legislation in the form of various directives that each deal with a particular aspect of consumer contract law, the Commission has come to the conclusion that some harmonisation is needed.[8] Accordingly, the Proposal for a Directive on Consumer Rights does not break new ground in the sense that new areas subject-matter is being explored. Rather, its aim is to draw together four existing directives, namely the directives on doorstep selling, distance selling, unfair terms in consumer contracts, and consumer sales and guarantees. The provisions on contracts of sale being the only ones regulating the contents of a particular type of contract, the Draft Directive follows a 'horizontal' approach rather than a 'vertical' one. The principle of unilateral force of statutory provisions – in the sense that the parties must not undercut the standard of protection accorded to the consumer – is being generalised as well. The proposal for a Directive on Consumer Rights subscribes to the principle that the statutory framework is binding for the business but not mandatory for the consumer. Pursuant to its Article 43, 'consumers may not waive the rights conferred on them by this Directive'.

For the theory of contract law, the Proposal for a Directive on Consumer Rights represents a major challenge. The time has come to ask whether the rules of contract law, whether they are created by lawmakers or judges, should be mandatory or of a default

Utility, and Wealth Maximization' (1980) 8 *Hofstra Law Review* 509 at 515. For a recent account of the methodological underpinnings of economic analysis of law, see L. Kaplow and S. Shavell, *Fairness vs. Welfare* (2002) at 15 ff.

5 G. Gilmore, *The Death of Contract* (1974).

6 For purposes of gender neutrality and convenience, this article envisages a female consumer and a male trader, professional or businessman.

7 Article 6 of Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, OJ 1985 L 372/31; Article 12(1) of Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts, OJ 1997 L 144/19 ff.; Article 6 of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ 1993 L 95/29 ff.; Article 7(1) of Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, OJ 1999 L 171/12 ff.

8 Proposal for a Directive of the European Parliament and of the Council on consumer rights of 8 October 2008, COM (2008) 614 final, at 3 and Rec. 2.

nature. This question has a particular bearing on business-to-consumer transactions. However, conceptually, it must not be confined to the area of consumer law. As long as the reasons and justifications for the continuing growth of mandatory contract law remain unclear, it is impossible to tell whether mandatory rules are a hallmark of consumer law, or whether they must be generalised, as they rest on general normative principles.

3 Comparative Overview

Analyses of mandatory rules in contract law are rare, if they exist at all. With the notable exception of scholars subscribing to the economic approach, the interest in conceptual clarity and theoretical consistency has been rather weak in recent years. One reason for the dearth of research on mandatory rules may be the fact that modern legislation in the area of contract law, at least in Europe, has focused exclusively on the relationship between businesses and consumers. As many scholars of general contract law tended to avoid the shady area of consumer protection, it was left to experts in this field, who developed the understanding that consumer law was a special area, detached from the traditional areas such as contract and tort law.

3.1 Common Law

This is particularly true for the common law. As far as England and Wales are concerned, articles discussing the distinction between mandatory rules and default rules are rare.[9] Many textbooks ignore the distinction between default rules and mandatory rules altogether[10], while others simply point out that '[a] wide range of social policies might justify the imposition of compulsory obligations.'[11]

To this, some authors add concepts of economic theory by pointing out that mandatory rules are needed to compensate for market failures and externalities.[12] Reserving the insights of economic analysis for the next section, these arguments, taken in the abstract, do not contribute much to the legal analysis.

It seems that the category of mandatory rules remained somewhat alien to the common law of contract even outside of the United Kingdom. It is said that it was imported into US law by scholars like Karl Llewellyn who were familiar with German pandectist theory and its affiliation with the classical distinction between *ius cogens* and *ius dispositivum*, which were translated as 'iron rules' and 'yielding rules'.[13]

3.2 Civil Law

Turning to the pandectist literature of late 19th century Germany leads to another disappointment. While it is true that the prominent authors of this age all note the distinction between default rules and rules of mandatory nature, most writers are content to leave it at that.[14] The normative reasons underlying the choice between these

[9] Cf. B. Rudden, 'Ius Cogens, Ius Dispositivum' (1980) 11 *Cambrian L.R.* 87; M. Freedland, 'Ius Cogens, Ius Dispositivum, and Personal Work Contracts', in P. Birks and A. Pretto (eds.), *Themes in Comparative Law – In Honour of Bernand Rudden* (2002) at 164. Another exception, in book form, is A. Ogus, *Costs and Cautionary Tales* (2006) at 83 ff.

[10] Cf. H. Beale, *Chitty on Contracts*, Vol. I (2008, 30th ed.) Chaps. 15 and 16, dealing with unfair terms and public policy but ignoring mandatory rules.

[11] H. Collins, *The Law of Contract* (2003, 4th ed.) at 248, 251.

[12] Id., at 248.

[13] A. Schwarz, 'Karl Llewellyn and the Origins of Contract Theory', in J.S. Kraus and S.D. Walt (eds.), *The Jurisprudential Foundations of Corporate and Commercial Law* (2000) 12 at 15 ff.; I. Ayres, 'Response: Valuing Modern Contract Scholarship' (2003) 112 *Yale L.J.* 881 at 885 ff.; J.H. Langbein, 'Mandatory Rules in the Law of Trust' (2004) 98 *Nw. U.L. Rev.* 1105 at 1106, n. 3.

[14] B. Windscheid, *Lehrbuch des Pandektenrechts*, Volume I (1891, 7th ed.) § 30 at 69; cf. also H. Dernburg, *Pandekten*, Volume I (1894, 4th ed.) § 31 at 69.

two types of rules are not examined. Therefore, this literature is not very helpful in analysing and evaluating the modern law of contract, especially in the area of consumer protection.

Within the European theatre, it seems that the French legal system is the most fertile tree in the garden of mandatory law. Treatment of the subject is centred around Article 6 of the *Code civil*, which famously provides that

> On ne peut déroger, par des conventions particulières, aux lois qui intéressent l'ordre public et les bonnes meures.

Even though the German Civil Code contains a similar provision (§ 134 BGB), Article 6 of the *Code civil* serves as a statutory anchor for a discussion of mandatory rules in private law generally. In contrast, the scholarly discourse in Germany always remained focused on public law statutes, whether from the criminal or the administrative law branches.[15] The mandatory rules of private law are not deemed to fall under the subject matter of § 134 BGB, as they are self-enforcing – in the sense that they invalidate agreements on their own accord.

French legal doctrine distinguishes between two categories of the *ordre public*, termed *ordre public classique* and *ordre public économique*.[16] The former category refers to the statutory provisions protecting the public interest in the narrow sense of the various branches of government, foreign policy, questions of diplomacy, defence, and the like. The *ordre public économique*, in contrast, is the modern version of public policy that aims at protecting certain classes of parties that are thought to be in a weaker position in comparison to their counterparts. The domain of the *ordre public économique* is the playground of today's lawmakers and contains such topics as the law of landlord and tenant, insurance law, labour law, and consumer law.[17]

3.3 The DCFR

The framers of the Draft Common Frame of Reference (DCFR) based their work on the four principles of freedom, security, justice, and efficiency.[18] No reasonable person would call these principles into question, but the problems only begin here as the four values may point in opposite directions. However, with respect to the relationship between contractual freedom and mandatory law, the solution is unequivocal − freedom of contract takes priority, since it serves as the 'starting point':

> As a rule, natural and legal persons should be free to decide whether or not to contract and with whom to contract. They should also be free to agree on the terms of their contract.[19]

For the purposes of this article, the second sentence is the crucial one: the default rule is that the parties are free to agree whatever terms best fit their interests. The position expressed in the introduction to the DCFR is affirmed by the operative part of the DCFR itself. The general provisions in Book II on 'Contracts and other juridical acts' include an article affirming the priority of party autonomy. Article II. – 1:102 DCFR was modelled on Article 1:102 PECL and Articles 1.1 and 1.5 of the UNIDROIT Principles of International Commercial Contracts and reads as follows:

1) Parties are free to make a contract or other juridical act and to determine its contents, subject to any applicable mandatory rules.

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[15] For an overview, see Armbrüster, in *Münchener Kommentar zum BGB* (2006, 5th ed.) § 134 at para. 50 ff.

[16] F. Chabas, *Lessons de droit civil, Obligations, Théorie générale* (1998, 9th ed.) para. 118 ff.; J. Flour, J.-L. Aubert and E. Savaux, *Droit civil, Les obligations*, Volume I: L'acte juridique (2004, 11th ed.) paras. 282, 292; Terré, Simler and Lequette, *Droit civil, Les obligations* (2005, 9th ed.) paras. 377, 382; cf. also Bénabent, *Droit civil, Les obligations* (2005, 10th ed.) para. 160.

[17] Terré, Simler and Lequette, above n. 16, at para. 384.

[18] C. von Bar, E. Clive and H. Schulte-Nölke (eds.), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (Outline Edition 2009) at 60.

[19] Id., at 62.

2) Parties may exclude the application of any of the following rules relating to contracts or other juridical acts, or the rights and obligations arising form them, or derogate from or vary their effects, except as otherwise provided.

3) A provision to the effect that parties may not exclude the application of a rule or derogate from or vary its effects does not prevent a party from waiving a right which has already arisen and of which that party is aware.'

