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# PRINCIPLES OF THE GERMAN LAW ON STANDARD TERMS OF CONTRACT

## INTRODUCTION

Standard terms of contract (*Allgemeine Geschäftsbedingungen* or *AGBs*[1]) including standard form contracts *(Formularverträge)* are of considerable practical significance in German contract law, as numerous companies, businesses associations and other professional bodies enter into these standardized legal tools with their customers. In Germany, *AGBs* were traditionally regulated under the former Act on Standard Terms of Business (*Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen, AGBG*). However, in 2002, these statutory rules were integrated into the German Civil Code (*Bürgerliches Gesetzbuch, BGB*) during Germany's civil law reform by way of the Act on the Modernization of the Law of Obligations (*Schuldrechtsmodernisierungsgesetz vom 26.11.2001*).[2]

After a brief outline of the historical background of *AGBs* and an analysis of the benefits and risks associated with using *AGBs* this article provides an overview of the current German statutory framework for *AGBs* as embodied the *BGB*.

## I. GENERAL ASPECTS OF STANDARD TERMS

### 1. Historical background

The history of *AGBs* can be traced back to the age of industrialization in the nineteenth century, during which the mass production of goods and services fundamentally changed economy and society.[3] The phenomenon of mass production has been accompanied by a proliferation of *AGBs* enabling the mass distribution of products and services. Since then, in many areas of business (such as insurance, transport and banking) the entering into of contracts has been dominated by the unilateral use of standard terms by one party as a set of pre-formulated rules tailored to that party's own purposes.[4] Such terms are often referred to in layman terms as "the fine print" ("*das Kleingedruckte*"), because they are often included in the contract in small type. It is common practice that the party making the offer to enter into a contract includes standard terms in the offer with the intention that these terms become part of the contract.

### 2. Benefits of using AGBs

No company today can afford to do business without standardization of its terms of contract, as without such standard terms it would have to renegotiate each individual term for every transaction. Recurring transactions typically require standardization of contractual elements

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1 Or, as they are also called, general terms of business/conditions of business.

2 BGBl. I., 3138.

3 See *Karl-Heinz Neumayer*, Contracting Subject to Standard terms and conditions, in International Encyclopaedia of comparative law, Volume VII, Contract in General (1999), Arthur T. von Mehren, Chief Editor, 7 et seq.; see also *Konrad Zweigert/Hein Kötz*, Introduction to Comparative Law (2nd Edition, translated by Tony Weir), Oxford 1992, 356 et. seq.

4 See *Karl-Heinz Neumayer*, id., 7 et. seq.; see *Markus Stoffels*, AGB-Recht, München (2003), note 15 et seq.; see *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, München 2010 Überbl. v. § 305 *BGB*, note 3 et seq.

such as the requirements for entering into and performing the contract, delivery of the goods, transfer of risk, the method of payment, the scope of any warranties and termination provisions.

Issuing standard terms to the other party will usually either significantly shorten the duration of negotiations with regard to the contract or render them unnecessary. This means that contracts can be entered into much more quickly with content pre-formulated by the issuer of the terms (the *Verwender).*[5]

Further, certain terms limit the risks to the issuer of the terms. This can be seen for example with regard to the typical retention of title clause, which states that ownership will remain with the supplier until complete payment has been effected.

A further benefit of *AGBs* is the opportunity to fill in gaps in the statutory legal framework. As Germany has a civil law system, unlike the common law systems in the UK and the USA the legal landscape has traditionally been dominated by comprehensive codes and statutes promulgated by the legislature in all major areas of the law. This is true in particular in the area of private law, where the *BGB* remains the principal piece of legislation, comprising more than 2,300 sections and covering many important areas of civil law, including contract, tort, property law, family law and the law of succession. Nevertheless, despite its broad scope, the *BGB* is not exhaustive and is silent on various legal issues which are of significant importance in practice. For example, the *BGB* only provides provisions for a limited number of types of contracts, such as contracts for sales, loan contracts and contracts for services. [6] The *BGB* provides detailed provisions for these types of contracts, for example with regard to their entry into force and remedies of the parties in the event of defective performance. On the other hand, there are many other important areas of commercial practice today such as factoring, franchising and leasing which are not regulated by the *BGB* or by any other German code. In these areas, the development of legal rules, including *AGBs,* has been left to the contracting parties and to the courts when examining agreements between private individuals.[7]

Finally, *AGBs* are developed to best serve the interests of the party issuing them. *AGBs* will cover many important issues of the contractual relationship, including details of performance and payment, liability, scope and time limits for remedies, choice of law and place of jurisdiction and within the limitations explained below, *AGBs* therefore enable the issuer to construct a carefully tailored contractual legal framework with which to do business.[8]

## 3. Risks associated with the use of AGBs

Given the benefits outlined above of using *AGBs,* the risks faced by the other party are obvious. First of all, there is a risk that the issuer of the standard terms drafts the individual provisions in such a way that they contract out of liability, burdening the other party with all of the risks. Typical clauses may limit or exclude the issuer's liability for performance or non-

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5 See *Helmut Köhler*, BGB Allgemeiner Teil, 33. ed, Munich 2009, § 16, note 1.

6 *Barbara Grunewald*, Bürgerliches Recht, 7. ed., Munich 2006, § 6 note 1 et seq.

7 Cf *Karl Larenz/Manfred Wolf*, Allgemeiner Teil des BGB, 9. edit., Munich 2004, § 43 note 2; *Barbara Grunewald*, Bürgerliches Recht, 7. ed., Munich 2006, § 6 note 1 et seq.; *Hans Brox/Wolf-Dieter Walker*, Allgemeines Schuldrecht, 34. ed. Munich 2010, § 4 note 32.

