UNCONSCIONABILITY: A CRITICAL REAPPRAISAL

RICHARD A. EPSTEIN
University of Chicago Law School

I. Introduction

THE classical conception of contract at common law had as its first premise the belief that private agreements should be enforced in accordance with their terms. That premise of course was subject to important qualifications. Promises procured by fraud, duress, or undue influence were not generally enforced by the courts; and the same was true with certain exceptions of promises made by infants and incompetents. Again, agreements that had as their object illegal ends were usually not enforced, as, for example, in cases of bribes of public officials or contracts to kill third persons. Yet even after these exceptions are taken into account, there was still one ground on which the initial premise could not be challenged: the terms of private agreements could not be set aside because the court found them to be harsh, unconscionable, or unjust. The reasonableness of the terms of a private agreement was the business of the parties to that agreement. True, there were numerous cases in which the language of the contract stood in need of judicial interpretation, but once that task was done there was no place for a court to impose upon the parties its own views about their rights and duties. "Public policy" was an "unruly horse,"[1] to be mounted only in exceptional cases and then only with care.

This general regime of freedom of contract can be defended from two points of view. One defense is utilitarian. So long as the tort law protects the interests of strangers to the agreement, its enforcement will tend to maximize the welfare of the parties to it, and therefore the good of the society as a whole.[2] The alternative defense is on libertarian grounds. One of the first functions of the law is to guarantee to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties: if one individual is entitled to do within the

[1] Richardson v. Mellish, 2 Bing. 229, 252; 130 Eng. Rep. 294, 303 (1824).

[2] The crucial question for the tort law concerns the scope and identification of the "interests" to be protected. On the one hand, they could be defined as to include the expectation of profit from trade, in which case all economic harm would fall within the scope of the tort law. On the other hand, they could cover the exclusive use and possession of one's person and property, in which case most forms of economic harm would fall outside the protection of the tort law. For a defense and elaboration of the second point of view, see Richard A. Epstein, Intentional Harms, 4 J. Leg. Studies 391 (1975).

confines of the tort law what he pleases with what he owns, then two individuals who operate with those same constraints should have the same right with respect to their mutual affairs against the rest of the world.

Whatever its merits, however, it is fair to say that this traditional view of the law of contract has been in general retreat in recent years. That decline is reflected in part in the cool reception given to doctrines of laissez-faire, its economic counterpart, since the late nineteenth century, or at least since the New Deal. The total "hands off" policy with respect to economic matters is regarded as incorrect in most political discussions almost as a matter of course, and the same view is taken, moreover, toward a more subtle form of laissez-faire that views all government interference in economic matters as an evil until shown to be good.[3] Instead, the opposite point of view is increasingly urged: market solutions—those which presuppose a regime of freedom of contract—are sure to be inadequate, and the only question worth debating concerns the appropriate form of public intervention. That attitude has, moreover, worked its way (as these things usually happen) into the fabric of the legal system, for today, more than ever, courts are willing to set aside the provisions of private agreements.[4]

One of the major conceptual tools used by courts in their assault upon private agreements has been the doctrine of unconscionability.[5] That doctrine has a place in contract law, but it is not the one usually assigned it by its advocates. The doctrine should not, in my view, allow courts to act as roving commissions to set aside those agreements whose substantive terms they find objectionable.[6] Instead, it should be used only to allow courts to

[3] "Laissez faire has never been more than a slogan in defense of the proposition that every extension of state activity should be examined under a presumption of error." Aaron Director, The Parity of the Economic Market Place, 7 J. Law & Econ. 1, 2 (1964).

[4] See Friedrich Kessler & Grant Gilmore, Contracts, Cases and Materials 1-14 (2d ed. 1970), for a perceptive essay that highlights and endorses the shift from laissez-faire to the regulatory state. For a typical statement of the modern position, see John E. Murray, Jr., Unconscionability: Unconscionability, 31 U. Pitt. L. Rev. 1, 2, 8 (1969).

[5] The literature on unconscionability is already quite extensive; for some of the more notable instances, see M. P. Ellinghaus, In Defense of Unconscionability, 78 Yale L. J. 757 (1969); Arthur Allen Leff, Unconscionability and the Code—The Emperor's New Clause, 115 U. Pa. L. Rev. 485 (1967) [hereinafter cited as Leff]; Robert Braucher, The Unconscionable Contract or Term, 31 U. Pitt. L. Rev. 337 (1969); Arthur Allen Leff, Unconscionability and the Crowd—Consumers and the Common Law Tradition, 31 U. Pitt. L. Rev. 349 (1969) [hereinafter cited as Leff, Unconscionability and the Crowd]; John E. Murray, Jr., *supra* note 4; John A. Spanogle, Jr., Analyzing Unconscionability Problems, 117 U. Pa. L. Rev. 931 (1969).

[6] The substantive doctrine of unconscionability appears in several forms and guises. Often, the term is used as a modern equivalent of the traditional notion of contracts against public policy. In some cases the doctrine, whatever it is called, is of common law creation. In others it is developed in connection with statutory rules which in broad outline define certain sorts of consensual arrangements as "unreasonable" or "unconscionable", or simply "unlawful". Yet even where these rules restricting the freedom of contract are of statutory origin, their language is of such looseness that a court has wide latitude in their interpretation, so judicial attitudes

police the process whereby private agreements are formed, and in that connection, only to facilitate the setting aside of agreements that are as a matter of probabilities likely to be vitiated by the classical defenses of duress, fraud, or incompetence.[7] In order to show how the doctrine of unconscionability can function usefully in this manner, we shall examine first the traditional limitations upon the freedom of contract. That done, we shall show how a doctrine of unconscionability, when properly used, enables us to further at an acceptable cost the ends served by these classical limitations.

With a place for unconscionability thus established, we shall explore the results achieved when the doctrine of unconscionability is used to oust on substantive grounds the terms of private agreements that have been formed by unexceptionable means. While this examination cannot demonstrate conclusively that the substantive doctrine necessarily will have harmful effects, it can, I think, show that use of the doctrine tends on balance to work more harm than good, and should therefore be abandoned.

II. Traditional Common Law Defenses

a. *Duress*

We begin our examination of contractual limitations with duress. In its simplest form the defense of duress allows A, a promisor, to excuse himself from performance of his part of the bargain because the promisee, B, used force or the threat thereof in order to procure his consent. The defense makes perfectly good sense even in a regime that respects the freedom of contract once it is recognized that the initial distribution of rights under the tort law protects both a person's physical integrity and his private property. Duress is an improper means of obtaining A's consent because it requires him to abandon one of these two initial rights ("your money or your life") in order to protect the other.[8] A's case is crystal clear where for example, he transfer goods, under a threat of force to his person; and it is but an easy extension to the next

remain important as well. Note, for example, the repetitive use of the term "unconscionable" in section § 2-302 of the Uniform Commercial Code, perhaps the most important statutory codification of the unconscionability principle.

§ 2-302. Unconscionable Contract of Clause. (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

The situation is quite different where there is a complex statutory scheme, like, for example, the truth in lending laws, where the question of judicial interpretation, while important, assumes a more interstitial role. This is especially true where the statute empowers a regulatory agency to interpret the statutes by appropriate administrative regulations. In this discussion, we shall ignore the variations on the unconscionability theme, except in the few cases where they appear to be material.

