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Unconscionability Revisited: A Comparative Approach

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UNCONSCIONABILITY REVISITED: A COMPARATIVE APPROACH

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Perhaps no two doctrines developed during the 19th century and the first half of the 20th century were seen as so inimical to the establishment of a basic fairness and equity in the marketplace as were the doctrines of *caveat emptor* and an absolute "freedom of contract." As commercial norms began to change, however, the genesis of the philosophy of consumerism began to emerge, recognizing the importance of a genuine bargain entered into by parties with a modicum of equal bargaining power.

In this changing environment, a new emphasis was placed on the evolution and application of the doctrine of unconscionability, a doctrine which had been developed as early as the mid-1750s to deal with essentially unequal contractual situations.

This article will consider the historical development of the doctrine of unconscionability from its common law origins through its incorporation into the Uniform Commercial Code (UCC or Code). The article will analyze the traditional factors considered by a court in determining whether or not a contract, or a clause of a contract, is unconscionable; discuss the elements of "procedural and substantive" unconscionability; and consider the application of the substantive law of unconscionability found in the UCC (section 2-302) to collateral, non-UCC cases.

In the analysis, this article will consider the development of federal common law in the area of unconscionability, which is important because of the number of cases filed in federal courts based upon "diversity" jurisdiction. The article will also analyze the decisions of selected federal courts of the First, Second, and Third Federal Judicial Circuits from both the early and late 1980s, decisions which are important in the further development and extension of the doctrine.

1. *Background and the Importance of the UCC to the Development of the Doctrine*

The UCC was the product of a Permanent Editorial Board under the joint authority of the American Law Institute and the

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National Conference of Commissioners on Uniform State Laws.[1] A draft of the proposed statute was first approved by these bodies in 1952, and in 1953 the UCC was enacted by the Commonwealth of Pennsylvania, the first state to do so.[2] The Code was originally published with "Official Comments" that were prepared by the Permanent Editorial Board. The *Comments*, while not law in the technical sense, have proved both valuable and critical in resolving difficulties, conflicts and problems. Reacting to recommendations of the New York Law Revision Commission (which had rejected adoption without significant changes), the Permanent Editorial Board made extensive revisions to the Code.[3] A revised edition, known as the *1958 Official Text with Comments*, was published in 1958, followed four years later by the *1962 Official Text*. Between 1957 and 1967, all states enacted the Code, with the exception of Louisiana, which opted instead for continuance of its own system of civil law based, to a great extent, on the Napoleonic Code.[4]

The UCC contains nine articles. Article 1 contains general provisions and definitional considerations applicable to all "transactions" governed by the Code. Article 2 broadly governs transactions in goods.[5] From the outset, however, Article 2 has been looked to by courts for guidance in areas other than the sale of or transactions in goods.[6] Article 3 deals with commercial paper; Article 4, bank deposits and collections; Article 5, letters of credit; Article 6, bulk transfers; Article 7, warehouse receipts, bills of lading and other documents of title; Article 8, investment securities; Article 9, secured transactions, security interests, sales of accounts, and chattel paper.

Section 1-102(2) outlines the purposes and policies of the Code:

> (a) to *simplify*, *clarify* and *modernize* the law governing commercial transactions;
>
> (b) to permit the continued *expansion* of commercial

1. *See* William A. Schander, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1 (1967); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 30 (1972).

2. WHITE & SUMMERS, *supra* note 1, at 3.

3. *Id.*

4. *Id.* at 5.

5. U.C.C. § 2-102. For a definition of goods, see § 2-105.

6. *See generally* Daniel E. Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 FORDHAM L. REVIEW 447 (1971); and Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning*, 65 COLUM. L. REV. 880 (1965) (early view of the future application of the Code to non-Code situations).

practices through custom, usage and agreement of the parties;
(c) to make *uniform* the law among the various jurisdictions.[7]

In connection with the development of substantive law in the area of unconscionability, Professors Calamari and Perillo have noted that "few, if any, sections of the Uniform Commercial Code have attracted more attention than its provision on unconscionability."[8] The Code writers clearly attempted to bring to the fore a new view of the essential relationship between parties to a commercial transaction by moving away from such concepts as absolute "freedom of contract" and *caveat emptor* to new responsibilities and duties for sellers. Sellers often have superior bargaining power that enables them to extract tough and difficult concessions from parties who have little or no economic power or business experience and who are vulnerable to a grossly unequal bargain.

2. *The Concept of Unconscionability*

"Unconscionable is a word that defies lawyer-like definition."[9] The concept of unconscionability has deep and distinct roots in the American legal system in both law and equity but, as Chief Justice Stone noted, primarily in equity. Stone stated that the concept of unconscionability underlies "practically the whole content of the law of equity."[10] An early and seminal definition of unconscionability was provided by Lord Chancellor Hardwicke in an English case from 1750, *Chesterfield v. Janssen*:[11]

> [A contract that] such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains.[12]

The system of equity has traditionally been concerned with the concept of unconscionability in the process of *formation* of contracts. Courts of equity frequently set aside or refused to

7. U.C.C. §§ 1-102(2)(a)-(c) (1991).
8. JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 317 (2d ed. 1977) (footnotes omitted).
9. *Id.* at 325.
10. Harlan F. Stone, *Book Review*, 12 COLUM. L. REV. 756, 756 (1912).
11. 28 Eng. Rep. 82 (1750).
12. Chesterfield v. Janssen, 25 Eng. Rep. 82, 100 (1750). In this case, Johnson Spencer, a distant ancestor of Winston Churchill, borrowed 5,000 pounds and promised to repay 20,000 pounds upon the death of his grandmother, who was then 70 years of age.

enforce agreements based on such doctrines as undue influence, misrepresentation, unilateral mistake, or other types of so-called "procedural unconscionability." It thus appeared that a court of equity would refuse to enforce a contract unless it "is fair and open, and in regard to which all material matters known to each have been communicated to the other."[13] However, courts of law generally refused to directly condemn a contract as being unconscionable, resorting instead to "imaginative flanking devices"[14] to set aside the underlying agreement under such theories as failure of consideration, lack of consideration, lack of mutual assent, duress, fraud, or a "strained interpretation after finding ambiguity where [in reality] no ambiguity existed."[15]

3. *Unconscionability and the UCC*

In *Wille v. Southwestern Bell Telephone Co.*,[16] Judge Harmon noted that "the doctrine [unconscionability] . . . received its greatest impetus when it was enacted as a part of the Uniform Commercial Code."[17] Section 2-302 of the UCC reads as follows:

> (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.[18]

It is interesting to note at this point that a precise *definition* of unconscionability cannot be found in the provision, and it is clear that the writers of the Code did not define the contours of the doctrine. The *Wille* court noted that at least one writer suggested that this apparent omission may have been the "real intent

13. Rothmiller v. Stein, 38 N.E. 718, 721 (N.Y. 1894).

14. CALAMARI & PERILLO, *supra* note 8, at 320. "These approaches, although producing justice in individual cases, were highly unreliable and unproductive." JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS 401 (3d ed. 1987).

15. CALAMARI & PERILLO, *supra* note 8, at 320. *See also* Tibbits Contracting Corp. v. O & E Contracting Co., 206 N.E.2d 340 (N.Y. 1965). *Substantive unconscionability* arises when the contract terms on their face oppress one party to the point that the "conscience is shocked" so that the "sum total of its provisions drives too hard of a bargain for a court of conscience to assist." Campbell Soup Co. v. Wentz, 172 F.2d 80, 84 (3d Cir. 1948). *Procedural unconscionability* arises "when certain factors, such as a lack of commercial sophistication, apparently prevent a contracting party from exercising his freedom to choose the terms of an agreement." Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1053 (1977).

16. 549 P.2d 903 (Kan. 1976).

