Agreements on Standard Form Contracts:
Self-Regulation, Cost Reduction, or Collusion?

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NOTE: This is a preliminary draft of a comparative EC-U.S. look at the competition-law and contract-law issues presented by agreements by firms on standard form contracts.

I. INTRODUCTION

In both the U.S. and Europe, standard form contracts are a common feature of commercial relationships. Some such contracts are created and used by individual firms, but others are created and adopted collectively by trade associations and similar entities, sometimes under the aegis of state actors. Standard contract forms can serve several purposes. Not only can they reduce transaction costs but they can also offer the potential of increased competition by making it easier for contracting parties to compare available terms. In addition, they can perform regulatory functions by mandating or prohibiting particular terms that might be viewed as desirable or undesirable.

The collective formation of standard-form contracts has recently begun to receive greater academic attention.1 The focus of this attention, however, has been primarily on contract-law issues, emphasizing the nature of the entity or entities creating the form contracts2 and its implication for the proper approach to interpreting the resulting contracts.3 The literature in this area generally has not focused specifically on issues specific to the collective formation of the contracts.

Contract standardization may be limited by both contract law and competition law. Moreover, the legal treatment of standard contracts may differ depending on whether the contract at issue is one between businesses (BtoB) or is one between a business and consumers (BtoC). The significance of this difference is probably greater in contract law than it is competition law. Even in contract law, the involvement of a consumer as one of the contracting parties has more significance in the EU than it does in the U.S.

Contract law imposes constraints on both procedural and substantive contractual terms. Those constraints would apply to the extent that the standard contract introduces terms that are unfair, to use the European terminology, or that violate one of the analogous, though narrower, U.S. doctrines, such as unconscionability or reasonable expectations.

Competition law could prohibit a standard form contract if the contract either constituted collusion among firms agreeing to the contract or created barriers to entry in the market in which those firms operated. In the first case, agreement among the firms on would lessen competition among them—competition with respect to contract terms. In


the second, the agreement would lessen competition between the agreeing firms and possible entrants.

This paper analyzes the relationship between the various contract doctrines focusing on unfairness (in a broad sense) and anticompetitiveness in the antitrust sense, looking comparatively at the US and the EU. The paper will ask whether anticompetitive contract provisions are also unfair in a contract sense, and vice versa, or whether the tests to evaluate anticompetitiveness and unfairness are distinct because they are aimed at different goals. For example we will consider limitations of liability or termination rights in BtoC standardized contracts and ask whether the analysis to establish their potential violation of antitrust law coincides, diverges, or conflicts with contract objectives.

The relative importance of the costs and benefits of standardization depends, of course, on the background legal rules and on the underlying economic characteristics of the transaction. Consequently, the contract and antitrust scrutiny given to contract standardization should also differ with those contextual characteristics. The scrutiny applied to standard contract provisions should also depend on whether legal rules, such as those in contract law or consumer law, already provide the benefits (or prevent the harms) that the private parties are seeking to achieve through standardization. One focus of this paper is on whether antitrust’s and contract law’s approaches to agreements on form contracts in fact reflects these contextual characteristics.

In the EU the question also has to be framed in a larger debate concerning the potential convergence of the objectives of antitrust law and consumer protection.4

We conclude that collectively created form contracts present competition issues distinct from those posed by contract or consumer-protection perspectives. To the extent that contract and consumer law regulate form contracts, they generally do so through a focus on oppressive terms. But a distinct issue for collectively created and agreed-upon form contracts is the antitrust one: that the terms of the standard form contract are the product of an agreement, and therefore eliminate competition. This concern exists even if the terms of the contract are reasonable in themselves, because the standard form can still eliminate competition in the range of reasonableness, i.e., among reasonable terms.5 The result is that the different needs of different customers are not met. Although some overlap may exist, antitrust and contract or consumer protection limitations to standardization perform different, somewhat complementary goals.

These differences concern, among other things, the domain and the scope of antitrust control and the different tests concerning pure self-regulatory arrangements and co-regulatory arrangements, where firms standardize in response to a delegation from public authorities, either legislators or public regulators.6 But they also concern the scope and domain of contract law control over standardization.


5 The issue here is not one of an agreement, independent of the contract, on terms like price that are then implemented in the contract. There have been some cases addressing agreements of that kind; the most recent instance involves Realtors and access to MLS systems. The focus here is on the harm caused by uniformity on the standard form contract; that is, the contract itself is the anticompetitive agreement; it is not evidence of some other agreement. There have been very few cases on this issue.

6 On these distinctions see F. Cafaggi, Rethinking self-regulation in European private aw, in Id. (ed.) Reframing self-regulation in European private law, Kluwer, 2006, p..
II. TYPES OF STANDARD FORM CONTRACTS

A. Purposes of standardization

There are several goals that firms or other entities might seek to achieve in agreeing on standard contracts:

1. Reducing transaction costs choices;
2. Promoting a network effect;
3. Regulating the market by mandating or prohibiting particular terms; or
4. Integrating the market by addressing legal fragmentation.

1. Reducing transaction costs. Most simply, the creators of a standard form contract might seek to lessen the transaction costs associated with contractual negotiation by agreeing on a standard contract. The transaction costs that could be reduced in this way would typically be related to the business elements of the transaction. For example, the agreeing parties might adopt common language for commonly used terms.7 Or they might enter into substantive agreements on minor terms.8

The advantage of such agreements would be to make it easier for parties to compare contracts and to switch from one contract to another. In that sense, agreements of this kind can be analogized to product standardization efforts that are directed to interoperability. The purpose of product standards directed at interoperability is to define aspects of product design, like interfaces, that allow products from multiple manufacturers to work together. Such standards are very common in the electronics and computer industry. Contracts, of course, generally do not have to “work together” in the same sense, but the lawyers or businesspeople negotiating them do, and contracts with standard terms provide a common “interface” to ease that negotiation process and reduce transaction costs.

2. Promoting a network effect. A standard contract can also create a network effect. A network effect is present when the value of a good—in this case, a contract—is greater if more people use it. The lowering of transaction costs discussed above is not, strictly speaking, a network effect in itself, because it does not give the contract a greater value but instead lowers the cost of using it. That is, it lowers the effective price of the contract, rather than increasing the demand for it.

But contract standardization can also increase the inherent value of the contract. That is so because a contract that is more commonly used is more commonly interpreted by courts, and therefore is a contract whose meaning and interpretation is more certain. To the extent that a user values this certainty, as most do, the contract is therefore more valuable even for users that are not familiar with its terms.9

This effect has been recognized in some cases involving standard contracts, such as bond indentures:

7 Wilhelmsson, supra note 1, at 54-56.
8 Id. at 56-58.
9 Of course, if courts interpret a standard term in an unexpected way, it may be that the contract’s value is lessened to a particular party. But the gain in certainty may still exist.
Uniformity in interpretation [of bond indenture provisions] is important to the efficiency of capital markets. . . . Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice. Just such uncertainties would be created if interpretation of boilerplate provisions were submitted to juries sitting in every judicial district in the nation.10

Interestingly, though, in some recent cases there have been dramatic differences in the interpretation of provisions in these sorts of financial contracts.

3. Regulating the market by mandating or prohibiting particular terms.11 Alternatively, firms might seek to regulate their conduct in more fundamental ways that are not aimed specifically at uniformity and transaction costs. For example, they might choose to forbid certain terms that are arguably unfair from inclusion in the contract. This sort of agreement would pose questions similar to those that are presented for product standards by efforts to impose, for example, safety standards. The focus is not on transaction costs but on what are perceived as socially desirable goals. The problem, for an antitrust perspective, is that the firms entering into the agreement might not have a uniformly accepted view of what goals are socially desirable.

4. Integrating the market by addressing legal fragmentation. Finally, in the contract context there is a third possibility that does not have an obvious analogue in product standards. That is that firms might agree on terms that alter the law applicable to the transaction. They might, for example, agree on a deviation from the default contract-law rule, or on the choice of a particular legal regime. Because a contract is not only a business document but also a legal one, the parties can define their own law in a way that differs from standardization of the characteristics of products.12

Interestingly, though, a recent U.S. example suggests that parties will not always choose this legal uniformity. A form contract promulgated by the American Trucking Association (ATA), which is discussed further below, actually results in less uniformity. Uniform law for certain aspects of trucking in the U.S. is provided by federal provisions that preempt state law. These provisions are not mandatory, though, and the ATA form contract waives them, thus making state law applicable. To be sure, the form contract provides its own alternatives, which might themselves result in a uniform contract, though one different from the uniform federal version. But the contract also leaves a blank for the parties to specify which state’s laws apply, which could affect the

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10 Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982).
11 In the U.S., the term “self-regulation” is usually reserved for circumstances in which firms seek to reduce their incentives for some form of exploitation of consumers.
12 Of course, the same provision might be interpreted differently in different jurisdictions. Still, standardization is likely to narrow the range of such interpretations.
interpretation of the contract’s provisions. Uniformity appears not to have been a significant goal in creation of the ATA form.