[7] The concern is, in other words, with what has been aptly called "procedural unconscionability." Leff 487.

[8] "It is always for the interest of a party under duress to choose the lesser of two evils. But the

case where force is used to procure not the transfer of goods, but the promise thereof. The defense of duress allows A, as defendant in a contract action, to vindicate *both* his initial entitlements, even though he has yielded to the force of the moment. A's consent has been given, but there is good reason to set it aside.

The issue of duress is important in another class of cases, those involving the so-called problem of the "duress of goods."[9] Suppose that B has agreed to clean A's clothes for $10. After the work is done, B tells A that he will return the clothes only if A pays, or promises to pay, him $15. If A pays the $15, it is quite clear that he has an action to recover the $5 excess. B has put him to a choice between *his* clothes and *his* money. As in the case of duress by the threat of force, B has required A to abandon one of his rights to protect another, and the action to recover the $5 is designed to make certain that A will be able to protect them both. Suppose A, however, has only agreed to pay the $15 to secure the return of his goods. In B's action on the promise, A will have a defense against the $5 overcharge, similar to that available where the promise was made under the threat of force. This defense of duress of goods also vindicates the distribution rights created, not by the tort law alone, but by the tort law and private agreement in combination.[10] In neither case does the defense of duress turn upon the reasonableness of the terms of the agreement; nor does it rest upon the market position of the parties to it immediately before it was formed. The process of formation provides the court with all the information it needs to allow the promisor to escape from performance under the contract, and the court itself can and must remain unconcerned with the substantive terms of the bargain.

---

fact that a choice was made according to interest does not exclude duress. It is the characteristic of duress properly so called." Union Pacific R.R. v. Public Service Comm'n, 248 U.S. 67, 70 (1918). (per Holmes, J.).

[9] See John Dalzell, Duress by Economic Pressure I, 20 N.C. Law Rev. 237, 241-42 (1942), John P. Dawson, Economic Duress—An Essay in Perspective, 45 Mich. L. Rev. 253 (1947) [hereinafter cited as Dawson]. Principled extensions of the doctrine of duress of goods are quite straightforward. The doctrine should apply to a refusal to render services one has agreed to provide or the refusal to deliver papers on intangibles. See, on these variations of the theme, Dawson 280.

[10] The common law doctrine of consideration, that required every promise to be "purchased" by a return promise or act, can be justified in part as a way to protect promisees from threats of nonperformance by their promisors. See, for example, the classic case of Foakes v. Beer, 9 App. Cas. 605 (1884), where the House of Lords held the partial forgiveness of a debt was void for want of consideration. There was evidence in the case that the creditor released the debt because of the debtor's threat not to pay it. While the result in the case is arguably correct on its facts, it is better that the issue of duress be raised expressly by the creditor, preferably as an exception to a defense based upon the release. Ironically, consideration and unconscionability both function as indirect means of striking down promises which should be set aside because of duress. The difference between them is, in the end, that the price paid is too high under the consideration approach, but not under the unconscionability approach. See generally, on this approach to consideration, Lon L. Fuller, Consideration and Form, 41 Colum. L. Rev. 799 (1941).

The defense of duress, though capable of extension, is also subject to limitations, the most important of which concerns the question of "economic duress." Suppose that B at the outset refuses to clean A's clothes unless A pays him $15, even when B's previous price had been $10. There is no doubt that A is worse off on account of B's decision to make a "take it or leave it" offer, but it would be the gravest mistake to argue that B's conduct constitutes actionable duress because it puts A to an uncomfortable choice. Indeed the case is sharply distinguishable both from the threats or use of force and from the duress of goods. In those two cases of duress, B put A to the choice between two of his entitlements. In this situation he only puts A to the choice between entitlement and desire, between A's money, which he owns, and B's services, which he desires. It is the very kind of choice involved in all exchanges. A could not complain if B decided not to make him any offer at all; why then is he entitled to complain if B decides to make him *better off* by now giving him a choice when before he had none? If A does not like B's offer, he can reject it; but to allow him to first accept the agreement and only thereafter to force B to work at a price which B finds unacceptable is to allow him to resort (with the aid of the state) to the very form of duress that on any theory is prohibited. There is no question of "dictation" of terms where B refuses to accept the terms desired by A. There is every question of dictation where A can repudiate his agreement with B and hold B to one to which B did not consent; and that element of dictation remains even if A is but a poor individual and B is a large and powerful corporation. To allow that to take place is to indeed countenance an "inequality of bargaining power" between A and B, with A having the legal advantage as he is given formal legal rights explicitly denied B. The question of duress is not that of the equality of bargaining power in a loose sense that refers to the wealth of the parties. It is the question of what means are permissible to achieve agreement. Where, as with force, the means themselves are improper, the threat to use them is improper as well; where those means are proper, so too is the threat to use them.[11] It is a mistake to assert that the law of duress is designed to protect "freedom of the will" without specifying those things from which it should be free.[12] "Economic duress" is not a simple generalization of the common law notions of duress; it is their repudiation.[13] The integrity of the law of contract can be preserved only if that notion is flatly and fully rejected, and the

[11] But, note the opposite opinion of Holmes: "When it comes to the collateral question of obtaining a contract by threats, it does not follow that, because you cannot be made to answer for the act, you may use the threat." Silsbee v. Webber, 171 Mass. 378, 381, 50 N.E. 555, 556 (1898).

[12] But see Dawson 256, where it is argued that the concerns with the doctrines of duress were but a portion of the larger question having to do with freedom of the will.

[13] For the opposite point of view, see John Dalzell, Duress by Economic Pressure II, 20 N.C. L. Rev. 341 (1942), and Dawson. For a judicial expression of this position, see the dissenting opinion of Frankfurter, J., in United States v. Bethelem Steel Corp., 315 U.S. 289, 312 (1942).

role of duress limited to the case where one party puts the other to a choice between two of his entitlements by means, such as force or the breach of contracts that in and of themselves are valid.

b. *Fraudulent Misrepresentations*

The case against fraudulent misrepresentation is easy to make out.[14] As a moral matter, a person should not profit by his own deceit at the expense of his victim; and as a general matter, no social good can derive from the systematic production of misinformation. It is quite true that a person is in a better position to defend himself against fraud than against force, if only because he can check out the representations from his own sources or walk away from their maker without adverse legal consequences. But the carelessness of a victim does not excuse, much less justify, the perpetration of fraud. Where a promise induced by fraud is yet to be performed, the fraud is a good defense against an action for breach. Where the promise has been performed, the fraud is good reason to give the promisor the remedy of rescission,[15] or where that is inappropriate, money damages. As with duress, the agreement is not respected because of the process of its formation. The reasonableness of the terms are of no concern to the court, and the same is true of the market position of the parties. (A monopolist can be a plaintiff in a fraud action.) The conduct of the promisee alone is sufficient to allow the promisor to repudiate the agreement.

