Power Imbalances in Contracts: An Interdisciplinary Study on Effects of Intervention

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This paper offers an interdisciplinary study of effects of intervention in two interacting parties facing a power imbalance. The main purpose of this paper is twofold. First, I present a systematic framework for evaluation, by using input from social psychological studies on power. Second, I give an overview of knowledge on and experience with the effects of intervention. It appears that surprisingly little is known about the effects of interference, while on the other hand, more seems to be known about the sources and effects of power in relationships in general. This knowledge is used to distinguish three archetypes of power imbalances in contracts: 1) mental and/or physical predominance, 2) information asymmetry, and 3) dependency asymmetry. Law systems offer contracting parties in these cases two types of intervention: outcome-based and process-based intervention. Which of these two categories of intervention (or which mixture of the two) offers the best assistance to contracting parties facing power imbalances? There is not enough empirical evidence to answer this question yet. However, there are some signals that point into a certain direction. Mental and/or physical predominance cases seem better dealt with by outcome-based intervention, while dependency asymmetry cases seem better dealt with by process-based intervention. Information asymmetry is a matter of finding the mixture of the two that best enables a low-power party to absorb the information needed.

I. Introduction.......................................................................................................4
II. Power Imbalances in Contract Law..................................................................6
   A. How are Power Imbalances Dealt with in Contract Law?.........................6
   B. Outcome and Process-Based Intervention.............................................6
   C. Assumed Differences of the Two Categories .......................................8
   D. Two Topics of Debate..........................................................................9
III. Input from Social Psychologists ..................................................................11
   A. Theory on Sources of Power ................................................................11
   B. Archetypes of Power in Contract Law ..................................................13
      1. Case I .............................................................................................13
      2. Case II ...........................................................................................14
      3. Case III ..........................................................................................14
   C. Can We ‘Measure’ Power? Criteria Used by Courts and Other Interveners ..........................................................15
IV. Effects of Intervention; Case Studies .......................................................18
   A. Case I: Mental and/or Physical Predominance......................................18
      1. A Short Overview of Interventions ..................................................18
      2. What Do We Know about the Effects? ..........................................19
      3. What Can We Learn From (Social) Psychological Studies on Power ? . ..........................................................19

29/11/2007 version : 1.0
4. Best Assistance .................................................................................. 20

B. Case II: Information Asymmetry ............................................................. 21
   1. A Short Overview of Interventions ...................................................... 21
   2. What Do We Know about the Effects? .............................................. 22
   3. What Can We Learn from (Social) Psychological Studies on Power? 23
   4. Best Assistance .................................................................................. 24

C. Case III: Dependency Asymmetry .......................................................... 24
   1. A Short Overview of Interventions ...................................................... 24
   2. What Do We Know about the Effects? .............................................. 26
   3. What Can We Learn From (Social) Psychological Studies on Power? 28
   4. Best Assistance .................................................................................. 28

V. Conclusion...................................................................................................... 29
I. INTRODUCTION

This paper contains an interdisciplinary study of the effects of intervention in two interacting parties facing a power imbalance.

The main purpose of this paper is twofold. First, I will present a systematic framework for evaluation, by using input from social psychological studies on power. Second, I will give an overview of knowledge on and experience with the effects of intervention. This paper is inspired by the work of Collins. In his *Regulating Contracts*, Collins discusses the question of what form and content of legal regulation enables the legal system to perform its functions in supporting the market system most effectively and efficiently. In this paper, this question will be discussed specifically in situations where both parties face an evident power imbalance.

The notion to protect the low-power interacting party is historically founded in western society. Over the decades, many ways to protect the low-power party have been implemented in western legal systems. The effects of these protective measures are often uncertain. Some empirical evidence exists in specific fields, yet remarkably little is known about the effects of interference in contracts. This is surprising because it appears, that in the modern law of contract, it is recognized that a complex connection between the individual freedom and markets is required. This is even more surprising, because more seems to be know about power and the impact of power on relationships in general. The concept of power is analysed by many disciplines, social psychology among them. This paper focuses on the impact of power on two interacting parties, a dimension that is most frequently studied by social psychologists.

Extensive literature on sources of power gives more insight into what it is that makes one party more powerful than the other. Furthermore, specific studies show effects of power imbalances on both interacting individuals.

The systematic evaluation consists of two categories of interference empowering low-power parties in three prototype cases of power imbalance. In this paper, ‘interference’ refers to a source that takes over control by way of modification ex ante or ex post. Interfering in contractual relations occurs for many reasons. In this paper, I will only focus on interference primarily aiming to empower low-power parties.

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1 The author wishes to thank Prof. J.M. Barendrecht, Prof. J.B.M. Vranken, and Prof. D. De Cremer for their valuable insights and comments.


7 There are several other reasons for interfering. See in particular law and economics theories on market failure (R. Cooter & T. Ulen, *Law and Economics*, fourth ed., Boston [etc.]: Pearson Addison Wesley 2004, at 44-48). These other reasons are not taken into consideration in this paper.
Furthermore, I will focus on interventions that most legal systems have in common, despite differences in requirements and implementations. Finally, I highlight interventions in the relationship of two interacting contracting parties. Macro-economic policies on anti-competitive agreements will not be taken into account, nor will the more philosophical relationship of the state versus its citizens.

In general, two categories can be distinguished; the first imposes legal rights and duties concerning the substantive part of an agreement (substantive or outcome-based interference), the second regulate the way parties communicate and interact (process-based interference). The function and interrelation of both categories of interference has become more and more a subject of debate. This debate seems to take place in different areas. For example, the function of and distinction between both categories of intervention is one of the fundamental topics in discussions on procedural versus substantive justice. In addition, national initiatives to reform civil (procedure) rules often deal with similar discussions.

The two categories of intervention differ on two important aspects. First, there is party autonomy. Party autonomy seems less affected in interventions with little ‘force’ on the substantive outcome. On the other hand, though, low-power parties seem less able to really benefit from merely process-based intervention. The second aspect concerns side effects. Outcome-based intervention seem to have a broader impact than the process-based one. How much, though, is really known about the validity of these assumptions? This questions is answered for three archetype cases of power imbalances in contracts. These cases derive from studies on the sources of power. The first case involves mental and/or physical predominance, the second case deals with information asymmetry, and the last archetype case considers ‘dependency asymmetry’ (an imbalance in the level of dependency on the other).

In Section II, I will discuss the issue of power imbalance in contract law. How are power imbalances dealt with in Contract Law? What are, in general, the most frequently used interventions, and how can they be classified? Examples of outcome- and process-based interventions will be given. The main differences between the two categories will be discussed, as well as the difficulties distinguishing between the two categories. In Section III, I use input from social psychological studies on sources of power. I distinguish three archetypes of power imbalances in contracts. Some difficulties in measuring contracts will be discussed, followed by an analysis of the criteria that are used by courts and other ‘interferers’. Section IV sets the stage for

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8 Naturally, those differences may influence the effects of an intervention. Even a minor change in a specific requirement could make a difference in specific cases. However, the essence of this paper is not to compare and/or fine-tune these differences in empowerment interventions among the legal systems.

9 As will be pointed out later, it is sometimes hard to make a sharp distinction between the two types of intervention. Nevertheless, interventions often have more process elements than substantive ones, or vice versa. Those with a stronger emphasis on the process of interaction are the process-based interventions, and those with a stronger emphasis on substance, are the outcome-based ones.

case studies on effects of interference. After a short overview of the most common interventions made in legal systems, I will analyse what is known (based on empirical research done by others) so far about the effects. Furthermore, I will apply outcomes from social psychological studies on the effects of power to the specific case. Finally, in Section V, the question will be answered of what is actually known about the effects, what can be assumed and what future research may be useful.

II. POWER IMBALANCES IN CONTRACT LAW

A. How are Power Imbalances Dealt with in Contract Law?

Despite the differences of legal systems in general, it could be said that most (if not all) legal systems protect low power parties to some extent. This is often class protection. Rules of contract law specify categories of contracting parties that are protected because they are assumed to be the low-power party. Consumers and employees, tenants and investors are examples of categories in class protection. Contracting parties facing power imbalances that do not fall within the scope of a ‘statutorily recognised’ class are protected only to a minimum. According to some, in particular smaller businesses need a higher amount of protection by statutes and court orders.

The idea to interfere for reasons of empowerment is more or less controversial in classic contract law. Party autonomy was, and still is, a solid foundation of contract law. Interventions by higher authorities should not take place, assuming that both contracting parties enter into the relationship of their own free will. Exceptions are remedies for invalid formation of a contract, because of an absence of consensus. There is no reason to interfere because of a power imbalance if the requirements of formation are met.

