UNCONSCIONABLE CONTRACTS — A COMPARATIVE STUDY

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I  FREEDOM OF CONTRACT AND UNCONSCIONABILITY OF TERMS

The doctrine of the sanctity of contracts is entrenched in both the Anglo-American and in the Western European legal systems. Its origin is in the postulates of natural law, which considered it "natural" that parties perform their bargains or pacts.¹ The phrase by which the doctrine is known today—"the freedom of contract"—can be traced back to the late 18th and the early 19th century.² In that period the doctrine found its way into the Prussian Code of 1794 and into the French Civil Code promulgated in 1804. It was adopted in due course in later Continental codifications. English law embraced it, as a manifestation of the freedom of trade, at approximately the same period.³ The widespread acceptance of "freedom of contract" is, in all probability, to be explained by the influence of the laissez faire spirit, championed by the rising and eventually triumphant middle classes of Europe.⁴ This influence explains why the doctrine continues to be known by a phrase which emphasises the word "freedom".

At present "freedom of contract" has come to mean that the parties to a transaction are free (or "entitled") to agree on, or "to choose", any lawful terms. Usually, the courts will not interfere with a bargain and will not re-shape its terms. A person who has voluntarily entered into a contract is bound by it even if, subsequently, he finds the contract unacceptable and has valid commercial, though not legal, grounds for wishing to avoid it. Obviously the emphasis has come to fall on the word "contract". This, however, was not the primary sense in which the doctrine was understood in the earlier stages of its development. Thus, paragraph I 3.1 of the Prussian Code reads:⁵

Undertakings can give rise to [enforceable] rights only in so far as these undertakings are freely given.

The main object of this provision was to ensure that contracts and other dealings would not bind a person who had entered into them without giving his free consent. In other words, the doctrine's aim was not to

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¹ Note in particular Grotius, *De iure Belli* Vol II, ch 15; see also infra p 304 as regards English case law of the 17th century.
² For emphasis on "freedom", see in particular Domat, *Traité des Loix* ch IV: II; Portalis, *Discours Preliminaire* Fenet II, 463.
⁵ Our translation. See also para I 4.4 concerning a declaration of intention. The notion of free will is echoed in para I 5.1 concerning contracts; see *Allgemeines Landrecht für die Preussischen Staaten*, Edited Text published in 1970 (Alfred Metzner Verlag); introduction by Dr Hans Hattenhauer at 31.
consecrate bargains but to ensure freedom of action. In a society divided into superior and inferior classes this was a step in the direction of liberalism. The very same emphasis on the "freedom of will" aspect is echoed in articles 1108-1112 of the Code Civil and in paragraphs 116 and 145 of the German Civil Code, the BGB.

With this background in mind, it is understandable that the Codes—and likewise the common law—were eager to recognise, as defences to actions brought in contract, pleas showing the absence of "free will". Duress, undue influence, deceit and mistake are examples in point. The Codes and the Anglo-American case law of the early 19th century had no pressing need for additional safeguards. Standard form contracts, conferring excessive rights on one party whilst depriving the other of any effective remedy, were not a serious problem in that period.

It is ironic that in the last decades of the 19th century and in the 20th century the concept of the "freedom of contract", which originally had the object of combating the validity of contracts made without the freely given consent of all the parties thereto, became the very tool used to establish the sanctity of standard form contracts. There are numerous cases in which it was held that a person who was foolish enough to enter into an oppressive standard form contract without reading it could not expect a reprieve from the courts.6 Judges have, of course, commented on the fact that many contracts of this type were not meant to be read and, least of all, to be understood.7 Nevertheless, it has been consistently held that, in cases of this type, a party's inability to understand the terms of the "freely" made contract did not negate his consent to its terms.