There are strong common law limitations on the reach of fraud doctrines, similar to those applied to duress. True, it has been always possible at common law to maintain actions for concealment (as with the man who papers over cracks in the walls of a house to hide evidence of termites from a prospective purchaser). Yet, by the same token, a contract cannot be set aside on account of the simple *nondisclosure* of facts, which if known might

[14] I put aside in this discussion the treatment of "innocent" misrepresentations, whether or not carelessly made. In those cases in which the representation is made in order to assist the representee, no liability should attach, absent agreement to the contrary, because the representee may be fairly said to take the risk that the information is in error. Where, however, the representation is made in order to induce the representee to act for the benefit of the representor, he should be held if the representation is false; such happens, for example, when a purchaser of real estate is allowed either rescission or damages when the seller makes a material but innocent, misrepresentation about the property sold. The "benefit test" in effect seeks to estimate the ways in which the parties would have allocated the risks if the matter had been brought to their attention. Fraud is the easy case because the allocation of risks is easy, given the deliberate nature of the defendant's conduct. For a case that recognizes the general right of action for "negligent misrepresentation," see Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465 (1963). The defendant in that case used a disclaimer form which the House of Lords allowed, consistent with the contract analysis, to control in the particular case.

[15] The limitations on rescission are concerned, for example, with the protection of third parties, or with the restoration of benefits received by the victim of the fraud. See generally, John D. Calamari & Joseph M. Perillo, Contracts, ch. 13 (1970).

have put the other party off the agreement that was in fact reached.[16] This position has, of course, come under attack, as many have advocated the imposition of affirmative duties to disclose in a wide variety of contexts.[17] Yet that course is fraught with difficulties of its own. First, it is difficult to determine as a matter of public policy what information must be disclosed because it is "material." It is most likely much cheaper and more effective to allow the parties in question to ask for the information that *they* regard as material, after which the general rules governing fraud and misrepresentation may be applied to the responses that are given.[18] Second, disclosure requirements are always awkward because the party subject to them will have to act as a fiduciary toward someone with whom he wishes to deal at arm's length. Why must A be required to reveal to B at no cost information that he possesses no matter what its cost to him? The common law has been reluctant to impose affirmative duties to speak, just as it has been reluctant to impose affirmative duties to act. The undistinguished record of legislative disclosure laws, be it in truth-in-lending[19] or in securities regulation,[20] suggests that the traditional common law response to the prob-

[16] There is the intermediate case where there is a disclosure of some relevant information, but a nondisclosure of other information that makes its significance clearer. Given the familiar injunction to tell the "whole" truth, these have been treated as cases of fraud.

[17] See generally William L. Prosser, Handbook of the Law of Torts 695-99 (4th ed. 1971). Note, some of the exceptions to the nondisclosure rule are consistent with the traditional position. In particular, the rule that requires a fiduciary to disclose his interest in any transaction dealing with the subject matter of his trust is a fair implication from the close relationship between parties, who do not deal with each other as strangers. Again, the rule that requires the insured to make full disclosure of any information material to the question of whether the insurance company takes the risk, or the premium at which it is taken, is in almost all cases not a rule of positive law but an express provision of the insurance contract.

[18] Note, there is a "materiality" question even with actual misrepresentations, but it will in practice create many fewer problems, because there will be a strong presumption that whatever was in fact inquired of will be material, at least if it goes to the attractiveness of an investment. On the capacity for markets to provide contracting parties with the appropriate amount of information, see R. H. Coase, The Choice of the Institutional Framework: A Comment, 17 J. Law & Econ. 493 (1974); Richard A. Posner, The Federal Trade Commission, 37 U. Chi. L. Rev. 47 (1969); for a more cautious view, see Leff, Unconscionability and the Crowd. On the question of legislation to cure the defects of a market dissemination, it must be remembered that the case for regulation is not made out even if there is conclusive identification of a market defect. The costs and imperfections of the regulatory process must be considered as well, and these are apt to be great indeed, as for example, Professor Posner points out in his article on the FTC, *supra* at 60-82.

[19] See, for example, William C. Whitford, The Functions of Disclosure Regulation in Consumer Transactions, [1973] Wis. L. Rev. 400. Whitford concludes that it is likely that truth-in-lending legislation has had little, if any, impact on consumer behavior. One possible explanation is that this regulation cannot give the buyer information about personal factors—for example, desirability of location—that bulk much larger than disclosure in the purchasing decision. Although Whitford does not believe that this regulation serves its major function, he does think that non-economic justifications for it can be put forward. *Id.* at 435.

[20] See, for a general account of the disclosure requirements, 3 Louis Loss, Securities Regula-

lem was indeed a sound one, which insured that the prohibition against fraud was not by artifice allowed to swallow the basic premise in favor of freedom of contract.

c. *Defense of incompetence: infancy, insanity, and drunkenness*

Before we can turn to the question of unconscionability, we must, within the framework of the classical model, deal with questions of infancy, insanity, drunkenness, and the like, all going to the competence of the contracting parties. With the competence thereby called into question, it becomes difficult to argue that the consent, even if given, is in the best interests of the party who has given it, or that the punctual enforcement of the agreement is likely to advance the public good. The important question is, how can we minimize the cost associated with the rules governing incompetence? These costs are of two sorts: first, enforcing contracts that should not be enforced and, second, not enforcing those that should be enforced. The rules fashioned to minimize them should, I believe, take into account three considerations. First, they should attempt to identify broad classes of individuals who in general are not able to protect their own interests in negotiation. A case-by-case analysis of incompetence is for the most part too costly to administer, and it generates too much uncertainty in all transactions. Second, the rules should be designed to allow third parties to identify persons in the protected class in order that they may steer clear of contractual arrangements with them. It is one thing to prohibit exploitation of incompetents; it is quite another to say that people must deal with them, even to their own disadvantage. Third, the rules in question should not create artificial incentives for parties to lower the level of competence they bring into the marketplace. It is dangerous to allow people to plead their own incompetence in any transaction that they wish, with the benefit of hindsight, to repudiate.

These considerations suggest that the refusal to enforce contracts against infants is in general appropriate.[21] It is quite likely that most, though not all, infants will be unable to protect their own interests in negotiation, even in transactions not vitiated by fraud. Those who deal with infants will, moreover, usually be on notice of their special status and can take therefore steps to protect themselves. They can refuse to deal with the infant at all, or

tions 1445-1519 (2nd ed. 1961), 6 *id.* [supp. to vol. 3] 3556-3744 (1969) to get a sense of the complexity of the disclosure problem and the securities law. For a recent industry criticism of SEC disclosure requirements, see Concerns Say New SEC Disclosure Rules Would Sharply Boost Auditing Expenses, Wall Street Journal, March 18, 1975, at 36, col. 1.