Nowadays, we seem to adhere to a more complex system of intervention. Interventions are not limited to one specific moment in time (the formation of contracts), they take place after formation on grounds of power imbalance as well. Some are based on specific legal statutes, others on more general notions of good faith and fair dealing. Furthermore, many other forms of intervention take place nowadays. Statutory and court control are sometimes ‘replaced’ by other types of intervention. In the next Section, I will discuss more types and examples of intervention.

B. Outcome and Process-Based Intervention

Interference (or intervention) in a contractual relation refers to an authority that takes over control by way of modification, ex ante or ex post. In general, two types of interference can be distinguished: interventions that impose legal rights and duties concerning the substantive part of the agreement (outcome or substance-based  

11 Collins, supra n. 2 (at 73): “The differentiation by class is the hallmark of the insertion of externalities into private law reasoning”.
13 See also Collins, supra n. 5, at 270 ff.
14 See also Collins, supra n. 5, at 282.
15 Examples are given in Section II B.
interventions) and interventions that take over control concerning the way parties communicate and interact (process-based interventions).\(^\text{16}\)

Examples of outcome-based interventions aiming to empower low power parties are the ‘classic interventions’ mentioned earlier: statutes on duress, fraud, mistake, undue influence and (some) clauses on unconscionable bargains.\(^\text{17}\) Successfully invoking these interventions often leads to rescission of the contract. Other outcome-based statutes governing intervention in a power imbalance are those prohibiting the use of unfair terms, for example, Council Directive 93/13/EEC on unfair terms in consumer contracts.\(^\text{18}\) According to this Directive, a term in a contract between a seller and a supplier of goods or services and a consumer which has not been individually negotiated, is subject to a requirement of fairness. The requirements entail, for example, a prohibition of terms which give a significant advantage to the seller or supplier, without a compensation to the consumer. Other examples are restrictions on the use of terms of waiver, and prohibitions to end a long-term contract without a good cause.

Examples of process-based interventions are duties to inform, duties to disclose, and duties to (re)negotiate. These duties are often imposed by statutory provisions and court orders, but also by arbiters or other neutral commissions. Complaint procedures in sales contracts (imposed by statutes) is another example of a process-based intervention. Perhaps the most far-reaching intervention on how parties should interact is one that is governed by a mediation process.

In industries characterised by a highly innovative and complex nature, important other types of process-based intervention occur as well. This category of intervention, recently analysed by Jennejohn, is known as a pragmatic governance mechanism.\(^\text{19}\) Case studies show that in particular contracts concerning biopharmaceutical research (70%) and software development (81%) entail elements of pragmatic governance.\(^\text{20}\) The contracting parties themselves ‘construct’ this intervention. It consists of flexible standard procedures on how to collaborate and innovate. These flexible standard procedures integrate three pragmatic mechanisms: benchmarking, simultaneous engineering, and error detection/correction institutions. A supervisory body, often a committee that is staffed by an equal number of representatives, obliges the parties to follow particular standard procedures, such as ‘root cause analysis’ and ‘continuous improvement’.\(^\text{21}\) In essence, ‘pragmatic

\(^\text{16}\) Naturally, interventions differ in different legal systems. Some differences are minor, some are not. In this paper, I focus on examples of interference that most legal systems have in common, despite the differences that are inevitably there, supra n. 8.

\(^\text{17}\) An example of English law is the case Lloyds Bank Ltd. v. Bundy [1975], QB 326. In this case, a bank manager did not advise an elderly farmer (who had been a customer of the bank for many years) to seek independent advice at a critical moment. The Court of Appeal interfered on the basis of undue influence, but Lord Denning M.R. added that interference was justified on the broader ground of inequality of bargaining power.

\(^\text{18}\) OJ L 95, 21 April 1993.


\(^\text{20}\) Jennejohn, supra n. 19, at 48.

\(^\text{21}\) Jennejohn (supra n. 19) also analyses how courts should enforce these contracts: courts should not only vindicate rights, they also should collaboratively craft solutions. If the parties do not provide the information necessary to solve the dispute collaboratively, the court must enforce the contract formalistically.
governance' entails traditional control rights combined with pragmatic procedure mechanisms.\textsuperscript{22}

\section*{C. Assumed Differences of the Two Categories}

People often assume that the two categories of intervention have a different impact on the contracting parties and on others as well. The first assumption concerns party autonomy. Obviously, party autonomy seems less affected if parties are obliged to renegotiate instead of implement a contract modification imposed by a court order. In general, we could say that process-based interventions leave more room for the parties themselves. Having control is important to people. The literature on procedural justice suggests that people put a high value on being able to participate and having a voice.\textsuperscript{23} For example, it appears that solicitors reaching a settlement without the clients being present are confronted with dissatisfied clients more often than solicitors reaching a settlement in the presence of their clients, even if the outcomes objectively better serve the clients' interests.

This issue has an opposite side as well. Balancing power without imposing an outcome means that both the high-power party and the lower power party are able to balance the power more or less on their own. It is questionable whether strict guidance in their interaction while balancing the power is sufficient to empower the lower power party. Recent psychological research shows that powerful people are less capable of adopting the other person's perspective.\textsuperscript{24} Moreover, powerful people seem less likely than less powerful people to take into account that other people do not possess their privileged knowledge, a result suggesting that power leads individuals to 'anchor too heavily on their own vantage point'.\textsuperscript{25} On the other hand, there are indications that high power parties do have strong incentives to balance the power on their initiative.\textsuperscript{26} Other research shows, for example, that the best deals are made if both parties are more or less equal.\textsuperscript{27} Moreover, it appears that both parties are more satisfied with compromises made under more or less equality, which means that the performance rate of these contracts is higher than that of other contracts.\textsuperscript{28}

The second assumed difference between process and outcome-based intervention concerns side effects. Imposing a substantive outcome on one contractual relation may have an effect on similar other cases, at least if that the rule imposing the outcome becomes publicly known. In other cases, parties will adjust their behaviour, for example, by trying to avoid specific consequences. These consequences are sometimes positive on a larger scale, i.e. wrongful behaviour is prevented, but can be negative as well. Legislation on protection of employees for example could result in

\begin{itemize}
\item A good example is the agreement between Cisco and KPMG: their agreement contains traditional control rights (the parties are prohibited from raiding entire groups of employees from one another) complemented with simultaneous engineering provisions (parties notify one another if they are going to make an offer of employment to the other's employee), see Jennejohn, supra n. 19, at 33.
\item See, for example, the work of Tyler, supra n. 10.
\item Galinsky, Magee, Ena Inesi & Gruenfeld, supra n. 24.
\item Rubin & Brown, supra n. 27, at 257-258.
\end{itemize}
discriminating specific groups of employees that most employers would rather not employ for a longer period of time.\textsuperscript{29} These negative side effects are more likely to be the result of interventions imposing a publicly known substantive outcome than by interventions imposing certain steps in the interaction without strict guidance on the substantive outcome.

Again, there is a downside. The result of process-based interventions is normally not publicly known. Some are more guided than others, but we could say that the parties more or less find their outcome themselves. Parties of similar cases cannot ‘learn’ from other outcomes; they have to come up with new inventions. In general, we could say that the development of law is no longer on the agenda, with all its negative consequences.\textsuperscript{30} Furthermore, positive (side) effects, for example, the prevention of wrongful or undesirable behaviour, are absent as well.

These are the most important assumed differences between the process and outcome-based interventions, but how much do we actually know about these assumptions? Are they valid? And how can we analyse the validity of this broad, but important, topic of contract law? One thing is certain: more insight into the validity of these assumptions would affect many discussions on how to give the best assistance to contracting parties facing power imbalances. In fact, discussions on, for example, fine tuning legal statutes aiming to empower low power parties, on whether or not courts should protect small businesses, and on the (dis)advantages of mediation versus a procedure in court in cases of power imbalance, seem rather superficial without at least having some view of the broader picture. Before discussing this further, I will analyse two topics of debate related to the distinction between process and outcome-based interventions.

\textbf{D. Two Topics of Debate}

The first issue to discuss is the impossibility to draw a clear line between some process and some substantive-based interference.\textsuperscript{31} For example, a duty to observe a notice period when exercising a right to terminate a contract: technically, it is “a procedural obstacle in the way of its opportunistic use”, thereby placing it in the category of process-based interference. This procedural obstacle, however, hardly fits the description of a code that governs the interaction between two contracting parties.\textsuperscript{32} At least, it is a rather superficial way of governing interaction.\textsuperscript{33} Nevertheless, it governs the interaction, more than it governs securing the performance of what both parties promised.