8 See *Wiebke Seyffert*, Law of Contracts, in Business Transactions in Germany, Vol. 1 Newark, San Francisco 2006, Dennis Campbell, General Editor, § 10.08 [1], 10.112 et seq.

performance or other breaches of contract, or permit it to increase prices or supply substitute goods. Other standard terms may prevent the customer from offsetting debts due from withdrawing from the deal or from cancelling the contract, or they may impose penalties or liquidated damages in the event of delay on the part of the customer.[9] When these terms are presented (as they typically tend to be) in a "take it or leave it" manner, the other party is likely to simply sign the contract, thereby agreeing to be bound by the standard terms without properly considering their content. If the proposed standard terms appear too biased towards the issuer, the party receiving the standard terms of contract could of course seek to deal with an alternative party on more favorable terms. However, in many industries, for example insurance, banking, automobile and retail, the standard terms of contract used by competing issuers hardly differ in reality.[10] Experience shows that although there may be competition as far as the price and quality of goods are concerned, competition hardly ever exists with regard to the standard terms of contract under which they are supplied[11].

It is now widely recognized that the law must protect the customer against *AGBs* which prejudice his rights and liabilities.[12] In Germany, the courts began quite early on to develop control mechanisms - initially based on sections 134, 138 and 242 BGB -[13] to protect parties, in particular consumers (section 13 *BGB*)[14], from potential abuses of the freedom to contract in relation to *AGBs*. *AGBs* are regulated for fairness and appropriateness and if they violate statutory requirements, they are considered null and void. Although the freedom to contract is based on the idea of the equal bargaining power of the contracting parties, in practice the situation is quite different.[15] It is sometimes evident from the outset that negotiations will be futile, because a company is so powerful that there is no necessity for it to make concessions. Also, the customer often lacks the know-how and experience to be able to negotiate with the other side effectively.[16] However, even if the supplier was prepared to negotiate and the customer was in a position to do so, such bargaining would be likely to be unprofitable for the customer, because the time and effort required to read the small print and formulate counter-offers would be out of proportion to the likelihood that any risks borne by the customer under the standard terms would actually arise.

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9 See *Konrad Zweigert/Hein Kötz*, id. 357 et. seq.

10 *Barbara Grunewald*, id., § 6, note 2.

11 *Wiebke Seyffert*, id., § 10.08 [1] 10-113; *Hans Brox/Wolf-Dieter Walker*, id. § 4 note 33; *Helmut Köhler*, id. § 16 note 1.

12 See *Konrad Zweigert/Hein Kötz*, id., 357; from a comparative perspective, see *Karl-Heinz Neumayer*, id., 7 et. seq.

13 See *Konrad Zweigert/Hein Kötz*, id., 359; *Markus Stoffels*, id., 9 et seq.; based on the concept of good faith and fairness as fundamental notions in contract law, as formulated in section 242 *BGB*, the courts have indeed rendered many clauses invalid.

14 See for the definition of „consumer" (§ 13 *BGB*) and „entrepreneur" § 14 *BGB*) B IV; consumer as every natural person who enters into legal transactions for purposes outside of his trade business or profession. In contrast, pursuant to Section 14 BGB an entrepreneur "is defined as natural or legal person or partnership with legal personality who/which acts within his trade, business or profession when entering into legal transactions.

15 Cf. *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, id., Überbl v § 305 BGB note 7 et seq. correctly points out that the liberal contract theory underlying the German Civil Code (*BGB*) reflected a more ideal situation than reality already back in the 1900s.

16 See *Konrad Zweigert/Hein Kötz*, id., 357; *Wiebke Seyffert*, id. § 10.08 [1] 10-113.

**Example**[17]:

A young couple purchased furniture from a discount store, leaving some of the purchase price outstanding. When problems were discovered with the furniture, the couple refused to pay the balance of the purchase price until it was repaired. The contract of sale excluded all rights except the right of repair. However, the store was unable to repair the furniture. In this case, the German Federal Supreme Court (*Bundesgerichtshof = BGH)* decided that the purchaser should not effectively be denied all rights when the only right available was useless. Therefore the clause was unfair and the couple could return the goods.

The legal principles evolving from this case law developed by the German courts in order to control unfair contract terms were later codified in the German Act on *AGBs* of 1976 (*AGBG*). The *AGBG* also codified principles derived from prior case law on *AGBs*, introduced various new principles and expanded the scope of application of the principles developed by the courts.[18] This act applies to contracts between "merchants" as defined by the German Commercial Code (*Handelsgesetzbuch, HGB*) and private customers as well as to contracts between merchants or between private customers. Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts of 5 April 1993[19] created a Europe-wide regime for the supervision of clauses. As a result, German provisions are to be interpreted in conformity with this Directive.[20]

The regulatory framework for *AGBs* was embodied in the *AGBG* as a separate codification, but in the course of reforming the law of obligations in 2002 (*Schuldrechtsmodernisierungs-gesetz)*, the German legislature incorporated the legal rules on *AGBs* into the new sections 305 et seq. *BGB*, including the implementation of several EC directives.

Sections 305 to 310 *BGB* provide detailed rules on *AGBs* with a two-step control procedure. As a first control mechanism, German law requires that *AGBs* are validly incorporated into the contract between the parties (see C). Where the standard terms have been validly incorporated into the contract, the *BGB* provides for a second control mechanism in relation to their content (see D).

However, before commencing the control procedure, it must first always be checked whether a certain term used by the issuer can be considered to be a standard term of contract within the meaning of the *BGB*. The provisions of the law controlling the content of standard terms comprise a general clause (section 307 *BGB*) and a catalog of prohibited terms (sections 308 and 309 *BGB*). Protection against unfair standard terms is also achieved by means of rules on the inclusion of standard terms in a contract (section 305 paras. 2 and 3 *BGB*) as well as rules on unexpected and ambiguous clauses (section 305c *BGB*).

## II. THE GERMAN LAW ON STANDARD TERMS OF CONTRACT – SCOPE AND DEFINITION

### 1. Statutory definition of standard terms

17 BGHZ 2, 90; see *Nigel G. Foster/ Satish Sule*, German Legal System & Laws, Oxford, 2002, 409.

18 See *Joachim Gres / David J. Gerber*, The German Law governing standard business conditions (1977), Köln 1977, 1 et. seq.

19 Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts of 5. April 1993, ABl. EG 1993, Nr. L 95/29.

20 *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, id, § 310 *BGB* note 23 et seq.