Paragraphs 1 and 2 of Article II. – 1:102 DCFR make it clear that mandatory rules that place limits on the freedom of contract are the exception, not the rule. The 'ordinary' provisions of the DCFR are only of a default nature and have to step aside where the parties have provided otherwise. Article II. – 1:102 (3) DCFR adds the qualification that even mandatory rules do not exclude the authority of the parties to waive any rights that have already accrued under such a scheme. This is important, as the parties to a dispute that is governed by mandatory law would otherwise lack the authority to settle their dispute by any means other than litigation to the very end. As a settlement necessarily requires some measure of retreat by both parties, it involves a partial waiver of vested rights. Without Article II. – 1:102 (3) DCFR, the parties would be unable to settle controversial cases.

4 Economic Analysis

As has already been indicated, economic analysis has made major contributions in advancing the understanding of mandatory law.

4.1 The Economic Justification for Freedom of Contract

Before delving deeper into the topic of mandatory rules, it is important to outline and define what is in question. Even though economic theory does allow for mandatory rules, freedom of contract remains the overriding principle.[20] Within the neoclassical economic model, the market is the mechanism for making social decisions on the allocation of the means of production and the distribution of goods and services. The invisible hand of the market is thought to be superior to the conscious decisions on allocation and distribution made by a collective decision-maker such as a planning agency. The market is populated by parties who are strictly rational, in the sense that they strive to maximise their utility, given their preferences. The primary function of the law of contract is to enable the parties to go beyond spot-transactions and to agree on sequential performance.[21] Where one party performs unilaterally, it exposes itself to exploitation by the other side, which may renege on its promise and decide to run with the value delivered to it. Basically, the same problem arises in respect to contracts involving customised goods that still need to be produced by the seller. Again, the seller runs the risk of exploitation by an opportunistic buyer who may refuse to accept the goods and pay the price.[22]

By focusing on the organisation of efficient exchanges over time, economic analysis certainly captures an important function of contract law. However, it must not be overlooked that contract law has a role to play in spot-transactions too. Tellingly, the Roman law of sale was developed in regard to such spot-transactions, agreed on in the open market where foodstuffs, animals, and slaves were traded.[23] The ancient 'warranty law' was created by the Roman police who monitored and controlled the activities on the open market, and settled disputes where they arose. Such transactions raised a range of problems, such as the passing of risk, the consequences of defects, and liability in

[20] B.E. Hermalin, A. Katz and R. Craswell, 'Contract Law', in A.M. Polinsky and S. Shavell (eds.), *Handbook of Law and Economics*, Volume I (2007) at 21 ff.

[21] Id., at 9 ff.; Shavell, *Foundations of Economic Analysis of Law* (2004) at 296 ff.

[22] Hermalin, Katz and Craswell, above n. 20, at 10 ff.

[23] R. Zimmermann, *The Law of Obligations* (1990) at 311 ff.; M. Kaser and R. Knütel, *Römisches Privatrecht* (2008, 19th ed.) § 41 at para. 1 ff.

damages for the consequences of such defects. This shows that there is a need for legal rules – a law of contract – even for spot-transactions. In the absence of an elaborate 'warranty law', the parties to a contract of sale would have to draft, negotiate, and agree the relevant rules themselves, at the price of considerable transaction costs.

4.2 The Economic Justification for Default Rules

The previous point highlights the economic justification for the parts of contract law, which operates by formulating default rules, from which the parties may derogate if they so wish. In theory, the parties could devise and agree such rules among themselves, making a law of contract, made by legislators or judges, seem unnecessary. The real function of default rules is to facilitate transactions by relieving the parties of the burden of drafting and negotiating their own 'law of contract'. Default rules reduce transaction costs and, therefore, increase the benefit of the bargain to be shared between the parties. In addition, they increase the amount of transactions that can be executed in any given economy. These desirable effects require the default rule in question to provide a solution that reflects what both parties would have agreed on, had they attempted to achieve a negotiated solution. Where the pool of parties is not homogenous, in the sense that one group would have agreed on rule X and another one on rule Y, lawmakers and judges should pick the rule that the majority of potential parties would have settled on had they negotiated the issue – the so-called "majoritarian default rule."[24] The costs of contracting around the default are relevant only where such costs differ between several groups of parties. Given these differences, the objective is to reduce the combined transaction costs incurred by all the parties concerned.[25]

In recent years, the economic analysis of default rules has developed far beyond the function of saving transaction costs. The theory of penalty default rules points out that there are default rules that do not reflect the intentions of the majority of potential parties, but are contrary to the parties' interests.[26] Their purpose is not to economise on transaction costs but to provide the better-informed party with incentives to share the information with the other side. Here, default rules work as a remedy to an asymmetric distribution of information relevant to a certain transaction.

Another strand of research on default rules questions the assumption that the parties will deviate and create their own rule when the solution supplied by the default rule contradicts their interests. In theory, a tailor-made solution will only be negotiated where the value added by this solution is greater than the transaction costs incurred by achieving it. In practice, it seems that parties fail to derogate from default rules even where transaction costs are relatively low. It seems therefore, that default rules may be much 'stickier' than suggested by models of contracting.[27]

4.3 The Economic Theory of Mandatory Law

Compared to default rules, mandatory rules within the law of contract have received less attention.

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[24] R. Cooter and T. Ulen, *Law and Economics* (2008, 5th ed.) at 221; Shavell, above n. 21, at 299 ff.

[25] Hermalin, Katz and Craswell, above n. 20, at 87.

[26] Path-breaking: I. Ayres and R. Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 *Yale L. J.* 87; advocating a different opinion: E. Posner, 'There are No Penalty Default Rules in Contract Law' (2006) 33 *Fla. St. U. L. Rev.* 563.

[27] R. Korobkin, 'The Status Quo Bias and Contract Default Rules' (1998) 83 *Cornell L. Rev.* 608; id., The Endowment Effect and Legal Analysis' (2003) *97 Nw. U. L. Rev.* 1227; O. Ben-Shahar and J.A.E. Pottow, 'On the Stickiness of Default Rules' (2006) 33 *Fl. St. U. L. Rev.* 651; L. Bernstein, 'Social Norms and Default Rules Analysis' (1993) 3 *S. Cal. Interdisc. L. J.* 59 ff.

4.3.1 Internalisation of External Costs

A classic purpose of mandatory law is to prevent the parties from imposing costs on non-parties.[28] In the interest of social welfare, the parties to a transaction should consider not only its total benefit, but also the full costs. Where this objective requires the creation of legal rules that attribute external costs to the party whose activity caused them, it is self-evident that the application of such provisions cannot be excluded by mere agreement of the parties. If the parties were allowed to contract around a rule that aims to internalise external costs, they would certainly take advantage of this authority. If it were possible to validly agree on a contract to the detriment of a third party, the parties would do so. Therefore, provisions against externalisation of costs must necessarily be mandatory in nature.

4.3.2 Safeguarding Rational Decisions

Another function of mandatory law is to serve as a safeguard for the rules on contract formation, or at least for relevant parts of the law dealing with contract formation.[29] Every legal system includes provisions that are meant to protect those members of society that are unable to make rational decisions and to act accordingly. The classic example is the law of capacity, which invalidates promises made by minors and the mentally ill. These rules are supported by economic reasoning: individual decisions only lead to efficient outcomes if they are made by rational agents.[30] Even though adults are assumed to have such capacity, the ability to make reasonable choices may be absent or impaired in a particular situation. For this reason contracts concluded under the influence of fraud or duress do not qualify as a means of resource allocation.[31]

4.3.3 Compensation of Informational Asymmetries

Another domain of mandatory law are situations where information is asymmetrically distributed between the parties. As long as this asymmetry only has distributional consequences, it is of no concern to economics. For the purposes of allocative efficiency, it does not matter how the surplus is divided between the parties.

However, informational asymmetries may also distort the allocation of scarce resources. Akerlof's seminal work in this area was concerned with the market for used cars. The upshot of the analysis of a so-called 'lemons market' was that the uncertainty of buyers, about the quality of the cars offered, resulted in a 'race-to-the-bottom' that drove quality and prices down to a level that did not reflect the interests of either party. The situation may be remedied by imposing a 'duty to inform' on the party with superior information towards the party lacking it. An alternative is to make that party liable for breach of an implied warranty of fitness for ordinary use.

From the perspective of paternalistic elements in contract law, another consequence of informational asymmetry is even more interesting, namely restrictions on signalling.[32] In essence, signals are devices that a party with private information may use in order to credibly transmit this information to the contracting partner. Signals are helpful where the private information is beneficial for the party with such information, because it suggests that the quality of the goods or services promised, or the probability of performance, will be above average. A seller offering high-quality commodities might offer long-term warranties in order to induce buyers to pay a higher price in exchange.

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[28] Cooter and Ulen, above n. 24, at 226 ff.; Hermalin, Katz and Craswell, above n. 20, at 30 ff.; Shavell, above n. 21, at 320.

[29] Cooter and Ulen, above n. 24, at 225 ff.; cf. also Hermalin, Katz and Craswell, above n. 20, at 40 ff.; T. Kronmann, 'Contract Law and Distributive Justice' (1980) 89 *Yale L.J.* 472, 490 ff.

[30] Hermalin, Katz and Craswell, above n. 20, at 40 ff.

[31] Shavell, above n. 21, at 329 ff.

[32] P. Aghion and B.E. Hermalin, 'Legal Restrictions on Private Contracts Can Enhance Efficiency' (1990) 6 *J. Law, Econ. & Organ*. 381; Hermalin, Katz and Craswell, above n. 20, at 34 ff.