The four possibilities discussed above are represented in the following table, with the first two both effects resulting from agreement on substantive terms:

<table>
<thead>
<tr>
<th>goal</th>
<th>product standards</th>
<th>contractual standardization</th>
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<tbody>
<tr>
<td>uniformity of business elements</td>
<td>interoperability standards</td>
<td>agreement on substantive terms</td>
</tr>
<tr>
<td>uniformity of legal elements</td>
<td>product design as controlling legal “code” (Lessig)?</td>
<td>agreement on governing law</td>
</tr>
<tr>
<td>self-regulation</td>
<td>e.g., safety standards</td>
<td>e.g., disclosure standards</td>
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Interestingly, the benefits of conforming legal rules differ significantly in Europe and the U.S. In Europe, where there remains considerable variation in the contract law of the member states, standard form contracts can serve to conform contractual relationships in the different states, at least to the extent permitted by contract law. This conformity of contractual relationships can in turn serve the goal of market integration of the European economy. The creation of the internal market might depend on the competitive supply of comparable standard contract forms. Indeed, this has been a focus of the scholarship on standard form contracts in Europe and a part of the rationale for harmonizing the law with directive 93/13 and with the recent proposal on a new horizontal directive on consumer rights.

The U.S. is different in this respect. Although contract law is state law, so that formally there are fifty different bodies of contract law, the law is largely uniform among the states. As a result, standard form contracts are not generally viewed as a means of integrating contract law—legal integration, if you will—but as an efficient means of reducing transaction costs—economic integration.

Even the transaction-cost-reduction justifications are less compelling in the U.S. Language uniformity and large firms that operate throughout the U.S. and beyond

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13 This assumes, though, that the remediing of shortcomings in the legal system is a valid goal. In fact, it is not at all clear, even if it were agreed to be clearly desirable to integrate European contract law, or to increase U.S. consumer protection law, as discussed below, that private self-regulation would be the proper approach. Generally speaking, antitrust law, at least in the U.S., takes the approach that private agreement on the terms of doing business is inappropriate even if those terms would be desirable if they were adopted by individual firms.

14 This uniformity has been achieved by statute in the sale of goods, through widespread adoption of the Uniform Commercial Code, but even in other contexts the common derivation of U.S. contract law from English sources has resulted in great similarity among the laws of the different states. But see G. Miller, 2008, underlying the differences between NY and California contract law.

15 The usual justification for standard agreements is that they allow savings in drafting and negotiation costs, which is often said to aid smaller sellers and new entrants. Standard contracts can also make price comparison easier for consumers. But whether these possible beneficial effects in fact outweigh anticompetitive ones is unclear, particularly because the standard contracts are often created by only one side to the transaction at issue.
contribute both to greater commonality among contracts even without inter-firm standardization and to lower costs in moving from one contract to another.

B. Costs of standardization

Standardization can also cause negative effects, of course. Most obviously, firms could agree on form contracts that have effects the opposite of those described above. For example, they could agree on contracts that increase transaction costs. Such contracts could be anticompetitive in a variety of ways. More subtle, however, would be contracts that appear to be procompetitive but are not. Although each of the goals described in the previous section is generally procompetitive, each also presents the possibility of harm.

1. Reducing transaction costs. Any reduction in transaction costs achieved by making contracts more uniform is likely to limit consumer choice. Uniformity is exactly that: a limitation on choice. Although it is possible that only choices not desired by consumers are eliminated, or that the benefits of uniformity will exceed its costs, it is also possible that contract standardization could be used by sellers as a practice that constitutes or facilitates collusion.

The benefits of contractual uniformity are more likely to outweigh its harms when consumers are uniform as well. Significant differences among consumers would be likely to mean differences in contractual preferences, which would make it difficult to achieve uniformity without denying some consumers their preferences. Of course, standardized contracts can offer menus of choices rather than single terms, but that lessens the value of the standardization.

Indeed, the fact that firms have agreed on a form contract means not only that they are likely to propose using the contract, but also that they are less likely to be willing to deviate from it, or even to discuss its weaknesses. Moreover, because discussion of, and competition among, contracts can serve to elicit information about the underlying transaction to which the contract applies, an agreement on a contract may make such information more difficult to obtain. In this respect, the informational aspect of contracts may cause them to differ from other, more typical products.

2. Promoting a network effect. Similar points apply to network effects. When network effects are present, they can constitute significant barriers to entry. It is difficult for even improved products, like new contractual forms, to establish the informational benefits that widely adopted and long-used contracts will have. In that respect, firms and consumers may prefer the known quantity of an established contract term to a new and apparently better term whose interpretation is uncertain.

3. Regulating the market by mandating or prohibiting particular terms. This is a standardization effect that might well be treated dramatically differently by contract

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law and competition law. Contract law might pose no obstacle to the elimination of unfair terms, but competition might object to the elimination of such terms collectively. Generally speaking, competition law does not permit firms to agree on the terms on which they will do business, even if those terms are desirable, if the firms could adopt the same terms unilaterally.

When terms are adopted not to achieve uniformity, but to promote some particular view of fairness, there seems no reason why a single firm could not adopt the term individually. But perhaps if the goal was to have both desirable terms and uniformity, a collective effort would be necessary.

4. Integrating the market by addressing legal fragmentation. The use of contractual uniformity to counter legal diversity has the same problem as does uniformity with respect to business matters: it eliminates choice for consumers. Here, though, where one jurisdiction’s legal treatment is merely replaced by another, it is not clear that consumers would have significant choice in the absence of the standardization.

But this form of legal integration presents another potentially undesirable effect. If different states choose different legal rules intentionally, then an imposed uniformity defeats those intentions. Of course, the legal rule can be changed only if it is not mandatory but permissive. That leads to the question of whether a state might choose to have a legal rule be permissive, but object to its being changed through a collective effort.

C. Participants in the standardization process

One can also distinguish among standard form contracts based on the means by which they are formed. Of primary importance, particularly for antitrust law, are the parties that are involved in the standardization effort. If parties from both sides of the contract are involved, the legal treatment of a standardized contract may be more generous:

Antitrust analysis also considers the extent to which consumers have a voice in the standard setting process. Exclusion of consumers may be evidence of anticompetitive intent. Allowing policyholders to express their views on proposed coverages would tend to dispel any inference of anticompetitive motive on the part of an insurance rating organization’s members.19

The involvement of parties from both sides of the transaction may be of even greater significance in Europe, where there are a broader range of institutional mechanisms for addressing form contacts. Consumer associations play a greater role in Europe, both in the creation of standard-form contracts and in their monitoring and challenge.20

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19 ABA Section of Antitrust Law, Insurance Antitrust Handbook 70 (2d ed. 2006) (citing Moore v. Boating Industry Ass’n, 819 F.2d 693, 703 (7th Cir. 1987); Consolidated Metal Products, Inc. v. American Petroleum Institute, 846 F.2d 284, 295 (5th Cir. 1988); Letter from Joel I. Klein, Assistant Attorney General, Antitrust Divisions, to Joseph C. Bell & Mary Ann Mason, June 17, 1999).

20 Fabrizio Cafaggi, Self-regulation in European Contract Law, EJLS, 2007, 1 available at www.eui.eu
The involvement of the state can result in even more lenient treatment under the state action doctrine. State involvement can take at least two forms. One possibility is that the government or a regulatory agency can become part of the regulatory arrangement. It can sign codes of conduct, promote or favor their drafting, or approve them *ex post*. Another possibility is that the legislature or an administrative agency can formally delegate responsibility without other direct intervention of a public authority.\(^{21}\) This delegation could also involve monitoring power on the part of the delegating agency as well as direct or indirect sanctioning power. In either case the specific nature of the state involvement will affect the antitrust analysis and in Europe also contract analysis\(^{22}\).

Thus, for the participants in the standardization effort, we have these possibilities:

a. firms on one side of the contractual relationship at issue;

b. firms on both sides of the contractual relationship (in BtoB contracts) or firms and consumers (in BtoC contracts);

c. firms on one side and consumer associations on the other side; or

d. firms and possibly consumers with supervision of the state.

This categorization actually somewhat over-simplifies matters, because there are variations on these possibilities. For example, a standardization effort might be controlled by firms on only one side of a contractual relationship, but might receive input from other industry participants that are not immediately involved in that relationship. An example is offered by some of the American Institute of Architects contracts discussed below.

