

## INEQUALITY OF BARGAINING POWER AND PROVING IT IN COURT

**Bakulin A.F.<sup>1</sup>, Kuzmina A.V.<sup>2\*</sup>,**

<sup>1</sup> Senior Lecturer of the Department of Civil Law and Procedure of the Law Faculty, Mari State University, Mari El Republic, Russia, baculin.af@marsu.ru

<sup>2</sup> Candidate of Legal Sciences, Associate Professor of the Department of Civil Law and Procedure of the Law Faculty, Mari State University, Mari El Republic, Russia, tsyplenkova@mail.ru

\*Corresponding author

### Abstract

Good faith of the parties at the time of the making and performance of the contract has been recognized in Russia as a leading principle of civil-law transactions. However, many contracts are drafted in the context of inequality of bargaining power. The authors of this article examine problems related to observing good faith in negotiation of contractual terms, discuss the criteria of inequality of bargaining power and the peculiarities of proving them in court.

This article proposes developing standards of proof, unknown to Russian procedural law, and using the experience of common law countries. In the authors' opinion, inequality of bargaining power is presumed to exist unless proven otherwise. Circumstances restricting bargaining power of the weaker party, impeding their negotiation, and other forms of onerous imposition of mutual rights and obligations without the maintenance of the balance of interests of the parties, are among the facts to be proven, when challenging compulsory contractual terms. The court may, on its own initiative, to redistribute the burden of proof and to impose on the drafting party a higher standard of proof of good faith in negotiations and of the fairness of contractual terms.

The authors believe that courts may revisit unfair contractual terms between business parties only in exceptional circumstances, if the weaker party had no cognizant choice when entering into the contract, if its terms were initially favorable for the drafting party, and if such terms were accepted without a detailed discussion and without a possibility to understand their meaning when reading them.

**Keywords:** contract of adhesion, inequality of bargaining power, good faith, unfair contractual terms, reform of law of obligations.

### 1 INTRODUCTION

Modern legislative regulation and judicial practice should make a choice: to defend the inviolability of a freely concluded commercial contract and to dismiss any objections as to the unfairness of its terms by all means or to limit and restrict freedom of contract by establishing, *inter alia*, the right of the weaker party to challenge onerous contractual terms in court. Russian law reflects a principal choice in favor of the very possibility of protection of the weaker party to a business-to-business contract. And among the facts to be proven are

those evidencing that the contract was drafted only by one of the parties, showing the existence of circumstances creating inequality of bargaining power at the time of negotiation of the disputed contractual terms, as well as onerousness and unfairness of such terms.

## **2 METHODOLOGY**

This study carried out within the framework of the discipline of civil law adhered to the following methodological principles: the principle of cognizability of the world at its gnoseological level; dialectics of cognition; social practice as a basis for cognizability of the world; the principle of verifiability within the aspect of the requirement of confirmability; the principle of congruence or consistency; and the principle of coherence or systematicity. The methodological basis of this article includes the methods of dialectics, of deductive and inductive reasoning (as general scientific methods), and specific scientific methods, such as the historical method, the technical legal method, the method of formal logic, and the method of systemic analysis. The techniques of logic and of lexico-grammatical analysis have been used in understanding specific legal schemes, definitions and categories.

## **3 RESULTS**

### **3.1. Good Faith and Limiting Freedom of Contract**

#### *3.1.1. Limits of Freedom of Contract*

Founded on freedom of contract, market economy allows participants with power and authority to determine contractual terms for their own substantial benefit. A contract has been understood as a compromise of interests. Civil law science has come to an understanding that many contracts are drafted in the context of inequality of bargaining power and, therefore, the weaker party, in its constrained position, needs to be legally protected. R. Zimmermann, director of the Max Planck Institute for Comparative and International Private Law, recognizes that contracts cannot ensure fair regulation when one of their parties is usually deprived of free choice, and it is exactly for this reason that the legal system should exercise certain control in such situations [Zimmermann, 2019].

We believe that the limits of freedom of contract may be established by mandatory statutory prohibitions and may also be subjugated to a fair and balanced distribution of mutual rights and obligations between the parties to a transaction. Any possible federal statutory limitations on freedom of entrepreneurship and freedom of contract must, from the perspective of general principles of law, conform to the requirement of fairness. Freedom of contract may be restricted only in exceptional circumstances for the purposes of protection of interests and economic expectations of third parties, protection of the weaker party to a contract and the foundations of law and order or morality.