As stated above, section 305 para. 1 clause 1 *BGB* defines *AGBs* as "all those contractual terms which are formulated in advance for a multitude of contracts which one party (the issuer (*Verwender*)) presents to the other party upon entering into a contract". The terms may cover the complete content or individual parts of the contract. For example, a standard form contract such as a standard lease agreement will already include most of the fundamental terms, with the exception of the names of the contracting parties, the lease object, the rent and the beginning of the lease. In contrast to this, the conditions of payment used for example in a purchase agreement may only cover an individual part of a contract.[21]

Pursuant to section 305 *BGB*, *AGBs* must have been pre-formulated for use in multiple contracts, and the statutory rules will therefore not apply if pre-established terms are only intended to be used once. German courts have considered it sufficient if standard terms are intended to be used at least three times,[22] even when used in transactions with the same party.[23]

When determining whether terms qualify as standard terms, it is irrelevant whether the standard terms appear as a part of a contract, whether they form a separate part or whether they are included in the contract document as an attachment. It is also irrelevant how complex they are, what typeface is used or in what form the contract is concluded. *AGBs* can also be publicly displayed at the issuer's premises, for example in the form of a notice.[24] The German courts have even considered unilateral acts such as declarations of consent to be *AGBs* if they have been freely formulated in a pre-established agreement.[25]

Furthermore, the standard terms have to be dictated by one party only. This requirement is met if one party makes an offer to incorporate its standard terms into the contract. The other party must not have any real opportunity to alter them, but must be required to accept them as presented if they wish to complete the transaction.

## 2. Distinguishing individually negotiated terms and agreements

For terms to be regarded as standard terms it is essential that they are issued on a unilateral basis. This criterion is not satisfied where contractual terms have been individually negotiated between the parties (section 305 para. 1 clause 3 *BGB*), as pursuant to section 305b *BGB,* such terms will always prevail over standard terms.

However, the requirements as to when parties have properly negotiated are very strict.[26] With regard to individual negotiations it is not sufficient that the other party is invited to make amendments to the text or to reject individual clauses[27] nor is it deemed sufficient that the customer may choose between various conditions or fill in potential gaps in the contract (for

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21 *Wiebke Seyffert*, id., § 10.08 [2], 10-114 et seq.

22 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2002, p. 138.

23 See Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 1998, 2286; 1997, p. 135; Bundesarbeitsgericht, in Der Betrieb (DB), 2006, p. 1377; *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 BGB note 9.

24 *Helmut Köhler*, id. § 16 note 4.

25 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2000, p. 2677; the case concerned a pre-formulated declaration of consent by a bank customer to the opening of a bank account in form of a standard form contract; cf. *Helmut Köhler*, id. § 16 note 4.

26 See BGHZ 104, 232, 236; *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 BGB, note 18 et. seq.

27 BGHZ 98, 24, 28; *Helmut Köhler*, id. § 16 note 8.

example in relation to price or duration of the services).[28] It is the issuer of the terms who has to demonstrate a real willingness to deviate from their own standard terms for there to be proper negotiations, with the issuer providing the customer with sufficient scope for negotiation for the latter to have the possibility to safeguard his interests by influencing the content of the contractual conditions.[29] An indication of openness to negotiate will often take the form of a handwritten annex or an amendment in another typeface after respective discussions between the parties. However, simply writing the parties' initials on each page of the contract will not normally be considered sufficient. Very often it is done "mechanically" with the issuer of the terms not actually leaving any scope for action by the other party to negotiate the individual provisions. Where the contractual partner of the issuer is an "entrepreneur" as defined by the *BGB*, i.e. some natural or legal person or partnership acting in the exercise of his business, the courts tend to be less strict than with consumers with regard to the negotiation of *AGBs*. Only if the above mentioned requirements are met will a contractual clause be considered to have been individually agreed upon, thereby avoiding the strict scrutiny reserved for *AGBs*.[30]

### 3. Scope of application of the statutory rules

Section 310 *BGB* defines and limits the scope of application of sections 305 to 309 BGB. Pursuant to section 310 para. 1 *BGB*, the protection of business contractors is reduced by excluding the application of sections 305 para. 2 and 3, 308 and 309 BGB to businesspersons and legal persons.[31] There is a different level of protection herewith regard to *AGBs* because business persons and legal persons (such as stock corporations or limited liability companies) are considered to have sufficient legal knowledge to negotiate effectively and enter into agreements, i.e. they do not require the same level of protection as consumers. Therefore, only specific provisions of the law on *AGBs* will apply to them, for example the invalidation of terms which unreasonably discriminate against the contractual partner contrary to the requirements of good faith and fair dealing (section 307 *BGB*).

Furthermore, the legal framework for standard terms does not apply to legal transactions in the areas of the law of succession, family law or company law. Nor do the rules apply to the law of industrial relations (*kollektives Arbeitsrecht*), in particular to collective bargaining agreements (*Tarifverträge*). There is no special need to protect one party in case of a collective bargaining agreement between an employer or an employers association and a trade union; hence they are not subject of control in this respect. However, they do apply to individual employment agreements (section 310 para. 4 *BGB*), but when applying these rules in the area of labor law, the peculiarities of the area must be taken into account.

Rules dealing with the procedural enforcement of these provisions (previously sections 13-24a *AGBG)* are now found in the Act on Actions of Injunction for the Protection of Consumers (*Unterlassungsklagengesetz*). In accordance with the general trend in the law, which is also evident in wider public interest in environmental law and competition law, it is

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28 See *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 BGB, note 12, 19 et. seq.

29 See Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2000, p. 1110; *Wiebke Seyffert*, id. § 10.08 [2], 10-115; See *Andreas Stadler/Michael Huber*, German terms of Business, in Wendler, Michael, Tremml/Bernd, Buecker, Bernard, Key Aspects of German Business Law, 3rd ed. Berlin (2006), 88.

30 *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 *BGB*, note 21 et seq.; *Markus Stoffels*, id., 65 et seq.

31 See BGHZ 90, 273 (278).

not only the specific person who has entered into the contract who may take legal action against illegal terms in a contract. Consumer organizations and chambers of commerce also have a legally enforceable right to demand that persons using illegal standard terms cease to do so or retract them (section 3 *Unterlassungsklagengesetz*).