D. Form of the standardization effort

Another way in which standardization efforts can differ relates to the exact nature of the private involvement. One possibility is that the parties may enter into a specific contract to regulate conduct concerning contractual relationships. The obligations arising out of these contracts can in principle only affect signatories of the contract, but in fact they often can also regulate relationships between signatories and third parties. For example, these contracts may oblige parties to introduce or to refrain from introducing clauses in contracts with third parties, be they firms or consumers.

The performance of these obligations could be monitored by parties through the conventional apparatus of contract law. Although these contracts are generally not specifically regulated by civil codes or common law, with some adjustments, general

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\(^{21}\) For example a clear relation between the use of expertise and co-regulation is expressed in the European Commission, European Governance, White Paper, Brussels, 25.7.2001, COM(2001) 428 final: ‘Co-regulation combines binding legislative and regulatory action with actions taken by the actors most concerned, drawing on their practical expertise. The result is wider ownership of the policies in question by involving those most affected by implementing rules in their preparation and enforcement. This often achieves better compliance’.

\(^{22}\) If the standard contract forms are produced by a trade association on the basis of a formal delegation by a public authority the anticompetitive nature can only be scrutinized expanding the analysis to the delegation act which involves a different scrutiny from that which would operate on the basis of an independent initiative by the associations or a group of market players.
contract law could be deemed applicable to them.\(^{23}\) The main issue is related to the effectiveness of these contracts in relation to third parties. For example, if the signatory of a code of conduct is bound to refrain from inserting a clause in a contract with a consumer, how can the breach of the code affect the contract between the firm and the consumer? Does it only have consequences among signatories, usually firms, or can the consumer, technically a third party, sue the enterprise on the grounds of the breach of regulatory contract or the code of conduct?\(^{24}\)

Legal systems of European Member States differ quite significantly, but reasonable reliance on the binding nature of the regulatory contract or code of conduct can be a relatively strong basis for such a claim. The principle of reliance is becoming a strong basis for enforceability in contract law and more broadly in consumer law as the recent directive on unfair trade practices shows.\(^{25}\)

Even aside from legal sanctions, parties that enter into a contractual agreement on a standard form contract are likely to use that contract. They are unlikely to join the effort to create the contract if they do not intend to use it, at least if there are not any other benefits to joining the group engaged in drafting the contract (in which case the effort might better be viewed as organizational, as discussed below). Two plausible exceptions can be imagined. First, a party might deviate from an agreed-upon contract if its purpose in agreeing to that contract was to receive some sort of seal of approval, as perhaps in cases involving codes of conduct. In that case, again, one could view the nature of the effort as organizational rather than contractual. Second, a party might deviate from an agreed-up contract in the way that firms deviate from cartels.

As suggested in the previous paragraph, the complexity of these regulatory arrangements may require a broader set of devices than those provided by contracts. Parties may thus decide to set up an organization with different legal forms: association, foundation, company, cooperative, etc. Such an organization would produce rules through the enactment of codes of conduct and regulatory contracts, but also guidelines, codes of best practice, etc. dealing both with internal governance and with the contractual activity concerning members and their relationship with third parties. The organization will generally monitor its compliance through a specific apparatus or delegate this function to an independent body unlike the contractual system which will generally refer to a public judge or an arbitrator.

And finally the standard terms may only be recommended, and therefore may be formally voluntary. This could be the case for some organizationally created form contracts, particularly if the organization is independent of the market participants. The legal implications of such voluntary arrangements are discussed below, but the point here

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\(^{23}\) Adjustments may be required in the area of *causa/cause* /consideration, and in that of remedies, where sanctions for breach should not be focused on damages but on specific performance (i.e. to enforce the regulatory obligations) and the typical contractual sanctions can be combined with reputational ones.

\(^{24}\) The implications of this alternative are clear. If the consumer is allowed to bring a legal action on the ground of the regulatory contract she can claim damages even in case of void contracts and precontractual unlawful conduct breaching obligations determined in the code of conduct. Otherwise she will only be able to sue on the grounds of a valid contract and therefore will have no contractual remedy in case of breach of regulatory obligations by the firm when the contract is void.

\(^{25}\) See F. Cafaggi, Regulatory contracts, Codes of conducts, reasonable reliance and third parties, unpublished manuscript.
is that some such arrangements may have no formal enforcement mechanism. In that case, the only additional incentive for parties to use the form contract (beyond the effects of the contract itself) is the market power of the approval or imprimatur of the organization that creates the contract.

Thus we have three possible sources of form contracts, each of which creates different incentives for use of the form contract. In addition, we can add the state, either as a source of form contracts itself or as mandating the use of organizationally created contracts. The primary incentives for compliance are presumably either the benefits of the contract itself, either in the form of its reduction of transaction costs or other procompetitive benefits or in the form of the advantages of collusion. The table below presents the other incentives offered by form contracts:

<table>
<thead>
<tr>
<th></th>
<th>formal compliance mechanisms</th>
<th>market compliance incentives (in addition to benefits of contract or collusion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>state</td>
<td>legal rules</td>
<td>market significance of state approval</td>
</tr>
<tr>
<td>contractual</td>
<td>breach of contract action or boycott</td>
<td>none?</td>
</tr>
<tr>
<td>organization of</td>
<td>state mandate or</td>
<td>market significance of organizational approval</td>
</tr>
<tr>
<td>contracting firms</td>
<td>membership sanctions</td>
<td></td>
</tr>
<tr>
<td>independent organization</td>
<td>none</td>
<td>market significance of organizational approval</td>
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III. THE U.S. ANTITRUST BACKGROUND

A. **Antitrust and Standardization in the U.S. Courts**

Both the anticompetitive and the procompetitive effects of standardization are recognized by antitrust law. Most of the antitrust standardization cases have differed from the circumstances surrounding standard form contracts, however, in two ways. First, most of the litigated cases have involved product standards. In such cases, the concern has been that sellers whose products do not conform to standard will be unable to sell their products, even if consumers would want them, because consumers are dissuaded by the absence of a standard-setting organization’s seal of approval or similar imprimatur.

In these cases, the courts have usually used a procedural test rather than a substantive one. In the U.S., the Supreme Court set out the basic standard in *Allied Tube*: “When . . . private associations promulgate safety standards based on the merits of objective expert judgments and through procedures that prevent the standard-setting process from being biased by members with economic interests in stifling product competition, those private standards can have significant procompetitive advantages.”

It is not clear that this is the proper approach for a case involving standard form contracts. The focus of the analysis described above is on whether fair and objective
procedures have been applied, an approach that the courts perhaps adopt for product standards because they lack technical expertise in most areas of standardization. But courts presumably understand contracts. Consequently, a closer, more substantive scrutiny might be appropriate for contractual standardization.26

The second way in which the litigated cases differ from the form contract situation is that the alleged harm has generally been that to competitors, not (directly) to consumers.27 As noted above, the harm has been the inability of sellers whose products do not conform to standard to sell their products, even if consumers would want them, because consumers are dissuaded by absence of conformity to a standard. Similar claims could be brought for standard form contracts, but it is also possible that all sellers are content with the standard. In that case, the harm, if any, would be to consumers.

It may be easier to assess damages to a seller in the standardized market than it would be to calculate damages to a consumer in that market. An injured seller could probably show lost sales, but for customers of standard contracts, it would likely be difficult to show damages. That is especially so because defendants could argue that price compensated for disadvantageous terms, or at the very least that if different terms had been included, the price would have been different as well, lessening any damages.

B. **Standardization of Contracts in the U.S. Supreme Court**

The U.S. Supreme Court has considered several cases involving agreement by sellers on terms of their contractual relationships with buyers. Of course, a price-fixing agreement concerns the terms of the agreement between buyers and sellers, too. Some cases, particularly in the lower courts, have presented challenges to standard contracts on the ground that agreement on the contract reflected a price-fixing agreement. That is, those cases have generally alleged price-fixing, and the contract’s role was just as a vehicle for the price-fixing agreement. The focus here is on cases in which other aspects of the contract were standardized.

In *Paramount Famous Lasky Corp. v United States*,28 the Supreme Court considered an agreement among movie distributors under which they agreed to do business with exhibitors only with a “Standard Exhibition Contract.” Among other provisions in the contract was an arbitration provision that was the focus of the antitrust challenge. The Court’s condemnation of the contract, or of the agreement to use it, was somewhat obscure, responding primarily to the defendants’ argument that the term was a reasonable one:

> The fact that the Standard Exhibition Contract and Rules of Arbitration were evolved after six years of discussion and experimentation does not show that they were either normal or reasonable regulations. That the arrangement existing between the parties cannot be classed among “those normal and usual agreements

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26 On the other hand, it is possible that the effects of contractual standardization require a greater understanding of the market at issue than does the standardization of other products. see infra

27 Although standardization could cause harm to consumers (and presumably would, even in a case brought by an injured competitor), there have been relatively few cases claiming that

28 282 U.S. 30 (1930).
in aid of trade and commerce” spoken of in *Eastern States Lumber Assn. v. United States*, [234 U.S. 600, 612 (1914)], is manifest. Certainly it is unusual and we think it necessarily and directly tends to destroy “the kind of competition to which the public has long looked for protection.” *United States v. American [Linseed] Oil Co.*, [262 U.S. 371, 390 (1923)].

