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Approaching the European Union Directive on Unfair Terms in Consumer Contracts Through the Lens of the Principle of Good Faith

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Abstract: The article aims to delve into the nuanced interpretation of the principle of good faith within the domain of unfair terms prevalent in consumer contracts. This principle has proven pivotal in appraising the fairness of terms, serving as a benchmark. Its multifaceted application across legal domains necessitates a precise explication of its contextual significance. Emphasizing the imperative to delineate the exact connotation of the good faith principle in the judicial realm of consumer safeguarding, the article subsequently elucidates this proposition through a meticulous analysis of the Directive and its corresponding legal cases. However, the initial analysis underscores the Directive's somewhat ambiguous delineation of the good faith principle. This prompts an inquiry into whether such ambiguity hampers the comprehensive evolution of this principle within the broader context of EU private law. Consequently, the subsequent discourse endeavors to rationalize this aspect within a redefined comprehension of the jurisprudential underpinning of the Directive.

Keywords: good faith principle, unfair terms, consumer contract, consumer protection

1. Introduction

The European Union Directive on Unfair Terms in Consumer Contracts is considered one of the most essential directives for protecting consumers. However, understanding its provisions and determining the criteria for unfairness requires further contemplation. It is generally believed that consumer protection differs from the concept of contract protection, which has gradually emerged due to the significant disparity between operators and consumers since the industrial age. Legal intervention involves the notion of protecting the vulnerable, and the principle of good faith, a traditional concept in contract law, is understood differently in various EU member states. When used as a criterion in the directive, it has also sparked considerable debate in the development of specific cases. Exploring the underlying purpose of the directive helps mitigate this contradiction, and establishing its legal foundation on preventing "market failure" contributes to a shift in thinking.

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2. The Principle of Good Faith in the Context of Unfair Terms

The principle of good faith is widely referred to in EU legislation as well as in court legislation. But its specific content and better understanding has been left to specific interpretation [1]. The principle of good faith is to a large extent a broad concept and the definition has been established through the Commission Proposal for a Common European Sales Law. It says that " 'good faith and fair dealing' means a standard of conduct characterized by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question."

And this definition also shows that the principle of good faith is a sub-principle of the principle of solidarity, since, unlike the parties' own interests, which are pursued in traditional private contract law, the principle of good faith requires consideration of the interests of the transaction as well as of the relationship in question.

In the fields of doctrine, a distinction is usually made between the subjective and objective concepts of the principle of good faith. The former designates the mental state of a particular person, while the latter refers to a necessary standard of conduct. In conclusion, legal writers refer to three basic functions: good faith may help to interpret and apply the written law; it may supplement legislative provisions where lacunae become visible; and it may in some cases even recalibrate valuations embedded in the law [2].

Although the principle of good faith is enshrined in most of the EU member states, Germany in particular gives it a high status, the primary law of the Union does not contain an explicit reference to good faith. When focused on the secondary law of the union, especially on the regulations and directives, several issues could be found. The principle of good faith not only appear in the duty to negotiate or performance of contractual obligations, but function as a standard of review. Starting with the Unfair Contract Terms Directive in 1993, the EU has taken several measures to use the good faith standard to review single contract terms or commercial practices in general.

In this section the passage explains the general lineage of the development of the good faith principle and in what guise it has entered the field of consumer contracts. The next section will move on to the framework of the Directive to analyse the content of this standard of review.

2.1. The Role of the Good Faith Principle in the Directive

The principle of good faith is considered to be one of the criteria for judging the unfairness of the provisions in the framework of the Directive, and an accurate understanding of its meaning and function requires a specific understanding of the broad purpose and framework of the Directive, as well as its interpretation in relation to the other elements of its provisions.

2.1.1. Context and Fundamental Objective of the Directive

The directive itself is given high priority and is seen as having a great impact. Directive 93/13 is properly seen as the first intrusion of Community law into the heart of thinking about national contract law. A number of Member States have legislation on unfair contract terms, but the control techniques used are varied.

So in terms of the purpose of the Directive, the minimum legal rights that consumers have within the EU, as stated in the recital to the Directive, will promote confidence in the viability of the internal market. As is stated in the recitals to the Directive and the CJEU referred to this repeatedly: the system of protection implemented by the Directive is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge.

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It is also stated in the guidance which demonstrates that the directive has double objectives, the first is "the effective protection of consumers as the typically weaker party against unfair contract terms which are used by sellers or suppliers and have not been individually negotiated" and the second is "contributing to the establishment of the Internal Market through the minimum harmonization of the national rules aiming at this protection."