\textsuperscript{29} More on this in Section IV C2.
\textsuperscript{31} What complicates it is that both ‘procedural’ and ‘substantive’ seems to have different meanings among authors. Some refer to process in a narrow sense (The Civil Procedure Rules), others (i.e., Collins, supra n. 5, at 290) place concepts like misrepresentation and undue influence in the context of process-based interferences. As mentioned, in this paper, a process-based interference means an interference that takes over control concerning the way parties communicate and interact.
How to distinguish substance from procedure is a debate in literature that is far from new. Lawrence B. Solum gives an vivid description of the debate since the *Erie R.R. Co v. Tompkins case* (1938).\(^34\) The case gave rise to the idea that when federal courts hear state law claims, they are obliged to apply the relevant state’s substantive law but may apply the federal rules that are procedural in nature. Solum points out that it is indeed impossible to draw a clear line between the two types of standards. He refers to rules that are substantive in form serving a procedural function (i.e. tort of spoliation of evidence), and vice versa, rules that are procedural by nature serving a substantive function (i.e., the parole evidence rule). The line between the two types of standards may be hazy, but the general idea behind the two is clear. The whole idea of procedural justice is based on the thought that, in essence, procedural standards, though inherently interconnected, are differently shaped and often serve a different function than substantive ones.

The more general question behind the debate of procedural justice is how to guide action; how to accomplish compliance over time with standards, rules, and principles that are generally accepted.\(^35\) The answer is still rather controversial, but one thing is clear: the inherent interconnection between substance and procedure plays a big role. Some claim procedure is the ultimate source of legitimacy (and therefore of acceptance and obedience), others advocate guidance by substantive rules, but nobody claims that procedures can do without fair outcomes, and vice versa.\(^36\) This indicates that it is more a matter of finding the right mixture of procedural and substantive elements in rules, rather than trying to draw sharp lines of distinction.

The second issue to discuss is the equality of process and outcome-based interference. Placing these two types of interference as two equal means of intervention raises questions. Many will adhere to the thought that procedural rules only exist to enforce substantive rules, thereby placing procedural rules in an inferior position.\(^37\) However, procedural rules, even in an inferior position, may still have a strong impact on balancing power in contractual relations. Procedural rules (in the sense of rules regulating the way parties should interact) may very well have a stronger impact in this field. The idea that regulations on the way parties should interact may be helpful in many areas is not new. In the English Civil Procedures Rules (hence: CPR), for example, is case management an important tool to streamline civil procedure. Qualifying Case Management as regulations on how parties should interact would not do justice to this important tool of the English CPR, but traces of regulating the interaction between parties are obviously there.\(^38\)

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\(^{34}\) Solum, supra n. 10, at 9 ff.

\(^{35}\) T.R. Tyler, *Why Do People Obey the Law?*, New Haven, Conn. [etc]: Yale University Press 1990; Tyler supra n. 10; Solum supra n. 10.

\(^{36}\) See for example J. Brockner, D. De Cremer, A.Y. Fishmann, S. Spiegel, When Does High Procedural Fairness Reduce Self-Evaluations Following Unfavourable Outcomes?. The Moderating Effect of Prevention Focus, *Journal of Experimental Social Psychology* (2007), doi: 10.1016/j.jesp.2007.03.002. The authors argue that self-esteem is negatively affected if procedures are fair but the outcome is negative.

\(^{37}\) Solum, supra n. 10, at 2-4, with references to others.

\(^{38}\) CPR 1.4 (2): “Active case management includes:- (a) encouraging the parties to cooperate with each other in the conduct of the proceedings; (b) identifying the issues at an early stage; (c), (e) encouraging the parties to use alternative dispute resolution procedure if the courts considers that appropriate and facilitating the use of such procedure; (f) helping the parties to settle the whole or part of the case; (g) fixing timetables or otherwise controlling the progress of the case.” See further M. Zander, *Cases and Materials on the English Legal System*, ninth ed., London [etc]: LexisNexis UK 2003, at 55 ff.
Others claim that a fair process is more important to people than the outcome of a conflict. Tom R. Tyler is one of the founders of this theory, known as ‘procedural justice’. According to Tyler, people attach most importance to a fair procedure, second, to a fair outcome and, third, to what they actually receive as an outcome. The theory of procedural justice implies that acceptance of standards over time is best accomplished by applying the standards according to fair procedures, not by the content of the standard itself. Standards protecting low power contracting parties are, in other words, better accepted if they represent people’s values on fair procedures, instead of fair substantive outcomes. The lack of acceptance of a standard is a serious problem; it seems to result in the opposite situation, where high power parties behave strategically to avoid the standard. A good example is given by Macaulay, describing a business lawyer’s solution not accepting attempts of states to empower employers, consumers, and franchisees:

Sneak an arbitration clause into something you could call a contract, create a Kangaroo Court as an arbitration panel located in places as inconvenient as possible, and find sympathetic judges who will sing the praises of ADR while applying the Federal Arbitration Act while ignoring any requirement of communication.

The ideas of procedural justice seem convincing, but most of the results are based on experiments in laboratories. Although many of the results are now frequently tested in real life situations as well, it still seems controversial to attach more importance to a fair procedural standard than to a (fair) substantive standard. Therefore, in this paper, substantive and procedural interventions are considered two equal means of intervention.

III. INPUT FROM SOCIAL PSYCHOLOGISTS

A. Theory on Sources of Power

The sources of power are described by many, in classic and more recent work. All underline the notion that analysing all sources of power is highly complex. In particular much depends on the context and the specific definition of power, which is a rich topic of debate. Dahl, one of the leading authors in this field, refers to power as the ability to get things done the way someone wants them to be done. In a more

39 Tyler, supra n. 10.
40 See also Solum, supra n. 10: “The real work of procedure is to guide action after the formal legal proceedings have ended.”
43 An overview of the debate is given by Barnhizer (Inequality of Bargaining Power), supra n. 4, at 154-160.
44 Dahl, supra n. 42.
legal sense, power refers either to the relation between two interacting parties (including the state as a private party), or the relation between a state (as a public institution) and its individuals. The definition is connected with the context of the analysis of power. The context of this analysis is that of two interacting private parties, rather than ‘state versus individual’, or ‘state versus state’. The definition used by Barnhizer seems to fit this context perfectly: a contracting party has power if it has the ability to intelligently effect a preferred outcome in bargaining relationships.

The next issue to discuss are the sources of power. French and Raven identify five sources: expert power, reward power, coercive power, legitimate power, and referent power. Lewicky and others, who concentrate on the context of two interacting parties, focus on three sources in particular: information and expertise, control over resources (e.g. money, time), and position power. According to Lewicky and others, these power sources are implemented through ‘strategies and tactics of interpersonal influence’. These strategies of interpersonal influence are discussed thoroughly. In essence, they seem to trace back to better communication skills or a position of less dependency on the other. This means that we could identify the following sources of power:

1. better access to resources,
2. better access to information,
3. better position in an organisational structure,
4. better communication skills, and
5. less dependency.

Not all these sources are ‘recognised’ in contract law. For example, most legal systems do not interfere in power imbalances directly based on a better access to resources, like money. Such an imbalance in power can very well be of influence indirectly. However, to my knowledge, there are no clear examples of statutes balancing power directly based on the fact that one of the contracting parties is wealthier. The same applies for a better position in an organisational structure.

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45 Military capability, political influence, and the ability to dominate relevant markets are more important sources of power from a political or organisational point of view, not from the perspective of two interacting individuals. For these sources see Barnhizer (Inequality of Bargaining Power), supra n. 4, at 166-167.

46 See Barnhizer (Bargaining Power in Contract Theory), supra n. 4, at 9 (based on work of Fisher). The definition used by Lewicky and others is ‘relational’ as well: “[A]n actor ... has power in a given situation (...) to the degree that he can satisfy the purposes (goals, desires, or wants) that he is attempting to fulfill in that situation”; this definition is based on the work of Deutsch; Lewicky, Barry, Saunders & Minton, supra n. 26, at 192.

47 French & Raven, supra n. 42.

48 Lewicky, Barry, Saunders & Minton, supra n. 26, at 193 ff.

49 Whether or not the other party actually is influenced by those strategies is, of course, a complex issue. It depends on its own interests, fears and needs in a given situation. This aspect will be discussed later.