It is a well known fact that the use of standard form contracts burgeoned in the late 19th century and that they have gained popularity ever since. At present they are predominant in most areas of trade and commerce. The reason for this development is equally well known: it is the increasing number of situations in which the parties to a contract do not have an equal bargaining power. No doubt this has always been the case in some specific types of contracts, such as lending and tenancy agreements. But, generally speaking, a lawyer writing in the 18th or in the first half of the 19th century had good reason to regard a contract as a bargain made between parties with a comparable capacity to safeguard their respective rights. In a period in which small traders and artisans were competing for custom, the law of supply and demand precluded the introduction of standard form contracts with one-sided terms. The position changed completely with the emergence of large monopolistic companies, such as the early railways, which had the power to offer their services on whatever terms they pleased.8 Any suggestion of an equality of bargaining power between such giants and the average citizen was, and has remained, illusory. The situation has been further aggravated by the creation of multi-national corporations and their subsidiaries. It is typical that even state-controlled bodies, such as state-owned railways, use standard form contracts which give them a decisive upper hand.9

6 See eg L'Estrange v F Graucob Ltd [1934] 2 KB 394; Galbraith v Mitchellall Estates [1964] 2 QB 473, 479 and, more recently, South Australian Railways Commissioner v Egan (1973) 47 ALJR 140.
7 See in particular Lord Devlin in McCutcheon v David MacBrayne Ltd [1964] 1 WLR 125, 133.
8 Note the ticket cases such as Parker v South Eastern Railway Co (1877) 2 CPD 416.
9 For example South Australian Railways Commissioners v Egan supra n 6, in which standard form contracts used by such a body were described as oppressive.
It would be unrealistic to suggest that the use of standard form contracts is, in itself, objectionable or unconscionable. A large industrial concern has a genuine interest in defining its liability to customers and in standardising the terms on which it supplies goods or furnishes services both to its retail outlets and to the public. Whilst some specific terms, such as the price or the date of payment, may be the subject of individual negotiations, the general terms and conditions relating to the supply of the goods or to the furnishing of the services are usually governed by a standard form. A similar system is used by other sections of the commercial world, such as lending institutions, carriers and insurers.

The true concern is that, although standard form contracts are not objectionable as such, they tend to be one-sided documents. Indeed, some contracts of this type exonerate the suppliers from any liability for the quality of the goods or give them extremely far reaching powers exercisable in the event of any default or delay in performance by the other party. In certain cases the contract is so decisively slanted in favour of this stronger party that it becomes oppressive. The exact nature of the oppressive or unfair element may vary a great deal. It may be found in an excessive interest rate or in a contractual penalty; it may be found in onerous provisions pertaining to the re-possession of goods supplied under a hire purchase agreement; and it may be present in a particularly wide exemption clause. The common factor found in all these cases is the "unconscionability" of the bargain.

In analysing these types of contract and the problems created by them, it is important to distinguish between two methods or strategies employed by the party with the upper hand in order to safeguard his position to the utmost or to enable him to reap the maximum profit. First and foremost continues to be the inclusion of clauses which confer on this party some specific rights or protections, such as an exemption clause which absolves him from any liability for default in the performance of the contract or the provision for an excessive interest rate and for penalties for arrears in payment. The second strategy relates not so much to the actual terms of the contract as to the manner in which the stronger party exercises his rights under a clause which, in itself, may be unobjectionable. A good illustration is a clause in a hire purchase agreement which entitles a finance company to seize the goods and to demand payment of the total outstanding balance of the debt if the hirer makes a default in the payment of an instalment. If the hirer becomes insolvent, this clause may assist the company to establish a priority over the hirer's general creditors. The clause in this case serves a legitimate object. The position differs where the company exercises its rights under this clause against a solvent hirer, who has a good financial record, simply because there is a short delay in the payment of a single instalment. From a commercial point of view it is unreasonable to use the clause in this type of case. This is particularly so if the company—in reality—does not aim to retain and to re-sell the goods but intends to reinstate the contract after extracting a penalty or "bonus" from the hirer. However, the indignation provoked by this type of case ought to be directed at the company's behaviour rather than at the clause itself.