#### *3.1.2. Good Faith of the Parties to a Contract*

Good faith of the parties at the time of the making and performance of the contract has been recognized in Russia as a leading principle of civil-law transactions and requires each party to abide by moral standards and act honestly, fairly and to take into account the other party's interests. Russian civil law officially disapproves unfair commercial practices since participants in entrepreneurial activity may not take advantage of their illegal or unconscionable conduct (Article 1(4) of the Russian Civil Code ("the RF CC")). Good faith on their part implies acting in a manner expected of a reasonable participant in civil-law transactions who takes into account the other party's rights and legal interests and assists such party in performing obligations and receiving sufficient information. The principle of good faith is a reflection of law in the unity of its letter and spirit. It is just and fair to preventively protect the weaker person whose position is more vulnerable.

#### *3.1.3. Judicial Control over Unconscionable Contractual Terms*

It is enormously difficult for the weaker party to a contract to prove its case in a lawsuit. Such party must establish that subjective rights have been abused in relation to it and that clearly onerous obligations were imposed on it at the time of the making and performance of the business-to-business contract. In addition, it has to show bad faith in the other (stronger) party's actions and to substantiate its weakness and the fact that it has been constrained. Methods and rules of proof in this category of cases are of specific distinctive nature and are determined by the substance of the applicable civil law norms. And among the facts to be proven are those addressed in Articles 421 and 428 of the RF CC, evidencing that the contract was drafted only by one of the parties, showing the existence of circumstances creating inequality of bargaining power at the time of negotiation of the disputed contractual terms, as well as onerousness and unfairness of such terms. It is exactly judicial decisions that form the rules of good faith conduct of participants in civil-law transactions,

including the standards of typical fair terms of commercial agreements between participants in entrepreneurial activity.

The conduct of one of the parties may be declared unconscionable in Russian arbitration (arbitrazh) proceedings not only if there is a substantiated claim of the other party but also on the court's initiative when it is clearly evident that the actions of a participant in civil-law transactions deviate from good faith practices. Courts exercise control over good faith in contractual terms on their own initiative if there are clear doubts as to their reasonableness and practicability. A judicial decision merely establishes clear bad faith in actions of a party to a contract at the time of its conclusion rather than uncovers the essence of fairness of the disputed contract. The principle of fair trial is also realized in such a judicial ruling.

### **3.2. Proving Inequality of Bargaining Power**

#### *3.2.1. The Doctrine of Inequality of Bargaining Power*

The civil law doctrine of inequality of bargaining power has not been sufficiently developed in Russia. The weakness of a party to a contract is usually explained by the influence of such factors as market power, the asymmetry of information and professionalism, the existence of fiduciary relationships, and personal dependence, at the same time narrowing the understanding of such weakness down to the characteristics of such party who, because of a greater interest, concluded the contract on the terms of a professional counterparty in the sphere where the weaker party is not a professional [Tomtosov, 2016]. Studies conducted in common law countries are of similar reach. They develop the ideas of invalidity of unconscionable contracts [Darr, 1994] and of the need of judicial control with the view to preventing the stronger party from abusing its capabilities [Kie Hart, 2011].

Inequality of bargaining power is considered to be proven if the weaker party had no cognizant choice when entering into the contract, if its terms were initially favorable for the drafting party, and if such terms were accepted without a detailed discussion and without a possibility to understand their meaning when reading them. These circumstances are established in the course of judicial proceedings by clarifying, in the first place, the issue about the drafting party. Evidence showing that the offer was drafted without the participation of the other party, documentary and other information about the place, time period and methods of familiarization of such party with the draft contract and about limited possibilities for negotiation of the draft contract may be considered convincing grounds by the court in order to apply norms protecting the weaker party.

#### *3.2.2. Contract of Adhesion*

If a contract has been concluded by adhering to general terms, in their entirety, determined in a pre-printed contract form or another standardized or standard-form contract (Article 428(1) of the RF CC), the weakness of the adhering party's negotiation position is presumed and need not be proven by detailed evidence. It is implied in relation to contracts of adhesion that the adhering party has no possibility to take part in the determination of contractual terms. Such contracts will contain terms unilaterally benefiting the drafting party and, on the contrary, prejudicing the rights of the adhering party [Vitryansky, 2019]. Therefore, an agreement entered into by participants in entrepreneurial activity where one of them adhered to the draft contract in its entirety and where the terms of such contract were determined only by the other stronger party is initially based on inequality of bargaining power of the parties. And it is the stronger party that must refute by evidence the fact that the contract was adhered to without creating any clear advantages for such party in the subsequent performance of contractual obligations. Moreover, the adhering party is entitled to present evidence that the conduct of the drafter of the offer completely excluded individual negotiation and consideration of any proposals and objections.