### 4. Special provisions in relation to consumer contracts

The German legal framework for *AGBs* contains special provisions in relation to consumer contracts, originating in part from the implementation of EC Directive 93/13/EEC on Unfair Terms in Consumer Contracts.

According to section 310 para. 3 *BGB*, a consumer contract is defined as a contract between a consumer (as defined in section 13 *BGB*) and an entrepreneur (pursuant to section 14 *BGB*). Pursuant to section 13 BGB, a consumer (*Verbraucher*) is defined as "any natural person who enters into a legal transaction for a purpose outside his trade or profession". Section 14 *BGB* defines an entrepreneur (*Unternehmer*) as a "natural or legal person or a partnership with legal personality who or which, when entering into a legal transaction, acts in the exercise of his trade or profession".

In consumer contracts, all clauses must be considered standard terms, even if it is only intended that they will be used once, because of the fact that they have been pre-formulated by the issuer/entrepreneur (section 310 para 3 no. 1 *BGB*).[32] It must be noted however that they are only considered to have been dictated to the consumer if they were not incorporated into the transaction upon the consumer's initiative. Hence, any and all terms of contract suggested by the issuer to the consumer are subject to sections 305 et seq. *BGB*.

According to section 310 para. 3 no. 1 *BGB*, the terms do not actually have to have been dictated by a party to the contract for them to be considered to be *AGBs*. It may suffice if they have been incorporated into the contract by a third party, e.g. a broker, an association or a notary. It is generally assumed that terms are initiated by the issuer except where he can prove that the standard terms are initiated by the consumer or his representative (*Drittbedingungen*).[33]

With regard to the regulation of the content of consumer contracts, contrary to the general view when interpreting standard terms, section 310 para. 3 no. 3 *BGB* provides that individual circumstances have to be considered when examining standard terms in light of the general rule (see D II 4.).[34]

## III. INCLUSION OF STANDARD TERMS IN THE CONTRACT

### 1. Integration requirements

### 1.1 Inclusion of AGBs in contracts with customers / consumers

In order for standard terms to govern a contract, the issuer of the terms must provide the other party with the opportunity to take notice of them. The requirements for standard terms to be

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32 *Helmut Köhler*, id., § 16, note 12.

33 *Christian Grüneberg, in* Palandt, Bürgerliches Gesetzbuch, § 310 *BGB*, note 16; *Helmut Köhler*, id., § 16, note 12; *Hans Brox/Wolf-Dieter Walker*, id. § 4 note 64;

34 *Helmut Köhler*, id., § 16, note 13.

validly incorporated into a contract with a consumer are set out in section 305 para. 2 *BGB*. Section 305 para. 2 *BGB* provides that *AGBs* are incorporated into the contract only if three conditions are satisfied when entering into the contract.

Firstly, the issuer of the terms must expressly draw the other's party attention to them (in written or verbal form and the reference may be for example included in the contract offer) or if an express reference to them would be unreasonable due to the manner in which the contract is entered into, attention must be drawn to them by means of a clearly visible sign at the place where the contract is entered into. For example, if the *AGBs* are printed on the back of a contract offer, there must be a clearly visible reference to this on the front page. If a clear reference is only possible with considerable difficulty, section 305 para. 2 no. 1 (second alternative) *BGB* allows the posting of a notice at the place of entering into the contract, e.g. at a car-wash, in multi-storey car parks, or at dry-cleaning establishments; however, such notice must always be clearly visible. In the case of online contracts, it is sufficient for the customer to have the opportunity to read the text of the standard terms on the website before submitting an online order, provided that access to the terms does not involve a considerable amount of time and technical know-how.[35]

Further, the opportunity to view the content of the standard terms must be in a manner that also takes reasonable account of any physical handicap of the other party discernible by the party specifying the terms (section 305 para. 2 *BGB*). However, based on the needs of the average person, the standard terms should be legible, in a clear layout and comprehensible. Standard terms with unclear or incomprehensible content will not meet the statutory requirements for inclusion in the contract, in accordance with the obligation of transparency (*Transparenzgebot)* (for more details see D II 5).[36] The customer has to be on notice of the standard terms before or at the time of entering into of the contract and if the party specifying the terms presents them on the receipt, they will not constitute part of the contract. Finally, the party receiving the terms must agree to the contract by signing the document.

### 1.2 Inclusion of AGBs in contracts with entrepreneurs

The statutory framework on *AGBs* applies not only to consumer contracts but with certain restrictions also to contracts with entrepreneurs (such as businesspersons or companies) as defined in section 14 *BGB.* As mentioned above, according to section 310 para. 1 *BGB*, the specific requirements set out in section 305 paras. 2 and 3 BGB for the inclusion of standard terms in contracts with consumers are not applicable to agreements between entrepreneurs, as is expected that a businessperson will acquire knowledge of standard terms upon their own initiative. As a result, there are no special provisions in these sections that regulate how standard terms become a part of legal transactions among entrepreneurs or merchants. Hence it suffices where the other party becomes aware that the standard terms of its partner will become an integral part of the legal transaction. For that to happen, the party issuing the standard terms must in some way refer to the standard terms as binding for the contract and grant the other party the opportunity to examine their content. Therefore, if the entrepreneur

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35 *Wiebke Seyffert*, id. § 10.08 [2], 10-116; *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 BGB, note 38.

36 *Markus Stoffels*, id. note 283.

does not act, the contract will be governed by the standard terms on the basis of an implied agreement, even though the entrepreneur may in fact not be familiar with the actual content.[37]

Agreement to the standard terms by the other party may be expressed or implied. Where the issuer explicitly draws attention to its *AGBs* and where the contractual partner accepts the offer without mentioning them, they will be deemed to govern the contract, i.e. agreement will be assumed if the transaction is then performed. On the other hand, if an offer made by the customer and accepted by the issuer, who mentions his own standard terms, this will be regarded as a refusal of the customer's offer combined with the making of a new offer.