Although this was not the focus of the court, the government argued that “[t]he arbitration provisions of the standard exhibition contract and the manner in which they have been enforced are unfair and unjust to the exhibitors. All exhibitors outside the State of New York are compelled to arbitrate under the law of a foreign jurisdiction.” This appears to be an argument that would sound more in contract law than in antitrust. The response of the Court, on the other hand, with its focus on what sorts of agreements are “normal” and its reference to *Eastern States Lumber Association*, focused more on whether the agreement was one that was of a type that sellers typically enter into. But the case was an early one, so it is difficult to draw from it implications for current law.

In *National Society of Professional Engineers v. United States*,29 the Court considered a provision of the society’s code of ethics that effectively forbad competitive bidding. The provision did not affect contracts formed between engineers and their clients, except in that it forbade submission of a fee proposal before a client had chosen an engineer and begun negotiations on a contract. The Court rejected the society’s justification, which was that competition would produce inferior engineering work. But the Court approached the case as a simple assault on competition, not as presenting issues particular to contractual relations.

*Catalano, Inc. v. Target Sales, Inc.*,30 was somewhat similar, in that although it involved contractual arrangements, the Court addressed the case as one involving straightforward price-fixing. The restraint was one under which wholesalers agreed to eliminate credit sales. Interestingly, though, the Court also rejected the argument that the restraint would lead to greater price transparency:

Nor can the informing function of the agreement, the increased price visibility, justify its restraint on the individual wholesaler’s freedom to select his own prices and terms of sale. For, again, it is obvious that any industry-wide agreement on prices will result in a more accurate understanding of the terms offered by all parties to the agreement. . . . [T]here is a plain distinction between the lawful right to publish prices and terms of sale, on the one hand, and an agreement among competitors limiting action with respect to the published prices, on the other.31

More recently, in *Hartford Fire Insurance Co. v. California*,32 the Supreme Court considered efforts to force the use of insurance policy forms with particular terms. The

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30 446 U.S. 643 (1980).
31 Id. at 649-50.
ISO had proposed to offer two alternative forms, one for what was at the time the traditional “occurrence” policy and another for a “claims-made” policy. Several insurers objected and organized a boycott of the ISO forms, enlisting reinsurance companies in the boycott as well. As a result, the ISO responded to some of the insurers’ demands.

The Court had no trouble concluding that this conduct was anticompetitive, but because the conduct was part of “the business of insurance,” it was arguably exempt from antitrust scrutiny under the McCarran-Ferguson Act. As a result, the Court was not called up to provide a full antitrust analysis of the effect of the standardization. It did not, for example, need to decide whether the standardization would have been anticompetitive had the ISO not been coerced to make the changes. It might be, that is, that it was the coercion that was the anticompetitive act, and that it would have been anticompetitive regardless of the competitive effect of the standardization itself.

It is perhaps odd that the Court has not, at least since Paramount Famous Lasky, faced a case focusing specifically on the standardization of a contract. But the Court has actually considered relatively few cases involving standardization generally, and those that it has taken have typically involved egregious conduct on the part of the defendants. In deciding those cases, the Court has emphasized the potential benefits of standardization, suggesting that any standard-setting case is likely to get rule of reason treatment.

Consequently, plaintiffs may believe that the likelihood of prevailing, combined with cost of trying a rule of reason case, make bringing a case impractical.

On the other hand, cases like Professional Engineers and Catalano, which show that the Court will at least sometimes quickly condemn agreements on terms related to contractual relationships, would seem to suggest that there might be merit in a challenge, at least if no convincing procompetitive justification is present. The discussion of specific standardization efforts discussed below seeks among other things to determine whether that condition is satisfied with respect to those efforts.

C. “Voluntary” Standards

One preliminary issue is that the standardization of most of the contracts discussed below is, formally at least, voluntary. In some instances, there is a legal requirement that a particular form be used. In the U.S., for example, where there is government regulation of contracts, as with fire insurance, there are sometimes such requirements. Generally, though, parties are free not to use the agreements.

Nevertheless, in many instances sellers do adopt the standard contract. From an antitrust point of view one can draw an analogy to a situation in which parties, instead of agreeing on a price (which would obviously be price-fixing), agree on what they

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33 Id. at 773.
34 Id. at 775-76.
35 The Court considered whether the conduct alleged might have been a “boycott,” which is an exemption to the antitrust immunity conferred by the McCarran-Ferguson Act. See also UNR Industries, Inv. v. Continental Insurance Co., 607 F. Supp. 855, 862-63 (N.D. Ill. 1984) (“Therefore, the conspiracy to refuse to issue occurrence policies, which it might violate the antitrust laws as a concerted refusal to deal, is exempt from antitrust scrutiny under the McCarran-Ferguson Act.”).
announce is a reasonable price, and then all of them, “independently,” charge that price. There would certainly be antitrust liability in those circumstances, and the same result could presumably obtain with the uniform adoption of form contracts.

The key difference is that the adoption of standard contracts, unlike the adoption of higher prices, could make sense for a firm individually, even if other firms do not adopt it. That would certainly be so if the contract were a straightforward improvement on previous contracts. As a result, there is no particular reason to infer collusion. That would be so, at least, if the benefits of the contract were not those of uniformity. For a uniform contract to reduce transaction costs, it must be widely adopted. There is therefore a network effect that provides an incentive for all firms to adopt the standard contract, whether or not the contract is in itself well-drafted.36

[Discuss antitrust cases on voluntary standards. Schachar, etc.]

IV. EXAMPLES OF STANDARD FORM CONTRACTS IN THE U.S.

The paragraphs below offer several examples of organizational contract standardization. Interestingly, there appear to be relatively few public examples, at least in the U.S., of purely contractual formation of standard contracts, i.e., contractual formation of such contracts outside an organizational structure. A probable reason for this is that firms that would find it useful to create a standard contract probably have a trade association, and therefore effect the standardization through the organization.

Interestingly, though, several of the U.S. Supreme Court cases above—Paramount Famous Lasky, Catalano, and Hartford Fire Insurance—did involve what appear to be ad hoc groups that created form contracts. It may be, however, that such contractual efforts, especially when they pose the competitive problems present in those cases, are not public. It also may be that such cases, when they become public, are more likely to be litigated than perhaps more competitively ambiguous organizational standard-setting.

The discussions of the standard-setting efforts below seek to compare the contract-law implications of the efforts with their antitrust implications. Under contract law, the contracts could be evaluated for their procedural and substantive fairness, and the standardization might play a role in that evaluation. Under antitrust law, the unfairness would also be relevant, but the focus would be on the collective standardization effort. As will be seen, though, the legal analysis of organizationally created form contracts has been slight under either body of law.

A. Organizational Creation of Form Contracts by Firms on One Side of the Contractual Relationship

Several interesting issues are presented by recent model contracts promulgated to govern the relationship between motor carriers, or trucking companies, and the brokers that make the arrangements under which those carriers transport goods for shippers. The most fundamental point of significance is that there are two such contracts. One was promulgated in June 2006 by the Transportation Intermediaries Association (TIA), an

36 On the network effect see above.
organization whose members include brokers. The other was promulgated just two months later, in August 2006, by the American Trucking Associations, Inc. (ATA), which represents the trucking industry.

The ATA model contract—actually, two contracts, a short and a long one—was presented as an alternative to the TIA one:

The ATA model contracts follow the release earlier this summer of a TIA-developed model motor carrier/broker agreement. ATA has previously cautioned its members that it believes that the TIA model, which has not undergone DOJ antitrust review, favors in many instances the interests of brokers and shippers over that of motor carriers.

Thus, the two contracts, and the ATA one in particular, starkly present the issue of a contract promulgated by one side of a contractual relationship.

The main point of contention, judging from the ATA press release, appears to be that “the TIA model asks motor carriers to agree that the broker ‘is the sole party responsible for payment of carrier’s charges’ and contains an absolute prohibition against motor carriers seeking payment of freight charges from a shipper that has paid a broker.”

The ATA and the TIA had in fact previously sought to negotiate a joint agreement, but they could not agree on terms, and their primary disagreement was on this issue.