50 Lewicky and others analyse the concept of leverage in relation to the use of power and influence. They treat power as ‘potential influence’, and influence as ‘power in action’. In other words, the five sources are not of equal value; see Lewicky, Barry, Saunders & Minton, supra n. 26, at 189. In this paper, I opt for an approach based on the result of possessing power; it is hard to imagine legal interference if power does not lead to influence on others, at least from the chosen perspective of two interacting parties (see Section I).

51 Abuse of a better position in an organisation may be an example of interference because of ‘abuse of rights’.

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29/11/2007 version : 1.0
other three sources seem to be laid down in a legal interference more clearly.\textsuperscript{53} Several remedies try to balance power structures based on a better access to information. The issue of dependency is manifested in at least in one prototype: the unilateral ending of complex long-term contracts. Better communication skills is a more difficult one. To my knowledge, there are no clear examples of remedies explicitly aiming at power imbalances because one of the contracting parties is a better skilled communicator. However, the remedies available for those who are - for several reasons - less able to express their own will can be regarded as the contract-law equivalents. This all indicates that, from a contract law perspective, in particular the following sources of power are of relevance:

1. better access to information
2. better communication skills, and
3. less dependency.

If anything, the extensive literature shows that analysing power is highly complex and subtle. Differentiations are necessary. One important differentiation is that the sources of power overlap in many cases. A legal interference is often based on a complex combination of circumstances. On the other hand, the tension between contractual freedom and protection of low power parties has historically been a core theme of contract law, which has been expressed in more or less well-defined different doctrines. This indicates that, at least to some extent, it must be possible to analyse the contractual sources of power in archetypes.

\subsection*{B. Archetypes of Power in Contract Law}

\subsubsection*{1. Case I}

The first case is an example of power imbalance caused by mental predominance. It is based on a recent decision of the Dutch Supreme Court.\textsuperscript{54} In my view, a power imbalance in this type of cases is caused by a dominant position of one of the contracting parties, based on evident mental and/or physical advantage.

\textbf{Mental/physical predominance}

An 82-year old man sold land considerably below the market value. The old man died shortly after the deal had been closed. The inheritor instituted legal proceedings, claiming that the buyer had exerted undue influence. The seller had been treated for depression in the last two years of his life. Some employees of the institution where he was cared for shortly before his death, reported clear symptoms of dementia. Others (i.e., the civil-law notary) claimed that the man had made his decision in a clear state of mind. Seller and buyer knew each other well; they were neighbours and there was a relationship of trust between them. The District Court granted the claim for avoidance. However, the Court of Appeal argued there was not enough evidence to support the claim. The Dutch Supreme Court concluded otherwise: the circumstances mentioned were of such a rare nature that the Court of Appeal could only deny the claim for avoidance under strict conditions of motivation.

\textsuperscript{53} Nathal Thal identifies three categories of bargaining weakness protected by the law: 1) cases in which the relevant weakness is ignorance, 2) cases in which the relevant weakness is necessity, and 3) cases in which the obligation arises out of a relationship of trust. The last category remains ‘somewhat unclear’, see S. Nathal Thal, The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness, 8 \textit{Oxford Journal of Legal Studies} 17 (1988), at 30-32.

From a ‘civil law perspective’, case I is based on better communication skills/abilities. The idea that both contracting parties are able to communicate freely about their needs is affected in this case. Interacting is communicating: if a person is more skilled in communication, he/she is better able to influence the other. The ‘core business’ of effective communication in a nutshell, is asking the right questions at the right time and responding in such a way that the other feels heard and is able to listen to your arguments as well. The ability to ask the right questions is perhaps the most important communication skill. Some other personal skills and qualities enhance communication skills, for example intelligence, awareness, emotional control, intuition, appearance, and physical strength."

2. Case II

Case II deals with information asymmetry. A power imbalance in this type of cases is based on a disparity in access to information. One of the contracting parties has a dominant position because of an evidently superior capacity to be informed. Case II is also based on a recent court decision of the Dutch Supreme Court.  

**Information asymmetry**

A buyer of a second-hand car wishes to terminate the contract because of non-performance. The issue at the District Court was whether or not the car met the standards the buyer could reasonably expect, in other words, whether or not there actually was non-performance. Both the District Court and the Court of Appeal denied the claim of non-performance, arguing, in short, that the second-hand car was not in such a miserable state that it was unsafe. Furthermore, there was no clear evidence that the seller had committed fraud. The Supreme Court decided otherwise. The mere facts that the car was not unsafe and that there was no clear evidence of fraud did not mean that the car fulfilled the reasonable expectations of the buyer. The Solicitor General specifically added that there were no specific circumstances that indicated the buyer accepting a greater risk than other non-experts would accept in similar situations.

Better access to information is the key source of power imbalance in Case II. The seller was in a better position to know the specifics of the second-hand car. Those specifics were not entirely inaccessible to the buyer, but it would cost him much more effort to obtain the information.

3. Case III

Case III involves ‘dependency asymmetry’, which in my view, means a disparity in the level of dependency on the other. Interacting contracting parties invest to some extent in the relationship. Relation-specific investments in particular make contracting parties more and more dependent on the other. A power imbalance occurs if one of

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56 Case II: Dutch Supreme Court, Kousedghi/Rental BV, HR 8 July 2005, NJ 2006/22.
the parties clearly makes more relation-specific investments than the other." Again, this case is based on a recent court decision of the Dutch Supreme Court."

Dependency asymmetry

A wine producer ended a dealership-contract after a period of 100 years. The dealer disputed the ending, claiming that this dealership could only end unilaterally for good reasons. Moreover, in the event the court allowed the ending, it also claimed damages for useless relation-specific investments. The District Court found the ending in itself lawful, but, the notice period was too short. On appeal, the ending itself was considered unlawful, because the wine producer had no good reason for ending this relationship. The Supreme Court considered the question of whether or not parties of a long-term contract should always be able to end a contract unilateral even without a good reason. Such an ‘absolute right to end a relationship’ does not exist. It depends on the circumstances whether or not a good reason is required. Nowadays the relationship between the wine producer and the dealer still continues.

The alleged power imbalance in Case III is based on an unequal level of interdependency. This asymmetry is caused by the fact that one of the parties has an alternative that is nearly as attractive as continuing the relationship, while the other party has not. The more other options are available, the less dependent and the more powerful an interacting party is." Investing is a specific relation brings along a vulnerability, because other options become more expensive (switching costs). An unequal level of relation-specific investments ultimately results in a power imbalance.

The three archetypes of power are not the ultimate answer to a topic that is as hard to unravel as power imbalances in contracts. However, it could be an instrument to come up with a more systematic approach of evaluating successful and unsuccessful interventions in contractual relationships. First, I will discuss the difficulties interveners face when measuring a power imbalance in a contractual setting.

C. Can We ‘Measure’ Power? Criteria Used by Courts and Other Interveners

Can we measure power? Contract law seems to assume we can, since it provides opportunities for courts and other interveners to step in. Social psychologists show that measuring power is difficult. There are several reasons; only the most prominent ones will be mentioned."

One of the reasons is that the lack of any form of power is only thinkable under the most extreme circumstances. Every individual has some form of power in almost

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58 Case III: Dutch Supreme Court, Latour/De Bruijn, HR 3 December 1999, NJ 2000/120; a similar case is Shell Oil Co v. Marinello, 63 NJ 402, 307 A 2d 598 (1973) (protection of a dealer against the exercise of termination at will).


60 More thoroughly on this topic, Barnhizer (Inequality of Bargaining Power), supra n. 4; Barnhizer (Bargaining Power in Contract), supra n. 4; Adler & Silverstein, supra n. 4; Nathal Thal, supra n. 51.
every interaction.\textsuperscript{61} Power (and imbalance of power) is a dynamic feature, and inherently attached to all interactions.\textsuperscript{62} The extent and form of power depends on the context; time, location, needs, fears, the mental and physical state of both interacting individuals, third persons, etc.\textsuperscript{63} The person who appears to be the more powerful one might therefore actually be the less powerful one. An employer is supposed to be more powerful one in an interaction with an employee, but there are circumstances thinkable where it is actually the other way around. The same applies for franchisors and franchisees, and other class-protected contracting parties.

Furthermore, the appearance of power seems to be far more important than the actual power. It is not about actually having more power; it is about the other party believing that the other has it. This is what is called the self-fulfilling effect of power. If you really believe you have more power, the chances increase that the other will respond in such a way that you actually have more power.\textsuperscript{64} It works the other way around as well: if you actually have more power and the other one is not convinced of that, the chances increase that in the end the other proves to be more powerful.