Note that reposessions have been the subject of legislative controls in most Western European countries. The current law in the United Kingdom is governed by ss 90-93 of the Consumer Credit Act 1974. In Australia see eg the Hire Purchase Act 1960 (NSW) ss 15ff and, more recently, the Consumer Transactions Act 1972 (SA) ss 27-29.
It is arguable that, in the majority of cases, the stronger party's objectionable conduct and the clause used to justify it are inseparable. Thus, in the last illustration the company could not make its unreasonable demand if the clause were more narrowly phrased. The inclusion of a clause with such a wide or general scope of application is, however, frequently dictated by common sense: it is virtually impossible to foresee every situation in which a clause of the type described above may be required.

For the purposes of this paper it is necessary to emphasise the distinction between unconscionable clauses of a contract and the harsh and unfair exercise of contractual rights. It will be shown in the next Part that both common law and civil law countries have developed some doctrines, applicable in specific fields, which have the object of providing suitable remedies in both types of case. Some of these doctrines were developed by the courts from the general principles of the law of contract. In the majority of cases though, the assault on the citadel of the sanctity of contract was conducted by the legislature.

The object of this paper is to compare the approaches to the problem of unconscionability in two representative common law systems, those of England and of the United States, and in two civil law jurisdictions, those of France and of Germany. It will be shown that, although the source of the problem—the doctrine of freedom of contract—is common to the four systems, there are marked differences in the devices used to combat abuses. Whilst two systems have developed some general doctrines as a basis for the granting of relief, the two remaining ones have persistently used a piecemeal approach.

It is envisaged that the comparative treatment of the problem of unconscionability in contractual dealings will furnish materials for the discussion of recent proposals for a general reform advocated in Australia and in New Zealand. These proposals are discussed in the last Part of the paper.

II Comparing the Systems

Scope of Discussion

The comparative study conducted in this Part of the paper concentrates on the development of unconscionability concepts in given areas in the systems under consideration. It does not discuss specific defences of a general nature such as duress, undue influence and mistake, which are distinguishable from unconscionability from both a conceptual and a practical viewpoint. Conceptually these defences aim at protecting a person who has entered into a contract without his genuine consent whilst unconscionability rules are operable where a person has willingly though foolishly accepted a bargain including oppressive terms or where the stronger party exercises his rights under the contract in a manner which is harsh or unfair. The practical distinction relates to the remedy. Where duress, undue influence or mistake are established the contract is usually avoided or set aside. A monetary remedy granted to either party would, therefore, be in tort or in restitution. A contract tainted with unconscionability, on the other hand, need not be treated as void or be set aside: once relief is granted against the oppressive term or against the objectionable exercise of powers by the stronger party the contract may
be left intact or be made enforceable subject to a variation. It will be seen that this characteristic of unconscionability rules manifests itself in the four systems discussed in this paper.

**Unconscionability in Select Areas of English Law**

In English law the sanctity of contract constituted a well-established common law principle by the 17th century. Equity, however, intervened in a limited type of case to give relief against harsh and unconscionable bargains. These cases are discussed in detail in a recent study,\(^{11}\) which demonstrates that the assault on harsh and unconscionable types of contracts and clauses has been the prime cause of the development of certain principles of the law of contract, such as the setting aside of penalty clauses and the entrenchment of the equity of redemption. The most interesting instance, though, is the development of unconscionability rules in respect of bargains extracted from expectant heirs.

The origin of the rule that equity will grant relief against harsh and unconscionable bargains extracted from expectant heirs and remaindermen can be traced back to Lord Chancellors Ellesmere, Bacon and Coventry.\(^{12}\) By the end of the 17th century it had become the basis for re-opening bargains in which young noblemen sold their expectancies or granted rent-charges against them for inadequate considerations. In the leading case of the *Earl of Ardglasse v Muschamp*\(^ {13}\) the Lord Keeper, Lord North, and Lord Jeffreys LC observed that in cases of this type relief would be granted only if the transaction involved some trading on a weakness of the expectant heir. Otherwise equity would not intervene to set aside or to re-open a bargain entered into voluntarily. In the *Ardglasse* case the transaction was re-opened as the young Earl, who had been engaged in wild and riotous living, had signed the agreement whilst incapable of comprehending the nature of the bargain. In *Wiseman v Beake*,\(^ {14}\) decided only a few years later, relief was granted to a remainderman who was a Proctor at Doctors Commons because it was established that the consideration was so inadequate as to be indicative of a fraud and, also, that the remainderman's dire need of money was employed to extract the harshest terms possible.