17. Wille v. Southwestern Bell Tel. Co., 549 P.2d 903, 905-06 (Kan. 1976).

18. U.C.C. § 2-302(1) (1991).

of the drafters of the Code."[19] The court went on to say that "[t]o define the doctrine is to limit its application, and to limit its application is to defeat its purpose."[20]

The *Official Comments* are important in illuminating the legislative purposes of the unconscionability provision:

> This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass *directly* on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. . . . The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.[21]

The Code provision was designed to attain two purposes: (1) Encourage courts to openly and directly strike down provisions of agreements which had previously been denied enforcement through indirect or "covert" means (Professor Karl Llewellyn, principal author of the UCC, noted perhaps somewhat wryly: "Covert tools are never reliable tools.");[22] and (2) Achieve a substantial merger of equity and law in the interests of a uniform treatment of unconscionability.

4. *Implications of the Doctrine of Unconscionability*

Since the general acceptance of the UCC by American courts (accomplished during the 1960s), several interesting develop-

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19. *Wille*, 549 P.2d at 906.

20. *Id.* (citing Clinton A. Stuntebeck, Note, *The Doctrine of Unconscionability*, 19 MAINE L. REV. 81, 85 (1967)).

21. U.C.C. § 2-302, Official Comment (1991) (citation omitted) (emphasis added). *See also* Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948).

22. KARL N. LLEWELLYN, THE COMMON LAW TRADITION 365 (1960).

ments have occurred. First, the application of section 2-302 has extended beyond the specific area of the sale of or transactions in goods into the main body of contract law. Seminal decisions from the 1960s and 1970s applied the substantive law of unconscionability to cases involving service contracts,[23] home improvement contracts,[24] equipment leases (bailments),[25] real estate brokerage contracts,[26] space leases,[27] banking service contracts,[28] an apartment house lease,[29] a security transaction under Article 9 of the Code,[30] the lease of a service and repair gas station,[31] and the settlement of a will contest.[32] Cases decided in the early 1980s in federal courts (especially in the First, Second, and Third Circuits) further broadened and expanded the application of the doctrine.[33]

Second, although it was apparent that individual consumers were intended to be the principal beneficiaries of the doctrine of unconscionability (on the theory that experienced or sophisticated businessmen might be expected to be able to look out for their own interests to a greater extent than an unsophisticated consumer),[34] it has now become clear that the *small business entrepreneur* may likewise be the victim of "unfair surprise or hardship" and may seek the protection of the courts. However, in the *Wille* case discussed earlier, the court took special note of the business experience of the plaintiff, Mr. Wille, and denied recovery under the theory of unconscionability on the ground that Wille was an *experienced* businessman (with thirteen years in the field) *rather* than by focusing on the nature of the underlying agreement, pointing to the "heavy burden" placed on the small businessman.[35]

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23. *See* County Asphalt, Inc. v. Lewis Welding & Eng'g Corp., 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971).

24. *See* American Home Improvement, Inc. v. MacIver, 201 A.2d 886 (N.H. 1964).

25. *See* Fairfield Lease Corp. v. Pratt, 278 A.2d 154 (Conn. Cir. Ct. 1971).

26. *See* Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843 (N.J. 1967).

27. *See* Lazan v. Huntington Town House, Inc., 332 N.Y.S.2d 270 (N.Y. Dist. Ct. 1969), *aff'd*, 330 N.Y.S.2d 751 (N.Y. App. Term. 1972).

28. *See* David v. Manufacturers Hanover Trust Co., 298 N.Y.S.2d 847 (N.Y. App. Term. 1969).

29. *See* Seabrook v. Commuter Hous. Co., 338 N.Y.S.2d 67 (N.Y. Civ. Ct. 1972).

30. *See* Hernandez v. S.I.C. Fin. Co., 448 P.2d 474 (N.M. 1968).

31. *See* Weaver v. American Oil Co., 276 N.E.2d 144 (Ind. 1971).

32. *See* Abbott v. Abbott, 195 N.W.2d 204 (Neb. 1972). Calamari and Perillo note that the doctrine may have "[come] full circle to its equitable origins . . . ." CALAMARI & PERILLO, *supra* note 8, at 323 (citing *In re* Estate of Vought, 334 N.Y.S.2d 720 (N.Y. Sup. Ct. 1972)).

33. *See* text, *infra* Parts 6 & 7.

34. Mr. Wille, for example, was a businessman with thirteen years of practical business experience in the area of contracts. Wille v. Southwestern Bell Tel. Co., 549 P.2d 903, 904 (Kan. 1976). See *infra*, the text of Part 6.3 for the view of the Third Circuit in the application of the doctrine of unconscionability to "non-merchants."

35. *Wille*, 549 P.2d at 910-11.

Third, the text of the UCC makes it clear that the substantive issue of unconscionability is one to be decided by the court as a matter of law.[36] While challenged on the ground that such a provision denies a litigant an opportunity of a trial by jury, this section has been upheld on the basis that the issue of unconscionability is, at its core, an *equitable* issue for which no constitutional right to a trial by jury exists.[37]

Fourth, it must be noted that the Code provides a court with wide latitude in fashioning remedies. The text permits the court to select from any of the following alternatives: refuse to enforce the contract, excise or eliminate the offending clause that is found to be unconscionable, or limit the application of an unconscionable clause. It is noteworthy that an early draft of the Code specifically granted the court the right to reform (rewrite) the contract by, in essence, remaking the bargain for the parties[38]—a practice long-rejected by a court of law.[39] While this provision was deleted from the final draft, courts have, in the main, consistently redrawn bargains by reducing the price term,[40] increasing the duration of a business relationship arbitrarily terminated (by requiring "just cause" in the termination of a service station franchise),[41] or by reducing an interest rate provided for in a contract.[42]

Finally, in at least one jurisdiction (New Jersey), unconscionability has been held to constitute *actionable fraud* within the meaning of state consumer protection legislation, permitting the state attorney general to bring suit to enjoin the enforcement of a contract deemed unconscionable.[43]

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36. U.C.C. § 2-302(1) (1991).

37. *See, e.g.*, County Asphalt, Inc. v. Lewis Welding & Eng'g Corp., 444 F.2d 372, 379 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971). While it is essentially an issue of law on which the court must take evidence, the matter may not be decided as a matter of summary judgment, but only upon a hearing at which each party must be afforded a reasonable opportunity to present evidence bearing upon the issue of unconscionability. *Id.* In such a hearing, the party claiming unconscionability has the burden of establishing it. Butcher v. Garrett-Enumclaw Co., 581 P.2d 1352, 1358 (Wash. Ct. App. 1978).

38. *See, e.g.*, Note, *Section 2-302 of the Uniform Commercial Code: The Consequences of Unconscionability in Sales Contracts*, 63 YALE L.J. 560, 564 (1954).

39. *See, e.g.*, Frederick v. Professional Bldg. Maintenance Indus., Inc., 344 N.E.2d 299, 301 (Ind. Ct. App. 1976) (the court noted that it was reluctant to subject the parties to an agreement they had not entered).

40. *See, e.g.*, Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 266-68 (Sup. Ct. 1969). The "saga" of *Jones* continued in Star Credit Corp. v. Ingram, 347 N.Y.S.2d 651 (Civ. Ct. 1973), in which the Star Credit Corporation was assessed $15,000 in *punitive damages* for continued fraudulent and unconscionable conduct. *Ingram*, 347 N.Y.S.2d at 654.

41. *See, e.g.*, Shell Oil Co. v. Marinello, 294 A.2d 253 (N.J. Sup. Ct. Ch. Div. 1972), *modified*, 307 A.2d 598 (N.J. 1973) (holding that a franchise contract, as a valuable business asset, may not be cancelled without just cause). *Marinello* was seminal in developing basic rights upon termination for franchisees.

42. *See, e.g.*, *In re* Elkins-Dell Mfg. Co., 253 F. Supp. 864 (E.D. Pa. 1966).