Another reason why it is so difficult to measure power is because power depends on the psychological state of mind of both parties. In order to be really powerful, a contracting party must be willing to use that power. This is partly about believing as well: the other party must believe that you are willing to use it, but it is also about actually using it. If things don’t work out, be willing to walk away and move on. Not everyone is able to do that, even if the alternative is not that bad at all.

The last reason why is it so difficult to measure a power imbalance is because the sources of power do not make anyone powerful if others are not affected by it, for whatever reason. Power is not something that can be confiscated; it can only be given to someone because others are affected by acts, position, recourses, or qualities. It depends on someone’s own needs and fears whether or not someone is affected by the acts, position, recourses, or qualities of the other.\textsuperscript{65} We could say that the ultimate source of power is other people’s needs and fears, not someone’s recourses, ability to get information, communication skills, or position in society.\textsuperscript{66} Criteria to define the existence and extent of a power imbalance should therefore (at least to some extent) relate to the parties’ own needs and fears, and not only to recourses, position, communication skills, etc. In other words, the criteria should include the fact that power imbalances derive from a specific interaction, rather than

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\textsuperscript{61} See the work of Atiyah (supra n. 3), stressing that freedom of contract presupposes equality of parties, an ideal that never exists; see also Barnhizer (Bargaining Power in Contract Theory), supra n. 4 at 14.

\textsuperscript{62} See Collins, supra n. 5 at 280-281: “The mistake made by the classical lawyers was to suppose that an examination of the terms of the contract was irrelevant to the protection of freedom of contract. (...) (T)he practical application of the idea of voluntary consent necessarily entails an examination of the fairness of the terms of the contract.”

\textsuperscript{63} French & Raven, supra n. 42.

\textsuperscript{64} See, for example, R. Korobkin, Bargaining Power as Threat of Impasse, 87 Marquette Law Review, 867 (2004).

\textsuperscript{65} See, for example, the work of S.B Bacherach & E.J. Lawler, Power and Tactics in Bargaining, 34 (2) Industrial and Labor Relations Review 219 (1981): Experiments show that an actor’s own dependence, rather than his opponent’s dependence on him is the primary basis for his evaluation and selection of tactics.

\textsuperscript{66} Adler & Silverstein, supra n. 4, at 20 (“Negotiating power depends less on the other side’s strength than on one’s own needs, fears and available options”); Nathal Thal, supra n. 51, at 30 (“Thus, it should be clear that the inequality of bargaining power doctrine is relevant to inequality arising from one party’s weakness”).
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It may make the job to measure true power imbalances in contracts even more difficult; nevertheless, it seems more accurate to look at the interaction between two contractual parties, rather than at general characteristics of either one of them.

In general, we can say that courts do not use criteria that fit that description. The criteria used by American courts mostly address the inequality of bargaining power in terms of the weaker party’s lack of meaningful alternatives, the nature of the goods or services or the inability to negotiate terms. Courts also rely upon typical characteristics to support the idea that there might be an inequality, like wealth, consumer status, business sophistication, education or knowledge, and monopoly power. Courts in Europe use more or less the same approach. These ‘criteria’ refer to characteristics that parties have, regardless of the needs and fears of the other party.

Research done by Brickley and others shows that these criteria can lead to false assumptions. Their research is focused on the assumption that franchisees negotiating with the most successful, experienced, and sophisticated franchise organisations have to deal with greater power imbalances than franchisees negotiating with the small or medium sized businesses. They assumed that a short-term contract with high entry fees were indications of high power imbalances. Based on these assumptions, the power imbalances turned out to be quite similar. In fact, the first category of businesses (the sophisticated franchise organisations) offered contracts for a longer period of time than the second category of businesses.

We could say that power is difficult to measure, and that most courts do not have the right tools to adequately measure a power imbalance. How do other interveners handle this matter? Recent research by Gensberg gives an idea of the criteria that mediators use to define a power imbalance. Based on interviews with mediators, she categorised five problems indicating power imbalances: 1) certain interests are not represented, 2) some parties have difficulty participating, 3) parties do not have access to information they need, 4) some parties are not fully exploring their

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67 A full assessment of the parties’ power requires a look beyond their BATNAs. A full assessment includes the analysis of what each party can do for (needs-based) and to (threat-based) the other, not only what each side can do compared to one other. See also Adler & Silverstein, supra note 4, at 20.

68 See also Barnhizer (Inequality of Bargaining Power), supra n. 4, at 169, and Barnhizer (Bargaining Power in Contract Theory), supra n. 4, at 17.

69 Barnhizer (Inequality of Bargaining Power), supra n. 4, 199-201, with many references to court judgements; see also Barnhizer (Bargaining Power in Contract Theory), supra n. 4 at 33, mentioning four criteria that American courts use to trace power imbalances: 1) bargaining behaviour (e.g., standard form presented on a ‘take it or leave it’ basis), 2) seller characteristics (monopoly status, size, and sophistication), 3) buyer characteristics (poverty, education), and 4) transactional characteristics, necessity or a shortage of the subject matter. Two examples of cases where these criteria were applied are Shell Oil Co v. Marinello [1973] 63 NJ 402, 307 A 2d 598 and Henningsen v. Bloomfield Motors Inc. [1960] 32 NJ 358, 403, 161 A.2d 69.


alternatives to mediation, and 5) parties are not gaining as much through mediation as they could. With these criteria, mediators seem better equipped to measure a true power imbalance in contractual relations than most courts are. Although probably far from perfect to understand the true dynamics of the interaction in a concrete case, it seems more likely that these criteria signal a power imbalance in a more accurate way. Needless to say, ‘courts’ simply do not have the same opportunities to apply such criteria, in particular, in cases of class protection.

Summarizing, we can say that measuring power in contractual settings is highly complex, but not impossible. It will often take much effort and time, and probably cooperation of both contracting parties. Relying on general characteristics will often not present a clear picture of the dynamics of power. Yet, many interventions (outcome and process-based) are built on those general characteristics. On top of that, we do not seem to have a clear picture of the effects of interventions in different sorts and types. In the next Section, I will analyse what we know, and in particular what we do not know about the effects of intervention.

IV. EFFECTS OF INTERVENTION; CASE STUDIES

A. Case I: Mental and/or Physical Predominance

1. A Short Overview of Interventions

In both the US and Europe, there are several legal provisions designed to empower contracting parties with a mental and/or physical disparity. Duress, fraud, and undue influence are the most prominent examples. The range of the subjects mentioned differs in continental Civil Codes and common law systems. The concept of undue influence in common law systems is used, for example, for cases which are usually dealt with under the concept of ‘duress’ in continental law systems. In common law, duress usually only applies to cases in which a person made a promise under threat of physical violence. The remedy of undue influence protects parties who are in a special relationship with the other, in such a way that the other gains extraordinary trust. Courts generally consider the fairness of the contract, the availability of independent advice, and the vulnerability of the dependent party to determine whether a dominant party exerted undue influence. Furthermore, the common law doctrine of unconscionability protects low power parties from oppression and unfair surprise.

These interventions are mostly outcome-based, although there are some examples of process-based interventions (i.e. the ‘unfair surprise’ element of the doctrine of unconscionability – more on this under Case II). Other and more general examples of process-based interventions are hard to find in this type of cases. A few examples result from interviews with mediators handling power imbalances. Low power parties facing inferior mental and/or physical conditions usually have poor negotiation skills.

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73 For English law, see Collins, supra n. 5, at 270 ff.; for an overview of European systems on this topic (including English law), Beale et. al., supra n. 70, at 295 ff.; see for the US Alder & Silverstein, supra n. 4, at 29 ff.
75 Adler & Silverstein, supra n. 4, at 31.
76 See Beale et al., supra n. 70, at 476.
77 Gensberg, supra n. 72.
in comparison with the other party. It appears that the mediators step in, trying to empower the low power party. The techniques they use vary from training the low power parties' negotiation skills in a formal setting and making ‘gentle comments’ during the process to pairing the low power party up with people who are better skilled in negotiating. Some mediators make a clear distinction between helping the parties to participate versus helping them to come up with specific strategies to achieve more in the negotiations. The first activity falls within their job description, the latter does not.

2. What Do We Know about the Effects?

The effects of the legal provisions are uncertain. As far as I know, there are no empirical figures on empowerment and/or side effects for any sort of interventions in this type of cases. This makes it probably more difficult to, for example, empirically test empowerment. Side effects (negative or positive) are also difficult to test empirically. This may be explained by the absence of a specific well-defined class and the rather vague criteria of the interventions.