It would appear that up to a point these cases went beyond the granting of a remedy against an oppressive bargain; they involved an attempt to protect the estates of the landed classes. This element is echoed in the decision of Lord Thurlow LC in *Gwyne v Heaton*:\(^ {15}\)

> The heir of a family dealing for an expectancy in that family should be distinguished from ordinary cases, and a bargain made with him should not only be looked upon as oppressive in the particular instance, and therefore avoided, but as pernicious in principle and, therefore repressed.

This indeed may have been one of the factors which in due course led to a slanting of the doctrine in favour of the expectant heir.\(^ {16}\) Cases

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\(^{11}\) S M Waddams, "Unconscionability in Contracts" (1976) 39 MLR 369.

\(^{12}\) See references to earlier cases in *Batty v Lloyd* (1682) 1 Vern 141 which also cites Bacon's Tracts; see also *Earl of Chesterfield v Janssen* (1750) 2 Ves Sen 125, 129.

\(^{13}\) (1684) 1 Vern 237.

\(^{14}\) (1690) 2 Vern 122.

\(^{15}\) (1778) 1 Bro CC 1, 9.

\(^{16}\) As regards the emphasis put on the existence of an unconscionable element such as the trading on the heir's desperate need of money in 18th century cases, see eg *Osmond v Fitzroy* (1731) 3 P Wms 129 and *Earl of Chesterfield v Janssen* supra n 12.
show that by the middle of the 19th century a mere inadequacy of the consideration had become a sufficient reason for the re-opening of the bargain. 17

This modification of the underlying principle led to two undesirable consequences. The first was that bargains with expectant heirs became too easily set aside or modified, a development which induced Lord Selborne to observe that at one stage the rule had become arbitrary. 18 To clarify the position the Legislature had to re-establish in 1868 that a sale of an expectancy or a reversion could be re-opened only where the bargain was unconscionable. 19 The second consequence, resulting directly from the ease with which the courts intervened in bargains with expectant heirs, was a growing reluctance to extend the application of the rule. Obviously this became an impediment to the development of a general doctrine which could have enabled the courts to grant relief against any bargain tainted with unconscionability. 20 Even in cases involving usurious bargains, which became free from legislative controls in 1854, 21 the courts were slow to intervene. It is true that in Barrett v Hartley 22 and in Nevill v Snelling 23 it was held that the courts would re-open a harsh and unconscionable lending transaction even where the borrower was not an expectant heir. But cases of this type did not lead to the establishment of a general rule. It was left for the Legislature to establish it, in respect of loans, in the Moneylenders Act 1900.

It is interesting that a similar pattern can be seen in other areas of the law of contract. Waddams' study demonstrates that the assault on forfeiture and on penalty clauses, which aimed at combating their harshness, ended with the development of doctrines which, on the one hand, defined in detail the type of clause which could be set aside but which, on the other hand, obliterated the underlying question of unconscionability. His most topical example is that of exemption clauses. 24 It is clear that the attack on exemption clauses was motivated by the unconscionable effect of some of them. However, instead of dealing with the problem by means of a criterion based on the unconscionability of clauses considered in disputes, the courts developed specific doctrines such as rules of construction and the controversial doctrine of fundamental breach.

A resistance to the direct use of an unconscionability concept can likewise be discovered in the struggle against the harsh use of contractual rights. The rule *de minimis non curat lex* and the construction of clauses making the purchase of land "subject to finance" are useful illustrations.