[21] The arguments about insanity and drunkenness closely parallel those about infancy. One possible difference is that it may be more difficult for an outsider to know of the insanity (though not the drunkenness) of the person with whom he deals. If that point could be set to one side, as seems likely, then these situations could be governed by most of the same rules that apply to the contracts of infants.

they can demand that he be represented by a guardian of full age and capacity in any transaction. Finally, it is likely that most, but not all, infants will not be able to manipulate the legal rules to their conscious advantage.[22]

The recognition of the infancy defense in light of these considerations is not without its costs, as the rule in question will either block or increase the costs of certain transactions for infants who are quite capable of protecting themselves. In order to minimize the dislocations it is possible to recognize certain exceptions to the general rule consistent with its major purposes. Take for example a case of a merchant who has delivered necessaries to an infant who has consumed them. To refuse to enforce the contract will require the merchant to lose both his goods and the price for them, while leaving the infant enriched at his expense. To avoid this outcome, courts properly have allowed the merchant an action for the reasonable value of the goods consumed, a figure that may well be lower than the contract price.[23] The rejection of the contract price represents a degree of judicial intervention that prevents *both* exploitation by the merchant and the unjust enrichment by the infant, and as such is preferable to a simple refusal to give any action to the merchant. Take another instance: suppose the infant represents to the merchant that he is of full age in circumstances where that is believable. If goods have been delivered and consumed, it is again proper to protect the merchant by allowing him to recover the reasonable value of his goods, or, given the infant's fraud, even the benefit of his bargain.[24]

III. Unconscionability Applied

The merits of these exceptions to the general rule in favor of contractual enforcement is one question; their proof in particular cases is quite another. The courts could place upon the defendant a burden of proving fraud, duress or incompetence, say by the preponderance of the evidence. That approach would tend to insure that each of these defenses will be established only where the facts of the case so warrant. There is, however, a cost created

[22] In dealing with these factors, it is important to choose the right age for the infancy defense to apply. Traditionally, that age has been twenty-one. However, many teenagers leave the direct control of their parents at eighteen, either to go to college or to join the work force; and there is little reason to suppose any major increase in competence between ages eighteen and twenty-one. Eighteen has therefore in recent years been adopted in many jurisdictions as the age of majority, a sound result.

[23] Where the goods have not been consumed but only delivered, the better view is that the infant must restore them in order to escape from the consequences of the contract, it being unjust to allow him to keep both the goods and the price thereof. 2 Williston on Contracts § 238 (Jaeger ed., 3rd ed. 1959).

[24] Generally, an action is denied under these circumstances because it is impossible to restore the very goods sold and delivered. Indeed if the goods have been resold, the action for restitution is not allowed to reach the proceeds of sale. See G. C. Cheshire, C.H.S. Fifoot & M. P. Furmston, The Law of Contract (8th ed. 1972).

by putting this burden upon the defendant. Solely because he cannot meet the appropriate standard of proof, he may not be able to establish a contractual defense in a case where it in fact applies. If this last form of error results in substantial costs, then it should be appropriate to modify the rules of evidence in a manner that makes it easier for the defendant to establish fraud, duress or incompetence. It may well be that the relaxation of the standard of proof required to make out any defense will increase the number of instances where the undeserving defendant is able to defeat the plaintiff's legitimate contractual expectations. But if the costs thereby created are low, then the change in the rules of proof is justified on the grounds that it reduces the total error in enforcement, even though all error is not thereby eliminated.

The legal system has long used this rationale to justify some restrictions on the freedom of contract. The Statute of Frauds,[25] which requires that certain kinds of agreements be put in writing, has the prevention of fraud as one of its chief objects. Yet its application necessarily insures the nonenforcement of certain untainted oral transactions. The parol evidence rule, which prohibits the use of oral evidence to vary or contradict the provisions of an "integrated" written contract, is also designed to control fraud;[26] and it, too, frustrates the enforcement of legitimate consensual arrangements. One can attack either of these two rules on the ground that the control of fraud comes at too high a price (measured by the number of proper transactions nullified), given the alternative means of its control and prevention.[27] But neither rule can be attacked on the ground that it is directed toward an illegitimate end.

The doctrine of unconscionability, properly conceived and applied, serves the same general end as the Statute of Frauds and the parol evidence rule. Ideally, the unconscionability doctrine protects against fraud, duress and incompetence, without demanding specific proof of any of them.[28] Instead of looking to a writing requirement to control against these abuses, it looks both

[25] An Act for Prevention of Frauds and Perjuries, 29 Car. 2, c.3 (1677).

[26] For one version of its modern statutory expression, see U.C.C. § 2-202.

[27] Corbin has made the most powerful attacks against both these rules on precisely these grounds. "[The Statute of Frauds and the parol evidence rule] appear to have a similar purpose, at least when we regard the latter rule as in truth a rule of admissibility. That purpose is the prevention of successful fraud and perjury. Under both statute and rule, this purpose is only haltingly attained; and if attained at all, it is at the expense and to the injury of many honest contractors." Arthur L. Corbin, The Parole Evidence Rule, 53 Yale L.J. 603, 609 (1944).

[28] There is one other relevant point. The doctrine of unconscionability can be applied as well in cases in which there has been, as a matter of fact, no consent by a party to certain terms contained in standard form agreements. See, for thorough discussions, John E. Murray, Jr., *supra* note 4, at 16-18; W. David Slawson, Mass Contracts: Lawful Fraud in California, 48 So. Calif. L. Rev. 1, 11-14 (1974). Note, however, even where the terms of the written document are not an accurate expression of the agreement between the parties, it is not clear what terms should replace them, especially in more complex commercial arrangements.

to the subject matter of the agreements and to the social positions of the persons who enter into them.[29] The difficult question with unconscionability is not whether it works towards a legitimate end, but whether its application comes at too great a price.

The traditional case of undue influence, though not always so classified, falls under the general rubric of unconscionability.[30] It involves cases in which one person brings to bear psychological pressure of considerable force and duration against the will of another individual who, while of full legal capacity, may be irresolute, feeble or weak. Any agreement between the party who exerts the influence and the party who yields to it is not likely to work in the interests of both; it is much more likely to be the doing of the stronger party even if the formal expression of both. While the weakness of the party under the influence might not be easy for a stranger to detect, it is doubtless known to the party who takes advantage of it. In general the judicial position that allows agreements to be set aside if procured by undue influence seems unexceptionable, even though some cases will, no doubt, fall close to the line. Those who wish to deal with persons who might be subject to such influence are well advised to be sure that independent advice is provided them in order to forestall any possible abuse. And once that is done, whatever agreement is reached can then be enforced under the general rules of contract law.

Another similar case, no longer much litigated, involves the sale of an interest in a trust fund or in real estate.[31] The seller is a young person, but of full age, perhaps encumbered by debts. The buyer is a mature person, experienced in such transactions. The sales price is a fraction of the "real" market value of the property. The argument in favor of setting aside such transactions is not without its merit. The transaction in question could be seen as one in which the buyer takes advantage of the incompetence of the seller, perhaps even by resorting to fraud. In the alternative, we could view it, less ominously, as one where the seller took advantage of the best offer available in a thin market. The "situation sense" of most courts has been that this last construction is in general not the proper one, and on that view the case is ripe for intervention. Here the unconscionability doctrine can (at the cost of upsetting some useful transactions, or otherwise increasing their costs) act as a useful protective rule. Indeed, its greatest importance is not to set aside agreements already formed, but to insure that future transactions

[29] Rules governing incompetence, for example, can be regarded as a special case of those governing unconscionability, particularly since they are a suitable means of preventing fraud and duress. They represent an effort to minimize the errors in the administration of the law of contracts, with as much precision as the judicial process admits.

[30] See Dawson 262. The doctrine applies as well to gifts and bequests, and fits well with Dawson's theory about freedom of the will, as well as with the narrower theory developed here.