A construction company may agree to high penalty clauses, in case of late completion, in order to induce the owner to accept its bid, even if it comes at a higher price. But even for diligent sellers and construction companies, the use of such signals comes at a considerable cost, which may pose a significant risk. Even assuming a perfectly rational actor, it may be that owners and buyers will find it difficult to separate good-type sellers or construction companies from bad-type sellers or construction companies, triggering a process that leads to ever more intensive signalling. In the end, good-type sellers or construction companies might have an interest in offering clauses calling for excessive penalties, even though they would be better off with more moderate penalties. This effect has been identified even without introducing psychological dispositions, such as over-optimism, self-serving bias and underestimation of low-probability events, which may reinforce the tendency to 'signal' excessively. Mandatory restrictions on signalling may, therefore, be in the interest of both parties. A pertinent example is the authority of courts to take action against excessive penalty and liquidated damages clauses.

4.3.4 Monopolistic Markets

An obvious case for legal intervention by means of mandatory law is the presence of a monopoly.[33] However, the preservation of competitive markets is primarily within the remit of competition or antitrust law, not of the law of contract. Competition law itself operates through the use of mandatory law. Otherwise, cartel members would (of course) exclude the application of competition law by agreement, which would render the entire legal framework meaningless.

Outside the domain of hard-core cartels, the division of labour between competition law, on the one hand, and contract law, on the other, is less clear. Tellingly, Article 102 TFEU (formerly Article 82 EC) prohibits the abuse of a dominant position in the market and, in doing so, invalidates contractual provisions that grow out of such abuse.[34] Vice versa, beyond the scope of competition law, a whole range of 'small cases' remain where the market stays competitive, while the transaction in question is affected by monopoly power. The rules banning usury are a pertinent example of the reaction of a legal system to a case of 'situational monopoly'.[35] Here, one party exploits the distress of the other party in order to extract benefits that it would not be able to obtain outside the distressed situation.

5 Paternalism – An Antidote to Economic Analysis?

How does paternalism relate to economic analysis, particularly in the area of contract law? It is widely believed that paternalism is in conflict with economic reasoning, or even its antidote. In order to obtain a more nuanced perspective, the concept of paternalism needs some clarification. Adopting a definition suggested by Gerald Dworkin, paternalism means 'the interference with a person's liberty of action justified by reasons referring exclusively to the welfare … of the person being coerced'.[36] As has been pointed out in the literature, the requirement of 'coercion' must not be understood too narrowly.[37] In order to be qualified as paternalistic, the intervention may also take advantage of the unconsciousness of a person (e.g. conducting a blood transfusion on an individual who rejects such measures for religious reasons), or may remove an opportunity that a person would otherwise have used at a later point in time (e.g. the removal of drugs from the bedroom of a depressed person in order to prevent suicide).

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[33] Cooter and Ulen, above n. 24, at 230 ff.; Hermalin, Katz and Craswell, above n. 20, at 39 ff.

[34] This is not say that Article 102 EC is limited to invalidating contracts; for an overview, see R.J. van den Bergh and P.D. Camesasca, *European Competition Law and Economics: A Comparative Perspective* (2006) at 247 ff.

[35] Cooter and Ulen, above n. 24, at 230 ff.

[36] G. Dworkin, 'Paternalism' (1972) 56 *The Monist* 64 at 65.

[37] J. Kleinig, *Paternalism* (1984) at 5 ff.; B. Gert and C.M. Culver, 'Paternalistic Behaviour' (1976) 6 *Phil. & Pub. Aff.* 45, 46 ff., whose critique of Dworkin's definition seems overdrawn.

Given this definition – interference with a person's liberty against her will for the purpose of furthering her own welfare – it seems obvious that paternalism is at odds with economic theory. As explained above, economic reasoning maintains that the satisfaction of individual preferences promotes the common good. The underlying assumption is that individuals know best what is good for them. Paternalism relies on the opposite view: that individuals are error-prone in regard to the promotion of their own well-being. Therefore, it seems incompatible with economic reasoning.

Matters are, in fact, more complicated than the incompatibility thesis suggests. This is because economics is not concerned with the matter-of-fact satisfaction of real preferences, but with rational decisions that lead to efficient outcomes.[38] If the objective of economics was the satisfaction of actual preferences of individuals – and nothing more – one would not have to be concerned with asymmetric information and other obstacles to rational decision-making. As a normative discipline, economic analysis presupposes that decisions are made rationally, and on the basis of as much information as is available, given the costs of gathering and processing such information. Where the condition of full information is not given, it is believed that regulatory interference with market processes, in the name of economic efficiency, is justified.

However, the argument does not stop there. Even absent asymmetries of information, it is conceivable that there are individuals who are unable to make rational decisions; that is, to choose rationally between different options. In as much as reality does not correspond with this assumption, it is difficult to see why, from an economic point of view, the law should not intervene. Not surprisingly therefore, Kaplow and Shavell argue that 'proper welfare economic analysis takes these imperfections [i.e., limitations on individual's decision-making] into account'.[39] Their conclusion is:

> … that the empirical inquiry becomes more difficult when individuals' choices in the marketplace or in other settings are not reliable indicators of their actual well-being.[40]

In summary, economic theory operates on the basis of a stylised, ambitious concept of rational choice and does not take the actual choices made by individuals as a given. Therefore, standard textbooks on economic analysis of contract law do not criticise or even reject traditional legal concepts, such as capacity, fraud and duress, even though they serve to invalidate promises that were made in accordance with actual preferences.[41] In the textbook of Cooter and Ulen, the rule invalidating promises made by incompetent persons is explained as follows:

> A rational decision-maker can rank outcomes in order from least preferred to most preferred. In order to rank outcomes, the decision-maker must have stable preferences. If the decision-maker's preferences are unstable or disorderly, he or she cannot make competent judgements about his or her own interests. Such a person is legally incompetent. For example, children, the insane, and some mentally retarded adults are legally incompetent.[42]

No-one will dispute that the preferences of children must not be taken at face-value and that this justifies legal intervention. It should also be clear that this intervention is of a paternalistic nature. The actual preferences of minors, the mentally retarded and the insane are discounted in favour of decisions made by others – parents or guardians – in 'the best interest' of the child or adult. Even though the case for intervention is uncontroversial, the justification seems questionable. Is it really true that children under the age of majority and mentally disabled people are unable to form stable preferences? Imagine a mentally disabled billionaire who developed a habit of giving money away randomly, such as paying taxi-drivers a fortune for short journeys. The preference of making other people happy, by showering them with money may be stable, yet the law would intervene nonetheless. Of course, faithful economists might reject the intervention as unwarranted in the previous example, but it is hard to deny that there

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38 For a detailed account, see E. Zamir, 'The Efficiency of Paternalism' (1998) 84 *Virginia L. R.* 229, 241 ff.
39 Kaplow and Shavell, above n. 4, at 410 ff.
40 Id., at 413.
41 R. Cooter and T. Ulen, above n. 24, at 279 ff.
42 Id., at 280.

are other examples where even stable preferences will be set aside. If a twelve-year-old develops a stable preference for heroin, few economists would dispute that paternalistic intervention is justified.

If it is accepted that economic analysis is built on rational decision-making and not simply on maximising the actual preferences of the moment, which are formed on the basis of deficient information, then it is immediately clear that the problem is not black and white.

An adult person is certainly in a better position to form stable preferences, and to act accordingly, than a child or mentally retarded person might be; but it is obvious that adults differ dramatically not only in their ability to make rational decisions but also in their capacity to form preferences that satisfy the conditions of commensurability, transitivity, invariance, cancellation, and dominance.[43] Among those, the requirement of commensurability is by far the most important and complex. It requires that actors are able to identify the perceived consequences of all the options available in a given situation in advance, to measure the expected utilities, and to transform the result into numbers, in order to make a comparison and to pick the option that promises the most utility.[44] Particularly where outcomes are uncertain, a calculation such as this is complicated, even for academics with plenty of time, let alone ordinary people operating in real-life situations under considerable time pressure.

The next step in the analysis must confront the question of whether it may even be legitimate to override the actual preferences of an individual in a given situation and to reshape them in the desired way. Whether this is done for the purpose of furthering some abstract notion of the "common good" or the "good life", goes beyond the scope of this article. However, the issue of paternalism arises where the intervention is justified by reference to the interests of the party whose preferences are to be realigned.[45] A pertinent example is the regulation or prohibition of smoking, even in areas where third parties are not affected at all or are only trivially affected.[46] As smoking harms the health of the smoker, such regulations are of a paternalistic nature: the smoker has the preference to smoke but must not indulge in this habit for the sake of his own health. By banning smoking, lawmakers may hope that the habit or addiction may subside in order for the smokers themselves to benefit in the long run. This line of reasoning raises a serious issue: whether the actual preferences of the individual, at the time she wants to light a cigarette, may be set aside in light of her perceived preferences years later, when disease would set in.

It seems that there is nothing within the economic approach that stands in the way of a critical assessment of preferences. A purely paternalistic approach would measure the actual preferences of an individual against an 'objective', external yardstick in order to justify intervention, if the two do not match up. An individualistic approach would not subscribe to an external measure of well-being, but would rather rely on the articulated long-term preferences of the individual concerned, or even the future preferences of the individual as perceived by the scholar or policy-maker instead. There is no point denying that reliance on articulated – but not actuated – preferences, or even the construction of future preferences, remains problematic, since it opens the door to the imposition of external conceptions of 'rational preferences'. Therefore, lawmakers and judges would be well-advised to act with restraint when disregarding the actual preferences of the individual in favour of 'rational preferences'. Moreover, there is nothing that stands in the way of taking future preferences into account, even where they contradict the actual preferences of the individual at the present time.