43. Kugler v. Romain, 279 A.2d 640, 653 (N.J. 1971).

5. *Import of the Doctrine*

In analyzing the various factors which might lead a court to declare a contract unconscionable, four have been held to be especially critical: (1) absence of meaningful choice; (2) great inequality of bargaining power; (3) inclusion of terms which might result in surprise, hardship or oppression; (4) circumstances where race, language, literacy, ethnicity or education are significant factors in determining the nature of the bargain.[44]

Additional factors which might be relevant to a determination of unconscionability were outlined by the court in *Wille*:[45]

> (1) [t]he use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide standards offered on a take it or leave it basis to the party in a weaker economic position;
> (2) a significant cost-price disparity or an excessive price;
> (3) a denial of basic rights and remedies to a buyer of consumer goods;
> (4) the inclusion of penalty clauses;
> (5) the circumstances surrounding the execution of the contract, including its commercial setting, its purposes and actual effect;
> (6) the hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract;
> (7) phrasing clauses in language that is incomprehensible to a layman or that divert his attention from the problems raised by them or the rights given up through them;
> (8) an overall imbalance in the obligations and rights imposed by the bargain;
> (9) exploitation of the underprivileged, unsophisticated, uneducated and the illiterate; and
> (10) inequality of bargaining or economic power.[46]

In addition, the court in *Wille* noted that the doctrine of unconscionability is used by the courts to "police the excesses of certain parties who abuse their right to contract freely. It is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences *per se* of uneven bargain-

44. RICHARD J. HUNTER, THE LEGAL ENVIRONMENT OF BUSINESS 16 (1987).
45. 549 P.2d 903 (Kan. 1976).
46. Wille v. Southwestern Bell, 549 P.2d 903, 906-07 (Kan. 1976) (citation omitted).

ing power or even a simple old-fashioned bad bargain."[47]

Professor Williston, the principal author of the *Restatement of Contracts*, noted that parties in general should be permitted to contract on their own terms

> without the indulgence of paternalism by courts . . . [unless] it turns out that one side or the other is to be penalized by the enforcement of the terms of a contract so unconscionable that no decent, fair minded person would view the ensuing result without being possessed of a profound sense of injustice . . . .[48]

It is thus apparent that the two-fold purpose of section 2-302 (prevention of oppression and unfair surprise) had led to a distinction between *substantive* unconscionability (oppression) and *procedural* unconscionability (unfair surprise). However, Calamari and Perillo note that "the cases do not neatly fall into these two divisions."[49] In cases where a court has ruled an excessive price as unconscionable, it appears clear that the purchaser was *unaware* that the price was exorbitant or excessive.[50] As a result, these "significant cost-price disparity" cases may be viewed as examples of oppressive terms (substantive unconscionability) *coupled with* unfair surprise (procedural unconscionability).

For example, in *Kugler v. Romain*,[51] the court noted that "sales solicitations were consciously directed toward minority group consumers and consumers of limited economic means."[52] In such factual circumstances, the complaint of unconscionability may involve disclaimers of warranties, clauses which limit damages, or those clauses which might grant a significant procedural advantage (in the extreme, a confession of judgment clause).[53] In such cases, the one-sided nature of the bargain is often coupled with the fact that the unconscionable clause is hidden in small

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47. *Id.* at 907 (citation omitted).

48. *Id.* SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS at 51-52 (3d ed. Jaeger 1972) (quoting Carlsen v. Hamilton, 332 P.2d 989, 990-91 (Ut. 1958). *See also* M.P. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969).

49. CALAMARI & PERILLO, *supra* note 14, at 406 (3d ed. 1987). *See also* Jeffrey C. Fort, *Understanding Unconscionability: Defining the Problem*, 9 LOY. U. CHI. L.J. 765 (1978).

50. *See, e.g.*, Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 266 (Sup. Ct. 1969).

51. 279 A.2d 640 (N.J. 1971).

52. Kugler v. Romain, 279 A.2d 640, 643 (N.J. 1971). *See also* Frostifresh Corp. v. Reynoso, 274 N.Y.S.2d 757 (Dist. Ct. 1966), *rev'd in part*, 281 N.Y.S.2d 964 (App. Term. 1967), where a poor Spanish-speaking person was persuaded to promise $1,145 for a $348 appliance. It was noted that "[s]ales among these people [minorities] were thought to be easier." CALAMARI & PERILLO, *supra* note 14, at 406 n.86 (3d ed. 1987).

53. For a discussion of the application of the doctrine, see Cutler Corp. v. Latshaw, 97 A.2d 234 (Pa. 1953).

print and couched in language unintelligible to a person even of "moderate education"—to say nothing of a higher standard requiring that a seller inform a consumer in terms "the least educated can understand."[54]

In a case which presaged the view of the judiciary concerning the burden placed on a party that has succeeded in pressing an extremely hard bargain,[55] an Indiana court indicated that if a clause places great hardship or risk upon a party in a clearly inferior bargaining position, it must affirmatively be shown that "the provisions were explained to the other party and came to his knowledge and there was in fact a real and voluntary meeting of the minds and not merely an objective meeting."[56] It should also be noted, however, that a Missouri court held that unconscionability might even exist where the parties are on "about an equal footing."[57]

Finally, Professor Llewellyn (among others) argues that section 2-302 should not be viewed in an analytical vacuum; rather, it must be considered in conjunction with the obligation of "good faith" imposed by the Code for every contract.[58] The Code defines "good faith" as "honesty in fact in the conduct or transaction concerned"[59] and, in the case of a merchant, "good faith" means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[60]

Llewellyn further notes that while section 1-203 relates specifically to the performance or enforcement of a contract (or an incorporated term) rather than its formation, the "good faith" standard should be applied in determining the issue of unconscionability.[61] A series of important cases from the late 1950s and early 1960s attempted to refine the concept of unconscionability and, in doing so, the ruling courts have strongly focused upon the

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54. *See generally*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965); State v. ITM, Inc., 275 N.Y.S.2d 303 (Sup. Ct. 1966).

55. *See, e.g.*, Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948), where the court refused to award specific performance because Campbell Soup had driven an unconscionable bargain.

56. Weaver v. American Oil Co., 276 N.E.2d 144, 148 (Ind. 1971).

57. Miller v. Coffeen, 280 S.W.2d 100, 104 (Mo. 1955). For a very early view, see also Pope Mfg. Co. v. Gormully, 144 U.S. 224 (1892).

58. U.C.C. § 1-203 (1989). *See* LLEWELLYN, *supra* note 22, at 369.

59. U.C.C. § 1-201(19) (1989).

60. U.C.C. § 2-103(1)(b) (1989).

61. LLEWELLYN, *supra* note 22, at 369. This view of good faith as an "express limitation (of) Article 2" was justified in an important 1972 Delaware case, Sherrock v. Commercial Credit Corp., 290 A.2d 648, 651 (Del. 1972). *See also* Robert S. Summers, *"Good Faith" In General Contract Law and the Sales Provisions of the UCC*, 54 VA. L. REV. 195 (1968).

element of lack of good faith.[62] As noted in *Kugler v. Romain*, "[t]he standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and the observance of fair dealing."[63]

6. *Unconscionability and the Federal Courts—The First, Second and Third*

Judicial Circuits Respond in the Early 1980s

For comparative purposes, it is important to describe the views of three federal circuit courts of appeals on the issue of the collateral application of the unconscionability doctrine.[64]

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62. *See, e.g.*, Dow Corning Corp. v. Capitol Aviation, Inc., 411 F.2d 622 (7th Cir. 1969).

63. Kugler v. Romain, 279 A.2d 640, 652 (N.J. 1971).

64. In the early 1980s, only one case directly interpreted UCC § 2-302 in the Eighth Circuit, RJM Sales & Mktg., Inc. v. Banfi Prods. Corp., 546 F. Supp. 1368 (D. Minn. 1982). The case involved the contention that a termination clause in a contract between the plaintiff, a wholesale products broker, and the defendant, a wine company, was unconscionable. *Id.* The district court determined that a finding of unconscionability must be based upon a showing of both procedural and substantive unconscionability. *Id.* at 1375 (citing Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 139 n.12 (5th Cir.), *cert. denied*, 444 U.S. 938 (1979) (citing Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965))). In denying the claim of unconscionability, the court noted that neither aspect (procedural or substantive) was present and emphasized the business experience on the part of RJM and the availability of competitive options. *RJM Sales*, 546 F. Supp. at 1375. The court further noted that while the termination clause was "somewhat slanted in Banfi's favor, it is not so one-sided as to be unconscionable." *Id.* at 1396. In its conclusion, the court stated that in the absence of any showing of fraud or coercion, the two parties *as merchants* would be free to provide for reasonable allocations of risk in their commercial contracts. *Id.* It is also important to note that the district court exclusively relied on *federal precedent* in deciding the case and did not cite to any Minnesota statute or case in making its determination.