[31] See Dawson 267 for a more complete exposition.

will be conducted in a manner that avoids the question of unconscionability entirely. Once the buyer knows of the applicable rules, he can take (as in cases of undue influence) appropriate steps to limit their effect. He can insist that the seller be represented by independent counsel, or that the subject matter of sale be appraised. With these steps thus taken, the courts should then enforce the transactions in accordance with the general principles of contract law, without any resort to unconscionability doctrines, and without any independent examination of the "fairness" of the agreement's substantive terms.[32]

One of the strengths of the unconscionability doctrine is its flexibility, an attribute much needed because it is difficult to identify in advance all of the kinds of situations to which it might in principle apply. One recent case, for example, that appears to warrant the application of unconscionability rules, involves recently returned prisoners of the Vietnam war. After receipt of accumulated back pay, these men were approached by experienced salesmen who proceeded to sell them unattractive municipal bonds. These transactions should as a class be set aside at the option of the buyers. We have here a narrow class of purchasers, vulnerable by reason of their long captivity, given sudden control over substantial funds. Opposite them are salesmen who know how to exploit them. Proof of fraud is apt to be difficult in this case, even if the fraud itself is likely. Setting aside the transaction gives the shrewd buyer a chance to repudiate an arm's length deal he does not like, but it is highly unlikely that many buyers took conscious advantage of this legal benefit. It is also possible that some proper transactions will be set aside, but again those costs are apt to be small, measured against the gains derived. But the limits of the principle must be noted. The case should go the other way if, for example, these men on their own initiative went to a brokerage house to purchase these same bonds.

The limitations on the use of conscionability doctrines are as important as their application. Should, for example, the doctrine be used to protect those who are poor, unemployed, on welfare, or members of disadvantaged racial or ethnic groups? The perils of this course are great. First, it is difficult, if not impossible, to assert that the persons who fall into any or all of these classes are not in general competent to fend for themselves in most market situations. They are not infants, impressionable heirs, or gullible prisoners of

[32] There remains the question of whether courts should look to the ratio of value to price in cases when these procedural safeguards are not observed. In cases in which one deals with specialists in the purchase of such interests, the better answer is probably no, as it seems undesirable to give possible "outs" from the established procedure to those who know of its existence. When, however, the buyer is not experienced in dealings with these interests (as with a brother who buys his sister's land in order to help her out of financial difficulties; see, for example, Jackson v. Seymour, 193 Va. 735, 71 S.E. 2d 181 (1952)), the balance of convenience most likely lies in the other direction.

war. Second, the subject matter of the transactions is for the most part standard consumer goods that are sold in generally competitive markets, and not interests in trust funds or real estate difficult to value even under the best of circumstances. The costs of setting these transactions aside, moreover, are apt to be quite great, for it will be more expensive for members of the "protected" class to contract on their own behalf within a complex web of legal rules. In addition, there will no doubt be both opportunity and incentive for many to take advantage of the rights conferred upon them by law to manipulate the system to their own advantage. The absence of protective rules will have costs, measured by the tainted transactions given full legal effect, but these costs, all things considered, are apt to be lower than those incurred by demanding proof of fraud to set the transactions aside.

In consumer transactions, therefore, it will be necessary to take great care in specifying the circumstances where protective rules should be adopted in order to prevent fraud or duress. One possible case that might warrant the use of such protective rules involves door-to-door salesmen, who often rely on both high pressure tactics and outright fraud to complete a sale.[33] Yet I suspect that the unconscionability doctrine functions at best as a very blunt instrument in cases of this sort, and that it is better to adopt some legislative solution to control the problem.[34] Here for example it is possible to specify a short "cooling off" period in which the buyer is allowed as a matter of positive law to disaffirm the contract of sale at his own option without a showing of fraud or duress. In this context, moreover, it might even be desirable, given the costs of such a rule upon honest merchants, for the legislature to adopt one rule for encyclopedias and quite another for beauty products, particularly if different levels of abuse are involved in the two cases. We are not faced with an elegant question of legal theory or with a moral question of great urgency. The only issue is what combination of common law doctrine and legislative enactment will work to miminize the abuses in consumer transactions.

IV. Substantive Unconscionability

In this last section we shall deal with the doctrine of unconscionability in a way that first puts to one side all the considerations about fraud, duress, and incompetence. Instead, our attention shifts to the cases in which courts will strike down either whole contracts or, more frequently, particular clauses on

[33] See, for example, Frostifresh Corp. v. Reynoso, 52 Misc. 2d 26, 274 N.Y.S. 2d 757 (Dist. Ct. 1966), *rev'd for reassessment of damages,* 54 Misc. 2d 119, 281 N.Y.S. 2d 964 (Sup. Ct. 1967), though even there a case for fraud could be made out.

[34] There is good reason to believe that well-drafted legislation is the appropriate means to control, for example, the abuses of door-to-door selling, for there is too much fact variation between cases for a clear rule to develop by common law adjudication. See Leff, Unconscionability and the Crowd, *supra* note 5, at 353-58.

the ground that they are, as a *substantive* matter only, unfair and unconscionable. It is difficult in the abstract to insist that no contract language invites invalidation for these reasons.[35] But the crucial point is that most clauses that do *in fact* appear in agreements cannot be fairly challenged on those grounds. It is difficult to know what principles identify the "just term," and for the same reasons that make it so difficult to determine the "just price." And the problem with substantive unconscionability is further increased because the clauses so attacked are, at the time of formation, arguably in the interests of both parties to the agreement. I cannot within the compass of this paper examine most, let alone all, of the clauses that have been attacked on substantive grounds over the years. But the examination of a few typical clauses, drawn from both consumer and commercial transactions, can illustrate the pattern of argument appropriate to cases of this sort.

a. *"Add-On" Clauses*

One sort of clause that has come under both judicial and statutory scrutiny is the so-called "add-on" clause used in consumer credit sales. These clauses govern the security interest taken back by the seller, and, in one common form, provide that all previous goods purchased by the buyer from the seller will secure the debts incurred with the current purchase. The security agreement also provides that each payment made with respect to any of the items purchased would be applied against all outstanding balances, allowing the seller in effect to retain his security interest in all the goods sold until the debts with respect to all items are discharged. A single default on a single payment could trigger the plaintiff's right to repossess all the goods subject to the comprehensive security arrangement.[36]

[35] In this context I think it is dangerous to begin the analysis of unconscionability by talking about *hypothetical* clauses that have never appeared in any commercial agreement, particularly if the hypothetical case is then used as an argument in support of real control. As an instance of such clause: "The parties hereby agree that during the first year of operation of this automobile, should the automobile be operated on any Tuesday afternoon by a party wearing a red necktie, all rights in the automobile will be forfeited by the owner and ownership of the auto will revert to the seller." John E. Murray, Jr., Murray on Contracts 746 (1974). It is difficult to see how the clause so invented could ever be used; one would not expect, for example, to find it in jurisdictions that make no use of the unconscionability principle. On the dangers of arguing from imagined cases to real problems, see, R. H. Coase, *supra* note 18.