Logically, we may assume the low power parties that fit the criteria will be empowered. Empowerment as a result of a statute often means that the low power contracting party is released from promises that are unfavourable. The assistance to the low power mostly consists of ex post, case-by-case and short-term interference. A more general and long-term result, i.e. deterrence, is probably only thinkable if the criteria of intervention are clear and well-defined.

The effects of process-based interference in this type of cases are largely an 'open field' as well, short-term and long-term. Gensberg's interviews with mediators show that parties that are assisted in their negotiation skills seem to gain as a result. It also appears that parties must have some ability to influence the outcome. If this is not the case, mediators tend to withdraw from the process. This indicates that (short-term) empowerment can only result from process-based intervention in cases above a certain minimum standard, while most typical outcome-based interventions are in particular focused on cases below such a minimum standard. Justifiably so, it appears.

3. What Can We Learn From (Social) Psychological Studies on Power?

More and more (social) psychologists study the effects of power on those who possess it. For many years, Kipnis stood more or less alone in examining this topic. He examined whether possessing power corrupts. Recently, other researchers have examined the topic as well. These researchers found that possessing power causes individuals to attempt to influence the other party more, to increase the psychological distance from other people, to enhance self-perception, to pay less attention to others, and to use stereotypes more often. Other social psychological studies have shown that people with high power express their emotions more and behave in more

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78 Gensberg, supra n. 72.
socially inappropriate ways.\textsuperscript{82} Furthermore, high-power people are less able to see things from the perspective of the other.\textsuperscript{83} Finally, power leads to self-enhancement and other-derogation.\textsuperscript{84}

In general, we could say that these outcomes do not bode well for any type of power imbalance in contracts. The prototype case of mental and/or physical predominance is characterized by a short-term, straightforward exchange of goods,\textsuperscript{85} often preceded by a (long-term) relationship of trust. In many cases, the contract itself is a result of a more complex manipulation, based on personal characteristics. Any type of interference that appeals to a high level of self-management is therefore less suitable.

On the other hand, another social psychology study on the pursuit of equality in outcomes among individuals, shows a positive result for a society less ‘dictated by higher sources’. It appears that an individualistically orientated person - a person with little or no regard for outcomes for others - is inclined to forego personal gain, despite obvious selfish reasons to cooperate, when the outcomes were distributed unequally. It appears that the motive to ensure equality in outcomes is important to people, even to those who are individualistically orientated.\textsuperscript{86} So even high-power individualistically oriented contracting parties (a worst-case scenario) are generally inclined to take into account some moral values. This is a comforting thought, that enables us to experiment with interferences that leave more room for contracting parties themselves to deal with the outcomes, provided the procedure of interaction is fair. However, in this specific case, the problem lies within the word ‘generally’. Despite the positive figures, not all high power individuals will take notice of moral values. Do we really accept these individuals to take advantage of those who we consider the most vulnerable contracting parties?

4. Best Assistance

How can a law system offer the best assistance to contracting parties facing a power disparity because of a mental and/or physical predominance? We need more information to answer this question. The little information that is available shows some signals that substance-based intervention by a higher source is indispensable for these type of cases.\textsuperscript{87} It seems that process-based interventions do not sufficiently safeguard the interest of low power parties, at least in the most obvious cases of predominance. One of the difficulties of testing effects empirically will be that this case does not represent a well-defined class of contracting parties. On the other hand, because of that same reason, we could think that negative side effects of

\textsuperscript{82} See Anderson & Berdahl, supra n. 79, at 1363, with references to others.
\textsuperscript{83} See Galinsky, Magee, Ena Inesi & Gruenfeld, supra n. 24.
\textsuperscript{85} I.R. Macneil would label this contract as a ‘discrete’ contract. See the extensive work of Macneil on relational versus discrete contracts, for example, I.R. Macneil, The Relational Theory of Contract, London: Sweet & Maxwell 2001.
\textsuperscript{86} B. Van den Bergh, S. Dewitte & D. De Cremer, Are Prosocials Unique in Their Egalitarianism? The Pursuit of Equality in Outcomes among Individualists, 32 Personality and Social Psychology Bulletin 1219 (2005). See also Tyler, supra n 10, at 882-883 (fairness of the outcome is more important than winning).
\textsuperscript{87} See also Barnhizer (Bargaining Power in Contract Theory), at 45, who even claims that doctrines wholly outside of contract should regulate the relationship in cases where one of the parties lacks any ability to affect the outcome.
substance-based interventions will be reduced to a minimum. On top of that, the criteria of most substance-based interventions often leave much room for the circumstances of a specific case, which, on the one hand enables legal systems to offer micro-protection to those who need it most, and does not result in major macro-distributive effects on the other hand.

If these assumptions are valid, we may in these type of cases need to focus our attention in particular on the following questions: Are there more specific criteria to define power imbalances that need outcome-based interventions? What outcome-based interventions offer the best ex post empowerment? Do we want to deter future contracting parties, and what type of rules do we need for that? Is there any room for process-based interventions, and if so, in what role?

B. Case II: Information Asymmetry

1. A Short Overview of Interventions

Information asymmetry covers any situation in which one contracting party has access to more information than the other. In Case II, the seller has information about the condition of the car, the buyer hasn’t - or at least to a lesser extent. This makes the buyer a low power party. All legal systems have interventions related to this problem. Consumer protection is partly a result of information asymmetry. The doctrine of unconscionability is an important tool of courts to interfere in cases of oppression and unfair surprise in common law systems. In addition to the unconscionability doctrine, contract law offers contracting parties (including businesses) protection from unfair clauses in standard form contracts. Continental law systems often have similar tools, only mostly restricted to consumer contracts. These interventions are substance as well as process-based. Substance-based interferences are those restricting the use of unfair terms, process-based are those related to unfair surprises (‘hidden terms’). This distinction seems to have more impact in continental law systems; consumer protection is clearly divided into protection against unfair terms on the one hand and unfair surprises on the other, often with a stronger emphasis on protection against unfair terms. In the US, a number of courts insist that both elements are present before they will make a determination of unconscionability.

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89 Restatement (Second) of Contracts, § 211.


91 Adler & Silverstein, supra n. 4, at 45-46, with further references.
Furthermore, legal systems often contain more general obligations to inform, based on notions of good faith and fair dealing. Sometimes such an obligation is considered to be included in the obligation to cooperate, also based on the doctrine of good faith. Not only sales contracts contain such obligations to inform; providers of services are often under the obligation to inform their clients, as well as many others.

Mediators interfere in cases of information asymmetry, including in situations in which one of the parties has no access to technical expertise and the other one does. Most mediators intervene by making it a problem of both parties, stressing that it is in their mutual interest to remove procedural barriers to participation of both. Others go further by mentioning fundraising and suggesting names of foundations to contact. Some even provide necessary information (technical or otherwise) themselves - even if the party involved did not ask for it - in particular if the party is unrepresented by lawyers or other experts. Obviously, this last intervention can have a strong impact on the substantive outcome.

2. What Do We Know about the Effects?

Do these interventions lead to empowerment of the low power party? Most will be inclined to assume that provisions explicitly dealing with the information problem strengthen the position of low power parties. However, empirical research suggests that changes to standardized contract terms occur slowly following judicial invalidation or interpretation of a contract term. Furthermore, small businesses in particular face significant barriers to enforce in court legal status like unconscionability. Besides more general barriers (i.e., the costs of enforcement in court), the high burden of proof often appears to be a serious obstruction.

Furthermore, insights provided by behavioural economics indicate that the limitations of consumer protection need to be recognized. These insights suggest that consumers may not always respond as rationally to information provided as sometimes is assumed. For example, even if consumers take notice of information provided, they may have limited ability to understand and process information. Other factors that need to be taken into account are over-optimism, self-serving interpretations, the limited effect of a warning, and the impact of presentation. Empowerment through information also depends on the available alternatives and

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* See Beale et al., supra n. 70, at 287.
* See, for example, the obligation of a franchisor to inform the franchisee during performance with information concerning all sorts of conditions relevant for performing; M.W. Hesselink et al., Commercial Agency, Franchise and Distribution Contracts, Principles of European Law, Study Group on a European Civil Code; Oxford [etc]: Oxford University Press 2006, at 235 ff.
* Gensberg, supra n. 72, at 32-40.
* For small businesses see in particular Morant, supra n. 12. For the shortcomings of the doctrine of unconscionability, see Morant supra n. 88; see also Slawson, who analyses the shortcomings of the doctrines of unconscionability, contra proferentum and ‘reasonable expectations’.
* Howells, supra n. 98, at 359.
the switching costs.\textsuperscript{100} Whether process or substance-based, it appears that the interventions need to reflect more thoughtfully on how the information rules can be framed.