2.1.2. Exploring the Interpretation of Article 3(1)

According to Article 3, "A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer."

The test of fairness is usually considered as consisting of three elements: (i) a significant imbalance in the parties' rights and obligations; (ii) to the detriment of the consumer; and (iii) contrary to good faith.[3] In order to get the further understanding of the good faith, the provisions of the directives could help. Recital 16 refers to the bargaining power of the parties and explains that the requirement of "good faith" relates to the question of whether a seller or supplier deals fairly and equitably with a consumer and takes his legitimate interests into account.

A number of questions can be asked to provide further insight. Firstly, what is the difference between a breach of the good faith principle and an unfairness clause? The answer is very clear, the form of the Annex provided for in Article 3(3) of the Directive and Article 4(2) establish that the concept of unfairness can be inferred from other sources. Especially when reflecting on the function of the accessories, as stated in Article 3(3) of The Unfair Contract Terms Directive (93/13/EEC), the list in the Annex to The Unfair Contract Terms Directive (93/13/EEC) contains "only" an indicative and non-exhaustive list. Since the list is only indicative, the terms contained therein should not automatically be considered unfair. This means that their unfairness still has to be assessed in light of the general criteria defined in Articles 3(1) and (4) of the terms which may be regarded as unfair.

Taken together with the function of the principle of good faith, it is considered to be a better way of thinking about and complementary to the determination of unfairness, and can go a long way towards filling some of the gaps in the directive framework. The next question, however, is how to view it in relation to another standard —— "a significant imbalance in the parties' rights and obligations". It is evident that additional deductions cannot be extrapolated within the framework of the directive, necessitating a more comprehensive elucidation within the context of particular instances.

2.2. Unraveling the Good Faith Principle Through Judicial Cases

Before moving on to the case study, two basic questions will be introduced. Whether "good faith" is confined to procedural issues of "fair and open dealing", requiring the counterparty merely to provide the consumer with the necessary information concerning the nature and quality of the product as well as contractual rights, or whether it requires the seller or supplier to go further and take into account the legitimate interests of the consumer, or even establish some form of contractual solidarity in line with considerations of a social market and social contract law [4].

Moreover, two important cases should be mentioned. In *Océano*, A.G. Saggio was of the opinion that it was first necessary to ascertain whether the term is in fact an unfair term. While in *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v Hofstetter*, The Court pointed out that under Art.4, the consequences of the term under the law applicable to the contract must also be taken into account; hence consideration of national law is required. It was for the national court to decide whether a contractual term such as the one at issue in the main proceedings was unfair. The

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difference lies in the fact that the former only covers benefits to the seller, which are more complex when considering all the circumstances in which the contract was concluded and when weighing the advantages and disadvantages.

And the impact of this case has been widely established. The discussion of the distinction between the two standards of testing is therefore no longer relevant. The Directive, admittedly, envisages only partial harmonisation and allows Member States to introduce and maintain a higher level of consumer protection as long as compatible with the EC Treaty. There is no substantive guidance as to which terms may be unfair and which ones are acceptable within a particular legal system. As to the problems, the court provide further guidance.

The discussion will commence with an examination of the specific embodiment of the principle of good faith within the cases. A similar argument is evident in *Banco Primus* and *Andriciuc*, where the Court places significant importance on assessing whether the seller or supplier could have reasonably expected the consumer to accept the term during individual negotiations. In Aziz, a crucial determination by the Court is that "the national court must evaluate whether, by dealing fairly and equitably with the consumer, the seller or supplier could have reasonably assumed that the consumer would have accepted such a term in individual contract negotiations [...]." This elaboration can be seen as constituting the test of good faith.

As to the practice of a significant imbalance in the parties' rights and obligations. The same situation is in *Aziz*. To assess whether there is a significant imbalance to the detriment of the consumer, the CJEU held that a court must make a comparison between the situation where the contract was concluded and the situation where there is no contract. The latter refers to the situation where a court will apply the national rules as if there is no contract. A court can then assess whether and to what extent the consumer will be in a worse position. If so, there is a significant imbalance.

While in *Constructora Principado*, the court's core argument focused on paragraph 21 to 24. Firstly, as mentioned above, the court stresses the comparison to the situation where rules of national law would apply in the absence of an agreement by the parties in that regard. As to the function of the comparison, the court states that Such a comparative analysis will enable the national court to evaluate whether and, as the case may be, to what extent, the contract places the consumer in a legal situation less favourable than that provided for by the national law in force […]. Secondly, the court explains that the insignificant imbalance is not only limited to a "quantitative economic evaluation", but can "result solely from a sufficiently serious impairment of the legal situation."