It must be noted that *AGBs* can become part of any legal transaction even without notification where such practice is standard in that particular industry. However, until now this has only been the case for the standard terms of banks, airport operators and shipping companies, which have been explicitly recognized by case law.[38]

## 2. Conflicting standard terms – the "battle of forms" in business contracts

### 2.1 Problem

It is a frequent phenomenon of commercial practice that parties both refer to their own *AGBs* when trying to reach agreement during negotiations.[39] It is therefore often the case that both contractual partners add their standard terms to their declarations of will and these terms do not correspond.

**Example**:

The seller refers in his offer to his standard conditions of sale and delivery, while the buyer includes in his declaration of acceptance his standard conditions for the purchase of goods.[40]

Conflicts often arise, for example, with regard to the transfer of risk for items sold, modes of delivery and transport (including insurance in case of loss) and the scope and time limits of remedies available in the event of defective performance.[41]

As each party will obviously use the *AGBs* most favorable to their business, many of the terms will conflict. During negotiations, parties and their representatives tend to focus primarily on the essential elements of the agreement, such as the quality and quantity of goods or services to be delivered, price and payment mechanisms and warranties/remedies of the parties, thus sometimes neglecting other contractual provisions which may at first glance not appear to be of central importance to the deal.[42] On the other hand, in many cases the parties will fulfill all of their contractual obligations so that the issue of contract performance does not arise, regardless of the failure of the parties to agree on every detail beforehand.

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37 *Christian Grüneberg, in* Palandt, Bürgerliches Gesetzbuch, § 305 *BGB*, note 50 et seq.

38 See *Andreas Stadler/Michael Huber*, id., 88.

39 *Karl Larenz/Manfred Wolf*, id., § 43, note 24; *Markus Stoffels*, id., note 313.

40 *Helmut Köhler*, id., § 16 note 19.

41 *Markus Stoffels*, id., note 313 et seq.

42 See *Arthur T. von Mehren*, The Formation of Contracts (1992), International Encyclopeadia of Comparative Law, Ch. 9.

When dealing with a dispute between the parties with regard to conflicting terms, some provisions of the *BGB* must firstly be taken into account before examining how the German courts have addressed this problem. Section 154 *BGB* provides that a contract is not considered to have been successfully entered into unless all points required to be agreed upon by both parties have in fact been agreed upon. In addition, Section 155 *BGB* deals with a "hidden lack of agreement" (*versteckter Einigungsmangel*) between the parties, whereby the parties consider a contract to have been entered into but they have not in fact agreed on certain essential elements. The elements that have been agreed are considered to be valid if it can be assumed that the contract would have been entered into even without agreement on the missing elements.

## 2.2 Application of the "last word" doctrine

When dealing with conflicting *AGBs*, the German courts have taken a range of approaches. Originally, the German courts took a strict view of the process of contract formation by applying the "last word doctrine".[43] The courts referred to section 150 para. 2 *BGB*, under which an acceptance of a contractual offer with any modifications, restrictions or amendments is deemed to be a rejection of that offer combined with a new offer. By this mechanism, the original offeror now becomes the offeree who must in turn accept the counter-offer. When applying this rule to cases involving conflicting standard terms, the courts closely examined the communications between the parties involved. If the parties exchanged their *AGBs* during their contractual negotiations, the party who last referred to his terms, thus having the last word, would prevail.[44]

However, this doctrine of the last word soon came under heavy criticism, since its results often appeared arbitrary (depending on the last reference of one party to his terms). Furthermore, critics pointed out that consent to the standard terms of another party cannot be derived from the fact that during the negotiation process, the other party was the last to refer to them. This is particularly true if their standard terms contain a "defense clause", stating that the party will only be bound by its own terms and not by those of the other party.[45]

## 2.3 The doctrine of congruence

As a result, the courts now take a different approach. With regard to the parts of the contract which the parties have agreed upon, the agreement will be upheld in accordance with the doctrine of congruence[46] and for the remainder, the above-mentioned rules of dissent will apply (sections 154 and 155 *BGB*). However, this will not lead to invalidation of the contract as long as the parties begin to discharge their obligations. This performance of the contractual obligations indicates that the parties do not regard the lack of agreement as to the standard terms as an essential handicap to their contractual relationship.[47] With regard to the conflicting elements, the agreement obviously does not provide a solution. In this case, the courts will look to the statutory solutions provided by the *BGB*.

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43 *Markus Stoffels*, id., note 316.

44 *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, id., § 305 *BGB*, note 55; *Markus Stoffels*, id., note 319 et seq.
Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 1991, p. 1606; *Christian Grüneberg*, i*n* Palandt, Bürgerliches Gesetzbuch, § 305 BGB, note 55; *Helmut Köhler*, id., § 16 note 19.

46 *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305 BGB note 55; *Stoffels*, AGB-Recht, note 321 et seq.; *Helmut Köhler*, id., § 16 note 19.

47 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2002, p. 1651, 1653.

### 3. Disqualification of unexpected standard terms

Even where standard terms meet the requirements for inclusion in the contract, they do not become part of the contract if they are considered to be unexpected terms under section 305c para. 1 *BGB*. This will be the case if taking into consideration the circumstances of the contract, especially with regard to the appearance of the contract, the terms are so unusual that the contractual partner could not be expected to anticipate such clauses in the contract.[48] This applies for example to clauses that could not be anticipated due to their position within the text of the standard terms (for example under a certain heading) or due to their graphical layout. In these cases it is assumed that the customer often does not read the terms in detail but rather simply skims over the text. In other words, a clause is regarded to be unexpected where it is positioned in such a way that the reader runs the risk of not noticing the term.[49] The purpose of Section 305c para.1 *BGB* is to protect the customer who trusts that the standard terms have content that can be typically expected with respect to the relevant contract. The law assumes that the customer would not accept such a clause if he would not expect it under normal circumstances. The question of what is regarded as unexpected depends on the type and circumstances of the contract.

**Examples**:

A craftsman purchases a machine and in the standard terms of the seller, a maintenance agreement for the machine is included in the terms in a "hidden" position.