#### *3.2.3. Burden of Proof in Issues of Inequality of Bargaining Power*

Procedural constraints on proof imposed on the weaker party arise from such party's civil law unequal contractual position and is balanced by redistributing the burden of proof and establishing special standards of proof for certain categories of disputes.

Russian arbitration (arbitrazh) procedure law implies that the burden of proof lies on the party possessing evidence and being capable of using it to substantiate its own allegations or to refute arguments and evidence of the other parties. A failure to meet the burden of proof in relation to the circumstances named by the arbitrazh court is reflected in the court decision and leads to its adoption in favor of the other party to the dispute. The burden of proof of bad faith and the unreasonableness of the actions of a participant in civil-law transactions lies on the party claiming that to be the case (Ruling of the Supreme Court of the Russian

Federation No. 5-KГ15-92 of 1 September 2015). Being responsible for the determination of the facts to be proven, the court takes measures ensuring the correct distribution of the burden of proof [Reshetnikova, 2018].

In our opinion, inequality of bargaining power is presumed to exist unless the drafting party proves otherwise. There is a logical contradiction between the general equality-based procedural regulation and the examined facts of a clear inequality of the parties existing at the time of the making of the contract, which, therefore, should be taken into account when redistributing the burden of proof on the court's initiative. Courts determine the actual correlation of bargaining powers of the parties and establish whether the adherence to the offered terms was necessitated by the circumstances, and also take into account the level of professionalism of the parties in the relevant sphere, competition in the relevant market, and whether the adhering party had a real possibility to negotiate or conclude a similar contract with third parties on other terms, etc. At the same time, the plaintiff must prove that the terms of the contract are clearly onerous for him; that they materially disturb the balance of interests of the parties; and that the plaintiff could not negotiate the terms of the contract or was placed in a position which significantly impeded the negotiation of the contract.

The meaning of this rule for judicial practice is that the burden of proof of good faith in negotiation and clarification of untypical contractual terms and the burden of proof of the maintenance of the balance of interests of the parties should lie exactly on the offeror who drafted the contract. When distributing the burden of proof, it is implied that the weaker party to a business-to-business contract is not only entitled (if the presumption of inequality is applied) to demonstrate by evidence that its active participation in the negotiation of the disputed contractual terms at the time of its conclusion was impossible or had no prospect of success but it also must present separate evidence, available only to such party, of an exceptional disadvantageous nature of the imposed unfair term.

#### *3.2.4. Standards of Proof Applicable to Inequality of Bargaining Power*

Standards of proof have been introduced in judicial practice on the initiative of the Russian Supreme Court. This category has been unknown to Russian procedural law. The criteria of sufficiency of evidence (the standard of proof), making it possible to recognize claims as substantiated, are established by judicial practice (Ruling of the Supreme Court of the Russian Federation No. 305-ЭC18-6622 of 20 September 2018). This approach essentially offers courts to include additional circumstances, laying outside the scope of ordinary commercial transactions underlying the dispute, into the facts to be proven, to collect indirect evidence and not to trust documents that have been formally drafted and that are free from defect on their face.

It is reasonable in the current legal reality to use the "reasonable level of credibility" standard of proof as an underlying standard which makes it possible, from the point of view of the subsequent assessment of the presented evidence, to use a higher or high standard of proof depending on the facts to be proven and the burden of proof [Smola, 2018]. At the same time, even without referring to special standards, judge's inner convictions entirely correspond to the said formula, and the assessment of the totality of evidence in Russian civil law procedure is based on such convictions. So far, a higher standard of proof of good faith is not applied to the stronger party to an entrepreneurial contract regardless of the fact that it is exactly this party that has advantages in presenting evidence on the procedure of negotiation of contractual terms and the substance of such negotiation. Courts in Russia establish inequality of bargaining power in situations where one of the parties could not convince the counterparty to change contractual terms whereas the draft contract itself was formulated in a way that excluded any possibility for the other party to negotiate its substance.