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[43] R. Korobkin and T. Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 *Cal. L. Rev.* 1051 at 1064.

[44] Kaplow and Shavell, above n. 4, at 18, n. 6.

[45] Cf. R.H. Thaler and C.R. Sunstein, *Nudge* (2008) at 4 ff.

[46] For a thorough analysis, see R.E. Goodin, 'The Ethics of Smoking' (1989) 99 *Ethics* 574 at 582 ff.; see also J.D. Hanson and K.D. Logue, 'The Costs of Cigarettes: the Economic Case for Ex Post Incentive-Based Regulation' (1998) 107 *Yale L. J.* 1163 at 1203 ff.

6 Categories of Intervention

The next step in the analysis is to identify situations where the intervention of the law in the form of mandatory rules is warranted.

6.1 Protection of Self-Determination

6.1.1 Capacity, Fraud, and Duress

Significant parts of the law of contract aim at protecting the autonomy of the contracting parties in the sense of rational self-determination. The classic example are the rules on capacity, which protect people who are incapable of acting rationally. It is self-evident that the legal rules protecting minors and the mentally ill are not themselves subject to derogation by party agreement. A person suffering from Alzheimer's disease cannot waive the protection accorded by the law.

The rules on capacity do not exhaust the basic problem that people may conclude contracts in situations where they cannot act rationally. Capacity is a borderline case, as it is not concerned with the particular situation in which a promise is made, but with the characteristics of the person making the promise. The traditional doctrines on fraud and duress go one step further, in that they do not react to the condition of the person making the promise but to the situation in which the promise is made. For promises made at gunpoint, the law rightly presumes that the person concerned was incapable of making a rational choice, even though the promisor was a healthy adult. Basically, the same considerations apply to cases of fraud. Here, the choice was influenced by error, and the error was caused intentionally by the other side. The reason why the contracting partner engaged in such a manoeuvre is his assumption that, without the misrepresentation, the promise would not have been made. Again, it is obvious that such circumstances are inimical to rational choice, to the effect that the promise may be set aside at the discretion of the promisor. The protection from fraud would be meaningless if it were possible to waive such protection by means of an act that is itself a product of fraud. The rules against fraud are mandatory for a good reason.

Whether the rules on capacity, insanity, fraud, and duress may be categorised as 'paternalistic' is subject to debate. As explained above, they are not only staples of Western legal systems but are also supported by economic analysis.[47] Nonetheless, it seems possible to argue that the 'natural' will and the real preferences of the person are set aside where the law intervenes to protect the young and mentally ill, as well as normal adults acting under the influence of fraud or duress. Likewise, the use of rational self-determination as a yardstick for measuring real-life transactions may be disparaged as camouflage for the exogenous preferences of the decision-maker. Those arguments do not carry much weight, however. It is simply implausible to celebrate the promises of minors and the mentally ill, as acts of self-determination. Furthermore, while the law places the authority to make promises in the hands of parents or guardians where capacity is lacking, it does not authorise a third party to make choices on the behalf of others in the cases of fraud and duress. Here, it is simply wrong to label the intervention as paternalistic.

In current legal discourse, the traditional doctrines are beyond dispute. What moves the lawmakers and judges of today are not these classical exceptions to the principle of *pacta sunt servanda,* but the expansion of such rules into new areas, such as distance and doorstep selling, consumer credit, consumer sale, and consumer law in general. These are the instances that French legal doctrine has succinctly classified as touching upon the *ordre public économique*, which is to say, calling for the protection of the 'weaker party' within the contractual relationship.[48]

[47] See section 3.3.2 above.
[48] See section 2.2 above.

6.1.2 Doorstep Selling

Over the years, the European Union has created a body of law that aims to protect the consumer by introducing rights of withdrawal from contracts that were validly concluded. The starting point for this development was the Doorstep Selling Directive of 1985.[49] Pursuant to its Article 3, the Directive applies to contracts for the supply of goods or services by a trader to a consumer that are concluded away from business premises. Article 5 of the Directive confers upon the consumer a right to withdraw her promise within a specified time after receipt of a notice by the trader informing her of this right. Pursuant to Article 6 of the Directive, the consumer may not waive the rights conferred by the Directive.

The purpose of the Doorstep Selling Directive is explained in Recital 5, which provides that the trader meets the consumer unprepared for contract negotiations and in a situation where she cannot compare the quality and price of the trader's offer with the offers of other traders. The rationale behind the right to withdraw is to enable the consumer to understand her obligations under the contract and – additionally – to engage in some sort of cost-benefit analysis with respect to competing offers. The solicitation of a contract away from business premises therefore poses a serious threat to the rational self-determination of the consumer. However, the source of the most serious risk to the self-determination of consumers is not mentioned in the recitals, namely the fact that the seller (or rather his agent) intrudes into the privacy of the home of the potential buyer and thus forces a personal relationship on the buyer from which the latter may have difficulty escaping. The most striking case is the one where an agent visits the consumer at home, where the consumer may feel that the only way to make the sales agent leave is to sign the contract with which she is confronted. It is much easier to refuse a purchase in the anonymity of a public store than inside one's own home, sitting eye-to-eye with the seller or his agent.

In summary, the right of the consumer to withdraw a promise made on her doorstep is well founded. The current Proposal for a Directive on Consumer Rights will do well to maintain it.[50] It is also obvious that the right of withdrawal cannot be waived by a transaction concluded on the doorstep of the consumer. Precisely because the self-determination of the consumer is at risk, the exclusion of the right of withdrawal from a contract contaminated by such risk must be ineffective. For this reason, the right of withdrawal must be mandatory.

6.1.3 Distance Contracts

Another situation where a consumer operating on the European market has a right to withdraw from a contract for the sale of goods or the provision of services involves distance contracts. Under Article 6(1) of Directive 97/7/EC, the consumer has to exercise this right within seven days of receiving the goods.[51] Even though the legal tool remains the same, the right of withdrawal in cases of distance selling rests on a completely different foundation than the one granted in the case of doorstep sales. The latter is meant to allow the consumer to rethink and re-evaluate a deal struck in a situation inimical to rational decision-making. This concern is missing in cases of distance selling.

A consumer sitting at home in front of her computer is under no pressure whatsoever to enter into a transaction. She may freely decide to leave the website at any time, to compare offers of other sellers and come back whenever she wishes. The right of withdrawal is not a response to a situation where the rational self-determination of the consumer is put at risk. This does not mean, however, that the right of withdrawal in cases of distance selling lacks a normative foundation. Quite simply, it serves the purpose of allowing the consumer to physically investigate the goods before making a

[49] Council Directive 85/577/EEC, see above n. 7.
[50] Proposal for a Directive on Consumer Rights, see above n. 8, Article 8 ff.
[51] Directive 97/7/EC, see above n. 7.

final decision to buy, or to reject them. As a consequence, the time limit for exercising the right of withdrawal does not run from the day of the conclusion of the contract but from the day when the consumer receives the goods in question, that is, the day of delivery.

Why is it important to identify the normative concerns underlying the different rights of withdrawal? The answer is that the normative justification of the right to withdraw is important in regard to the choice between their default or mandatory nature. As regards contracts that were concluded away from business premises, it has been pointed out that the legal regime protecting the consumer must be mandatory, because the protection would otherwise be worthless. This reasoning does not correspond to cases of distance selling, for the simple reason that the conclusion of the contract is not contaminated with a potential deficit of rational self-determination. Therefore, a waiver of the right to withdraw is not suspect per se, even if it is agreed at the time of contract. A consumer may rationally decide to waive the right of withdrawal in exchange for a better price. Intermediate solutions may also be devised. In particular, the contract could allow for a right of withdrawal but allocate the costs of withdrawal (for example the costs of sending the goods back and forth and repackaging them for another sale), entirely to the consumer. Under Article 6(1) of the current Directive on Distance Contracts, the only amount that may be charged to the consumer for exercising her right of withdrawal is the direct cost of returning the goods.

The argument for party autonomy outlined above may be criticised on grounds of commercial practices observed in markets for distance selling. In fact, most sellers that are active in this segment of the market offer rights of withdrawal voluntarily, and go even further than the Directive requires in taking the full costs of withdrawal upon themselves. The motive behind this practice is, of course, to entice the consumer to order the goods in the first place. If an internet shoe seller did not offer a withdrawal right, hardly anybody would order the goods, even if they were sold at low prices. The same consideration applies to clothes and other goods that must 'fit' in order to make sense for the buyer.

Even though it is doubtlessly true that, even without the Directive on Distance Contracts, rights of withdrawal would be offered and agreed on a voluntary basis, this does not establish a need to make the right of withdrawal mandatory. In a sense, the lawmakers in Brussels arrived at the same conclusion, because they limited the scope of the Directive by means of an impressive set of exclusions. Pursuant to Article 6(3) of Directive 97/7/EC, the consumer may not exercise the right of withdrawal where any of the following transactions is involved:

- contracts for the provision of services if performance has begun, with the consumer's agreement, before the end of the time limit for withdrawal;
- contracts for the supply of goods or services the price of which is dependent on fluctuations in the financial market which cannot be controlled by the supplier;
- contracts for the supply of goods made to the consumer's specifications or clearly personalised or which, by reason of their nature, cannot be returned or are liable to deteriorate or expire rapidly;
- contracts for the supply of audio or video recordings or computer software which were unsealed by the consumer;
- contracts for the supply of newspapers, periodicals and magazines; and
- contracts for gaming and lottery services.