The rule *de minimis non curat lex* was developed in cases in which a buyer attempted to reject goods by reason of a minute departure from the prescribed weight or contractual description. In the leading case of

17 See comments of Kay J in Fry v Lane (1888) 40 Ch D 312, 324 and of Lord Selborne in Earl of Aylesford v Morris (1873) LR 8 Ch App 484, 490. Cf generally Sheridan, *Fraud in Equity* 73-86; Waddams, supra n 11 at 386.
18 Earl of Aylesford v Morris ibid at 490.
19 Sale of Reversions Act 1868 (UK).
20 As to an extension of the doctrine in Canada see Waddams, supra n 11 at 386.
21 Act to Repeal the Laws Relating to Usury and to the Enrolment of Annuities 1854 (UK).
22 (1886) LR 2 Eq 789, especially 795.
23 (1880) 15 Ch D 679, especially 696-697.
24 Supra n 11 at 378ff.
Shipton Anderson & Co v Weil Bros & Co\textsuperscript{25} it was held that an excess of 55 pounds above a stipulated limit of 4,950 tons was too insignificant to entitle the buyer to reject the goods. This finding is to be contrasted with the decision in Arcos Ltd v E A Ronaasen & Sons\textsuperscript{26} where a buyer was held entitled to reject staves which were of a thickness of nine-sixteenths of an inch instead of the thickness of half an inch prescribed in the contract of sale. The two cases are, of course, easily distinguished on the facts. The excess of 55 pounds in the first case was no burden to the buyer; the one-sixteenth inch difference in thickness in the second case could have been of importance in respect of the purpose for which the buyer required the half-inch staves. Presumably, if a deviation of one-sixteenth of an inch had occurred in staves which were to be of a thickness of ten inches, the court would have treated the discrepancy as insignificant and, therefore, as covered by the \textit{de minimis} rule. It is, however, interesting that an application of an unconscionability concept would have led to identical results: an insignificant difference in weight, which was meaningless from the buyer’s point of view, would not entitle him to reject an otherwise conforming shipment of goods. His attempt to reject the goods on such a trifling ground would constitute an unjustifiable exercise of his contractual rights. He could, on the other hand, plead a minute deviation if it rendered the goods unsuitable for the object for which they had been ordered.

The second example, that of contracts for the purchase of land which are subject to the arrangement of finance by the buyer, is of a more recent origin. It is clear that, in countries in which mortgage money is scarce, such a stipulation is justifiable. It enables a buyer, who is unable to obtain the required loan, to withdraw from the contract of sale without incurring a loss. However, in some instances this type of clause was invoked by purchasers who, having changed their mind about the sale, made no attempt to raise the required finance. The courts have persistently precluded purchasers, guilty of such conduct, from using this clause as an escape route. In some cases it was held that the contract included an implied term, imposing on the purchaser a duty to take reasonable steps in order to arrange finance.\textsuperscript{27} In one case, though, it was said that “where a contract is conditional on a purchaser raising a mortgage, the purchaser can assert the non-fulfilment of the condition only where it occurs without default on his part.”\textsuperscript{28} Obviously, in the case in question, the purchaser’s questionable conduct was the basis of the decision. The very same factor would have guided a court applying an unconscionability concept. It is, nevertheless, typical that in other cases in point the courts achieved their object by invoking an implied term.

It may be suggested that the illustrations discussed up to this point disclose a resistance by the courts to the development of unconscionability rules of general application and that this attitude may, in itself, defeat rules of this nature if introduced by statute. However, concepts akin to unconscionability have been employed successfully in some areas

\textsuperscript{25} [1912] 1 KB 574.
\textsuperscript{26} [1933] AC 470.
\textsuperscript{27} Mulvena v Kelman [1965] NZLR 656, 657; Scott v Rania [1966] NZLR 527, 534.
of the law of contract such as restraint of trade and estoppel. The use
of a statutory unconscionability concept is illustrated by the Money­
lenders Act 1900.