#### *3.2.5. The Weaker Party to a Contract*

An unprofessional and inexperienced in the relevant sphere debtor obliged to pay for goods, work or services usually becomes the weaker party to a contract concluded in the course of entrepreneurial activity in the context of limited participation of such party in negotiation of the draft contract. The authors' analysis of judicial practice in cases where the weakness of a party to a business-to-business contract was proven makes it possible to conclude that, as a general rule, inequality of bargaining power existed where it was established that: (a) certain contractual terms could not be negotiated or a detailed negotiation of all contractual terms, including their clarification, was impeded on the initiative of the party that proposed to sign its version of the draft contract; (b) the weaker party understood the disputed contractual terms as performable or did not envisage the likelihood of the occurrence of the events referred to in the contract due to the lack of professionalism in the sphere of entrepreneurship governed by the contract or due to the lack

of legal experience; (c) it was difficult for the weaker party to conclude a similar contract with a third party on more favorable terms or that this scenario objectively entailed additional costs and inconvenience in the course of the performance of such contract.

### **3.3. Unfair Commercial Contractual Terms**

#### *3.3.1. Clearly Onerous Terms*

Depriving the weaker party to a contract of the possibility to negotiate the contract entails the adoption of contractual terms which are extremely unfavorable and clearly onerous for such party and which disproportionally distribute rights and obligations in favor of the drafting party. Such terms are considered in science and judicial practice as unfair or unconscionable [Fogelson, 2010].

Article 428 of the RF CC contains a general reference to the terms that are clearly onerous for the adhering party and lists among them the deprivation of this party of the rights usually provided in contracts of this type, the exclusion or limitation of liability of the other party for violation of obligations, or other terms which the adhering party would not have accepted based on its reasonably perceived interests if it had the possibility to take part in the determination of contractual terms. For example, the following terms may be declared onerous: which do not permit a unilateral withdrawal from a contract in the case of its violation; which exclude the right to terminate the contract before the expiration of its term on the initiative of the adhering party; when such party is deprived of the possibility to enter into transactions involving the subject of the contract, at its own discretion; when there is an imposition of an additional obligation to conclude a contract with a particular third party; when the performance of an obligation peculiar to a certain type of contracts is required in a manner involving excessive costs; and which envisage a weaker party's obligation to return the items received under the contract (such as the object of lease or the amount of credit plus interest) immediately upon request made before the expiration of the relevant term.

#### *3.3.2. Judicial Protection from Unfair Contractual Terms*

The party considering itself to be weaker at the time of the making and performance of the contract has the right to require that one or several contractual terms be revisited or excluded in court proceedings. While remaining acceptable in terms of their content and not violating statutory prohibitions, clearly onerous terms may be characterized as unfair contractual terms when one of the following elements has been established: (a) that such terms were initially favorable for the stronger party that created advantages for itself beyond the reasonable limits of the exercise of subjective rights; (b) that it was clearly difficult for the weaker party to perform its obligations due to the imposition of unreasonable burdens and due to the excessive costs of such performance; (c) that the reasonably perceived rights and interests of the weaker party have been clearly prejudiced or otherwise deliberately limited; or (d) that the rights and obligations and liability measures were disproportionally distributed in favor of the stronger party.

Participants in entrepreneurial activity are considered to be professionals in such activity. They bear the risk of adverse consequences related to the imprudent participation in negotiations without due preparation, non-engagement of lawyers and specialists in such negotiations, and to the failure to act when negotiating the offered terms. When inequality of bargaining power has been proven, the unfair contractual terms may be revisited only in exceptional circumstances, as improvidence and business illiteracy may not be protected in court.

## **4 CONCLUSIONS**

A contract between participants in entrepreneurial activity may be understood not only as an agreement of equal partners who managed to reach a compromise in the distribution of mutual rights and obligations but also more often may be interpreted as a transaction between the stronger professional party and the inexperienced weaker party constrained in being able to object.

It seems important to establish the following presumption: "inequality of bargaining power is presumed to exist unless the drafting party proves otherwise". The burden of proof of good faith in the negotiation and clarification of untypical contractual terms and the burden of proof of the maintenance of the balance of interests of the parties should lie exactly on the offeror who drafted the contract.

The discipline of civil law and Russian civil law develop the ideas of protection of the weaker party to a contract from unfair and unconscionable terms imposed on such party on the basis of positions and approaches developed and implemented in European, most notably in German, law. The Russian science of procedural law follows the same path, and there is a process of formation of Russian judicial practice that makes it possible to apply standards of proof elaborately formulated by US courts, when resolving disputes.

However, peculiarities of the Russian understanding of good faith and fair business practices are taken into account as well.

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