Later in the decade, several interesting cases were decided within the Eighth Circuit. In a case heard in the bankruptcy court, *In re* First United Partners 9, 71 B.R. 233 (Bankr. W.D. Mo. 1986), the Chief Judge held that a sales agreement was a contract of adhesion and, as such, was unconscionable. *Id.* at 236. The court noted that the debtor, having been brought to the precipice of "financial distress" through the actions of the defendant, was faced with the defendant's offer either to accept the proferred agreement of July 26, 1984, or suffer the consequences of a disaster, as the defendant refused to make any further payments. *Id.* at 236-37. The court stated that "[t]ruly, the agreement was shown to have been such as no man in his right mind would have accepted and thus squarely within the categories of contracts which are nullifiable as 'unconscionable' or 'contracts of adhesion.'" *Id.* at 237. It is interesting to note that the court cited no precedent or authority for its determination—possibly indicating the extent to which the notions of unconscionability and adhesion are entrenched into the fabric of the common law.

Also in 1986, the Eighth Circuit heard a case concerning the attempt by a computer equipment manufacturer to disclaim the warranties of fitness for a particular purpose (UCC § 2-315) and merchantability (UCC § 2-314) where the buyer claimed that such a disclaimer was unconscionable. Hunter v. Texas Instruments, Inc., 798 F.2d 299 (8th Cir. 1986). After dispensing with the contention that the disclaimer was not *conspicuous* (UCC § 2-316(2)), the court considered the claim that the limitation was unconscionable under the Code. *Id.* at 302-03.

In resolving this matter, the Eighth Circuit relied upon an Arkansas precedent, Kohlenberger, Inc. v. Tyson's Foods, Inc., 510 S.W.2d 555 (Ark. 1974), and noted that "[w]hether a contract is unconscionable must be determined in light of the general commercial background, commercial needs in the trade or particular case, the relative bargaining position of the parties, and other circumstances at the time the contract was made," traditional indicia of unconscionability. *Hunter*, 798 F.2d at 303. In distinguishing

James Johnson commented in 1985 on the reasons for focusing on federal unconscionability decisions:[65]

> (1) [I]nterstate commercial cases filed in federal courts often arise because of diversity jurisdiction. Generally, these cases will receive treatment under state unconscionability decisions, yet "federal case law suggests that the presumption is rebuttable"[66] and a federal court might instead choose to rely on a federal precedent;
>
> (2) unconscionability remains essentially an "equitable exercise" of each individual court;
>
> (3) certain matters of federal litigation, especially contracts entered into by the federal government, require the application of "federal common law."[67]

It is generally recognized that while a federal court "sitting in" a given state is required to apply that state's common law

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the case from *Williams v. Walker-Thomas Furniture Co.*, the court noted that "[w]e deal here with a college educated buyer, one with some background in commercial law, who shopped extensively for computer equipment to suit his needs." *Id.* The court stated that the plaintiff had neither proved the absence of meaningful choice nor unreasonably favorable terms, and noted that such a finding was the "gravamen of an unconscionability claim." *Id.* at 304 (citing Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965)).

In 1988, the District Court for the Eastern District of Missouri heard an interesting and novel case brought by a participant in an auto race who was injured when he was struck on the leg and foot by a sprint car. Haines v. St. Charles Speedway, Inc., 689 F. Supp. 964 (E.D. Mo. 1988), *aff'd*, 874 F.2d 572 (8th Cir. 1989). The district court held that a release signed by the plaintiff was not against public policy, had not been procured by pressure, and was binding even if the plaintiff did not have the ability to read and understand it. *Id.* at 967-69. In rejecting the plaintiff's contentions, the court noted that despite the fact that the plaintiff was a functional illiterate, unable to either read or understand the release, it was "his duty to procure someone to read or explain the release to him before signing it." *Id.* at 968. In this situation, where the exculpatory clause was found not to violate public policy (*see, e.g.*, Dunn v. Paducah Int'l Raceway, 599 F. Supp. 612 (W.D. Ky. 1984)), and in the absence of proof of fraud, duress, mistake, or accident, the agreement would "be given full force and effect." *Haines*, 689 F. Supp. at 968 (citing Grand Motors, Inc. v. Ford Motor Co., 564 F. Supp. 34, 38 (W.D. Mo. 1982)). The court tacitly recognized the requirement of finding both procedural and substantive wrongdoing before it would entertain a decision as to invalidity.

On appeal, the Eighth Circuit, deciding the release was not overbroad, affirmed the decision of the district court and noted that "we are 'to effectuate the reasonable expectations of the average member of the public who accepts it.'" Haines v. St. Charles Speedway, Inc., 874 F.2d 572, 575 (8th Cir. 1989) (quoting Estrin Constr. Co., Inc. v. Aetna Casualty and Sur. Co., 612 S.W.2d 413, 419 n.4 (Mo. Ct. App. 1981) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 237, cmt. e (tent. draft 1973)). Thus, while the word "unconscionable" was not specifically used, the court employed the first part of the *Williams* analysis in determining that the plaintiff was not entitled to relief from an unambiguous document which bore his signature. *Cf.* Wille v. Southwestern Bell Tel. Co., 549 P.2d 903 (Kan. 1976).

65. James Johnson, *Unconscionability & The Federal Chancellors: A Survey of U.C.C. Section 2-302 Interpretations in the Federal Circuits During the Early Eighties*, 5 SIMON GREENLEAF L. REV. 115 (1985).

66. *Id.* at 119.

67. *See, e.g.*, Transamerica Oil Corp. v. Lyons, Inc., 723 F.2d 758 (10th Cir. 1983).

precedents under the rule of *Erie Railroad v. Tompkins*,[68] it is also possible that a federal court might look instead to federal precedents that might be especially persuasive in the application of unconscionability principles to collateral, non-Code matters.[69]

6.1 *The First Circuit*

The First Federal Judicial Circuit applied the doctrine of unconscionability in a non-commercial case in denying a law professor's claim of wrongful discharge where the plaintiff characterized the contract as unconscionable because it required her to execute a waiver of any substantive rights in order to be considered for tenure.[70] In *Scheele v. Mobil Oil Co.*,[71] the court refused to limit section 2-302 to a narrow interpretation and instead applied the doctrine of unconscionability to all aspects of the franchise agreement (especially the termination clause) and not just the aspects of dealing (transactions) in goods.[72]

6.2 *The Second Circuit*

The Second Circuit has been a bit more schizophrenic in its decisions. It has taken a more restrained view and has been less than enthusiastic (and unusually deferential to the prerogatives of the legislative branch) in applying UCC standards of unconscionability to lease agreements,[73] largely on the ground that "there may be some question whether the standards applicable to sales should apply to leases in the absence of a statute."[74]

In *United States v. Bedford Associates*[75] the district court, on a second remand, emphasized the substance of the lease as unreasonably favoring the government so as to be "so one-sided as to render the alleged new lease unconscionable."[76] The court also found the existence of procedural unconscionability in the way the General Services Administration (GSA) had misled Bedford, noting specifically that "the Government [had] placed Bedford in an

68. 304 U.S. 64 (1938).

69. *See, e.g.*, Mason v. American Emery Wheel Works, 241 F.2d 906 (1st Cir. 1957).

70. Meehan v. New England Sch. of Law, 522 F. Supp. 484, 494 (D. Mass. 1981), *aff'd*, 705 F.2d 439 (1st Cir. 1983).

71. 510 F. Supp. 633 (D. Mass. 1981).