Interestingly, though, it is not clear what position the ATA agreement adopts on this issue. The ATA agreement states that “it shall be Broker’s responsibility to remit freight charges owed to Carrier . . . , regardless of any late payment or non-payment to Broker by Shippers.” This provision does not prevent the carrier from seeking payment from the shipper, but like the TIA agreement it makes the broker responsible for payment regardless of whether the shipper has paid.

One industry commentator has pointed out the risk that this approach poses for brokers: Moreover, he points out that this may have disparate effects on large and small brokers:

This possibility of a major customer default is the reason numerous sophisticated brokers will not guarantee payment of freight charges incurred for the account of rust belt shippers with junk bond status. Smaller brokers should recognize the credit risk involved in guaranteeing payments notwithstanding shipper insolvency and the possibility of offset.

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39 Id.
40 Id.
41 Henry E. Seaton, Who Pays the Freight?, http://www.transportationlaw.net/articles/jan07article.html.
From this perspective, it appears possible that the TIA model puts small brokers at a distinct disadvantage, because they are assuming the credit risk of the shippers. Larger brokers are presumably better able to assume that risk than are smaller brokers. In that respect, the ATA model continues to leave the brokers at risk, but it also provides that shippers continue to be liable, or at least does not clearly provide otherwise.

More importantly, perhaps, the ATA agreement does not provide contracting parties with various options on this term, or highlight the issues, but instead merely applies the provision quoted above. That approach seems intended more to ensure that carriers are protected than to ensure that the parties carefully consider their positions on what seems clearly to be a competitively significant term. The failure to provide or explain options is especially significant in that a previous ATA model agreement, for agreements between carriers and shippers, provided commentary for its various sections outlining alternative provisions.

The ATA’s model contract, but not the former, received a favorable business review letter from the Antitrust Division of the Department of Justice.\textsuperscript{42} None of these issues are addressed by the DoJ’s business review letter. That letter simply states that “[t]he model agreements do not contain any provisions specifying rates to be charged or other competitively significant terms, and use of the agreements or any of their provisions will be left to the determination of each company acting independently.”\textsuperscript{43} Given that there is a stated disagreement between the TIA and ATA agreements on this very issue, it is somewhat difficult to understand how the DoJ could conclude that it does not involve “competitively significant terms.”

In fact, a reasonable positions seems to be that a model agreement should not take a specific position on any issue where there is known dispute, or at least one of significant magnitude. If that is so, neither the ATA agreement nor the TIA one should have chosen the terms for this provision. Instead, each could have offered alternative clauses, and parties could have chosen among them. The problem with such a blanket rule, though, is that there will often be many such disagreements, and a rule that alternatives must be offered could cause the loss of many of the advantages of standardization.

The DoJ’s approach puts its term “competitively significant” at the center of the analysis, and the meaning of that term is not clear. It might mean that the term is one with respect to which firms are in fact not competing significantly. That is, it might mean that the firms’ terms are already identical. If so, it is not clear that there would be a need for, or a benefit from, standardization. And even if there would be value in standardization, it also raises the question of what is the DoJ’s basis for its determination of competitive significance. There is no suggestion in the letter that the DoJ conducted such an assessment or even relied on one submitted by the ATA.

It is more likely that the DoJ’s meaning is that the parties to the contract do not devote significant attention to those terms. A term that is not “competitively significant,” then, would be a term that is not related to price or to the definition of other key terms of

\textsuperscript{42} Letter from Thomas O. Barnett to Kenneth P. Ewing, Esq. [regarding proposal for model contract by American Trucking Associations, Inc.], Aug. 10, 2006.

\textsuperscript{43} Id.
the contract. As a decision rule for which terms the parties on one side to a contract should be permitted to standardize, though, this definition is flawed.

Parties might, it is true, not focus on a term because the magnitude of its effect of the value of the contract is small. In that case, there might seem to be little harm to allowing one party to choose that term. (It does seem, though, that the DoJ should make some sort of comparison of that harm to the benefits of standardization.) But if there are many such terms, as there were in the ATA’s proposed contract, the cumulative harm to allowing one side to the contract to make the choices could be significant. What seems to be required is an assessment of whether all the terms together are competitively significant, yet the DoJ seems to be focusing individually on terms.\footnote{Id. (“The model agreements do not contain any provisions specifying rates to be charged or other competitively significant terms . . . .”)}

One might respond that any harm that would otherwise be caused by allowing one party to define many minor terms would be prevented by an adjustment to the price.\footnote{In the context of vertical restraints, and more particularly vertical price restraints, the usual justification for allowing manufacturers to impose minimum prices on its dealers assumes that such prices will force the dealers to provide more in the way of services.} But if the DoJ’s point is that the parties do not focus on these terms, then there is little to suggest that the standardization would result in a renegotiation of the price of the contract. Perhaps the standardization itself would make it cost-effective for the parties to focus on these terms, but it is far from clear that that is so, or that the DoJ focused on that issue.

It is also possible that parties might not devote significant attention to terms whose magnitudes might be significant but whose likelihood is low.\footnote{Hill v. Gateway.} If there are many such terms, though, the likelihood of at least one of them happening may be significant. Moreover, it is likely to be very difficult for the parties to evaluate the significance of these sorts of low-probability events, and the parties may have different views about the likelihood of them. Consequently, there is a significant informational issues presented by one-sided terms for unlikely events, and the DoJ letter does not address this issue.

In other respects, too, the DoJ letter does not seem to capture the potential issues posed by the ATA agreement. For example, the letter states that it is issued on the understanding that the term regarding dispute resolution “would be left blank for each carrier to negotiate separately with brokers.” In the published agreement, this is true only in a strained sense. Section 10 of the model states that “the terms and procedures set forth in Attachment 3 hereto shall be controlling if a dispute arises with regard to its application or interpretation.” This leaves the parties free to negotiate their own “Attachment 3,” but the agreement as it appears on the ATA web site includes an Attachment 3 that outlines detailed provisions for dispute resolution, including “final and binding arbitration under the Commercial Rules of the American Arbitration Association.”

It is interesting to consider why the DoJ seems to have overlooked these points. It may just be hard to evaluate these sorts of agreements. Although, as suggested above, the effects contract standardization would seem easy for lawyers to assess, since contracts are legal documents, in fact an understanding of those effects may require a fairly detailed
understanding of the business context in which those contracts will be used. In fact, a trucking lawyer who has followed the history of the ATA and TIA agreements has said that the DoJ probably knew nothing of that history. Standard form contracts may be more complicated or more obscure than a typical product or joint venture that the agency might review.

Because these form contracts were adopted in 2006, there has been no reported case addressing them. One prominent trucking attorney has objected to various provisions of both the ATA and the TIA contracts, but his focus has not been on the collective creation of the contracts, nor even really on any “unfairness,” but just on the costs and benefits of the various terms to the parties. In any case, the likelihood of challenge to the ATA contract is probably lessened by the existence of the DoJ business review letter; whether that letter would have any significance in a challenge to the TIA contract, if it is widely adopted, would be an interesting question.

B. Organizational Creation of Form Contracts by Firms on One Side of the Contractual Relationship, with Input from Other Industry Participants

One of the more prominent U.S. instances of collectively created standard form contracts is that of the American Institute of Architects (AIA). The AIA is the “dominant” provider of building design and construction documents and provides a wide range of documents that are commonly used in the construction industry. 47 It provides both form contracts that primarily involve architectural services and contracts that primarily involve other parties, such as contracts for use by building contractors and property owners.

Commentary from both scholars 48 and industry participants 49 suggests that the AIA’s documents favor architects and to a lesser extent contractors at the expense of owners. Professor Justin Sweet has provided a description of the AIA drafting process gained in part from his experience observing that process. He observes that the AIA solicits the views of the Associated General Contractors (AGC), and even receives the AGC’s endorsement for some of its documents. But he says that “the AIA document creation process is notable for the conspicuous absence of owners or groups with the owner’s interests in mind.” 50

Despite its dominant position and the alleged one-sidedness of its contracts, the AIA contracts have been subject to surprisingly little antitrust scrutiny. One reason, perhaps, is that use of the contracts is voluntary, but as with other form contracts, other options are more expensive. As Professor Sweet says, “[c]ustomized contracts are much more expensive than standardized contracts, such as those of the AIA.” 51 Moreover, the AIA contracts themselves are difficult to customize, 52 which makes it difficult to use only

48 Id.
49 Id. at 336-37
50 Id. at 322.
51 Id. at 325.
52 Id. at 335.
part of an AIA contract. Thus, although use of the AIA contract is formally voluntary, it may be necessary as a practical matter.