[36] One such clause, central to the important case of Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965), provided that "the amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills or accounts; and all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts due the Company by [purchaser] at the time each such payment is made." These add-on clauses are subject to many different forms, some of which do not extend the time for which the seller has a security interest in the earliest goods sold. See, John A. Spanogle, *supra* note 5, at 961, n.151. If, however, the

Although agreements of this kind can, and have, been attacked on unconscionability grounds, they make good sense in the cases to which they apply. One of the major risks to the seller of personal property is that the goods sold will lose value, be it through use or abuse, more rapidly than the purchase price is paid off. The buyer can, and quite often does, have a "negative" equity in the goods. The seller, therefore, who takes back a security interest only in the goods sold, runs the real risk that repossession of the single item sold will still leave him with a loss on the transaction as a whole, taking into account the costs of interest and collection. One way to handle this problem is to require the purchaser of the goods to make a larger cash down payment, but that, of course, is something which many buyers, particularly those of limited means, do not want to do. Another alternative is for the buyer to provide the seller with additional collateral; yet here the best collateral is doubtless in goods sold by the seller to the buyer. Other goods already in the possession of the buyer may be of uncertain value, and they may well be subject to prior liens. Again, they may be of a sort that the seller cannot conveniently resell in the ordinary course of his business. Even if the goods are suitable collateral for the loan, it could take a good deal of time and effort for the seller to determine that fact. The "add-on " clause allows both parties to benefit from the reduction in costs in the setting up of a security arrangement.

The case for the add-on clauses is strengthened, moreover, when we note its legal effects. As between the buyer and seller the clause allows the seller to collect on his unpaid debt without having to avail himself of the awkward procedures established for unsecured creditors. The clause assures the seller that the value he has furnished the buyer will, if need be, first be used to satisfy his own claims and not those of third parties. The only disadvantage to the buyer therefore is that he will not be able to use the goods purchased to obtain some economic benefit in a subsequent transaction. But it is difficult in a commercial context to see why a seller should not be paid before his buyer or third parties are able to use the goods he furnished for their own satisfaction.

The sense of these clauses, regardless of the particular form which they take, is demonstrated anew, moreover, once we realize that they operate

add-on clause used in Williams v. Walker-Thomas makes good economic sense, then these other variations will make good sense as well. In general, add-on clauses have not received a warm welcome in the academic literature. "Such [that is, add-on] clauses are forbidden in any respectable retail installment sales laws and should be held unconscionable in any contract for the purchase of consumer goods not expected to produce money income for the consumer." Robert Braucher, *supra* note 5, at 343. No reason is given why goods that are purchased for pleasure should be treated differently from those purchased for the production of income; as consumption is but a form of imputed income, it is difficult to see what justification could be offered.

within one very strong constraint, often imposed by statute,[37] which restricts the creditor in a secured transaction to the recovery of principal, interest and costs in cases of default by the buyer. Within the framework of these limitations, the add-on clause can do no harm at all, for it only makes it more certain that the seller will be able to collect that to which on any view he is entitled.

b. *"Waiver-of-Defense" Clauses*

Unconscionability arguments have been used to attack other clauses that govern the financing of consumer sales. Thus in many cases where the goods are purchased on an installment contract, the seller's rights under the contract are then sold, usually at a discount, to a finance company, which is then entitled to collect the payments as they come due from the buyer. In order to insulate itself from the disputes between the buyer and the seller of the goods, the company often insists that the original contract of sale include a term for its benefit which requires the buyer to continue to pay his installments to it even if the seller has not made good, for example, his warranty obligations.[38]

In spite of the enthusiasm for consumer protection, it is unwise to strike these clauses down as unconscionable. Suppose the seller sold goods under warranty for cash. The buyer then could only get the seller to honor the warranty by request or, that failing, by legal action; the withholding of payment is no longer a possible alternative. I take it, however, that no one would argue that this arrangement is unconscionable, even though it leaves the buyer at risk on the warranty. Why then should the position be different if he is at risk because he has waived his defenses against the finance company?

[37] See, U.C.C. § 9-501—507, for the applicable statutory provisions in the case of the sale of goods. Note, even these provisions, to the extent they cannot be varied by agreement (§ 9-501(3)), may be unwise in that they increase the administrative costs of repossession even though the goods are likely to be worth little or nothing in excess of the lien.

[38] One such clause reads as follows: "Buyer hereby acknowledges notice that this contract may be assigned and that assignees will rely upon the agreements contained in this paragraph, and agrees that the liability of the Buyer to any assignee shall be immediate and absolute and not affected by any default whatsoever of the Seller signing this contract; and in order to induce assignees to purchase this contract, the Buyer further agrees not to set up any claim against such Seller as a defense, counterclaim or offset to any action by any assignee for the unpaid balance of the purchase price or for possession of the property." Unico v. Owen, 50 N.J. 101, 106, 232 A.2d 405, 408 (1967). The court held the clause unconscionable, basing its decision on both the U.C.C. (§ 2-302; § 9-206) and the common law. These clauses are in part a response to the common law trend that makes it difficult, if not impossible, for third party transferees to be treated as "holders in due course" (U.C.C. § 3-302, *et seq.*). Holders in due course normally take free of "personal defenses," such as breach of warranty, that are effective as between the immediate parties to the contract. For an early case that rejected the plaintiff's holder in due course contention, see Commercial Credit Corp. v. Orange County Machine Works, 34 Cal.2d 766, 214 P.2d 819 (1950), where the plaintiff among other things supplied the finance forms to the seller.

The same point can be made if we consider another alternative method of financing the purchase of consumer goods. Suppose the seller says to the buyer of his goods, "If you wish to buy them on time, you must take out a bank loan for credit." Under that arrangement, the buyer remains unconditionally liable on his note to the bank even if his seller is in breach of his warranty obligation. If that arrangement is not unconscionable, why should it be unconscionable for the buyer to have no remedy against the lender because he happens to be chosen by the seller instead of the buyer?

There are also strong economic reasons that indicate that it is no one's interest, ex ante, to prohibit finance companies from disassociating themselves from the disputes between buyer and seller. The main advantage of seller financing over buyer financing is that it allows the parties to reduce the transaction costs of putting the credit arrangement together when security interests are necessary. Yet if that arrangement is incumbered by involving the finance company in disputes in which it wants no part, then there will be a shift to less desirable modes of financing. If it is argued that the finance companies should be held liable because they are better able to supervise the general activities of sellers, the quick answer is that if that is the case, then they will agree to do so as a matter of course for a fee. The fact that they do not is a strong suggestion that they have neither time nor skill to get involved in the narrow disputes which are apt to arise in consumer cases. What knowledge does the finance company have on the question of whether the buyer tampered with goods or used them in accordance with instructions? If buyers want protection against having to pay the price where there is a defect in the goods in question, then they should deal with sellers who carry their own contracts.[39] Whether that arrangement is preferable as an economic matter to one that contemplates third party financing is *not* the question that should be asked by the legal system. So long as both have their uses, as is likely the case, there is no principled justification for the judicial or legislative prohibition of either of them.

c. *Exclusion of Liability for Consequential Damage*

A close examination of still other clauses that have been incorporated into standard form contracts reveals that they too should be able to escape from the taint of unconscionability. In *Collins v. Uniroyal Inc.*,[40] a case of quite recent vintage, the defendant tire company sold a tire under a contract of sale which contained the following guarantee.

[39] Here one can even take the argument one step farther. If all parties who carry their own contracts refuse to allow breach of warranty to be a complete defense against the payment of installment obligations, there will be a good reason for them so doing: to wit, that most of the claims are manufactured as excuses for non-payment.

[40] 64 N.J. 260, 315 A.2d 16 (1974).