72. Scheele v. Mobil Oil Corp., 510 F. Supp. 633, 637 (D. Mass. 1981) (citing Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370 (Mass. 1980)).

73. *See, e.g.*, Curtis J. Berger, *Hard Leases Make Bad Law*, 74 COLUM. L. REV. 791 (1974). *See also* Johnson, *supra* note 65, at 125 n.34.

74. Berger, *supra* note 74, at 806-13.

75. 491 F. Supp. 851 (S.D.N.Y. 1980).

76. United States v. Bedford Assocs., 491 F. Supp. 851, 864 (S.D.N.Y. 1980), *rev'd*, 657 F.2d 1300 (2d Cir. 1981), *cert. denied*, 456 U.S. 914 (1982).

extremely precarious position financially and *deprived Bedford of any real choice* of action."[77]

However, in reversing the district court's decision, the Second Circuit Court of Appeals joined in expanding the standards of section 2-302 into non-commercial areas of the law which recognize the doctrine of unconscionability as a broad matter of common law application—but refused to do so in the case at bar.[78] In thus refusing this expansion, the Second Circuit emphasized the allocation of risks involved and the pricing provisions, as well as a point of good conscience (good faith) on the part of the government: "[W]e cannot say that the government overstepped proper boundaries in dealing with Bedford by threatening to exercise what it thought was a present legal right."[79]

Later, in the case of *Credit Alliance Corp. v. Joshco Mining Corp.*,[80] the District Court for the Southern District of New York considered the issue of unconscionability in connection with an action to recover amounts due on a promissory note.[81] The district court outlined four factors it would consider in determining whether the process of *formation* of a contract was so defective as to be branded unconscionable. Those factors were as follows:

> (1) Whether the material terms of the contract were misunderstood;
>
> (2) whether high-pressure sales tactics were employed;
>
> (3) whether surprise terms were hidden in the fine print;
>
> (4) whether gross disparity in relative bargaining power existed.[82]

The court held that procedural unconscionability will be recognized only in an "exceptional case," and denied that the defendant had in fact made such an exceptional showing in the instant case.[83]

In *BGW Associates, Inc. v. Valley Broadcasting Co.*,[84] the District Court for the Southern District of New York disallowed a contention of unconscionability in a dispute involving a consultation

77. *Bedford Assocs.*, 491 F. Supp. at 864-65 (emphasis added).

78. United States v. Bedford Assocs., 657 F.2d 1300, 1314 n.13 (2d Cir. 1981), *cert. denied*, 456 U.S. 914 (1982), *on remand*, 548 F. Supp. 732, 748 (S.D.N.Y. 1982) (emphasizing the "subjective" belief of the defendant).

79. *Bedford Assocs.*, 657 F.2d at 1314 n.13.

80. 90 F.R.D. 187 (S.D.N.Y. 1981).

81. Credit Alliance Corp. v. Joshco Mining Corp., 90 F.R.D. 187, 189 (S.D.N.Y. 1981).

82. *See id.* at 189.

83. *Id.*

84. 532 F. Supp. 1112 (S.D.N.Y. 1981), *upheld*, 532 F. Supp. 1115 (S.D.N.Y. 1982).

contract.[85] In doing so, however, the court relied upon *Williams v. Walker-Thomas Furniture Co.*[86] for its definition of unconscionability (encompassing both procedural *and* substantive unconscionability) as "an absence of meaningful choice on the part of one of the contracting parties, together with contract terms unreasonably favorable to the other party."[87] The court in *BGW Associates* implied that a showing of unconscionability requires both an absence of "meaningful choice," as where there is a "gross disparity [or inequality] of bargaining power,"[88] *and* contract terms that are "unreasonably favorable" to one party.[89]

Thus, the courts of the Second Circuit joined in a legitimate policy debate in inquiring if a court would require proof of *both* procedural and substantive unconscionability. While Justice Story argued that under the common law, both were required for a true "meeting of the minds,"[90] Johnson argues as forcefully that the "U.C.C. probably contemplates only a showing of either" and that "the presence of either arguably should suffice to prove unconscionableness even though a showing of a grossly unreasonable exchange is helpful."[91]

One thing seems fairly clear from the myriad of decisions of the important Second Circuit: unconscionability is indeed a rarity in cases *between merchants*, and the extension of section 2-302 to non-UCC cases was "treated cautiously" yet favorably in *Bedford*, even while ruling against the plaintiff on the underlying question. *Bedford*, however, stands as an important precedent for its core affirmation of the Second Circuit's understanding of and belief in unconscionability as potentially an important policy tool *generally* in the area of contract law.

6.3 *The Third Circuit*

The Third Federal Judicial Circuit decided a series of important cases in the early 1980s in the area of unconscionability. A New Jersey case, *Chatlos Systems, Inc. v. National Cash Register Corp.*,[92] concerned the sale of a computer system in which the seller resisted the buyer's claim for consequential damages on the

85. BGW Assocs., Inc. v. Valley Broadcasting Co., 532 F. Supp. 1112, 1114 (S.D.N.Y. 1981), *upheld*, 532 F. Supp. 1115 (S.D.N.Y. 1982).
86. 350 F.2d 445 (D.C. Cir. 1965).
87. *BGW*, 532 F. Supp. at 1114 (citations omitted).
88. *Id.* (noting that defendant had "ample opportunity to explore alternatives").
89. *Id.*
90. W. STORY, CONTRACTS 401-02 (1884).
91. Johnson, *supra* note 65, at 128 n.52.
92. 635 F.2d 1081 (3d Cir. 1980).

ground that an exclusive remedy existed in the contract.[93] The circuit court, in upholding the liability of the seller for breach of warranty, suggested *sua sponte* that the proper test in such a case was that of unconscionability, although this issue had not even been raised at the trial level.[94]

In a Pennsylvania case, *Camerlo v. Howard Johnson Co.*,[95] a suit was filed by a lessor seeking a declaratory judgment that a lease was void and unenforceable for several reasons, one of which was unconscionability.[96] In deciding the case based on unconscionability, the court again acknowledged two types of unconscionability, "substantive" and "procedural," while emphasizing the elements of gross disparity in price, "terms which violate the reasonable expectations of the parties," and procedural irregularities in the formation of the contract.[97]

Another district court in Pennsylvania examined three separate instances in which unconscionability had been raised as an issue in the context of dealings "between merchants": *Stanley A. Klopp, Inc. v. John Deere Co.*,[98] *Argo Welded Products, Inc. v. J.T. Ryerson Steel & Sons, Inc.*,[99] and *Melso v. Texaco, Inc.*[100]

In *Stanley A. Klopp*, the court concluded that the UCC was *generally* applicable to a franchise agreement, at least "by analogy."[101] However, the court did note that while unconscionability is especially applicable in cases involving consumers, the doctrine will "rarely" be recognized in cases between merchants.[102]

Argo Welded points to the heavy burden borne by a merchant who claims relief under a theory of unconscionability.[103] In dismissing the plaintiff's claim, the court noted the long history of prior dealings between the parties as clear evidence that would effectively refute a claim of "unfair surprise."[104]

Finally, in *Melso* the district court considered a *class action* suit filed by a group of independent Texaco retailers who strenu-

93. Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081, 1085-86 (3d Cir. 1980).
94. *Id.* at 1086-87.
95. 545 F. Supp. 395 (W.D. Pa. 1982).
96. Camerlo v. Howard Johnson Co., 545 F. Supp. 395, 398 (W.D. Pa. 1982).
97. *Id.*
98. 510 F. Supp. 807 (E.D. Pa. 1981), *aff'd mem.*, 676 F.2d 688 (3d Cir. 1982).
99. 528 F. Supp. 583 (E.D. Pa. 1981).
100. 532 F. Supp. 1282 (E.D. Pa. 1981), *aff'd mem.*, 696 F.2d 983 (3d Cir. 1982).
101. Stanley A. Klopp, Inc. v. John Deere Co., 510 F. Supp. 807, 810 (E.D. Pa. 1981), *aff'd mem.*, 676 F.2d 688 (3d Cir. 1982).
102. *Stanley A. Klopp*, Inc., 510 F. Supp. at 810.
103. *See* Argo Welded Prods., Inc. v. J. T. Ryerson Steel & Sons, Inc., 528 F. Supp. 583, 593 (E.D. Pa. 1981).
104. *Id.*

ously objected to the company's practice of assessing a three percent credit card invoice processing fee against the retailers.[105] One of the grounds cited by the retailers was that the standard form contract executed by each of them was unconscionable as a matter of Pennsylvania law.[106] In his decision, Justice Broderick once again noted that the Pennsylvania Supreme Court in *Witmer v. Exxon Corp.*[107] had adopted the "classic and oft-quoted" definition of unconscionability formulated by Judge Wright in *Walker-Thomas*.[108] The court then proceeded to dismiss the instant complaint, finding that the retailers were neither "unsophisticated, unreasonably charged, nor without reasonable alternatives."[109]

7. *Unconscionability in the 1990s—The Recent Past Provides a Glimpse of the Future*

Throughout the 1980s, the First, Second and Third Circuit Courts of Appeals continued to confront a variety of situations and cases in which the issue of unconscionability was raised. In light of the prevalence of cases decided by federal courts because of diversity actions, a sampling of representative cases from the mid and late 1990s may provide critical guidance to the future application of the doctrine of unconscionability in both federal and state courts.

7.1 *The First Circuit*

Securities Industry Ass'n v. Connolly[110] provides an interesting glimpse into a collateral application of the unconscionability doctrine into two areas of law which themselves will assume greater prominence in the 1990s: alternative dispute resolution and commercial arbitration.[111] The trade association of securities broker-dealers in Massachusetts brought an action challenging the constitutionality of state regulations concerning pre-dispute arbitration agreements on the ground that the Massachusetts regulations were *preempted* by the *Federal Arbitration Act*.[112] It was alleged that the regulations were patently designed to countermand a practice in which broker-dealers required customers to

105. Melso v. Texaco, Inc. 532 F. Supp. 1280, 1281-82, 1285 (E.D. Pa. 1981), *aff'd mem.*, 696 F.2d 983 (3d Cir. 1982).
106. *Melso*, 532 F. Supp. at 1295.
107. 434 A.2d 1222 (Pa. 1981).
108. *Melso*, 532 F. Supp. at 1295.
109. *Id.* at 1296-97.
110. 883 F.2d 1114 (1st Cir. 1989).
111. Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1119-21 (1st Cir. 1989).
112. *Id.* at 1116 (citing 9 U.S.C. §§ 1-14 (1982)).

sign pre-dispute arbitration agreements (PDAAs) as a condition precedent to the establishment of an account relationship.[113] The circuit court noted that the regulations were also "patently inhospitable to arbitration" in that they "(i) bar firms from requiring individuals to enter PDAAs as a nonnegotiable condition precedent to account relationships; (ii) order the prohibition brought 'conspicuously' to the attention of prospective customers; and (iii) demand full written disclosure of 'the legal effect of the pre-dispute arbitration contract or clause.' "[114]

In its analysis, the circuit court made reference to the case of *Perry v. Thomas*,[115] and noted that a core question in the case was *not whether* the law of unconscionability applied to arbitration, *but which* law of unconscionability applied[116]—a choice of law question which, in a diversity action, might require the application of either federal or state common law. Interestingly, the First Circuit specifically stated that "[t]he Court has not seen fit to question use of standard-form contracts in circumstances where parties having apparently unequal bargaining power have agreed to arbitrate."[117] This reaffirmed the notion that a combination of both procedural and substantive unconscionability would be required to attack the inclusion of such a clause in a broker-related contract.[118]

In a second case decided by the First Circuit in September of 1988, *Boston Edison Co. v. FERC*,[119] municipal utility companies under long-term electricity supply contracts challenged the inclusion of additional interest by Boston Edison arising from the construction of a nuclear power plant.[120] The terms of the contract limited interest expenses calculated in the rate to the interest on the original construction of the facility.[121] When FERC found for the customers, the utility appealed. The court applied what is

113. *Id.* at 1116-17. *See also* Drayer v. Krasner, 572 F.2d 348 (2d Cir.), *cert. denied*, 436 U.S. 949 (1978) (discussing industry standards as to the use of arbitration claims).

114. *Connolly*, 883 F.2d at 1117 (citations omitted).

115. 482 U.S. 483 (1987).

116. *Connolly*, 883 F.2d at 1119 n.3. *See also* New England Energy, Inc. v. Keystone Shipping Co., 855 F.2d 1 (1st Cir. 1988).

117. *Connolly*, 883 F.2d at 1124 n.9. The court also stated that "[t]he use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision." *Id.* (citing Webb v. R. Rowland & Co., Inc., 800 F.2d 803, 807 (8th Cir. 1986)).

118. For a collateral definition in a case involving an arbitration clause under UCC § 2-207, see N&D Fashions, Inc. v. DHJ Indus., Inc., 548 F.2d 722 (8th Cir. 1976). *See also* Anthony G. Eonas, *Mediation: An Expanding Role in Alternative Dispute Resolution*, 23 N. ATL. REG. BUS. L. REV. 27 (1990).

119. 856 F.2d 361 (1st Cir. 1988).

120. Boston Edison Co. v. FERC, 856 F.2d 361, 362-63 (1st Cir. 1988).

121. *See id.* at 364.

termed the *Mobile-Sierra* Doctrine[122] and took notice that an important and salient purpose of the Federal Power Act[123] was to preserve the " 'integrity of contracts'. . . [thereby permitting] 'the stability of supply arrangements.' "[124] The court took special cognizance of the importance of maintaining the integrity of agreements, absent any assertion that the claims limitation clause is "unconscionable, overweening, or otherwise unreasonable."[125] The court thus concluded that the practice of recognizing the integrity of agreements, absent unconscionability, "bring[s] certainty to the parties' dealings after an adequate period of time."[126]

In *E.H. Ashley & Co. v. Wells Fargo Alarm Services*,[127] the court considered a contract containing a limitation of liability clause.[128] The plaintiff claimed the contract was one of adhesion.[129] The court cited both *Williams v. Walker-Thomas*[130] and a 1986 Rhode Island Supreme Court case, *Grady v. Grady*,[131] in which certain idicia of unconscionability were noted: "disproportionate bargaining power, non-availability of alternatives, and illegal, oppressive, or unreasonable contract."[132]

Putting to rest the notion that the courts may be generally hostile to limitation of liability clauses "against allegations that they are violative of public policy or [per se] unconscionable,"[133] the *Ashley* court noted that the facts presented were essentially identical to those presented in *Firemen's Fund American Insurance Cos. v. Burns Electronic Security Services, Inc.*,[134] which stated that, on the contrary, " 'the [limitation of liability] clause was a commercially sensible arrangement, and the plaintiff is bound by it.' "[135]

It might also be well to note that the court made pointed reference to the lack of several other traditional indications of unconscionability: "[t]he limitation of liability clause was set forth in the

122. *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956); Federal Power Comm'n v. Sierra Pac. Power Co., 350 U.S. 348 (1956).
123. Federal Power Act § 205(d) (codified as amended at 16 U.S.C. § 824d(d) (1988)).
124. *Boston Edison Co.*, 856 F.2d at 370 (quoting *Mobile Gas*, 350 U.S. at 344).
125. *Id.* at 372.
126. *Id.*
127. 907 F.2d 1274 (1st Cir. 1990).
128. E.H. Ashley & Co. v. Wells Fargo Alarm Servs., 907 F.2d 1274 (1st Cir. 1990).
129. *Id.* at 1277-78.
130. 350 F.2d 445 (D.C. Cir. 1965).
131. 504 A.2d 444 (R.I. 1986).
132. *E.H. Ashley*, 907 F.2d at 1278 (citing Leasing Servs. Corp. v. Graham, 646 F. Supp. 1410 (S.D.N.Y. 1986)).
133. *Id.* (citing Ostalkiewicz v. Guardian Alarm, 520 A.2d 563 (R.I. 1987)).
134. 417 N.E.2d 131 (Ill. App. Ct. 1981).
135. *E.H. Ashley*, 907 F.2d at 1279 (quoting Firemen's Fund Am. Ins. Cos. v. Burns Elec. Sec. Servs., Inc., 417 N.E.2d 131, 132-33 (Ill. App. Ct. 1981)).