Interestingly, Article 6(3) of Directive 97/7/EC does not curtail the parties' freedom of contract, as the parties are free to agree a right of withdrawal if they wish to do so. It only abolishes the mandatory nature of such a right and also removes the corresponding default rule. Without going into the details of every category cited in Article 6(3) of Directive 97/7/EC, a first glance shows that there are valid reasons for their exclusion. If it were possible to withdraw from a contract for the supply of a newspaper some days after delivery, there would be a strong incentive to exercise that right after having read

the paper. A similar form of moral hazard would exist if one were allowed to return unsealed audio CDs to the seller. In these situations, the creation of an unconditional right to withdraw would virtually destroy the distance selling markets in regard to the goods in question.

The current Proposal for a Directive on Consumer Rights intends to keep the mandatory withdrawal right but to expand the catalogue of exceptions further than Article 6(3) of Directive 97/7/EC. Article 19(1) of the Draft Directive would add contracts for the supply of wine, provided that the price was agreed at the time of the conclusion of the contract, and that delivery was arranged for more than 30 days later and that the price of the wine was subject to market fluctuations beyond the control of the seller (Art. 19(1)(d) of the Draft Directive). Furthermore, under Article 19(1)(h) of the Draft Directive, contracts concluded at an auction shall be exempted from the mandatory right of withdrawal. The fact that the Commission has proposed expanding the catalogue of exceptions is telling. Again, it does not support the conclusion that withdrawal rights are dysfunctional in the case of distance selling. What it does show, however, is that the practice of contracting is very diverse, and that the interests of rational parties may differ from one situation to another, making it impossible to come up with a one-size-fits-all solution. It is highly unlikely that the catalogue of exceptions supplied by Article 19(1) of the Draft Directive exhausts the full range of cases, whereby a right of withdrawal is unwarranted as it does not correspond to the interests of the parties. This is immediately apparent with regard to future contracts, which are exempted if they call either for the supply of goods or services which are subject to price shifts in accordance with fluctuations in the financial market that cannot be controlled by the supplier, or for the delivery of wine at a later point in time. Quite obviously, there are many goods beside wine that may be sold under a forward contract, and the fluctuation of the market value of this good may be due to reasons other than fluctuations in the financial market. Other examples can be readily found, such as champagne, whiskey, or cognac. This critique is not meant to suggest that the catalogue of exemptions supplied by Article 19(1) of the Draft Directive should be expanded. It is a hopeless enterprise to try and draw up an exhaustive list of cases in which the right of withdrawal should not be available in advance. The lesson to be learnt from the Commission's efforts to rework the list is that the issue should best be left to party autonomy. The right of withdrawal should not be mandatory, but rather function as a default solution from which the parties should be allowed to derogate if they wish to do so.

The proposal to allow party agreements to exclude the right to withdraw is subject to objections turning on the prediction that sellers would immediately resort to this option if it were made available. This objection is without a sound basis for a number of reasons. Sellers engaged in distance selling have a strong incentive to offer an unconditional right to withdraw voluntarily. Even outside the area of distance selling, many shops are willing to grant their customers unconditional rights of return, which allow the buyer to return the goods in exchange for the purchase price within a fixed period of time. The reason why shop owners offer this privilege is not their altruism, but their interest in increasing the number of transactions. Obviously, consumers are more willing to buy products if they enjoy the option of returning them in case of remorse. The right to return works as an incentive to purchase. Therefore, it need not be made mandatory.

The second argument against the objection to party autonomy is based on Directive 93/13/EC on unfair terms in consumer contracts, which authorise the courts to intervene where the interests of consumers are harmed without just cause. The function and justification of this instrument will be explored in detail below. At this point of the analysis, it is important to point out that court control over consumer contracts, as established by Directive 93/13/EC, makes it impossible for sellers engaged in distance selling to exclude the right of withdrawal even where there is no valid reason to do so. A court would always be authorised to intervene if a seller of shoes or clothes excluded this right without a valid cause. The modern law of contract need not choose between unlimited party autonomy and mandatory rules but may opt for a third way, between the two extremes, namely court control over individual contracts where terms derogate from the default rules set by lawmakers. There is no evidence that this instrument would not work well in the area of distance selling and rights of withdrawal.

6.2 Court Control over Contract Terms

Directive 93/13/EEC on unfair terms in consumer contracts is a "hybrid instrument" in several respects. It occupies the grey area between mandatory law and default rules. More precisely, it transforms the vast body of contractual default rules into semi-mandatory rules. The result of the transformation is not the full exclusion of party autonomy, because it is for the courts to decide, on a case-by-case basis, whether a contractual provision is unfair and thus not binding on the consumer (Art. 5(1) of Directive 93/13/EEC). Thus, court control over individual cases substitutes the flat invalidation of contractual terms, which is the function of mandatory law. From a functional perspective, however, the legal regime of the Unfair Terms Directive also stands between the traditional positions. Given the current state of European contract law, and the framing of the problem of unfair terms as one of consumer protection, this function is difficult to discern. Its purpose is not to protect consumers as such, but to provide a remedy for situations in which the chance for rational choice is impaired. This is the case where, in the course of contract formation, one party is presented with a set of standard business terms that the other has taken time and care to develop. Where small stakes are involved, the party presented with such terms lacks any incentive to become active, i.e. to read the terms, to analyse them, and to engage in negotiations with the party that has drafted them. The stakes do not warrant the effort, so it is rational to remain apathetic. In itself, such rational apathy poses no problem, as market forces drive the quality of goods and services traded in a competitive environment, up to the efficient level. Nobody would argue with the baker about the composition of his bread, but this kind of ignorance and lack of interest remains innocent for product quality, because buyers will turn away from bakeries that offer sub-standard bread. With regard to contract terms, matters are different. Nobody cares about the fine print embodied in contract forms, because disputes are low-probability events that remain outside the focus of deliberate choice. As a consequence, sellers who offer high-quality terms cannot recoup the additional costs involved by charging a higher price, because buyers are not interested in the quality of contract terms and therefore unwilling to pay a higher price for a high-quality contract.

This process results in a 'market for lemons', as defined in the seminal article by Akerlof, in which the used car market serves as an example.[52] In a nutshell, the ignorance of the buyers about the quality of the cars put up for sale drives down the price they are willing to pay for a car, which in turn makes it rational for owners of high-quality cars to drop out. In the next round, the expectation of buyers is for even poorer cars, so that another group of sellers drops out, and so on. This process may continue until all potential parties have withdrawn from the market or, more realistically, when only bad cars (lemons) are offered for poor prices. Essentially, the same reasoning applies to the fine print of contract terms.[53] As pertains to contract terms, the market will never dry up completely, because standard terms and conditions are not important enough to influence the decision of whether or not to execute the transaction. However, the inability of high-quality sellers to charge a price covering the additional costs results in a race-to-the-bottom where only the poorest terms are offered, i.e. those that are most detrimental to the interest of the buyer.

Put succinctly, the combination of rational apathy on the part of buyers and the ineffectiveness of market forces results in the degradation of contract terms. One

[52] G. Akerlof, 'The Market for "Lemons": Qualitative Uncertainty and the Market Mechanism' (1970) 84 *Quart. J. Econ.* 488.

[53] The application of the 'lemons market' problem to standard contract terms is popular in German legal literature, less so with American writers: M. Adams, 'Ökonomische Analyse des Gesetzes zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen', in M. Neumann (ed.), *Ansprüche, Eigentums- und Verfügungsrechte* (1984) 655 at 660 ff.; H. Kötz, *JuS* 2003, 209 at 211 ff.; H.B. Schäfer and C. Ott, *Ökonomische Analyse des Zivilrechts* (2005, 4th ed.) at 513 ff.; G. Wagner, *Prozeßverträge* (1998) at 126 ff.; M.I. Meyerson, 'The Efficient Consumer Form Contract: Law and Economics Meets the Real World' (1990) 24 *Ga. L. Rev.* 583 at 594 ff.; but also Cooter and Ulen, above n. 24, at 302 ff.; A. Bebchuck and R.A. Posner, 'One-Sided Contracts in Competitive Consumer Markets' (2007) 104 *Mich. L. Rev.* 827 at 833, who argue on the basis of the assumption that 'a term [beneficial to the consumer] will be included if the average benefit exceeds the average cost' – which is the question.

remedy to this problem would be to transform the full set of default rules into mandatory law. However, in doing so, lawmakers would go overboard. The fact that the contract mechanism fails in the situation described above does not imply that the solution provided by a particular default rule is always first-best, i.e. that it always serves the legitimate interests of the parties in an optimal way. For the sake of party autonomy and contractual efficiency, it must remain possible to adapt the rules of contract law to specific situations by derogating from the off-the-rack solution embodied in a particular provision. The alternative to making contract law mandatory in its entirety is to address the problem more specifically by targeting the remedy on standard terms, and by abandoning the mechanism of mandatory law, in favour of court control over individual contracts. In essence, this is what the Unfair Terms Directive does.