> ROAD HAZARD—In addition, every such U.S. Royal Master tire, when used in normal passenger car service, is guaranteed during the life of the original tread against blowouts, cuts, bruises, and similar injury rendering the tire unserviceable. Tires which are punctured or abused, by being run flat, improperly aligned, balanced, or inflated, cut by chains or obstructions on vehicle, damaged by fire, collision or vandalism, or by other means, and "seconds" are not subject to the road hazard provision of this Guarantee.[41]

> *This Guarantee does not cover consequential damage, and the liability of the manufacturer is limited to repairing or replacing the tire in accordance with the stipulations contained in this Guarantee. No other guarantee or warranty, express or implied, is made.*[42]

The purchaser of the tire was killed when the car he was driving went out of control after the tire blew out. The weight of the evidence established that no defect whatsoever in the tire caused the accident, ruling out recovery on any tort theory of products liability. The New Jersey Supreme Court held, however, that the limitation in the warranty against the recovery of consequential damages was unconscionable under the Uniform Commercial Code, and that the defendant accordingly was liable on a contract theory for the death of the decedent.[43]

The Court's argument in support of that conclusion is, I believe, erroneous.[44] Under the New Jersey law, the defendant was required by statute to sell the tire with only a warranty of merchantability, under which its liability is triggered only if the tire is defective. The defendant here gave the buyer an extra measure of protection under its supplemental warranty, without which the plaintiff concededly could have recovered nothing. What is achieved by holding the defendant liable because it gave the plaintiff protection not required by statute when the effect of the decision may well be to *reduce* the protection that sellers will give their purchasers? Is it in the general interest of consumers that Uniroyal *not* include warranties of the sort provided in this case?[45]

[41] *Id.* at 264, 315 A.2d at 19.

[42] *Id.* at 265, 315 A.2d at 19.

[43] "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not." U.C.C. § 2-719(3). Note that there is no explanation given of the force of the words "prima facie" or what facts might be sufficient to override them. Note too the language of § 2-719 leaves the court that applies it with ample discretion in the particular case.

[44] See, in this connection, the strong dissent of Clifford, J., 64 N.J. at 263, 315 A.2d at 18.

[45] This kind of exclusion is not only found in consumer cases. Exclusions of consequential damages in commercial cases in which there is no question of unconscionability are commonplace. See, for example, Roto-Lith, Ltd. v. F. P. Bartlett & Co., 297 F.2d 497 (1st Cir.

Thus far we have assumed that there is justification for a rule that treats all limitations against recovery for consequential damages for personal injury as prima facie unconscionable.[46] Yet even that restriction itself is not beyond criticism. In typical actions for breach of the warranty of merchantability, the plaintiff must show something beyond his own injury in the use of the goods in order to recover consequential damages. Indeed the very restrictions about proper use and maintenance incorporated into the warranty in *Collins* apply with equal force to the straightforward warranty of merchantability. It might well be wise for a seller to tell his buyers that it is too difficult for him to determine whether a particular injury is attributable to his own manufacture, to the plaintiff's conduct, or to some external cause. The best solution might be to offer the tire at a lower price, leaving the buyer, if he chooses, to purchase insurance elsewhere against this particular risk. In this manner, market mechanisms could work to bring about the best distribution of risks between the parties, superior to that ordained by statute.

d. *"Due-on-Sale" Clauses*

There still are other sorts of clauses that appear in both consumer and commercial transactions. One of these, the "due-on-sale" clause allows a lender to call in the outstanding balance on the loan when the mortgagor either sells his interest in the property or further encumbers it with a second mortgage.[47]

The "due-on-sale" clause has been enforced in order to protect the lender against the deterioration of the underlying property or against the "moral risk" of foreclosure. Its use, however, is quite controversial where there is no threat to the lender's security interest. Suppose, for example, the borrower has a seven per cent mortgage with twenty years left to run. He now wishes to sell his equity, at a time when the interest rate for new loans is ten per

1962) (warranty that excluded the buyer's right to consequential damages if seller's emulsions did not work as described; replacement of emulsion at seller's expense was, however, required); Construction Aggregates Corp. v. Hewitt-Robins, Inc., 404 F2d 505 (7th Cir. 1968) (seller provided buyer with a conveyor system to be used in large engineering works; warranty excluded responsibility for consequential damages).

[46] Note the case could not be decided on process-unconscionability grounds. The exclusion clause was in italics, and the circumstances of sale presumably above suspicion. The Court sought to make something of the defendant's advertisements. "If it only saves your life once, it's a bargain." [64 N.J. 263, 315 A.2d 18] Here, there was, moreover, no proof that the plaintiff purchased on the faith of that advertisement. Even, however, if he did, it could be read to say that the risk of blowouts is quite small, *not* that the defendant took that risk, given the express and conspicuous limitation in the document.

[47] On due-on-sale clauses, see generally, Note, Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Reasonableness and Unconscionability, 27 Stan. L. Rev. 1109 (1975); and the literature cited, *id.* at 1110, n.4.

cent. In this context, the due-on-sale clause has been challenged as a unreasonable restraint on alienation.[48] The concern is, however, quite misplaced, for it fails to distinguish between restraints on alienation that can be ousted by private agreement and those that cannot. In the latter case, the restraint may well have adverse social effects, by preventing the movement of real estate to its highest and best use. A restriction that may be undone, however, serves a quite different function. It only determines the distribution of the purchase price between the bank (as mortgagee) and the seller (as mortgagor). The clause shifts to the bank the advantage from the increase in interest rates which would otherwise belong to the seller. The truth of this proposition is borne out by an examination of a recent California case, *Tucker v. Lassen Savings & Loan Association*.[49] There the property in question was subject to a mortgage which contained the standard due-on-sale clause. The seller, who had arranged to resell his interest in the property on an installment sale contract, challenged the clause as an unreasonable restraint on alienation, at least where resale was by installment contract. The court unanimously, but mistakenly, upheld his contention. It noted that the due-on-sale clause is acceptable in the normal case because the seller gets from his buyer sufficient funds to pay off the mortgage. With an installment resale, however, it argued that the clause works an unreasonable restraint on alienation because the seller does not receive from the sale the funds to discharge the bank's mortgage. As the bank could not show that the sale impaired its security, its justification for the restraint was weak, and it followed that the restraint as applied was unreasonable.

The first point in the court's argument is that the clause functioned as a restraint on alienation. That view of the situation, however, was belied by the very facts of the case. Before the case had been decided, the three parties involved had provisionally renegotiated the terms of the sale. The buyer received the property as before, although he paid a higher rate of interest to the bank and a smaller sum to the seller. The clause had no effect upon the alienation of the property as such; and indeed the suit was brought by the seller in order to recapture that portion of the price that the clause deflected from him to the bank.

The clause, therefore, was designed to protect the bank against rising interest rates in the event of resale. That protection could have been achieved in other ways, without ever raising the question of unreasonable restraints on alienation. Suppose that the original loan was for two years; no

[48] The applicable section of the California Civil Code, § 711, provides: "Conditions restraining alienation when repugnant to the interest created are void." The "reasonableness" language is of judicial creation. The crucial case is Coast Bank v. Minderhout, 61 Cal.2d 311, 38 Cal. Rptr. 505, 392 P.2d 265 (1964).