most conspicuous print . . . [;] [t]he contract was written in plain English; . . . [and] [t]here was no disparity in sophistication or bargaining power."[136] Because the plaintiff had asserted no facts whatsoever to support its bare contention that the contract was unconscionable, the court concluded that Aetna had no legal grounds for pursuing the appeal and directed that Aetna and its attorney be required to pay double costs and all reasonable attorney's fees expended by the plaintiff in defending the appeal.[137]

Perhaps the real importance of the *Firemen's Fund* case lies in the clear indication that principles of unconscionability have become so well-settled that the mere allegation of unconscionability and nothing more is no guarantee of sympathy from a court reviewing a record on appeal.[138]

7.2 *The Second Circuit*

In June of 1987, the Second Circuit decided *Middle East Banking Co. v. State Street Bank International*,[139] in which a bank customer alleged a breach of the depository contract and tortious conversion of the customer's funds upon the bank's debit of the customer's account and the return of funds to another bank which had originally deposited them under the so-called "CHIPS" system.[140] The court decided one of the issues (the effect of a waiver) by referring to the doctrine of unilateral mistake[141] judged by a standard of unconscionability, the basis of which may be found in the Restatement (Second) of Contracts, section 153:

> Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake . . . , and

136. *Id.* The court also noted that the officer who signed for Ashley admitted he understood the meaning of the limitation clause and made no effort to negotiate different or better terms. *Id.*

137. *Id.* at 1280. *See also* FED. R. APP. P. 38 & 39 (allowing the sanction of attorney's fees).

138. The *Ashley* court noted as follows: "Aetna's appeal in this case was wholly without merit because the result was obvious. The overwhelming weight of precedent militates against Aetna's position." *E.H. Ashley*, 907 F.2d at 1280.

139. 821 F.2d 897 (2d Cir. 1987).

140. Middle E. Banking Co. v. State St. Bank Int'l, 821 F.2d 897 (2d Cir. 1987). The Clearing House Interbank Payment System (CHIPS) is a "computerized funds transfer system used to process a large number of payments between banks." *Id.* at 900 n.1. At the time of *Middle E. Banking*, 140 banks participated in the system. *Id.*

141. *Id.* at 910. *See generally* 3 WILLISTON ON THE LAW OF CONTRACTS § 154 (4th ed. 1990); RESTATEMENT (SECOND) OF CONTRACTS § 153 (1979) (setting out the doctrine of unilateral mistake).

(a) the effect of the mistake is such that enforcement of the contract would be unconscionable . . . .[142]

Comment a under section 153 explains the rule: "[T]here has, in addition, been a growing willingness to allow avoidance where the consequences of the mistake are so grave that enforcement of the contract would be unconscionable."[143]

In its summary, the *Middle East Banking* court noted that the "New York courts clearly would consider whether [the plaintiff] should be allowed to void the contract of release on the ground that the effect of its mistake with respect thereto is such that the enforcement of the release would be unconscionable."[144]

West 14th Street Commercial Corp. v. 5 West 14th Owners Corp.[145] involved the application of unconscionability to a quasi-lease situation.[146] In this case, the Second Circuit was asked to construe the Condominium and Cooperative Abuse Relief Act,[147] which was enacted to protect the rights of tenants whose residential apartments were subject to conversion to cooperatives or condominiums.[148] Judge Cardamone recognized that Congress had involved itself in the process because "many tenants are too *unsophisticated* on account of age or infirmity to evaluate properly the complex choices offered [to] them upon conversion . . . ."[149] However, Congress also recognized that developers merit a "fair return" on their investments.[150] The major issue thus became one of judging whether or not a developer's profit is unconscionable or whether or not individual leases entered into were unconscionable.[151]

The *West 14th* court construed section 3608(c) of the Act,[152] which requires that upon a showing of unconscionability, "the parties shall be afforded a reasonable opportunity to present evidence at least as to:

(1) the commercial setting of the negotiations;
(2) whether a party has knowingly taken advantage of the

142. RESTATEMENT (SECOND) OF CONTRACTS § 153, cmt. a (1974).
143. *Id.*
144. *Middle E. Banking*, 821 F.2d at 911.
145. 815 F.2d 188 (2d Cir. 1987).
146. West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188 (2d Cir. 1987).
147. 15 U.S.C. §§ 3601-16 (1982).
148. *West 14th*, 815 F.2d at 190.
149. *Id.* (emphasis added).
150. *Id.*
151. *Id.*
152. 15 U.S.C. § 3608(c) (1982).

> inability of the other party reasonably to protect his interests;
> (3) the effect and purpose of the lease or portion thereof, including its relationship to other contracts between the association, the unit owners and the developer or an affiliate of the developer; and
> (4) the disparity between the amount charged under the lease and the value of the real estate subject to the lease measured by the price at which similar real estate was readily obtainable in similar transactions."[153]

The court, recognizing the importance of unconscionability as an underlying basis of the Act itself, quoted from a statement of Senator Harrison Williams, the author of the Act: "It is our intent that courts permit evidence on such matters as the relative bargaining position of the parties."[154]

7.3 *The Third Circuit*

In a 1987 case from the Third Circuit, *202 Marketplace v. Evans Products Co.*,[155] the court considered the question of whether or not a landlord had the right to terminate a lease because of a tenant's breach and default, and clearly raised as a major component the issue of unconscionability.[156] The court noted that under Pennsylvania law, four criteria determine whether a landlord may declare a forfeiture:

> Before a landlord may declare a forfeiture of a lease, . . . it must prove the existence of each of the following criteria: (1) that the right to declare a forfeiture was distinctly reserved; (2) that the proof of the happening of the event upon which the right is to be exercised is clear; (3) that the party entitled to do so exercised his right promptly; and (4) that the result of enforcing the forfeiture is not *unconscionable*.[157]

Yet, the court failed to move beyond a mere generic statement of the importance of unconscionability to an acceptance of the principle in the instant case, upholding the forfeiture.[158]

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153. *West 14th*, 815 F.2d at 200 n.8 (quoting 15 U.S.C. § 3608(c) (1982)).
154. *Id.* at 201 (quoting 126 CONG. REC. 28, 179 (1980)).
155. 824 F.2d 1363 (3d Cir. 1987).
156. 202 Marketplace v. Evans Prods. Co., 824 F.2d 1363 (3d Cir. 1987).
157. *Id.* at 1366 (quoting Cleveland v. Salwen, 141 A. 155, 156 (Pa. 1928) (emphasis added)).
158. *Id.* at 1368.

In another important and well publicized case decided on January 5, 1990, *Cipollone v. Liggett Group, Inc.*,[159] a smoker and her husband brought an action against two cigarette manufacturers after the smoker had contracted lung cancer.[160] After the smoker died of lung cancer, her husband continued the action, both individually and as executor of his wife's estate.[161] In discussing the claim of breach of an express warranty under UCC section 2-313 and applicable New Jersey law (regarding the health effects of smoking), the court first noted that "authority on the question of whether reliance [on specific statements of the cigarette manufacturer] is a necessary element of Section 2-313 is divided."[162] The court noted that no New Jersey court had addressed this question.[163] In support of this proposition, the court dropped a footnote citing *Collins v. Uniroyal, Inc.*,[164] in which the Superior Court of New Jersey held that a tire manufacturer's efforts to limit the remedy for breach of an express warranty to replacement of the tire was unconscionable and unenforceable.[165] The *Collins* court did not discuss the issue of "basis of the bargain" but focused instead on the patent unconscionability of the remedy limitation, a more traditional application of the unconscionability doctrine.[166] In *Cipollone*, the circuit court noted that "the buyer's reliance on an advertisement making broad claims about the safety of the product was thought relevant to the issue of unconscionability [and] does not necessarily imply that the buyer's nonreliance . . . would have precluded the advertisement from becoming part of the manufacturer's express warranty."[167] *Cipollone* clearly stands as an indication that the doctrine of unconscionability is still relevant and important to the more traditional category of UCC cases.

