



**Abstract:**  
**Standard form contracts and the limits of freedom of contract**

1. It is generally believed that, in order to improve the functioning of markets, the state should refrain from interfering with individual freedom. In particular, the state (i.e. the legislator and the courts) should enhance rather than restrict freedom of contract. Freedom of contract guarantees Pareto-efficient outcomes. Rational and informed parties only conclude contracts if *each* of them benefits from the transaction.

2. In the real world, however, irrationality, lack of information and transaction costs can cause market failure. Unlimited contractual freedom can produce inefficient results. Under such circumstances, restricting the parties' freedom of choice as to the content of the contract may prevent market failure.

3. In particular, restrictions on contractual liberty are necessary with regard to standard form contracts. In the absence of regulation, asymmetric information between the party proposing the standard terms (generally the supplier) and the opponent (the customer) would lead to market failure. For the customer, it is not worthwhile to read all the terms contained in the 'small print': the costs of information exceed the benefits. Hence, the customer will usually pay attention only to the few 'main' terms of the transaction (e.g. price, quality and other main characteristics of the good/service provided) and ignore all the other terms.

4. The lack of information on the part of customers induces suppliers to act opportunistically. They have an incentive to include terms in the 'small print' that are favorable to themselves but unfavorable to customers. By ignoring the abusive terms, customers are likely to overestimate the value of the bargain. As a result, customers obtain a smaller surplus from the transaction. In some cases, the surplus may be even negative, i.e. the contract is inefficient.

5. In the long run, unregulated standard form contracts result in adverse selection ('market for lemons'). By using standard terms favorable to themselves (e.g. exemption clauses and other clauses shifting risks to customers), suppliers can reduce production costs and hence underbid competitors who use terms more favorable to customers. Being unable to identify the content of the terms, utility-maximizing customers will prefer the 'low-price' suppliers to the 'high-price' suppliers. Thus, using abusive terms can be said to give suppliers a 'competitive edge'.

6. Regulation of standard form contracts is faced with a number of questions. What terms should be subject to regulation? In particular, should the prohibition on 'abusive terms' also extend to price terms? Is there a need for regulation in the B2B context? When assessing the abusiveness of a particular term, should courts take into account whether the transaction *as a whole* is unfavorable to the customer? As I will show in my presentation, economic analysis of standard form contracts provides a useful framework to answer these questions.