The absence of antitrust challenges is even more odd given the apparently pro-architect approach of the documents. Professor Sweet notes several ways in which the AIA’s documents are designed to protect the financial interests of architects. Instead, those opposed to the contracts have taken other approaches. In the 1960s, contractors objected to an indemnity clause in an AIA contract, and the contractor groups persuaded state legislatures to limit those clauses. The National Association of Attorneys General has also had concerns about AIA contracts, and it even at one time considered publishing its own model contracts.

There has been only slightly more scrutiny of the AIA’s agreements under contract law. In Harbor Court Associates v. Leo A. Daly Co., the court upheld a clause in a standard AIA contract that altered the default rule for application of the statute of limitations. The court relied on freedom of contract principles, though of course the parties did not negotiate the limitation rule specifically. The court did, however, note that “the parties to the agreement are sophisticated business actors who sought, by contract, to allocate business risks in advance,” suggesting perhaps that the result might have been different in other circumstances.

The court did not focus specifically on the collective AIA creation of the contract. Indeed, Professor Sweet says that “relatively few reported appellate decisions can be said to provide guides as to how AIA selected language will be interpreted.” One can, of course, view the legislative limitations on AIA contracts discussed above as contract-law based. It is likely that those limitations were imposed more as a result of perceived unfairness of the contract terms than as a result of the collective formation of the contracts.

One thing AIA contract formation illustrates is the difficulty of incorporating meaningful input from other industry players when the process is controlled by an organization like the AIA. Professor Sweet is skeptical:

The more difficult question will be whether the AIA will really share its power. Although perhaps willing to seek the input of more owner-oriented groups regarding AIA drafts, the AIA would strenuously resist giving up any real power. This resistance is reflected in the recent Futures Task Force Report concerning AIA Policy on Documents Preparation and Review where the AIA notes that participation must be “responsible.” More importantly, the report notes that the AIA must exercise control to insure full and fair consideration of all interests, document-making must be expeditious and orderly and AIA policy or the public interest must not be compromised. In short, the AIA must have “full and final authority.”

53 Id. at 320, 330-31.
54 Id. at 339.
55 179 F3d 147 (4th Cir. 1999).
56 Sweet, 324.
57 Id. at 341-42 (footnotes omitted).
It seems likely that similar problems would exist whenever the process is controlled by one industry group. Perhaps only a standardization effort that required formal approval by both sides of a contractual relationship could avoid the problem.

C. **Organizational Creation of Form Contracts by Firms on One Side of the Contractual Relationship, with State Approval**

In the U.S., much of the work of generating insurance policy forms is done by the Insurance Services Office, Inc. (ISO), an association of insurers.58 The ISO is an organization somewhat similar to the AIA and performs a variety of functions for the insurance industry, among them the preparation of model insurance policies. Associated with each policy, ISO provides actuarial and rating data, all of which makes it very efficient for insurers to use ISO forms. Indeed, the Supreme Court said in *Hartford Fire Insurance Co. v. California*,59 discussed above, that “[m]ost ISO members cannot afford to continue to use a form if ISO withdraws these support services.”60

ISO is owned in large part by insurers, so that its operation could be viewed as an agreement among those insurers. Its contract-development process, however, can have input from other industry participants:

This ISO drafting process is reminiscent of the legislative process, with input from interest groups and regulators, and collaborative drafting, comment receipt, and revision. The revision of standard form policies is akin to amendment of legislation. The issuance of a new endorsement to meet a new problem (e.g., the total exclusion of asbestos or pollution coverage) has elements of amendment, the promulgation of a new regulation, or an agency opinion.61

Although the process can include input from a variety of parties, some still view the result as often unfavorable to policyholders. Despite state supervision, the ISO contracts incorporate insurer-friendly provisions, some of which insureds may find it difficult to understand. This was especially apparent in the aftermath of Hurricane Katrina in New Orleans in 2005. [more]

This sort of private standard-setting would seem sufficient to subject the ISO and its constituent insurers to antitrust scrutiny. The ISO, however, operates against the background of an antitrust exemption for the “business of insurance” under the McCarran-Ferguson Act.62 There have, however, been frequent calls for the repeal or modification of the McCarran-Ferguson Act to restore antitrust scrutiny to the insurance

58 Other similar organizations include American Association of Insurance Services.


60 509 U.S. at 772.


62 See also *Pierucci v. Continental Casualty Co.*, 418 F. Supp. 704 (W.D. Pa. 1976) (complaint alleging that insurers “fix[ed] the terms of [insurance] policies” dismissed because state law provides for approval of policies, so complaints about policy terms should be made to state regulator).
industry. The Consumer Federation of America has argued for complete repeal of the act. J. Robert Hunter, director of insurance for the organization, called the act “a truly astounding piece of legislation,” not only because it for the most part exempts insurers from antitrust laws but also because it does not establish any other forms of oversight by the federal government of state regulation.

Interestingly, though, the EC has a somewhat similar approach. Specifically, the EC has a block exemption from antitrust law for form insurance contracts. The EC block exemption, like the U.S.’s McCarran-Ferguson Act, doesn’t really address whether agreement on contracts is likely to make them more or less consumer-friendly. Although the block exemption, among other things, prohibits insurers from agreeing on policies that combine coverage for multiple risks if those risks do not always appear together, for the most part it does not in itself attempt to define what terms might be undesirable.

The block exemption, however, does have one dramatic difference from the McCarran-Ferguson Act. It provides that the Commission can withdraw the exemption “at the request of a Member State or of a natural or legal person claiming a legitimate interest” if standard terms “contain clauses which create, to the detriment of the policyholder, a significant imbalance between the rights and obligations arising from the contract.” It is interesting that although the block exemption is addressed to competition law, the language of this provision is one of contract law.

In this respect, another DoJ business review letter is interesting. In 1993, the ISO requested review by the DoJ of the ISO’s marketing of a product that would provide premium-comparison reports for different insurance companies. This is the sort of information that can facilitate price-fixing, and indeed the DoJ stated that “[t]he Department would be concerned about the anticompetitive impact on insurance rates of the creation by competitors of a database that permits the detailed comparison of premiums currently being charged . . . .” The DoJ, however, said that because it appeared that the proposal was part of the “business of insurance” and because it was regulated by state law, it was exempt from antitrust scrutiny. Although this is not the sort of conduct that would be covered by the EC block exemption in any case, it does illustrate that even if antitrust exemption may often be appropriate in the insurance context, the desirability of applying antitrust law should at times overcome the exemption.

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63 These calls appear to have gathered force recently. In 2006, there was Congressional consideration of repeal of the McCarran-Ferguson exemption. See http://www.insurancejournal.com/news/national/2006/06/22/69707.htm. In addition, the Antitrust Modernization Commission

64 Id.

65 Do U.S. forms do this?

66 The EC block exemption also requires that the agreements must be public. In the U.S., in contrast, the ISO’s policies are not generally available, at least free of charge.

67 See F. Cafaggi, Self-regulation in European contract law, cit. p.00


Indeed, despite the McCarran-Ferguson Act, an antitrust suit in the late 1980s alleged that the involvement of insurers in the ISO’s preparation of form contracts was an antitrust violation. The suit was settled by the insurers with the state of Texas with an agreement that insurers would no longer have decision-making power regarding policy language, though ISO could still “consult” with them.70

The nature of this settlement is rather peculiar. Because of the ISO’s close association with the insurance industry, it seems likely that it will choose insurer-friendly policy language regardless of whether it or insurers formally make the decisions. The settlement seems therefore to elevate the organizational form of the ISO over its effectively collective substance.

Perhaps this concern would be lessened if the ISO’s deliberation and selection process were open, but it is not:

For obvious reasons, ISO and insurers resist turning over this so-called drafting and regulatory history. Even if a policyholder is able to obtain the information, ISO typically succeeds in obtaining a protective order precluding dissemination of the materials to third parties. Accordingly, much of this story remains hidden to the public, known only to those policyholders and their law firms that have prevailed in the requisite discovery battles.71

The relationship of ISO and insurers with state regulators is a controversial one. There are also difficult issues regarding specific interactions between the industry and regulators. In Morton International, Inc. v. General Accident Insurance Co.,72 the court considered the interpretation of a clause that limited recovery to “sudden” accidents. Although the court said that the term would describe only accidents that occurred abruptly, it refused to apply that limitation because the insurance industry had said “in its presentation to New Jersey and other state insurance regulatory agencies” that the clause was merely a clarification of existing coverage.73

The court focused explicitly on the importance of the relationship between the industry, collectively, and state regulators: “The industry’s presentation and characterization of the standard pollution-exclusion clause to state regulators constituted virtually the only opportunity for arms-length bargaining by interests adverse to the industry, insureds having virtually no choice at all but to purchase the industry-wide standard CGL policy.”74 A few cases have followed suit, but most have rejected Morton International’s regulatory estoppel approach.