[49] 12 Cal.3d 629, 116 Cal. Rptr. 633, 526 P.2d 1169 (1974).

doubt it could be renewed at a higher rate of interest. Or suppose the original loan was for twenty years at a variable rate of interest, but one which did not fall below a certain minimum. No matter: the borrower will be able to exact some benefit for insulating the lender from the downside risk, perhaps in the form of a lower basic interest figure, for the lender will not get something for nothing. If loans of this sort are proper, then due-on-sale clauses, which are but a different means to achieve that same end, must be proper as well.

The opinion of the Court is difficult to accept on a second point. For the restraint on alienation to be reasonable, it demands that the bank show that it has a "legitimate interest" in invoking the clause, where its own financial gain cannot count as that interest.[50] But why must there ever be justification to enforce a contract in accordance with its terms? Why is it inappropriate for a bank to improve its returns from its loans? Is that any more improper than borrowing at the most favorable rates of interest? The Court suggests that the lender's action amounts to an improper exaction of some collateral benefit from its borrower. That argument appeals implicitly to a tort model, as it treats the bank as though it used force to exact benefits from a stranger. But here the bank demands only the imposition provided for in the agreement, while borrower's imposition, for such it is, stands in defiance of the agreement. The burden should be on the borrower to show why the clause should not be enforced, not on the bank to show otherwise. As there is no impact on the alienability of property, one must look elsewhere for that justification, but none is forthcoming.

Its internal logic aside, the effects of the decision are apt to be unfortunate. First, as the case restricts the use of due-on-sale clauses, it is likely that banks will try to offset that loss in part by increasing the rates of interest that they will charge. It is difficult, however, to regard the mandated shift in contractual terms as a benefit to the parties; for if it were, then in a competitive market that solution would be adopted voluntarily. Second, the decision in *Tucker* should create an artificial (though not necessarily compelling) incentive to cast real estate sales in the installment mold, as that mold alone allows buyer and seller to divert to themselves cash that otherwise would go to the bank. A final effect of the *Tucker* rule is that it is likely to subject banks, particularly savings and loan associations, to great financial stress when interest rates rise. These institutions rely on short-term deposits to

[50] Note if the lender's legitimate interests are restricted to the protection of the security and the like, it will follow that clauses that demand repayment when the buyer makes a further *incumbrance* upon the property in general will be treated as improper restraints on alienation, as the original debtor still remains in possession of the property and liable on the note. Indeed, that was the position reached by the California court in La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 97 Cal. Rptr. 849, 489 P.2d 1113 (1971). The major exception to this is apt to be in the rare case where the second mortgage is part of a scheme for a disguised sale of the equity, where it is planned at the outset that the "mortgagee" will take possession by virtue of "foreclosure".

fund their long term commitments, particularly for home mortgages. The increase in rates can lead to a withdrawal of short-term deposits, requiring banks to go borrow at high short-term rates, as their long-term mortgages can not be called in. The due-on-sale clauses allow the banks to use the natural turnover in real estate to make themselves relatively short-term lenders, able to participate in the upturn in interest rates. In the long term, banks may be able to use variable interest loans or other devices to reduce the risks arising from sharp changes in the interest rates; but there is no guarantee that this sort of arrangement will meet with consumer acceptance.

e. *"Termination-at-will" Clauses*

Unconscionability arguments are not restricted to consumer contexts. To take but one instance of its application in commercial cases, consider a provision common to many franchise agreements that allows the franchisor to terminate the franchise at will, without, in other words, having to give any justification for his actions. The attack against such clauses is based upon the belief that they allow the franchisor to act as a tyrant, who can cut off his franchisee at whim, even before he has recouped his start-up costs in the venture.[51]

While these clauses are indeed open to this kind of abuse, there are reasons that make their adoption work in general in the interests of both parties to the agreement. The franchisor is concerned with, first, the profitability of the particular outlet and, second, with the impact that its operation will have upon his entire enterprise. If the franchise could be terminated only "with cause," his settlement costs on termination are apt to be high no matter what the circumstances, for the franchisee always could litigate the matter. If those costs deter the franchisor from termination, he loses the benefits of a substitute franchisee, while being forced to suffer from the continued erosion of his good will. All these costs are reduced, if not eliminated, if termination can be at will.

From the point of view of the franchisee, the clause need not work harm, and may do good. If the franchisee makes a good profit, it will not, in general, be in the economic interest of the franchisor to invoke the clause, as termination of the franchise will make him worse off. Indeed, the good

[51] See, for example, M. P. Ellinghaus, *supra* note 5, at 809, for a statement of the position. The argument against the clause based upon "public policy" was rejected, though uneasily, in Bushwick-Decatur Motors, Inc. v. Ford Motor Co., 116 F.2d 675 (2d Cir. 1940). The argument in favor of the franchisee received, at least in part, legislative sanction in the Automobile Dealer's Day in Court Act of 1956, 70 Stat. 1125, 15 U.S.C. § 1221-25 (1956), which provides, inter alia, that the termination of an automobile franchise must be made in "good faith." The "good faith" requirement is defined negatively, as the "duty of each party to any franchise . . . to act in a fair or equitable manner toward each other so as to guarantee . . . freedom from coercion, intimidation, or threats" thereof, § 1221(e). The position implicit in the negative portion of this good faith requirement echoes the arguments advanced in the body of the paper on the proper grounds for disregarding contractual arrangements. The affirmative requirement of "good faith" is in itself of uncertain effect.

franchisee may well want a termination-at-will clause to be included in *all* franchise agreements, because he may rightly perceive that the franchisor acts in his interest when he terminates a weak franchisee whose conduct erodes the goodwill of the entire enterprise, including his own. The real conflict, in other words, is not between franchisor and franchisee, but between franchisee and franchisee, as the franchisor acts in effect as the *de facto* agent of the superior franchisees. Where termination appears warranted, moreover, a franchisor has incentives to act in a manner which, no matter how informal, appears to be fair if he wishes to retain his other franchisees and attract new franchisees. When we look, therefore, at both the economic pressures and the contract terms, the termination-at-will clause may well be the best solution for both parties. The issue is not whether the clause will be required, but only whether it should be allowed. On that question, there is no need for judicial or legislative intervention so long as there are common circumstances in which the use of this clause is appropriate. Those who might wish to ban the use of the clause labor under a much greater burden than those who only want to permit its use, and that burden is not met by the invocation of unconscionability arguments.

Conclusion

In this paper I have sought to defend against modern attacks the principle of freedom of contract which was central to the classical common law. Properly understood, that position does not require a court to enforce every contract brought before it. It does, however, demand that the reasons invoked for not enforcing the contract be of one of two sorts. Either there must be proof of some defect in the process of contract formation (be it duress, fraud or undue influence); or there must be, but only within narrow limits, some incompetence of the party against whom the agreement is to be enforced. The doctrine of unconscionability is important in both these respects because it can, if wisely applied, allow the courts to police these two types of problems, and thereby improve the general administration of the contract law. Yet when the doctrine of unconscionability is used in its substantive dimension, be it in a commercial or consumer context, it serves only to undercut the private right of contract in a manner that is apt to do more social harm than good. The result of the analysis is the same even if we view the question of unconscionability from the lofty perspective of public policy. "[I]f there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice."[52]

[52] Printing and Numerical Registering Co. v. Sampson, L.R. 19 Eq. 462, 465 (1875).