In summary, in response to the above questions. Firstly, through the case study, the principle of good faith is reflected in the second aspect, which is a deeper requirement for the seller. And it is clear that the court's approach has adopted two tests in the analysis of the two standards. Although the guidance admits the close connection, advocate General Hogan even suggests that the absence of good faith is not a separate condition for the unfairness of a contract term at all, some statements of the Court do not necessarily support this position.

But in any case, the explanation given by the court is still not satisfactory. The use and definition of the principle of good faith is an important reason why scholars have previously argued that the directive goes to the heart of contract law and facilitates the process of European private contract law integration. However, It is found that the Court is not able to provide any further guidance on this. The criticisms is fully understood because, both in terms of the purpose of the directive and its discursive formulation, the directive has to give a substantive direction, as the jurisprudential basis that the directive has traditionally been considered to have requires. In the following this paper will deal in detail with two jurisprudential perspectives on directives, noting that the latter is more appropriate.

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3. New Angle: The Good Faith Principle as A Candidate for Advancing the Integration of EU Private Law

To gain a comprehensive comprehension of the essence of the unfairness clause, it is imperative to delve deeper into the jurisprudential foundation that underpins its interpretation. The conventional standpoint anchors this inequitable intervention on the disadvantaged position of the consumer. However, this notion can engender systemic perplexities when endeavoring to elucidate the comprehensive scope of the directive. It becomes imperative for the directive to furnish a precise delineation of the parameters of equity to alleviate such confusion. Equity serves as an evaluative yardstick underlying this premise. Alternatively, it is more judicious to regard this disparity as an initial condition. The essence of equity, in essence, lies in transcending this initial condition, as a result of a rational evolution in the allocation of rights and obligations to a party within the sphere of effectiveness.

3.1. Inequality of Bargaining Power

According to the traditional view, standard contract terms are subject to legislative and judicial scrutiny because they reflect inequalities in bargaining power. The exposition of F. Kessler has become a classic: “Standard contracts are typically used by enterprises with strong bargaining power. Standard contracts … could … become effective instruments in the hands of powerful industrial and commercial overlords enabling them to impose a new feudal order of their own making upon a vast host of vassals.” [5][6].

This general rationale of unequal bargaining power has been accepted by many national courts and has become the basic rationale for orders. In summary, the system of protection introduced by Directive 93/13/EEC is based on “[…] the idea […] that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge, which leads to the consumer agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of those terms […].”

What makes the party inequality is an asymmetry of information or expertise which are especially expressed in *Karel de Grote* and the bargaining power expressed in *Costea*. Moreover, when it comes to Article 6(1), The Court regularly emphasizes the central role, the idea that ‘the consumer is in a weak position vis-à-vis the seller or supplier’ also appears. Emphaized the non-binding character of unfair contract terms under Article 6(1) is aimed to create an effective balance between the parties under the contract.

Whereas these concepts are themselves descriptive rather than normative, the existence of this inequality does not necessarily suggest the presence of the type of inequity as it is comprehended. Both the inequality of information and the difference in bargaining power are a description of a factual state of affairs.

In light of the foregoing, a general apprehension emerges regarding the distinctive status of the notion of "fairness" within the Directive. However, a more comprehensive comprehension necessitates an exploration into the underlying objectives of consumer protection. The specific meaning of fairness needs to be understood in the context of the effective balance that Article 6 of the Directive aims to achieve. Since inequality of bargaining power is the initial state on which the normative value of the Directive is based, unfairness arises from the grossly unreasonable distribution of rights and obligations on that basis. There is no doubt that there is a natural tendency for the dominant party to continue to expand its dominant position, but such profit maximization is extremely common in normal contractual transactions or economic activity, and it is important to define the limits of what it can do with that initial state of equality. The determination of this threshold is more effectively accomplished through the safeguarding of the party with lesser

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influence. Thus, the establishment of the fairness threshold becomes feasible solely in situations where the apportionment of rights and obligations to the counterparty in the initial state exhibits an exceedingly unjust disposition. This effective balance is called effective because it does not consist in eliminating the inequality of the initial state or in curbing a natural tendency at great cost.

And on the basis of this sense, the Directive must answer the question of what a roughly fair range is, or the substantive criteria for an effective balance, and unfortunately the Directive does not fulfil that objective.