Alternatively, a consumer purchases a coffee machine and in the standard terms of the seller it says that the purchaser has to purchase a certain amount of coffee each month.[50]

## IV. CONTROL REGARDING THE CONTENTS OF STANDARD TERMS

### 1. Determination of content

### 1.1 Interpretation

Where standard terms form part of the content of a contract, the general rules on the interpretation of contracts apply.[51] Standard terms are to be interpreted literally and objectively, according to the way they would most likely be understood by honest business partners who are members of the group addressed by the relevant standard terms, of average intelligence and without any legal education.[52] In these cases, the interpretation of standard terms is not based on the standard of the individual contracting party but rather on the comprehension of an average customer. Legal terms are however not to be interpreted from a layman's point of view but rather on the basis of their technical meaning. Therefore, when

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48 BGHZ 102, 152, 158.

49 Cf. Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 1981, p., 117, 118.

50 *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, § 305c BGB, note 5 for more examples.

51 *Jürgen Ellenberger*, *in* Palandt, Bürgerliches Gesetzbuch, § 133 BGB, note 14; § 157 BGB, note 2 et seq.; *Wiebke Seyffert*, id., § 10.08 [2], 10-118.

52 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2001, p. 2165; BGHZ 79, 117, 119;

53 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2003, p., 1237, 1238; BGHZ 108, 52, 56; *Klaus-Peter Berger*, in Prütting/Wegen/Weinreich, BGB Kommentar, 5. ed., Neuwied 2010, § 305 BGB, note 18.

interpreting standard terms, only those circumstances will be considered that normally prevail and which are commonly known by the customer.

In contrast, in German law proceedings to set aside unfair standard terms (*Unterlassungsklage*), standard terms will be examined as to whether an interpretation is possible which is adverse to the interests of the customer, in which case the use of such a standard term will be prohibited (the principle of *"kundenfeindlichster Auslegung"*).[53]

### 1.2 Ambiguity rule

The ambiguity rule (*Unklarheitenregel)* under section 305c para. 2 *BGB* applies where the interpretation of a clause does not lead to a clear and obvious result. If in doubt, the clause is interpreted in favor of the contractual partner, thus restricting the rights of the contractual partner as little as possible. This interpretation should prevail where the term in question restricts the rights of the contractual partner to such an extent that the term would be invalid under the statutory regulation of standard terms. This is the most favorable solution for the contractual partner because the term would be void and the rules provided by law would be applied, which are often more favorable.[54] In other words, the idea behind this procedure is to induce issuers of standard terms to lay out their terms clearly and unambiguously if they wish to avoid the risk of a clause being declared null and void or of it being left in the contract, but with very advantageous effect for the customer in the case of doubt.[55]

### 1.3 Priority of individually negotiated terms

Where the parties have negotiated individual terms and those terms contradict the provisions of the standard terms, the individual term will prevail (section 305b *BGB*). This also applies where the parties do not explicitly exclude the remaining standard terms by agreement and where the standard terms provide that amendments to the content must be in writing and the parties agree orally on an individual term. However, it will often be difficult to prove at trial that an oral agreement was entered into. In German civil procedure law, there is a rebuttable presumption that a written contract presented to the court is complete and correct. It should be noted that the priority of an individual term is not a specific problem of standard terms, as even where a clause in written form has been agreed by way of an individual term, this clause may still be excluded orally by the parties. The reason for this is that the parties cannot restrict their freedom to contract against their common will.[56]

## 2. Fairness control – regulating the content of standard terms

### 2.1 Overview

If the standard terms have passed the test for successful incorporation into the contract, German law provides for another control procedure with regard to their content. As mentioned above, regulation of the content of standard terms is necessary, because the issuer of the terms designs the contract on a unilateral basis, excluding the influence of the contractual partner over the content of the terms. Therefore, sections 307 et seq. *BGB* provide

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54 *Wiebke Seyffert*, id. § 10.08 [2], 10-118.

55 *Andreas Stadler/ Michael Luber*, id., 89; *Hans Brox/Wolf-Dieter Walker*, § 4, note 44.

56 *Wiebke Seyffert*, § 10.08 [2], 10-117.

for regulation of standard terms by a general rule (section 307 *BGB*) as well as by a catalog of prohibited terms (sections 309 and 308 *BGB*).

The standard terms contained in the catalog of prohibited terms are either always void (section 309 *BGB*) or they are regarded as void where in an individual case it would lead to unjustifiable discrimination against the contractual partner (section 308 *BGB*). Where a term is not listed in the catalog, it may still be void due to a violation of the general rule of section 307 *BGB*.[57] Pursuant to this section, *AGBs* are invalid if they violate the requirement of good faith by placing an unreasonable disadvantage on the contractual partner.

However, the statutory regulation of the content of standard terms does not usually extend to service specifications or specifications of core contractual duties, e.g. descriptions in catalogs or product leaflets. It also does not extend to agreements as to the prices of products or services.[58] On the other hand, specific terms of price agreements (such as an agreement in the course of banking business on a value date for money transfers) may be subject to control of their content if such an agreement forms part of a standard form (banking) contract.

Even where specifications of contractual duties and price terms are not subject to statutory control of their content, such specifications will be subject to the transparency requirements of section 307 para. 3 clause 2 *BGB*. According to this transparency obligation, the courts will check whether the specifications of the contractual duties, the price and the price-performance ratio under the pre-formulated conditions are easily identifiable to an average customer or whether such specifications are obscured by unclear and imprecise language.[59]

## 2.2 Express prohibition of certain standard terms

Section 309 *BGB* lists certain terms which are automatically void without further examination, including the following provisions:

No. 1: Exclusion of price increases for four months after the contract is entered into.[60]

No. 3: A clause prohibiting the contractual partner of the issuer from setting off a claim which is undisputed or which has been declared final and absolute.

No. 5/6: Restrictions on the permissibility of lump-sum damages payments and promises to pay contract penalties.

No. 7a: Exclusion of liability for death or injury to body and health caused by the issuer.

No. 7b: Exclusion of liability for wilful intent and gross negligence.

No. 8a: Exclusion of the right to withdraw from the contract.

No. 8b: Limitation of rights in the case of defects in newly manufactured items or defective performance of work.[61]

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57 *Hans Brox/Wolf-Dieter Walker*, § 4 note 46, 47.

58 *Karl Larenz/Manfred Wolf*, id., § 43 note 43 et seq.