In *Berger v. United States Fidelity & Guaranty Co.*,[168] an action stemming from a dispute concerning an auto accident

159. 893 F.2d 541 (3d Cir. 1990), *cert. granted*, 111 S. Ct. 1386 (1991).

160. Cipollone v. Liggett Group, Inc., 893 F.2d 541 (3d Cir. 1990), *cert. granted*, 111 S. Ct. 1386 (1991).

161. *Id.* at 552.

162. *Id.* at 564. *See, e.g.*, Winston Indus., Inc. v. Stuyvesant Ins. Co., 317 So. 2d 493 (Ala. Civ. App. 1975) (purchaser permitted to sue under § 2-313 for breach of a warranty he never received), *cert. denied*, 317 So. 2d 500 (Ala. 1975); Royal Typewriter Co. v. Xerographic Supplies Corp., 719 F.2d 1092, 1101 (11th Cir. 1983) ("absence of reliance will negate the existence of an express warranty").

163. *Cipollone*, 893 F.2d at 564.

164. 315 A.2d 30 (N.J. Sup. Ct. App. Div. 1973) (per curiam).

165. *Cipollone*, 893 F.2d at 564 n.24 (citing Collins v. Uniroyal, Inc., 315 A.2d 30 (N.J. Sup. Ct. App. Div. 1973) (per curiam)).

166. *Id.*

167. *Id.*.

168. 834 F.2d 1154 (3d Cir. 1987).

involving an auto owned and insured by the plaintiff and driven by his son, the court considered the issue of unconscionability as a collateral matter and noted as follows: " '[The parties] apparently were of equal bargaining power, and were represented by counsel. The bargain which was struck involved no unfair advantage or unconscionability as to either. The parties were free to arrange for whatever degree of risk they desired.' "[169] It is also interesting to note a rather realistic view stated by the court concerning the nature of insurance contracts: " 'In New Jersey, it has long been established that while insurance policies are contractual in nature, they are not ordinary contracts but *contracts of adhesion* between parties who are not equally situated.' "[170]

However, while New Jersey courts have focused their attention on the element of inequality of bargaining power as a necessary requisite to any finding of unconscionability, they have at the same time recognized that in certain contracts, "construction of insurance policy language is not ordinarily controlled by the standards applicable to a contract negotiated at arms length between two parties on the same plane."[171] Thus, even the existence of a decidedly adhesive contract (*substantive unconscionability*), recognized as such by the court, may not necessarily condemn a contract as unconscionable, absent the allegation of *procedural unconscionability*.

Finally, in a case arising out of a notorious incident, *Hodes v. S.N.C. Achille Lauro ed Altri-Gestione*,[172] the passengers of the *Achille Lauro* brought an action arising out of the terrorist hijacking of the ship by Palestinian terrorists off the coast of Egypt on October 7, 1985.[173] The district court held that the "foreign forum selection clause" in a cruise ship ticket was unenforceable.[174] The appellate court held that the clause was enforceable and reversed the decision of the district court.[175]

Among the terms and conditions of the contract of passage were thirty-two *fine print* articles found on the back of the ticket. Article 31 stated as follows: " 'All controversies that may arise directly or indirectly in connection with or in relation to this pas-

169. Berger v. United States Fidelity & Guar. Co., 834 F.2d 1154, 1161 (3d Cir. 1987) (quoting County of Somerset v. Durling, 415 A.2d 371, 374 (N.J. Sup. Ct. Ch. Div. 1980)).

170. *Id.* at 1162 (quoting Meier v. New Jersey Life Ins. Co., 503 A.2d 862, 869 (N.J. 1986) (emphasis added)).

171. Linden Motor Freight Co., v. Travelers Ins. Co., 193 A.2d 217, 224 (N.J. 1963).

172. 858 F.2d 905 (3d Cir. 1988).

173. Hodes v. S.N.C. Achille Lauro ed Altri-Gestione, 858 F.2d 905 (3d Cir. 1988).

174. *Id.* at 906.

175. *Id.*

sage contract must be instituted before the judicial authority in Naples [Italy], the jurisdiction of any other authority being expressly renounced and waived.' "[176]

Interestingly, the court framed the issue as whether the terms and conditions of the cruise ship ticket were "reasonably communicated" to the passenger before the passenger boarded the vessel, a question of law for the court.[177] This formulation may be viewed as a correlative to earlier cases in which the courts stressed the necessity of communication ("meeting of the minds") as a necessary requisite to finding that the principle of unconscionability would not apply.

In *Hodes*, the court noted that the conditions had been communicated to the passengers prior to their boarding of the *Achille Lauro* (through the appellees' travel agent), and thus "appellees [were] charged with notice of the ticket provisions."[178] In finding that the provisions had been effectively communicated, therefore, the court could find no evidence of unconscionability.

8. *Conclusion*

The application of section 2-302 of the UCC to Code cases may be practically limited to a showing of *both* procedural and substantive unconscionability. This view has its clear origin in Judge Wright's formulation of unconscionability in *Williams* as "an absence of meaningful choice on the part of one of the parties *together with* contract terms which are unreasonably favorable to the other party."[179] Yet, in reality, there will be few instances where a contract is so one-sided as to "shock the conscience of the court" (substantive unconscionability) absent some strong evidence of unfair surprise, clauses hidden in fine print, or the exercise of grossly unequal bargaining power during the process of contract formation (procedural unconscionability).

In a wide range of non-Code cases, decisions of the First, Second and Third Federal Circuits in the 1980s indicate that the doctrine of unconscionability is a viable and valuable point of critical reference for evaluating contracts that smack of one-sidedness, an absence of meaningful choice, great inequality of bargaining power, or the failure to directly communicate important contract

176. *Id.* at 907 (quoting contract of passage).
177. *Id.* at 911.
178. *Hodes*, 858 F.2d at 912. *See also* Marek v. Marpan Two, Inc., 817 F.2d 242 (3d Cir.), *cert. denied*, 484 U.S. 852 (1987).
179. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965) (emphasis added) (footnote omitted).

terms. At the same time, however, no longer will the naked "allegation" of unconscionability result in a contract being striken by the courts.

In contrast to the pre-Code application of the unconscionability doctrine (which accomplished its intended purpose often through an indirect "manipulation" of the common law), the comment to section 2-302 suggests a "conspicuous intent"[180] of the writers to use the doctrine of unconscionability to lessen the burden contained in either boilerplate contracts or fine print clauses, particularly in warranty disclaimers or limitation of remedy clauses.[181] Taken together with sections 2-316 [Exclusion or Modification of Warranties] and 2-719 [Contractual Modification or Limitation of Remedy], and recognizing that a fine-print clause can in fact misrepresent the true and conscious agreement ("meeting of the minds") between the parties, section 2-302 can serve courts well, not only in their responsibility of equitable supervision of contracts for the sale of goods, but also in other collateral contracting matters. In doing so, the courts may facilitate the creation of an equitable "corporate conscience" that reflects a fundamental fairness and equity in contractual relations, decisively rejecting the sordid history of *caveat emptor* and the empty notions of an absolute "freedom of contract." This process may also point to the further importance of federal precedent in fleshing out the parameters of the unconscionability doctrine in both Code and non-Code cases.

180. Johnson, *supra* note 66, at 180.

181. *See* U.C.C. § 2-302, Official Cmt. 1 (1989) (citing Campbell Soup v. Wentz, 172 F.2d 80 (3d Cir. 1948)). *Accord* J. HONNONL, CASES AND MATERIALS ON THE LAW OF SALES AND SALES FINANCING 26-27 (4th ed. 1976).