The Proposal for a Directive on Consumer Rights follows the path of the Unfair Terms Directive in limiting court control to standard contracts with terms that were pre-formulated by the trader or a third party (Art. 30(1) of the Draft Directive). In doing so, the Draft Directive inherits the shortcomings of the original scheme. Minor issues aside, the central point is that the problems standard contract terms raise for the functioning of the contract mechanism are not limited to B-to-C relations. Rather, it seems plausible that the same toxic combination of rational apathy and failure of competitive forces also affects transactions between businesses. In the business world too, it is rational, and therefore common, not to over-invest in contract negotiations. The fine print often goes unnoticed and unanalysed, even in transactions involving more than small stakes. It is certainly true that businesses are in a better position to protect themselves from oppressive terms, since they can draw up their own standard business terms and use them as a shield against a contract partner aiming to infringe on its interests. Furthermore, it is evident that high stakes often trigger serious efforts in negotiating a scheme of remedies for low-probability events such as breach of contract. However, these considerations suggest that standard business terms must not be judged by the same standard when used in B-to-B relations but also that they should remain within the remit of the control of a court. This is why German law also authorises courts to exercise control over contract terms in B-to-B transactions.[54]

6.3 Regulating the Substance of Contracts: Consumer Sales

Within the European Union, the law of the sale of goods – as opposed to real estate – is governed by Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees.[55] This directive created a regime of remedies for breach of contract for which the UN sales law – the Convention on the International Sale of Goods (CISG) – served as a model. This is not the place to discuss whether the substantive provisions of the Directive reflect sound policy or whether they deserve criticism. By and large, the framework of the Directive certainly has its merits.

For present purposes, the critical provision of the Directive is Article 7. Under Article 7(1) of the Consumer Sales Directive, 'any contractual terms or agreements concluded with the seller before the lack of conformity is brought to the seller's attention which directly or indirectly waive or restrict the rights resulting from this Directive shall … not be binding on the consumer'. Article 7(1) also excludes party autonomy with regard to large portions of the law of sales. This is remarkable, given that the sale of goods is the most common and important type of transaction within the law of contracts. If mandatory law were to be the most appropriate means of legislation, there should be sufficient justification to use it anywhere.

The Consumer Sales Directive tries to provide a 'high level of consumer protection' in order to strengthen consumer confidence and entice consumers to shop abroad.[56] For these purposes, the Commission thought it necessary to ensure that the legal

[54] R. Zimmermann, *The New German Law of Obligations* (2005) at 175 ff.; B.S. Markesinis, H. Unberath and A. Johnston, *The German Law of Contract* (2006, 2nd ed.) at 165; P. Ranieri, *Europäisches Obligationenrecht* (2009, 3rd ed.) at 385 ff.

[55] Directive 1999/44/EC, see above n. 7.

[56] Id., at Recs. 1 and 5.

protection afforded by the Directive would not be thwarted by an agreement between the parties that restricts the rights of consumers.[57] This reasoning is based on the implicit assumption that benefits conferred on consumer-buyers come at the expense of sellers, so that the allocation of rights and duties is an exercise in balancing the conflicting interests of the parties. In reality, the consumer-buyers themselves have to pay for any rights they have under a contract of sale, because the total costs associated with the relevant scheme of remedies will be reflected in the contract price. The more expansive the remedies conferred on the consumer, the higher the price the seller will charge for the product in question. Of course, this argument does not imply that it is in the interests of the consumer to be confined to the narrowest scheme of remedies conceivable. Rational consumers will be prepared to pay extra in exchange for some protection from the delivery of defective products. Where this is the case, the law must supply the appropriate remedies. The crucial question for lawmakers, legislating in the area of contract law, is not black and white, i.e. a choice between protecting consumer-buyers either extensively or narrowly. It is also misguided to think of the task in terms of balancing conflicting interests. Rather, the guideline must be the interests of rational consumers, given that they have to cover the costs of any expansion in the scope of protection accorded to them by the law.

Within the context of this article, the analysis of what the scheme of remedies for breach of contract of sale should look like need not be continued any further. The following discussion will assume that an appropriate scheme of remedies has, in fact, been put into place. Even then, lawmakers are well advised not to cast the solutions they arrived at in stone, but to allow for flexibility. Mandatory law excludes the authority of the parties to adapt the statutory scheme of remedies to their particular needs and their interests in the transaction at hand. The full exclusion of party autonomy may be warranted where lawmakers are confident that rational parties will never want to deviate from the scheme of remedies provided. These conditions may indeed be satisfied in reality. In all legal systems, for example, liability of the seller for the consequences of defects cannot be excluded by contractual agreement where the seller, at the time of contract formation, knew of the defect and of the fact that it would deprive the buyer of the benefit of the bargain.[58] No rational consumer-buyer, if he or she thought about it, would agree to waive liability for known defects, if only for the reason that it would destroy any incentives on the part of the seller to be honest regarding the description of the goods he intends to sell.

The scheme of remedies supplied by the Directive on Consumer Sales does not pass this test. It is not the case that a rational buyer would never want to deviate from the statutory scheme of remedies set up by the Directive. In the present context, it is impossible to survey all the relevant situations systematically where rational consumer-buyers would have a legitimate interest in modifying or deviating from the Directive. Instead, anecdotal evidence must suffice. One striking example is the question of the allocation of the right to choose between replacement and repair, where defective goods have been delivered. Article 3(3) of Directive 1999/44/EC initially allocates this right to the consumer-buyer, in order to release the seller from the remedy chosen by the buyer, either where it is impossible, or where the remedy chosen involves disproportionate effort. This solution is reversed in the Proposal for a Directive on Consumer Rights, because Article 26(2) of the Draft Directive allocates the right to the seller whether to choose repair or replacement as a remedy for lack of conformity. There are certainly valid arguments in favour of both options, so that rational people may disagree on what the preferable rule is. In this situation, lawmakers should allow the parties to make their own choice instead of forcing the outcome of the legislative deliberations and power struggles of interest groups on the parties.

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[57] Id., at Rec. 22.

[58] Article 8:109 PECL; Article 7.1.6 of the UNIDROIT Principles of International Commercial Contracts; §§ 276(3) and 444 BGB; but cf. also *Photo Productions Ltd.* v. *Securicor Ltd.*, [1980] A.C. 827, 850 ff. (H.L., per Lord Diplock).

Another example of the adverse effects of the petrification of the law of sale concerns the market for used cars.[59] The German Federal Supreme Court (*Bundesgerichtshof* – BGH) has always allowed the seller of a used car to exclude liability for hidden defects. This case law formed the basis for the development of two separate markets for used cars. Potential buyers could choose between purchasing cars from a licensed dealer with a warranty and purchasing cars from an unauthorised dealership (often located in an abandoned gas station) without a warranty. It was common knowledge among consumers that there were two markets, and it was well understood that licensed dealers charged higher prices than the other traders who bought and sold cars for bargain prices. Depending on the attitude of potential purchasers towards the risk of a defect and on their willingness to pay, one group of consumers settled on the licensed dealers while others turned to the bargain traders. Particularly among young people with little money, plenty of time and some mechanical skills, it was common to buy a car for a low price without a warranty. With the enactment of the Directive on Consumer Sales, this bifurcated structure has been seriously impaired, if not destroyed. It is no longer possible to buy a car from a trader without a warranty. As a point of clarification, with regard to the sale of used goods, Article 7(2) of Directive 1999/44/EC authorises member states to allow the parties to contractually reduce the time for which the seller is liable from the regular two years (Art. 5(1) of Directive 1999/44/EC) to one year, which the German lawmakers have done.[60] The parties must not undercut this and are not permitted to exclude the liability of the seller for hidden defects altogether. In contrast, throughout the time preceding the adoption of the Directive, the BGH held that, with regard to the sale of a used car, the exclusion of liability for hidden defects was a matter of 'commercial reasonableness' (*wirtschaftliche Vernunft*).[61] The reasoning behind this argument was that the trader was under no duty to search the car for hidden defects since the costs incurred in doing so would be borne by the buyer anyway. In addition, when a used car breaks down after sale, it is difficult to tell whether a defect that becomes apparent at this time had already existed at the time of delivery. Therefore, it was a sound policy to resort to the ancient principle of *caveat emptor* and to allow traders of used cars to exclude their liability for hidden defects.

Apart from this (anecdotal) evidence from the German used car market, it is remarkable that, from a historical point of view, full liability of the seller for defects was the exception and not the rule.[62] In classical Roman law, the seller was not liable for defects of the good delivered, of which he had no knowledge, unless he had chosen otherwise and provided a warranty (*dicta et promissa*).[63] Up to the present day, the principle of *caveat emptor* has survived in important corners of the law of sales. One example is the sale of real estate, where liability for hidden defects is excluded as a matter of course in most jurisdictions.[64] Even though the sale of real estate lies beyond the scope of Directive 1999/44/EC, it remains telling that the parties and their legal advisers believe it to be in their own best interest to stick to the principle of *caveat emptor* when dealing with objects of particularly high value. Is it at all realistic to assume that the rule of no liability is appropriate only where the object of sale is an immovable? The answer to this question can only be negative.

The lawmakers in Brussels would have been well advised to allow the parties to derogate from the statutory scheme of remedies supplied by the Consumer Sales Directive. The risk involved would have been small. The Unfair Terms Directive would have, in any case, provided a tightly-knit safety net. Contractual deviations from the statutory scheme of remedies would have been subject to judicial control on a case-

[59] M. Martinek, 'Unsystematische Überregulierung und kontraintentionale Effekte im Europäischen Verbraucherrecht oder: Weniger wäre mehr', in S. Grundmann (ed.), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts* (2000) at 511, 537 ff.

[60] § 475(2) BGB.