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70 http://query.nytimes.com/gst/fullpage.html?res=9D0CE0DF1538F93BA15750C0A967958260 (“The Insurance Services Office will change its policy forms decision-making process nationwide as a result of an antitrust suit settlement reached with Texas state officials. ‘ISO agrees that decision-making authority in ISO with respect to all Policy Forms that are filed or to be filed in Texas shall be exercised by ISO staff,’ rather than by participating ISO insurers, according to the settlement agreement.”).

71 Kalis et al., Policyholder’s Guide § 1.02, at 1-5 (quoted in Stempel, § 4.05[A], at 4-30).


73 At the time, the states were split on the interpretation of “sudden.” Stempel at 4-33.

74 Id.
Although the decision is not directly applicable to antitrust issues, it is interesting that the *Morton International* court was willing to bind the “industry” to a particular contract interpretation based on collective action. It does not seem entirely clear that one insurer should be bound by conduct by other insurers or even by the ISO, yet the court did not seem concerned to identify the sources of the industry representations. One industry observer, however, has no trouble with the court’s approach: “[R]egulatory estoppel seems apt where the entity making the estopping statements is the insurance industry’s own official organization charged with drafting and standardizing lengthy agreements.”

There is another aspect of contract law that is relevant to the antitrust issues, though. In some instances, the benefits that parties claim for their standard contracts might better be provided by contract law. This may be true, for example, for insurance contracts in the U.S. The justifications for state regulation of insurance contracts and for the drafting efforts that the states largely leave to the ISO, focus primarily on contract and consumer-protection concerns particular to insurance transactions.

It is not clear, however, whether this regulatory approach makes sense in the insurance context. Some states require that certain provisions are part of the insurance contract, even if those provisions are not in the written agreement. And U.S. contract law has itself developed a variety of doctrines, many of them specific to insurance law, that greatly lessen the problems at which self-regulation is purportedly addressed. As a result, there are concerns that standard form contracts in the U.S. insurance context serve more to lessen competition than to protect consumers.

As a result, it is possible that there is little gained in preventing bad terms through regulation by state agencies. If so, then by promoting standardization when bad terms would be unenforceable in any event, the state regulatory may serve to eliminate good terms. This is especially so in that innovative, consumer-favorable terms are likely to come from small innovative insurers, which are exactly the ones that would find it difficult to afford the requirements for state review of new contracts.

V. IMPLICATIONS

The relative dearth of legal analysis of the joint creation of these contracts makes it difficult to draw any useful implications from them. There appears to have no fully litigated antitrust challenge to any of the contracts, and the contract cases, with the exception of *Morton International*, make little of the collective creation of the contracts. There is a case currently working its way through the courts, though, that has tentatively addressed some of these issues, and that presents a tutorial on the contract-antitrust interface.

Litigation against VISA, MasterCard, and their card-issuing banks in both the U.S. and Europe has challenged a variety of their practices as antitrust violations. Much of the litigation has involved bank interchange fees, where the allegation is effectively of price-fixing. But in the U.S. consumers have also alleged that the banks agreed among themselves to include mandatory arbitration clauses in their agreements with

75 Stempel, 4-38.
cardholders. The consumers challenged these clauses both under contract law and under antitrust law.

The first challenge the consumers made was under contract law. The challenge against the defendant banks argued that “(1) collusion by defendants renders their agreements unenforceable, and (2) defendants’ collusive behavior was procedurally unconscionable, which, combined with a waiver of class action remedies, renders the contracts unenforceable.” In (1), it is not clear whether the argument was that the contracts were unenforceable because they violated federal antitrust law, which would preempt state contract law, or that as a matter of contract law the enforcement of contracts obtained through an antitrust violation is impermissible. (There is an analogy there to the position of EC competition law vis-à-vis national contract law.)

In any event, the district court refused to hold that the contracts were unenforceable under (1). It cited a line of cases under which a court will enforce a contract that is an “intelligible economic transaction” separable (in some ill-defined way) from the alleged antitrust violation. The impetus for these cases seems to be a concern that the plaintiff may be seeking to take the benefits of the contract and then use antitrust to avoid paying its costs. In that case, the plaintiff could reap a windfall that would be greater than its antitrust damages. The courts therefore take the view that the contract may be enforced, and the plaintiff may bring a separate antitrust claim.

In (2), the argument was that the alleged antitrust violation had implications within contract law. The court rejected the plaintiffs’ unconscionability claim, but not on the ground that collusion did not constitute procedural unconscionability. Instead, it took the common view that both procedural and substantive unconscionability are required, and concluded that a waiver of class action remedies is not substantively unconscionable. It would be interesting to see how a court resolved this issue in a state that had a more flexible approach to unconscionability, as some states do.

Following this decision, the plaintiff consumers filed a separate antitrust action alleging that the same collusion was an antitrust violation. The district court rejected this suit on the ground that the suit was not ripe for adjudication because the plaintiffs had not yet had an injury that was subject to arbitration. But the Second Circuit Court of Appeals rejected this argument, distinguishing antitrust harm from contractual harm:

The harms claimed by the cardholders, which lie at the heart of their Complaint, are injuries to the market from the banks’ alleged collusion to impose a mandatory term in cardholder agreements, not injuries to any individual cardholder from the possible invocation of an arbitration clause. The antitrust harms set forth in the Complaint—for example, the reduction in choice for consumers, many of whom might well prefer a credit card that allowed for more methods of dispute resolution—constitute present market effects that stem directly

77 Id. at 258-59.
78 Id. at 259.
79 Id. at 259-60.
from the alleged collusion and are distinct from the issue of whether any cardholder's mandatory arbitration clause is ever invoked. The reduction in choice and diminished quality of credit services to which the cardholders claim they have been subjected are present anti-competitive effects that constitute Article III injury in fact.\textsuperscript{81}

That the agreement may constitute an antitrust violation does not, however, define the substantive standard that should be applied. The court’s reference to the “diminished quality of credit services” points in one direction. One wonders, though, whether the assessment of the quality of credit services would be made on average, including both those who do not care whether they are limited to arbitration and those who do, or if a diminished quality for any customer would be sufficient to constitute a violation. After all, the court focuses also on the reduction of choice, which seems to acknowledge the importance of individuals, not just collective interests. One also wonders if in light of the court’s focus on the reduction in choice it would be willing, as the district court was, to see the arbitration clause as an “intelligible economic transaction” independent of the antitrust violation. If not, it might conclude that the clause is unenforceable under contract law as well.

A. \textit{Contract law limits to standardization}

Standardization of contracts operates as a form of private rule-making complementary to legislation. Its relationship with the law-making process presents distinct issues. As the case law both of the ECJ and the member states shows, in Europe enterprises are limited in different ways by mandatory and default rules. Standardization of contract terms that refer to mandatory rules can specify the content of those rules and can only deviate by increasing the scope of protection of the rule\textsuperscript{82}. Thus in the context of BtoB relationships an agreement that defines the amount of indemnity due to agents in case of lawful termination of contracts can only \textit{increase} the indemnity due.\textsuperscript{83}.

From a substantive viewpoint standardization is limited in Europe by procedural requirements such as transparency and plain language and substantive requirements such as prohibition of unfair terms (which nevertheless falls far short of a positive requirement of contract fairness).

Reference to fairness concerns both BtoC and BtoB contractual relationships. While in BtoC relationships the main but not exclusive reference is directive 93/13 on unfair contract terms, references in the BtoB realm are more scattered. One example is the late payment directive 2000/35.\textsuperscript{84}

\begin{itemize}
\item \textsuperscript{81} Ross v. Bank of America, N.A. (USA), 524 F.3d 217, 223-24 (2d Cir. 2008).
\item \textsuperscript{82} See C-465/04 Honyvem Informazioni Commerciali Srl v. Mariella De Zotti, 23 march 2006. “… the indemnity for termination of contracts which results from the application of article 17(2) of the directive cannot be replaced pursuant to a collective agreement, by an indemnity determined in accordance with criteria other than those prescribed by article 17, unless it is established that the application of such an agreement guarantees the commercial agent, in every case, an indemnity equal or greater than that which results from the application of article 17”
\item \textsuperscript{83} See C-465/04 Honyvem Informazioni Commerciali Srl v. Mariella De Zotti, 23 march 2006. “… the indemnity for termination of contracts which results from the application of article 17(2) of the directive cannot be replaced pursuant to a collective agreement, by an indemnity determined in accordance with criteria other than those prescribed by article 17, unless it is established that the application of such an agreement guarantees the commercial agent, in every case, an indemnity equal or greater than that which results from the application of article 17”
\end{itemize}
Another example is the reference to fairness of indemnity due by the principal to the agent in case of contract termination\textsuperscript{85}. Directive 86/653 was clearly enacted to protect agents and collective agreements can only be enacted in conformity with that goal.