Contracts in restraint of trade have been the subject of intervention
by the courts for two basic reasons: the interest of the public in the
maintenance of free competition, and the danger of traders and of em­
ployees restricting their right to freedom of action. These concerns,
however, have had to be balanced against the legitimate interest of a
purchaser of a business in precluding the seller from setting up a com­
peting enterprise in the same locality and against the similar interest of
a tradesman or of a professional man who trains an apprentice in a
highly skilled business. In determining the validity of specific clauses,
the courts have applied two tests: first, whether the restrictive covenant
was compatible with the public interest and, secondly, whether it was
reasonable as between the parties. From a practical point of view, the
second test is based on an unconscionability concept: whether a specific
covenant is reasonable as between the parties depends on its not involv­
ing a wider restriction than is required for the covenantee’s protection.
The similarity between this test and the unconscionability concept has
been recognised by the House of Lords in A Schroeder Music Publish­
ing Co v Macaulay.

Similar references to fairness or equitability appear in some of the
cases concerning estoppel and waiver. Cases of this type occur where
one party, whose words or conduct have led the other to believe that
that other party need not perform a contractual duty on time or in the
manner agreed, changes his mind and insists on the performance of that
very duty. It would, of course, be wrong to overlook the specific rules
developed in this technical branch of law. But it is noteworthy that, in
one of the older leading cases in point, Lord Cairns observed that a
person would not be permitted to enforce his rights “where [this] would
be inequitable having regard to the dealings which have . . . taken place
between the parties.” The close connection between these words,
which do not constitute an isolated statement, and an unconscionability
concept is self-evident.

The last two illustrations suggest that the doctrine of unconscionability
need not be used in stealth. Where the courts use it openly it is, in all
probability, just as effective as the devices which are being employed to
attain the same object indirectly. Perhaps the best illustrations of its
effective use are the cases decided under section 1 of the Monevlenders
Act 1900 (UK) and its counterparts in Acts within the British Com­
monwealth. Pannam shows that this section has enabled the courts to
re-open usurious bargains and to determine, in each case, a proper rate
of interest, having regard to the security furnished, the risk, the period
of the loan and the amount advanced. Indeed the usefulness of this
provision of the 1900 Act was recognised by the draftsman of the Con­
sumer Credit Act 1974 (UK) when he adopted it in sections 137-140.

29 Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co [1894] AC 535, the
leading 19th century case in point, elucidates these tests.
31 [1974] 1 WLR 1308, 1315.
32 Hughes v Metropolitan Railway Co (1877) 2 App Cas 439, 448; the words are
33 Law of Moneylenders in Australia and New Zealand ch 17.
34 See eg the Hire Purchase Act 1960 (NSW) s 32; the Hire Purchase Act 1971
(NZ) s 37.
lines for the determination of the reasonableness of a clause. Factors to be taken into account include the relative strength of the parties’ bargaining positions, whether the customer received an inducement to agree to the term or had an opportunity to enter into a similar contract without the offending clause with another person, and whether the customer knew or ought to have known of the existence of the exemption clause. 46

It is, thus, clear that the new Act applies mainly in respect of exemption clauses in standard form contracts. Further, its scope is primarily confined to clauses involving “business liability”. 47 An exception is, however, provided by section 8, which governs clauses purporting to exempt a party from liability for misrepresentation. The section which renders such clauses effective only where they are reasonable has a general scope of application. 48

There is an obvious conceptual similarity between the “reasonableness” test of the new Act and the “harsh and unconscionable” doctrine of the Moneylenders Act. Moreover, both Acts focus on the offending clause and ignore the manner in which it is utilised by the stronger party. Yet a further similarity is that, in each of the Acts, the concept is applied to a given type of contractual clause. The major distinction between the two Acts pertains to the remedy. The Moneylenders Act confers on the courts the discretion to re-shape an unconscionable bargain. 49 The new Act renders an offending clause inoperable. This departure of the 1977 Act from the spirit of the doctrine of unconscionability suggests that a general doctrine of this type—applicable across the board—is not currently favoured by the legislature. 50

Unconscionability in French Law

The treatment of unconscionable contracts at French law is affected by two basic principles of the French Civil Code: freedom of contract and protection of family property. Obviously, the first principle supports the sanctity of contract in the same manner as it does in English law. The second principle pulls in the opposite direction for reasons similar to those which led English courts to set aside unconscionable bargains with expectant heirs.