The problem of information asymmetry is largely dealt with by class protection.\textsuperscript{101} Private law treats each consumer’s grief as an isolated event, without considering the impact on others. Little injustices are reconceptualised by collective harms.\textsuperscript{102} A negative side effect of consumer protection may be the empowerment of a select group at the expense of another (selective empowerment). Those who take advantage of information are likely to be the well-educated middle-class consumers.\textsuperscript{103} The others may be worse off, because in theory they could have known better. Another important topic related to consumer protection is the increase of prices. An entire class (consumers) pays the price for being protected.\textsuperscript{104} Although the topic has often been mentioned, there seems to be no evidence that price increases actually are the direct result of consumer protection.\textsuperscript{105}

Intervention by mediators has no negative side effects on others, although the effectiveness of the intervention in terms of empowerment is questionable. The most frequently used intervention - making it a problem of both parties – often seems to fail. Either the high power party simply is not convinced of the idea that it is in its interest as well to inform the other party, or the low power party does not trust the information provided with the help of the high power party.\textsuperscript{106} Other interventions by mediators (mentioning fundraising and providing necessary information themselves) seem more effective, although these - in particular the last one - are highly controversial in terms of neutrality.\textsuperscript{107}

3. What Can We Learn from (Social) Psychological Studies on Power?

Earlier, I mentioned the effects of power based-social psychological studies. Most results are not reassuring. In general, we could say that an imbalance in power is enhanced because of cognitive reactions that are inherent in human nature. This argues for interventions that take over control to a great extent. In Case I, it was shown that the power imbalance is often a result of manipulation based on personal

\textsuperscript{101} See also Hesselink 2006, supra n. 90, at 5.  
\textsuperscript{102} Collins, supra n. 2, at 70.  
\textsuperscript{103} Howells, supra n. 98, at 357; see also Cseres, supra n. 100, who claims that the liberalisation of network industries improved competition for larger users and provided better prices, at the expense of smaller consumers exercising their choice.  
\textsuperscript{105} The British Department of Trade and Industry showed that the increase of price due to the EU Directive on consumer sales was less than 0.25 %, see Hondius, supra n. 90, at 247.  
\textsuperscript{106} Cognitive biases further complicate negotiations. See, for example, Lewicky, Barry, Saunders & Minton, supra n. 26, at 152 ff. The thought ‘what is good for them must be bad for us’ is also known as the mythical fixed-pie belief, on this topic see in particular M.H. Bazerman & M.A. Neale, Negotiating Rationally, New York: Free Press 1992, Chapter 3 (The Mythical Fixed-Pie); also R.H. Mnookin, S. Peppet & A.S. Tulumello, Beyond Winning: Negotiating to Create Value in Deals and Disputes, Cambridge, Mass.: Belknap Press of Harvard University Press 2000.  
\textsuperscript{107} Gensberg, supra n. 72, at 37-38.
characteristics. Logically, we can presume that the need for empowerment by highly controlled ‘outside sources’ in these cases is high. In cases of information asymmetry, the ‘imbalance problem’ seems a matter of transaction costs rather than of manipulation based on personal characteristics. This could indicate that the cognitive and social ‘shortcomings’ are less problematic in these type of cases. It is clear, however, that rules (whether outcome or process-based) compelling sellers to overload consumers with all kinds of information, often do not result in better informed low power parties. In essence, it comes down to the conclusion that social psychological studies on the effects of power do not indicate whether outcome or process-based interventions offer the best assistance.

4. Best Assistance

Process and substance-based interventions are difficult to distinguish in this category of cases. The few interventions that are process-based with no effect on the substance (i.e. the intervention of a mediator to make it a mutual problem), often seem to have only a marginal effect. Serious doubts, however, are expressed considering the effects of (mostly) outcome-based interventions as well. The few interventions that do empower the low power party, seem to have some negative side effects on others, although too little empirical evidence is available. More empirical evidence is needed to conclude in general whether this class protection is the best assistance possible offered by legal systems. The evidence should entail figures on the actual empowerment of low power parties, as well as selective empowerment and price increases. Whether process or outcome-based, a key question is how the information rules are framed in order to reach the other most effectively. It is likely that there is no general frame, applicable to all contracting parties in need of information. It is also likely that effective intervention in this type of cases entails both process and substantive elements.

C. Case III: Dependency Asymmetry

1. A Short Overview of Interventions

As a result of relation specific investments, interacting contracting parties depend on each other. A substantial difference in the level of dependency exists in cases where one party has made excessively more relation specific investments than the other. The result is a power imbalance that might need interference from a higher source. The interventions in this category are various, though most of them logically

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108 Howells, supra n. 98.
109 See also Howells, supra n. 98, at 363.
110 See also Adler & Silverstein, supra n. 4, at 19 (“Power in negotiations typically arises from the dependence that each party has on the other”). Social psychological literature analyses a theory called the power dependency theory. According to this theory, power use increases with the imbalance of dependencies in a relation. For this theory, see in particular Linda D. Molm, Relative Effects of Individual Dependencies: Further Tests of the Relation between Power Imbalance and Power Use, 63 Social Forces 810 (1985).
111 See in particular the work of Williamson, supra n. 57.
112 The need to interfere depends, as in the other cases, on the chance of power abuse. Joskow’s empirical research provides support for the view that buyers and sellers in the coal market make longer commitments to the terms of future trade, and rely less on repeated bargaining, when relation-specific investments are more important; P.L. Joskow, Contract Duration and Relation-Specific Investments: Empirical Evidence from Coal Markets, 77(1) The American Economic Review 168 (1987); see also the work of Brickly,
are focused on the restriction of unilateral ending of complex long-term interaction. Eighteen states of the USA have passed laws that place related restrictions on franchisors in business-format franchises. European systems seem to be more reluctant in placing restrictions on the unilateral ending in franchise contracts, although some restrictions are imposed as well.\textsuperscript{113} Commercial agents are protected considerably better, as a result of the European Directive on Commercial Agents.\textsuperscript{114} Worth mentioning in Europe is the Belgian law on the protection of distributors; most other European legal systems impose - if any - more general and vague duties based on good faith.\textsuperscript{115}

The statutes and court orders mentioned are used to intervene by placing restrictions on the power to end a contract unilaterally. The restrictions vary from the requirement of a good cause to a notice period and/or compensation of damages. The lower power party is thereby given a chance to obtain some returns on the investments. These interventions are mostly outcome-based: the focus is balancing the performance more than structuring the interaction on how to perform.\textsuperscript{116} Exceptions are statutes and court orders obliging the parties to (re)negotiate. More profound process-based intervention also structure the way parties negotiate. Such interventions by statutes or court orders are rare. Mediation and arbitration procedures are more familiar with process-based interventions.\textsuperscript{117} The ‘pragmatic governance’ discussed earlier also structures the way parties interact.\textsuperscript{118} However, this intervention does not necessarily require parties to negotiate. The source that ‘takes over’ control in this type of intervention is primarily the committee, which consists of representatives of the contracting parties. Contracting parties more or less create their own internal arbitration procedure. Ideally, a court (or another ‘external’ arbitrator) respects this type of chosen intervention by handling this case in line with the internal procedures.\textsuperscript{119}


\textsuperscript{115} Boghaert & Lohmann, supra n. 114; see also The Principles of European Law, Hesselink et. al., supra n. 93, at 257 ff (notes).

\textsuperscript{116} See the earlier comment on a notice period, Section II D.

\textsuperscript{117} The concept of BATNA plays an essential role in dependency issues in mediation procedures, supra n. 59.

\textsuperscript{118} Jennejohn, supra n. 19.

\textsuperscript{119} Suggestions are given by Jennejohn, supra n. 19.
2. What Do We Known about the Effects?

Some empirical evidence on the effects of statutes protecting franchisees in specific states of the USA is available. Klick and others, for example, show that laws restricting franchisor termination rights leads to a reduction in franchising. This reduction is not offset by the increase in franchisor-operated establishments.120 Their focus was on fast food establishments. The termination rights were mostly restricted by good cause requirements, such as violation of contract terms or fraud on the part of the franchisee. Klick and others are focused in particular on data from Iowa, since it is regarded most unfavourable to franchisors. Iowa regulations require that franchisors allow franchisees a right to correct defects, and it explicitly restricts waiver and enforcement of contractual choice of law and choice of forum clauses. It appears that the total number of franchised units is reduced since the enactment of the Iowa statute. Further, their research shows that employment in franchise industries, as a proportion of total employment, drops significantly when states enact restrictions on franchisor termination rights.