[61] BGHZ 74, 383, 386 = *NJW* 1979, 1886; BGH *NJW* 1966, 1070, 1071; BGH NJW 1970, 29, 31; BGH NJW 1978, 261; critical: F. Peters, *JZ* 1991, 385, 386; Soergel-Huber, *BGB* (1991, 12th ed.) § 459 at para. 306.

[62] Zimmermann, above n. 23, at 307 ff.

[63] Kaser and Knütel, above n. 23, § 41 at para. 45; Zimmermann, above n. 23, at 308 ff.

[64] For the German perspective, see U. Huber, *AcP* 209 (2009) 143 at 162.

by-case basis. Consumers would have retained the right to appeal to a court, had they been deprived of the protection that is appropriate under the circumstances. Against the background of the Unfair Terms Directive, it is difficult to see a justification for mandatory law. Court control over contract terms that derogate from the default rules of contract law is a much more flexible instrument than the clumsy, black-or-white tool of mandatory law.

The Proposal for a Directive on Consumer Rights incorporates the provisions of Directive 1999/44/EC, albeit in a modified form. One important deviation has already been mentioned, namely that Article 26(2) of the Draft Directive allocates the right to choose between repair and replacement to the seller instead of the buyer. The major novelty of the Draft Directive, however, is to be found in its Article 27(2), which reads as follows:

> Without prejudice to the provisions of this Chapter, the consumer may claim damages for any loss not remedied in accordance with Article 26.

Whereas the right to damages was not touched upon by the Consumer Sales Directive, the Commission now wants to move forward and incorporate this remedy as well. From a general point of view, a right to damages as a remedy for the delivery of defective goods is adequate. What is missing, however, is an equivalent to Article 79 CISG, Article 8:108 PECL, Article 7.1.7 of the UNIDROIT Principles of International Commercial Contracts and Article III. – 3:104 DCFR. Under these provisions, the seller is released from liability where delivery of a product in conformity with the description in the contract failed due to an impediment beyond his control. If Article 27(2) of the Draft Directive were to be passed into law, the parties would not be able to remedy the situation themselves, namely by including a force majeure clause in the contract, because the right to damages is mandatory (Art. 43 of the Draft Directive).

The combination of Article 27(2) and Article 43 of the Draft Directive deserves criticism not only for its failure to provide an exception in cases of force majeure, but also for other, more general reasons. In commercial practice, the right to damages is one of the preferred objects of party agreements. For a variety of transactions, it is common, if not to exclude, then at least to specify, and limit the scope of, any damages available in case of breach. Staple provisions of contract practice include limitations on the amounts of damages available (caps), on the amount of time a product is warranted and on the categories of damages recoverable (pecuniary v. non-pecuniary loss). Article 27(2) of the Draft Directive stands in the way of such agreements. The seller is always liable for the full amount of damages, without an option to limit his exposure along the dimensions of time, quantum, and category.

It may seem unfair to sellers to impose full and unrestricted liability on them, regardless of the kind of good involved in the sale, and of the risks involved in the manufacture and transport of the particular item. However, it would be wrong to gauge the problem by weighing up the competing interests of buyers and sellers. Even though this may be true from an ex-post view, the ex-ante perspective is more relevant. From an ex-ante point of view, contractual limitations on the amount of damages owed in cases of breach, serve two functions, namely to prevent cross-subsidisation and to solve the problem of excessive reliance. The latter is caused by the fact that the amount of damages incurred is a function of the reliance investment of the buyer before the time of breach.[65] If the buyer can be certain, either to receive perfect tender, or to be compensated in full, she has no incentive to curb her investments and to take the probability of non-performance into account. While it is true that a general rule attenuating the incentives for excessive reliance has not been developed yet, the parties may rectify the problem in their contract, namely by agreeing on liquidated damages that reflect the damages the buyer would have incurred had she invested in reliance optimally.[66] In making the full compensation rule mandatory, the Draft Directive takes this solution out of the parties' hands.

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[65] Cf. Cooter and Ulen, above n. 24, at 269 ff.; Shavell, above n. 21, at 357 ff.

[66] Cooter and Ulen, above n. 24, at 273 ff.; Hermalin, Katz and Craswell, above n. 20, at 108.

Secondly, the invalidation of caps on the liability of the seller will lead to cross-subsidisation of those buyers who stand to lose large amounts in case of breach – the "large-loss-buyers" – by another group of buyers whose expected damages are small – the "small-loss buyers". Under a mandatory rule of full compensation, the seller will estimate the expected costs of liability and add them to the price charged for the product in question. Where sellers cannot discriminate price, because they cannot tell the two groups of buyers apart, the only solution for them is to charge each buyer the average amount of extra funds needed to cover expected liabilities. This amount will be 'too high' for the small-loss buyers and 'too low' for the large-loss buyers. A common example from an area other than the law of sales is the transport of goods. Ordinarily, carriers charge a price for their services that also covers the costs of some level of protection for cases of loss or other breaches. Customers who need more protection because they stand to suffer large losses in the event of breach may contract for more, but then have to pay a higher price as compensation. Articles 27(2) and 43 of the Draft Directive exclude the limitation of liability and thus make it impossible for the seller to offer a different set of contracts to their customers. This does not cause detriment to sellers, but harms their customers, specifically the low-risk buyers. They are forced to cross-subsidise the high-risk buyers because the contractual instrument for separating the two groups is taken out of the sellers' hands.

The same criticism applies to the DCFR, as its framers have supplied a mirror image of these provisions of the Proposal for a Directive on Consumer Rights in Article IV.A. – 2:309 and Article IV.A. – 4:101 DCFR.

7 Other Justifications for Mandatory Law

7.1 Full Harmonisation

One of the most controversial features of the Proposal for a Directive on Consumer Rights is its ambition to fully regulate all the subject areas it encompasses. Article 4 of the Draft Directive introduces the principle of full harmonisation, which removes the authority of the member states to maintain or create provisions in their national laws that deviate from the prerogatives of the Draft Directive. For the purposes of Article 4 of the Draft Directive, it is immaterial whether a rule of national law may improve the situation of the consumer above the standard of the Draft Directive, or whether it lowers the level of protection. Whether or not this shift away from the policy of minimal harmonisation is justified is beyond the scope of this article.[67]

What matters in the present context is the relationship between full harmonisation and the choice of mandatory law. The Commission does not link the two issues explicitly but stresses the need for certainty and uniformity:

> These disparities [within the consumer *acquis* and its transformation into the laws of the various member states] create significant internal market barriers affecting business and consumers. They increase compliance costs to business wishing to engage in cross border sale of goods or provision of services. Fragmentation also undermines consumer confidence in the internal market …
>
> Full harmonisation of some key regulatory aspects will considerably increase legal certainty for both consumers and business. Both consumers and business will be able to rely on a single regulatory framework based on clearly defined legal concepts regulating certain aspects of business-to-consumer contracts across the Community.[68]

[67] Critically: M. Faure, 'Towards a Maximum Harmonization of Consumer Contract Law?!?' (2008) 15 *Maastricht Journal of European and Comparative Law* 433; H. Micklitz and N. Reich, 'Crónica de una muerte anunciada: The Commission Proposal for a "Directive of Consumer Rights"' (2009) 46 *CMLR* 471; W. van Boom, 'The Draft Directive on Consumer Rights: Choices Made and Arguments Used' (2009) 5 *Journal of Contemporary European Research* 452; J.M. Smits, 'Full Harmonization of Consumer Law? A Critique of the Draft Directive on Consumer Rights', TICOM Law Working Paper No. 2009/02.

[68] Proposal for a Directive on Consumer Rights, see above n. 8, at Recs. 7 and 8.

Even though this reasoning does not explicitly address the role of party autonomy, it may imply that the advantages of uniformity in terms of increased legal certainty, better consumer confidence, and savings in transaction costs justify the decision not to let the parties derogate from the statutory framework.

In reality, however, such a conclusion seems to be misguided. Full harmonisation removes the sovereignty of the member states, while it is fully compatible with the autonomy of the parties. Contractual freedom of choice does not undermine the goals behind full harmonisation, because the parties will only agree to derogate from the statutory framework where, in their judgment, the benefits of doing so will exceed the costs in terms of increased transaction costs. If anything, the argument works the other way around: under a framework of a fully unified consumer law, there is more need for party autonomy than under a system of national consumer laws that allow for deviations. Party autonomy could balance out the inflexibility of a statutory scheme that subscribes to the principle of full harmonisation and ignores local preferences.[69] Therefore, it is particularly regrettable that the Commission combined full harmonisation with immutability instead of party autonomy.

7.2 Weakness of Consumers

In legal and political discourse, it is often argued that consumers are 'weak', at least in comparison to businesses, and that this creates a need for protection.[70] In the case of consumer sales, this seems to have been one of the major justifications for transforming this part of the law of sales into a set of mandatory rules.[71] However, the assumption of weak consumers is untenable in several respects. To begin with, it is simply implausible to assume that the vast majority of the population (consumers) suffers from some congenital psychological 'weakness'. It is also unrealistic, since the causes as well as the presumed consequences of this weakness are not explained. Are consumers unable to understand the product and the contract terms they are offered? Are they incapable of forming a rational will and of expressing it properly? Or are consumers aware of what they want, but simply unable to get their way because they lack bargaining power?