59 *Karl Larenz/Manfred Wolf*, id., § 43 note 48 et seq.

60 Example: This is particularly relevant in the area of car dealing, where it is frequently agreed that the customer will pay the list price of the car that is in effect on the date of delivery.

No. 12: Alteration of the burden of proof to the disadvantage of the contractual partner.

### 2.3 Prohibited clauses with interpretive leeway

In contrast to the categorically prohibited terms specified in section 309 *BGB*, the prohibitions listed in section 308 *BGB* only apply where an examination of the relevant term reveals that it contains an unfair disadvantage for the consumer. The purpose of section 308 *BGB* is to create an assumption of invalidity of the standard term. To illustrate the significance of this, two important provisions of section 308 *BGB* should be mentioned.

No. 3: Prohibits reserving the right to back out of the contract. The issuer of standard terms cannot grant himself the right to back out of the contract without an objective reason and without specifically mentioning that reason, since this would in effect mean that the contract was not binding.

No. 4: Prohibits reserving the right to make amendments to the terms of the contract. It is forbidden to unilaterally change the performance obligations ad initially stated, unless such changes appear reasonable under due consideration of the interests of the other party.[62]

### 2.4 Unfair disadvantage

It should be noted that the terms listed in sections 309 and 308 *BGB* do not form an exhaustive list of all potentially unfair terms. Therefore, the general rule (section 307 *BGB*) was introduced as a catch-all provision.[63] Where the term being examined does not fall under any provision mentioned in the catalog, the general rule of section 307 *BGB* may apply in cases where standard terms are designed in such a way that they lead to unjustifiable discrimination against the contractual partner. The element of good faith plays a vital role here.[64] If in doubt, an unreasonable disadvantage is assumed in two situations:

Firstly, where a provision cannot be reconciled with the essential principles of the statutory rules from which it deviates (section 307 para. 2 No. 1 *BGB*):

**Example**:

The standard terms of a broker provide that the broker's fees shall become due irrespective of performance by the broker. Although this clause does not violate any of the provisions of the catalogs under sections 309 and 308 *BGB*, it does violate the general rule of section 307 *BGB*. According to the statutory concept of the broker's rights, the claim for payment depends on the activity of the broker, i.e. if the transaction is completed by the broker (section 652 *BGB*). Therefore, the above clause would be invalid.[65] Secondly, according to section 307 para. 2

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61 However, section 309 No. 8b *BGB* does not apply to the sale of second hand goods, nor does it apply to moveable goods which are yet to be manufactured. Furthermore, where the customer is a consumer, § 475 *BGB* provides compulsory rules for the sale of goods; the respective rules also apply to contracts of work and labor (section 651 *BGB*), see *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, ID., § 309 *BGB* note 53.

62 *Andreas Stadler/Michael Luber*, id., 93 et seq.

63 *Wiebke Seyffert*, § 10.08 [2], 10-120.

64 Cf. *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, id., § 307 *BGB*, note 68 et seq. for numerous examples.

65 BGHZ 99, 374 et seq.; *Hans Brox/Wolf-Dieter Walker*, id., § 4 note 50.

No. 2 BGB, an unreasonable disadvantage to the contractual partner of the issuer of the terms is also assumed where a provision restricts the essential rights and duties resulting from the nature of the contract in such a way that there is a risk that the purpose of the contract may be frustrated.

**Example**:

The standard terms of a company providing security patrols exempt the issuer of the terms from any liability for insufficient patrols. Here the due performance of the patrol is challenged, which jeopardizes the entire contract.

It should be noted that the regulation of terms is based on objective standards, weighing the interests of an average customer against those of the issuer. Where the standard terms are used for different customers, the result as to the validity of the terms may differ. A clause that might be unobjectionable in a contract with an entrepreneur might be unacceptable in a contract with a consumer.

With regard to consumer contracts, section 310 para. 3 *BGB* provides that contrary to the general view in interpreting standard terms, individual circumstances also have to be considered when examining standard terms in the light of the general rule of section 307 *BGB*. Such circumstances may include the specific circumstances regarding the entering into of the contract (e.g. exploitation of time pressure by the issuer of the terms or from the opposite perspective a disproportionately long period of deliberation on the part of the consumer). Furthermore, the specific circumstances of the contractual partner of the issuer will also be taken into account, e.g. whether they are a sophisticated businessperson or a private consumer lacking any experience of standard terms. In sum, the specific circumstances may work to the advantage or to the disadvantage of the contractual partner of the issuer of standard terms.

For contracts with an entrepreneur, section 307 *BGB* forms the sole basis of regulation together with the customs and practices prevailing in the relevant business sector (section 310 para. 1 clause 2 *BGB*). The catalog in sections 308 and 309 *BGB* does not apply here, as entrepreneurs do not require the same level of legal protection as a consumer due to more frequent participation in business transactions and thus more awareness of the potential risks. However, with regard to the interpretation of section 307 *BGB*, a judge will take into consideration the legal concepts underlying sections 308 and 309 *BGB* when deciding on the question of whether a standard term used vis-à-vis businesspersons (such as entrepreneurs, merchants, companies etc.) will be treated as unfair. In this respect, the content of sections 308 and 309 *BGB* will also have an indirect effect on the regulation of standard terms among business people under section 307 *BGB*.[66]

As many standard terms are prohibited by sections 307 et seq. *BGB*, the issuer of the terms may try to circumvent these prohibitions. However, such avoidance is prevented by an explicit prohibition of circumvention (section 306a *BGB*). The rules of unfair standard terms will still apply even if there is an attempt to circumvent them by way of other arrangements.

## 2.5 Transparency obligation

[66] *Wiebke Seyffert*, id., § 10.08 [2], 10-121; cf. *Christian Grüneberg*, *in* Palandt, Bürgerliches Gesetzbuch, id., § 307 *BGB*, note 41.