These results indicate that substance-based interventions by statutes in (some) franchise relations have side effects that most of us would consider undesirable. As Klick and others point out, the idea is that effective regulation protecting franchisees, should increase, not decrease, the use of franchise contracts. An increase of the use of franchise contracts indicates that the regulation accomplishes its intended purpose of protecting franchisees’ expectations without frustrating franchisors’ objectives.

Other often considered negative side effects of interventions by protective statutes are price increases. Research done by Brickley indicates that franchisees are paying a higher price for franchises in states with protection laws. This conclusion is based on results showing that franchise companies headquartered in termination-law states charge significantly higher royalty rates than companies headquartered in other states (around 1% higher).121 Another empirical research shows that franchisors do not systematically increase or decrease their royalty rates as they become better established, which indicates that the price increases mentioned by Brickley are not the result of improved franchise formats.122

Furthermore, research done by Brickley, Misra, and Van Horn indicates that franchisor contracts are not designed by powerful franchisors taking advantage of less powerful and unsophisticated franchisees.123 The conclusions are based on empirical results, showing, among other things, that well established franchise companies offer longer term contracts. An abuse of power would indicate that successful franchise companies offer shorter term contracts. By doing so, successful franchise companies would profit from receiving more admission and/or renewal fees. Their study provides evidence that franchise contracts often reflect both the

123 Brickley, Misra & Van Horn, supra n. 71.
interests of the franchisee and the franchisor. However, the study does not seem to give insight into the incentives that trigger this behaviour.  

High relation-specific investments are also an issue in employment contracts. The effects of employment protection have been studied frequently. The results are not unambiguous. Some conclude that employment protection has no effect on the overall unemployment rate, while others find that employment protection increases unemployment and extends the period of employment adjustment. Several studies point out an important negative side effect of employment protection, which does not seem to be inconsistent with prior studies: selective empowerment. It appears that only a select group of employees benefits from strict employment protection, at least in the long run. The group that benefits most are prime-age male employees. Other types of employees do not seem to benefit from the protective statutes. Their participation in the labour market seems to decrease if protective measures are taken, which indicates that employers adjust their policy in hiring employees.

What do we know about the effects of process-based interference in any of the above mentioned fields? According to empirical data, the better a franchisor is able to credibly alleviate a franchisee’s fear of being exploited by opportunism, the stronger the growth generated in the entire franchise system. It also appears that the best way to alleviate that fear is by using non-coercive means and ‘cooperative management’. Both are process rather than substantive in nature.

In favour of process rather than outcome-based interventions are also the many calls on employers to educate employees in skills that may be useful in other relationships as well. The idea is that employees are better off improving their market value. As a counterbalance, employers are no longer faced with tight regulations. Remarkable enough, it seems that employers are triggered to educate employees by those tight regulations. Empirical data show that employers facing tight regulations invest more in training in comparison with their colleagues not facing tight regulations. However, taking into account the negative side effects of tight (often substantive) regulations,
there surely must be some other way to trigger employers to make those investments.

3. What Can We Learn From (Social) Psychological Studies on Power?

As mentioned, studies on the effects of having power show that high power parties are less able to see things from the perspective of the other.\(^{130}\) Not being able to see things from the other’s perspective may be a serious problem for successfully applying process-based interventions. This is a general point, not something that is typically related to the case of dependency asymmetry. On the other hand, what is typical in situations of dependency asymmetry, is that it involves complex interactions and long-term commitments instead of one shot exchanges.\(^{131}\) This could indicate that, in these situations, high power parties are better equipped to see things from the perspective of the other; at least, they are more motivated to do so, in particular if reputation damage could be an issue.

One of the assumptions of process-based intervention is that the level of taking over control by someone else is lower (Section II C). We know that the impulse to blame someone else is triggered by an underlying need to be in control.\(^{132}\) Process-based intervention therefore seem to have a better chance to prevent people from blaming each other. Blame can have serious consequences in all type of power imbalances, but in particular in the dependency asymmetry case. It takes a complex procedure to unravel a complex interaction. Blame is a factor that seriously threatens a successful outcome of such a procedure. Therefore, any intervention that specifically avoids triggering blame seems to be more attractive.\(^{133}\)

Add to that the study earlier mentioned that even individualistically oriented negotiators tend to forego personal gains when the outcomes are distributed unequally, despite obvious, selfish reasons to cooperate.\(^{134}\) It appears that moral values are important to most, even high-power self-oriented contracting parties. Exceptions seem acceptable in this type of case, in particular in comparison with case I, not only because our instinct tells us that Case I represents the most vulnerable contracting parties, but also because a sociological study of the power struggle in ongoing relationships shows that the greater the total amount of power in a relationship, the greater the use of conciliatory tactics.\(^{135}\) We can assume that the total amount of power in Case III is larger in comparison with Case I.

4. Best Assistance

What type of intervention offers the best assistance in dependency asymmetry cases? Again, it is hard to draw general conclusions if so much is still uncertain. There simply is not enough research on the effects of interference. Franchise and employment contracts have been an object of study more frequently. The outcomes of these studies indicate that tight regulations, mostly outcome-based, have the tendency to generate negative side effects. Only few data are, however, available about the effectiveness and impact of process-based intervention, or intervention that

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\(^{130}\) See Galinsky, Magee, Ena Inesi & Gruenfeld, supra n. 24.

\(^{131}\) On this topic, see in particular the work of Macneil, supra n. 85.


\(^{133}\) Further on this topic, see De Hoon, supra n. 33.

\(^{134}\) Van Den Berg, Dewitte & De Cremer, supra n. 86.

\(^{135}\) See Lawler, supra n. 26.
is partly outcome and partly process-based. Discussion on related issues, in particular in long-term contract cases, often only considers the question of whether or not mediation is to be encouraged, which seems to be a rather narrow-minded discussion. Process-based intervention is conceivable in many formats; negotiations in a mediation procedure is just one of them. Pragmatic governance - a type of intervention that is partly outcome and partly process-based, along with internal conflict management rules – is a good example of another format. Exploring other formats seems worthwhile, given the outcomes of studies on side effects.

V. CONCLUSION

In 2007, the checks and balances concept of Montesquieu is still current. Pragmatic governance is an example of an ‘internal’ structure that is based on the idea of checks and balances. In addition, knowledge from other fields is useful to take the issue of power imbalances in contracts to another level. First, social psychological studies on the sources of power are useful to get a more systematical view on power imbalances in contracts. We tend to generalize the topic too much, and if not, we focus solely on rather superficial characteristics of typical low-power or high-power parties. In these days, being a employee, consumer, or franchisee does necessarily make us the low power party. And even if it does, it is highly questionable whether traditional means of interference really meet our interests in the best possible way. This is where another ‘field of knowledge’ becomes useful: empirical research on the effects of specific types of intervention. Overall, there are not many studies to build on. Even so, drawing more generally applicable conclusions from them is often hard. Empirical social psychological studies on the effects of power are a valuable, though also limited, supplement.

Combining these ‘fields of knowledge’ leads to the following direction. In general, we could say that the contracting parties that lack any ability to affect the outcome are probably not sufficiently protected by process-based interventions. Negative side effects on others are in particular an issue in ‘class protection’, like consumer, employee and franchisee protection. Employees and franchisees are often more capable of influencing the substantive outcome of interactions than consumers, which makes them better candidates for handling process-based intervention. These types of intervention usually have few side effects, positive or negative. Ultimately, it may - at least in these type of cases - be a choice of selective empowerment and price increases on one hand, and the development of substantive standards (and thereby the development of law) on the other. From the perspective that one of a legal system’s goals is to offer the best assistance to contracting parties in a market, the choice will be not so difficult to make.

If anything, we could say that the question of how to offer the best assistance to contracting parties dealing with power imbalance requires a broader analysis than one primarily focused on fine-tuning legal provisions on specific topics, or weighing the (dis)advantages of mediation, arbitration, and proceedings in court. The analysis is more a matter of finding the right mixture of procedural and substantive elements in any intervention, taking into account the type (source) of power and the goals we value most in that type of cases. The real challenge is finding this right mixture in prototype cases, and follow up questions, i.e. how to handle cases that are a-typical. Finally, we should further explore the possibilities to implement such mixtures in existing types of intervention. Important traces of such an exploration are already there, in continental as well as common law systems. Whether or not interventions...
should ultimately take place (if they should take place at all) by mediation, proceedings in court, arbitration, new legislation, or something else, still is, and always will be, an important issue as well. Hopefully, this nut will be cracked only after we have more insight into the broader implications mentioned in this paper.