Framed in such broad terms, consumer weakness is a poorly-reasoned artefact. This is not to deny that consumers employ the same cognitive shortcuts and suffer from the same psychological shortcomings as any other human beings. In fact, consumers do not form a distinct class of human beings at all, since the concept denotes a social role rather than a social group. In some regards, everyone is a consumer.[72]

If anything, the assumption that consumers lack the relevant bargaining power *vis-à-vis* businesses may have merit. If one zooms in on a single transaction, it is certainly true that a consumer will have a hard time negotiating with a large enterprise or even with small businesses. For example, the attempt to negotiate with a local grocery store about the quality and price of baked beans will be futile. Even though this is true, it does not prove anything. The *bargaining power* that consumers have does not come in the currency of negotiating power, but manifests itself in the form of an option to walk away. In competitive markets, consumers are strong since they are free to turn down offers they do not like, and to turn to a competitor who offers better quality or lower prices.

Again, there is no point denying that perfectly competitive markets do not exist and that there are a number of factors that might prevent consumers from arriving at rational decisions. Some of the most critical situations have been analysed above. As this survey reveals, the law does react to the 'situational' weakness of consumers as human beings by providing customised remedies. These remedies range from the invalidation of contracts made by minors and mentally disabled persons, through rights of withdrawal, to judicial control over standard business terms. The critical difference between this

[69] G. Wagner, 'The Economics of Harmonizing European Contract Law' (2002) 39 *CMLR* 995, 999 ff.

[70] The Scandinavian systems rely heavily on the theory that consumers need protection because of their 'weakness'; Ranieri, above n. 54, at 374 ff.

[71] See section 5.3 above.

[72] Zimmermann, above n. 54, at 161.

approach and the wholesale assumption of consumer weakness is its specificity: legal intervention is legitimate only where a specific failure of the bargain mechanism, or of the market as a means of efficient resource allocation, can be established. The reaction of the legal system must be tailored not to social roles, but to situations of impaired rational self-determination.

8 Combining Flexibility and Legal Certainty: Options

The critique levelled at the dominance of mandatory rules in European consumer law offers the alternative of a multi-tiered system of specific remedies over the flat solution of immutable statutory rules. In particular, it has been advocated that the consumer should be allowed to waive her right of withdrawal in distance selling contracts, and that the mandatory nature of the law of consumer sales should be abandoned, in favour of court control under the Unfair Terms Directive.[73]

One argument against this approach is that flexibility may look attractive in theory but that it works to the detriment of both businesses and consumers in practice. Its main disadvantage is that it decreases legal certainty and the foreseeability of legal outcomes. The parties will only learn ex post facto whether a particular clause in their contract has stood the test of fairness, or was deemed to be unfair and found to be thus by the competent court. The literature focussing on the distinction between *ius dispositivum* and *ius cogens* has overlooked the fact that mandatory law serves another respectable purpose, namely the function of standardisation. Mandatory rules not only restrict the freedom of the 'stronger' party to the benefit of the 'weaker' party – or, in my terminology, protect parties in situations where rational self-determination is at risk – they also simplify transactions by supplying an immutable scheme of contract terms.[74] Where a contract is subject to mandatory rules, like the contract for the sale of a consumer good in Europe, the parties must settle on a single set of rules. This certainly restricts their freedom to customise contract terms to their special needs and interests. On the other hand, it makes life easier. For example, it reduces the cost of transactions. There is no point adjusting the contract terms since they are unalterable anyway. Mandatory contract terms act as a safe haven but go beyond this, as they abolish the freedom of the parties altogether: the safe haven *must* be used. With regard to transactions between businesses, on the one hand, and consumers, on the other, it seems plausible to argue that the benefits of standardisation will be distributed asymmetrically between the parties. Given that the costs to consumers of analysing, understanding, and negotiating contract terms are prohibitive, standardisation clearly works to their benefit. This is not to say that the savings in transaction costs must necessarily outweigh the dead-weight loss caused by imposing terms on parties against their best interests, but it does suggest that mandatory rules do generate benefits by standardising legal transactions.

For a general theory of contract law, it would be highly attractive to develop a tool that would marry the virtues of mandatory law in terms of standardisation to the obvious advantages of default rules in terms of contractual efficiency. It would have to combine the provision of a safe haven with the flexibility of allowing the parties to use it. Such a tool does in fact exist, and is described as an 'optional scheme'.[75] An optional scheme is characterised by the fact that the parties retain the authority to choose between different legal schemes, or 'options', but that they must not derogate from the schemes supplied by the legal system. A framework of options combines the advantages afforded by standardisation and flexibility. It is not that a uniform legal solution is imposed upon the parties. On the other hand, the parties are not left to their own devices. Rather, the legal system supplies a range of norms from which the parties may pick the set that maximises the joint surplus from the transaction at hand. Within the area of contract law,

[73] See section 5.1.3 above.

[74] C. Engel, 'Zivilrecht als Fortsetzung des Wirtschaftsrechts mit anderen Mitteln' (1995) 50 *Juristenzeitung* 213, 214.

[75] Cf. G. Bachmann, 'Optionsmodelle im Privatrecht' (2008) 63 *Juristenzeitung* 11, 13 ff., distinguishing between 'soft options' – default rules – and 'hard options' – the kind referred to in the present article.

the "options approach" calls for the creation of a menu of sets of contract terms from which the parties may choose freely. Once they have chosen, however, the parties would be unable to derogate from the scheme that they have selected.

The case of distance selling may serve as an illustration.[76] If the right of withdrawal was open to party agreement, a variety of different schemes would develop. Some internet sellers would stipulate generously long time limits for exercising the right of return, others would settle on short time frames, and others still would come up with peculiar form requirements, such as requiring a registered letter to be sent before the right of withdrawal is validly exercised. But the imagination of sellers would not stop there: they would move on to define the requirements for repackaging the goods and sending them back. Finally, all sorts of cost-allocation rules would develop. Such niceties would of course be buried in the fine print that every reasonable consumer-buyer would click away without reading.

In scenarios such as this one, the celebration of party autonomy may appear like the proverbial 'shibboleth for some well-known writers'.[77] There is no point denying that the development of a diverse multitude of contractually designed withdrawal schemes would become a nightmare. This may be one of the reasons why the internet industry lobbied in favour of a mandatory right of withdrawal during the drafting of the Directive on Distance Contracts. Instead of setting aside party autonomy, the options approach would downgrade the current framework of the right of withdrawal, as set out in the Directive on Distance Contracts, to the status of an option that the parties may either accept or reject. A consumer surfing the internet for bargains could decide whether to purchase the item right away without a right of withdrawal or to preserve such a right and thus to preserve the option of 'having second thoughts'. Presumably, the price of packaging the good and including a right of withdrawal would be higher than the price charged just for the naked good, but such price differentials would only reflect the additional costs incurred by including a right of withdrawal. Such a solution would put an end to the cross-subsidisation of negligent consumer-buyers, who order goods without prior reflection, and diligent consumer-buyers, who take care to avoid ordering goods that do not suit their tastes and are thus less likely to exercise the right of withdrawal. By offering two different kinds of contract – one including a right of withdrawal and another one excluding it – the sellers could force the buyers to separate into two different groups. One group could be labelled the "high-cost buyers," since the frequency of withdrawal will be high, whereas the other group could be labelled the "low-cost buyers," as their the frequency of withdrawal will be low. At the same time, by allowing a choice between a definite purchase and a purchase that is revocable by the consumer ex post facto, the options approach would preserve the core of party autonomy, namely the right to choose between two meaningful alternatives. The crucial difference between ordinary default rules and options lies within the terms and conditions of the right of withdrawal. Under the options approach, the parties would not be authorised to modify the statutory framework of the right of withdrawal or to draw up their own scheme for a right of withdrawal from scratch. Under such a system, consumers would be able to use a "switch" – turning the right of withdrawal on or off as they wish. Whoever opts for such a right would be certain to receive a standardised product that is well defined in the law and, therefore at once well-balanced and easy to manage.

9 Conclusion

The purpose of the present analysis was to dismantle the assumption, popular among scholars and lawmakers, that mandatory contract law is needed to compensate for the perceived 'weakness' of particular groups in society, such as workers, tenants, or consumers. However, the purpose was not to denounce the category of mandatory contract law as such, or to deny that there are situations that require regulatory intervention.

[76] Cf. H. Eidenmüller, 'Die Rechtfertigung von Widerrufsrechten' (2010) 210 *Archiv für die civilistische Praxis* 67, 77 ff.

[77] *Lochner* v. *New York*, 198 U.S. 45, 75 (1905, per Holmes, J.).

These situations are not characterised by the fact that there is a 'weak' party involved, but rather that rational self-determination is impaired or at risk. The reason why this is so may be rooted either in the individual characteristics of a party, which may be of minor age, disabled or incapacitated for some other reason, or in the particular situation in which the contract was formed, for example on the party's doorstep. The analysis of the Proposal for a Directive on Consumer Rights has revealed that a significant part of the current EU consumer law *acquis*, which employs the means of mandatory law, is in fact appropriate. Just as significantly, however, there appears to be no justification for resorting to the use mandatory rules in other areas of consumer law.

Apart from remedying situations where rational self-determination is put at risk, mandatory law serves the additional purpose of standardisation. Standardisation of contract terms reduces transaction costs and is more resistant to cognitive failures by the parties. However, the same goals may be reached without sacrificing party autonomy altogether, through the means of an alternative approach, namely 'options'. Optional contract law allows the parties to choose from a range of legal frameworks without the possibility of modifying any of them. In this manner, options allow for individual choice without simultaneously causing a dramatic increase in the complexity of contract practice. In combining the virtues of standardisation and party autonomy, options may be the 'third way' that leads Europe into the future.