An unfair disadvantage may furthermore result from a violation of the transparency obligation or, in other words, from lack of clarity or lack of unambiguous meaning of a standard term *(Transparenzgebot).* Issuers of standard terms are responsible for laying out the rights and obligations of their contractual partners in the plainest and clearest language possible. The term must allow its readers to clearly recognize the full and actual extent of the intended objectives and any disadvantages it might hold for them. If a standard term does not fulfill this requirement there will be an irrefutable assumption of unreasonable discrimination (*unwiderlegbare Vermutung einer unangemessenen Benachteiligung*) against the contractual partner.[67]

On the other hand, the transparency obligation does not go so far as to require the issuer to add detailed comments to its standard terms, elucidating the precise meaning and risk with regard to every single term of contract. Generally speaking, issuers of standard terms are not legally responsible for informing the contractual partner of all of the potential risks involved in any more detail than any other party to a contract.[68]

## V. LEGAL CONSEQUENCES

### 1. Determining the scope of invalidity of illegal standard terms

Section 306 para. 1 *BGB* provides that where a standard term has not become part of the contract or where such a standard term is invalid under sections 307, 308 or 309 *BGB*, the remainder of the contract will continue to be valid. This rule is an exception to the general rule under section 139 *BGB*, pursuant to which the contract is considered void in its entirety even if only parts of the transaction are invalid. The reason for this exception is that the result of section 139 *BGB* would be contrary to the purpose of the statutory control mechanisms for standard terms to protect the contractual partner of the issuer. In most cases it would be in the interests of the contractual partner of the issuer of standard terms that at least the remainder of the contract remained valid. Therefore, the issuer of the terms runs the risk that individual clauses may be excluded from the contract whilst still being bound to the remaining terms. Due to this mechanism, there is no incentive for the issuer to attempt to use very radical standard terms which may be at risk of invalidation.

With regard to a partial invalidation of *AGBs* one first needs to clarify the scope of invalidation, i.e. which parts of a standard form contract will remain valid. Where a standard term contract contains invalid clauses as well as unobjectionable content, the unobjectionable elements will remain valid as long as they affect the same legal subject.[69] This applies for example to the determination of a time limit and its commencement[70], the determination of the duration of the contract or to the termination of the contract against payment prior to maturity. The determination of the relevant time period is made under the principle of “blue pencil text”. Under this principle, the invalid part is theoretically deleted from the contract. Where the remaining fragment (*Torso*) of the clause does not contain any meaningful content and does not violate any of the rules set out in sections 307 to 309 *BGB*, the complete clause

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67 *Markus Stoffels*, id., AGB-Recht, note 561

68 *Andreas Stadler/Michael Luber*, id., 86.

69 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2001, p. 292, 294; 1998, p., 2284, 2286.

70 Bundesgerichtshof, in Neue Juristische Wochenschrift (NJW), 2000, 1110, 1113. Oberlandesgericht Düsseldorf, NJW-Rechtsprechungs-Report 1994, p., 1298.

is considered void. On the other hand, where it does contain meaningful content, the remaining part will be valid.

## 2. Preserving valid parts of invalid standard terms

Pursuant to section 306 para. 2 *BGB*, where standard terms have not become part of the contract or are invalid, the content of the contract will be subject to statutory regulation. As indicated above, in some cases only parts of a standard form contract will be invalid under the statutory regulation of standard terms. However, it is questionable whether and to what extent a standard term violating the principles embodied in sections 307 to 309 *BGB* can be upheld to a partial extent only, and controversy continues to surround this issue.

**Example**:

Someone organizing a car race attempts to completely exempt himself from liability (including liability for gross negligence and wilful conduct) in breach of section 309 *BGB*. The question arises as to whether this unsuccessful attempt of the issuer to completely eliminate his liability may be upheld in a legally permissible manner, i.e. whether this clause should be given the meaning that he is at least allowed to reduce his liability for slight fault or negligence (which is legally possible).

However, under the prevailing view of the German courts and German legal literature, such an attempt to reduce the scope of a standard term to a legally permissible content (*geltungserhaltende Reduktion*) is impermissible.[71] Otherwise, the law would be overly sensitive to the issuer of standard terms who would then be able to extent the scope of his terms beyond legally permissible content, with his contractual partner left hoping that the courts will invalidate the terms if he brought a claim against their validity.

Therefore, standard terms violating the principles embodied in sections 307 to 309 *BGB* will generally be invalidated.

**Example**:

The duration of a subscription to a newspaper cannot be reduced from four years (which is invalid according to section 309 No. 9 lit. a *BGB*) to a period of two years by way of interpretation.

### CONCLUSION

Standard terms of contract (*AGBs*) are a frequent phenomenon of business life. On the one hand, *AGBs* provide a useful tool for issuers to create a tailored contract. On the other hand, the recipient of the *AGBs* may well face an infringement of his rights, since *AGBs* will typically regulate key issues of the contract such as delivery of goods and services, payment obligations and the scope and time limit of warranties to the advantage of the issuer. In practice, the recipent is often in no position to (re)negotiate his position. This is true in particular in the case of consumers, who may not even be aware of all of the terms and their content. As a result, *AGBs* have traditionally been a subject of close legal scrutiny. In

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See for more detail *Klaus-Peter Berger*, id., § 306 *BGB*, note 4; *Hans Brox/Wolf-Dieter Walker*, id., § 4 note 57 et seq., especially concerning the exceptions from this rule.

Germany, the control of *AGBs* was a matter for the courts until the legislature passed a specific law on standard terms in 1977 (*AGBG*), which was integrated into the Civil Code (*BGB*) during Germany's modernization of its law of obligations in 2002. In keeping with the tradition of the *AGBG*, the new statutory framework applies a two-step control mechanism: provided that a contract term qualifies as an *AGB* (i.e. has been pre-formulated for use in multiple contracts) it must first be checked whether the term has been validly incorporated into the agreement. Provided that it has been effectively incorporated and the recipient of the *AGBs* was not unfairly taken unaware by its use, the *BGB* rules provide for a second control mechanism regarding the content of the terms. Depending on the extent of their departure from the statutory model, certain terms may be void or voidable according to the individual circumstances of the case. German law therefore provides a high level of protection against unfair standard terms. It is however not surprising that it is always necessary to review the jurisprudence of the German courts in order to be able to evaluate the validity and permissible use of *AGBs*. For despite detailed statutory regulation, the courts still play a vital role in controlling the use of standard terms of contract.

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