The European case law has offered interesting examples of collective agreements concerning distribution contracts or contracts between producers and distributors. The ECJ decided that collective agreements that increase the protection of agents can only be accepted if the higher protection is ensured ex ante\textsuperscript{86}. If there is risk that the criteria defined in the collective agreement may make the individual agent worse off, the standardization is impermissible. The ECJ simply says that the law can not be replaced by the collective agreement but does not specify whether the collective agreement whose application may make a single agent worse off is void or not binding. Thus unfair collective agreements can not be applied to the specific agent when the outcome is worse than it could have achieved by applying directly legislation\textsuperscript{87}.

In Europe contract law control over standard contract forms focuses on fairness. This control operates both in relation to contracts drafted by individual firms and those drafted by a group of firms, the entire industry, or a trade association. It only refers to terms which have not been individually negotiated. Thus it should encompass both unilaterally drafted standard contract forms and standard contracts negotiated between associations.

While European legislation was enacted to regulate BtoC relationships, some member states have expanded its application to BtoB as well, thus making it a general principle of contract law in those states\textsuperscript{88}.

Unfairness is related to the (im)balance of rights and obligations. Direct control over the fairness of the price or the main terms of the changes is not required. Some member states in the implementation of the directive have gone further, allowing judicial control over the fairness of clauses defining the contract price.

\textsuperscript{85} Art. 17 dir. CE 86/653 “ Upon termination of the contract, the principal shall pay the commercial agent an indemnity provided that at least one of the following conditions is fulfilled:

a) …

b) the payment of this indemnity is fair, having regard to all the circumstances and, in particular, the commission lost by the agent on the business transacted with such customers”

\textsuperscript{86} See C-465/04 par. 25 and 27

27 therefore it must be concluded from the foregoing considerations that Article 19 of the Directive must be understood as meaning that a derogation from the provisions of article 17 may be accepted only if , ex ante, there is no possibilitá that at the end of the contract that derogation will prove to be detrimental to the commercial agent”

\textsuperscript{87} In this case the agreement was meant to specify the very general criteria defined by the directive and a consistent interpretation would hold the agreement valid and not applicable in those cases where the agent could have been better off by referring to the general criteria defined by the law as applied by the Court.

\textsuperscript{88} See Contract I cit. “ In Austria, Estonia, Germany, Hungary, Lithuania, the Netherlands, Portugal, and Slovenia, there are general clauses which provide for a content review of standard terms which do not merely apply to B2C contracts, but also to B2B contracts” p. 236
In the restatement of the Acquis principles the difference between BtoB and BtoC is maintained and the evaluation of unfairness of contractual terms diverge significantly in the two areas\textsuperscript{90}.

In the BtoC context, the unfairness is related to a significant imbalance in the rights and obligations of the parties.

In the BtoB context, the reference point for evaluating unfairness is gross deviation from good commercial practice\textsuperscript{91}. In contrast to the BtoC context, then, commercial practices are the reference for unfairness. This criterion leaves many questions unanswered. For the purpose of this essay the most important is whether a good commercial practice should imply the existence of a competitive market and clearly for us the answer is affirmative. Another, more difficult question is whether the collective agreement on a practice by many, or even most, firms in an industry could be viewed as making that practice \textit{ipso facto} a good commercial practice.

The fairness control is aimed at preventing firms from abusing their power, because it only applies to terms that have not been individually negotiated. If there is individual negotiation, even if there is strong asymmetric market power, the directive does not apply. In this case abuse of market power that translates into unfair terms is controlled under national legal systems by the good faith clause or functional equivalents. There is thus a direct correlation between the (in)existence of a negotiation and the likelihood of contractual fairness.

Unfair terms may be let aside either by means of injunctive relief or because they should be considered not binding the consumer. Sanctions are thus comparable with those available in case of antitrust violations where consumers can seek injunctive relief and void the contracts which is the ‘direct’ result of the unlawful agreement or the act of an association of undertakings\textsuperscript{92}.

It is important to consider also a recent proposal for a new directive on consumer rights, where a revision of directive 93/13 is proposed\textsuperscript{93} No reference to any form of negotiated rule making concerning standard contract terms is made in this proposal. Worth noticing among the proposed changes related to unfair contract terms are the elimination of reference to non-individually negotiated terms for a broader formula which refers to the possibility of the consumers to influence the content of the clause\textsuperscript{94}.

\textsuperscript{90} Notice however that the general rule applies to all transactions but for the BtoB and that the special rule has become the BtoB.n See Art. 6:301 (1) and (2)

A different approach is used in the DCFR where three different standards are defined in relation to unfair contract terms

\textsuperscript{91} A term in a contract between business which has not been individually negotiated is considered unfair only if using that term amounts to a gross deviation from good commercial practice."

\textsuperscript{92} See above

\textsuperscript{93} Proposal of a Directive on consumer rights October 10 2008 COM (2008) 614/3

\textsuperscript{94} Art. 30 of Proposal directive on consumer rights “This chapter shall apply to contract terms drafted in advance by the trader or a third party, which the consumer agreed to without having the possibility of influencing their content, in particular where such contract terms are part of a preformulated standard contract”.
Reference to the modes of drafting and negotiating are also elements of (un)fairness evaluation95. These changes make the implementation of the principles more difficult and it is to be hoped that they will be modified in the final version.

Fairness control can give rise to different remedies, such as injunctive relief and set-aside remedies. The one that has proved to be most effective is certainly injunctive relief. Consumer associations have used extensively the power to seek injunctions for two different, sometimes conflicting, purposes: policing the market and increasing their negotiating power. Litigation over unfair contract terms has thus reduced the level of unfairness of standard terms, but the threat of litigation has empowered consumer associations and public bodies to negotiate ex ante standard forms. This model which had been used extensively in Scandinavian countries is now deployed in other legal systems with very different legal traditions such as the UK, Germany, and Italy. While there has been no legislation based upon the fairness dimension, it has become more and more a matter for negotiation, transforming de facto judicial intervention from dispute resolution into quasi judicial review96.

B. Contract law issues in the U.S.

In the U.S., there is much less focus on unfairness in standard contracts. (This is true at least in the courts; academics pay much greater attention to standard contracts. 97) Few cases have addressed the issue of collective agreement on standard contracts. In the case of the adoption of a standard contract by a single firm, though, standardization as such generally has little significance, though the U.S. doctrines that address unfairness, such as unconscionability and the reasonable-expectations doctrine, are applied most often in cases that involve standard contracts.

As noted above, a few cases have indicated that where a contract or contractual term has been standardized in an industry, the contract or term should be interpreted uniformly. Interestingly, to the extent that this rule were adopted to an arguably unfair contract, it could make enforcement of that contract more likely. That is so because at least the unconscionability rule addressing unfairness often turns on facts particular to an individual claimant, which a court focused on uniformity might not admit. On the other hand, the reasonable-expectations doctrine is more objective and would probably be applicable even if interpretation were uniform; indeed, the doctrine is in a sense one that demands a single objective interpretation.

Some courts have indicated that the standardization, or even uniformity, of contract terms across an industry will contribute to a finding of procedural unconscionability.99 This is so because an element—in California, a sufficient element—

95 See F. Cafaggi and H. Micklitz, ERPL, 2008
99 See Ting v. AT&T, 319 F.3d 1126, 1148-49 (9th Cir. 2003).
in a determination of procedural unconscionability is that the contract at issue is one of adhesion, *i.e.*, that a party can only accept or reject, but not negotiate. Some contracting parties contend that the availability of alternatives in the market will affect the adhesion analysis, but if a contract is standardized across the industry, there will be no such alternatives.

C. *Comparing contract law in the US and EU*

VI. CONCLUSION

Standardization of contracts constitutes a form of self-regulation, with different functions when it regulates BtoB and BtoC. It is limited by both antitrust and contract law. These limitations are grounded in different rationales and should not necessarily overlap. In particular in those jurisdictions where antitrust and consumer protection are attributed to the same agency the goals and means, though complementary should be kept distinct.

These differences should not imply total separation. We believe that the tests concerning unconscionability and unfairness of contract terms in standardized contracts should take into account the market forms within which standardization takes place. In principle we expect competition to be a force that will push firms toward contractual terms that advance consumer welfare. Thus, the higher the level of competition in the market, the lower the likelihood that unfair terms will be found in standard contract forms. Moreover, in the U.S. assessments of the contracting process itself, which are relevant in evaluating contractual enforceability, may turn in part on market structure, so that issues important in antitrust may also play a role in contractual analysis.