3.2. A Legal and Economic Viewpoint: Market Failure

In this chapter, there will be a reconceptualization of the consumer based on behavioral economics. This will be followed by an extensive exploration of the consumer relations paradigm through the lens of the economics of law, as well as a detailed analysis of the pertinent facets of the Directive within this framework.

The theoretical basis for consumer protection policies in the 1960s and 1970s was the "unequal bargaining power" of neoclassical economics [7], which first of all suggested that market failure was the reason for consumer protection from the perspective of the "perfect market". Consumer protection policy tended primarily to regulate operators. Secondly, neoclassical economics suggests that another reason for consumer protection is information failure from the perspective of the "perfect contract", arguing that information asymmetry is the main reason for unequal pricing power between parties in a contract. Consumer protection policies need to strengthen the ability of the consumer as a party to the contract by reinforcing the obligation of the operator to provide information [8].

But the rationale for modern consumer protection policy has been skewed towards behavioral economics. It argues that there is a great deal of irrational behaviour in the market economy [9]. Behavioural economics, from an "empirical" perspective, argues that consumer problems do not arise because consumers do not have enough information, but rather because they are unable or unwilling to use the information they have [10].

After discussing the behavioural changes of the consumer body, this study will further discuss the specific market paradigm. Firstly, in relation to the non-negotiated terms set out in Article 3.1(1) of the Directive, the majority of these are in standard form terms. In practice, it is often the case that form terms do not stand up to challenge. What is clear is that form terms arise out of the need for large-scale transactions. From the point of view of companies, which are faced with a large number of transactions, the use of form terms can reduce costs and, for the consumer, simplify the transaction and reduce transaction costs.

It is therefore not that the consumer is in a weak position to accept the terms of the form, but rather that there is no incentive to spend time or to seek changes or to check competitors' offers in order to find more favourable terms. The reason for this lack of incentive comes from an understanding of the two variables in the above discussion, which are the irrational position of the consumer and the extreme complexity of modern industrial society.

In such a situation of lack of incentive, based on the analysis of the unequal position of sellers and consumers, sellers and suppliers will take advantage of this situation to change the risks they do not want to take on their customers through standard contractual terms [11][12]. And because of the constant lack of incentives for consumers, this will lead to a "lemon market" effect.

The most effective measure to change the incentives is to make it mandatory for sellers to make the language of the contract clear and easy to understand. However, on the one hand, this is not an absolutely effective incentive, and the blind confidence that prevails in consumer psychology and the limited clarity of the contract language suggest that such a mandatory requirement is far from sufficient. Changing the incentives of consumers is not sufficient to achieve an effective balance.

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Another perspective is that of inhibiting the behaviour of sellers in the face of this natural tendency, and from this perspective effective control can only be achieved when an independent third-party subject intervenes. Determining the standard of review, or rather the broad scope of unfairness, is a difficult challenge, as it creates a moral hazard for the consumer if the standard applied is too strict, i.e. too favourable to the customer/consumer. Even sensible terms can be challenged and rejected. On the other hand, if the standards are too lenient, market failures may still occur. Because of these difficulties, it seems best and sufficiently to ensure that the outcome of the review process is completely unpredictable for any one contracting party.

The above doctrine reflects a basic logic, and in this perspective the Directive does not need to give a threshold of substantive unfairness on this basis. Moreover, this concept is also in line with the EU's desire to create a common market, with a full textual basis. All in all, the Directive's vague treatment of the good faith principle and the terms of the Directive can be justified.

4. Conclusions

In summary, this discussion has carefully examined the role of the good faith principle in EU private law and its application within the Directive's framework. By analyzing the provisions and case law, it's clear that the Court of Justice hasn't explicitly explained the inclusion of the good faith principle in the Directive or clarified its ambiguity compared to other standards. This leads us to wonder whether the current state of Directive development could hinder the gradual evolution of a common European standard of good faith in this legal context.

To tackle this question, one possible perspective suggests reconsidering how to interpret the Directive. The less straightforward treatment of the good faith principle within the Directive can be understood when considering market failures. The traditional approach of intervening in cases of unequal bargaining power requires the court to offer specific directions on the extent of intervention and the desired outcome. The introduction of an independent third-party mechanism and a shift in incentives from a market failure standpoint are in line with Article 3 and Article 4 of the Directive. From this viewpoint, transforming the task of addressing general criteria set by the community legislature into a judicial responsibility seems sensible.

In essence, this perspective suggests that the uncertainty surrounding the good faith principle in the Directive can be explained when seen in the broader context of addressing market inefficiencies. This proposed approach aligns well with the Directive's core content and provides a practical framework for judicial involvement.

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