The first principle is spelled out clearly in article 1134 al 1 of the Civil Code: “An agreement legally entered into is law for those who made it.” 51 When parties enter into a contract they are in fact legislating for themselves. Provided they legislate in a manner compatible with positive law, they are free to make and enforce against each other whatever bargains they wish. Contractual freedom may therefore be said to have been given a high place in the French system. At a practical level, however, it is essential to see what limitations the positive law forms and procedures place on this freedom. The existence in article 1134 itself of the rule that contracts “must be performed in good faith” 52 gives a

46 Section 11 and Schedule 2, which includes the full list.
47 Section 1 (3).
48 The section has replaced s 3 of the Misrepresentation Act 1967.
49 Moneylenders Act 1900 (UK) s 1.
50 Presumably there is concern about the wide discretion that an unconscionability doctrine, based on the re-shaping of a bargain by judicial decision, confers on the courts.
51 “Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites.” All translations into English are by Crabb, The French Civil Code (London 1977).
52 “[Les conventions] doivent être exécutées de bonne foi.” Cf also art 1135.
general hint as to the sort of controls the law exercises over contractual undertakings.

The second principle is more difficult to isolate. It is, however, clear and explicitly expounded in the case of the sale of immoveable property and the sharing of a succession, and is implicit in the rules relating to the compulsory portion of an heir in a succession, the bias against gifts, the traditional rules of civil delict, and the law of quasi-contract. The impression is not just one of the assiduous protection of the property of an individual, but more particularly of great emphasis on the protection and maintenance of family property. Even though over the years wealth may have changed its general character from immoveable to moveable assets the Code's principle remains the same. The abiding theme remains the keeping of the balance between patrimonies and the retention of wealth within a narrow family group.

The somewhat uneasy co-existence of the two principles of contractual freedom and of property protection has left its mark on the French law of contract. For a discussion of the problems that arise and of the ways of handling unconscionability, the rules relating to the formation of a contract provide a convenient starting-point. These rules on formation are found, along with the other general contractual rules, in Book 3 Title 3 of the Civil Code, which is entitled “On different ways of acquiring property”.

Immediately property notions are highlighted and in article 711, the article introductory to that Book and the one indicating its scope, those notions of property are tied to obligations. Contracts as voluntary obligations are thus directly affected.

In Title 3 the rules of article 1108 provide a base for the bargaining stance of the contracting parties and from an unconscionability point of view introduce requirements of equality. Each party must have capacity, he must agree to the obligation placed on him, his obligation must relate to definable property, and there must be a lawful cause or reason for his undertaking the obligation contracted. These requirements themselves are protective of the positions of the parties; the actual application of the rules is, in general, even more protective.

The Code elaborates the rules relating to formation in articles 1109-1133. Initially, it deals with the question of agreement. There is no agreement where the consent has been obtained by mistake, by duress or by fraud. The effect of the rules propounded by the Code for dealing with cases of this type is that where the parties enter into an agreement without full and fair knowledge of what is involved, the property of each party is protected. This result is attained by treating contracts entered into in such cases as ineffective. Also falling under the rubric of consent

53 "Des différentes manières dont on acquiert la propriété.”
54 “La propriété des biens s’acquiert et se transmet par succession, par donation entre vifs ou testamentaire, et par l’effet des obligations”: “Title to property is acquired and transferred by succession, by inter vivos or testamentary gift, and by the effect of obligations.”
55 “Quatre conditions sont essentielles pour la validité d’une convention: Le consentement de la partie qui s’oblige; Sa capacité de contracter; Un objet certain qui forme la matière de l’engagement; Une cause licite dans l’obligation”: “Four conditions are essential to the validity of a contract: The consent of the party who undertakes the obligation; His capacity to contract; An object that is certain as the subject matter of the undertaking; A legal cause for the obligation.”
56 Article 1109. These three vitiating elements are erreur, violence and dol; they are elaborated on in art 1110, arts 1111-1115 and art 1116 respectively.
is *lésion*.\(^57\) *Lésion* is usually dealt with as the loss which results from a serious imbalance or disproportion in the reciprocal obligations of the parties to a contract.\(^58\) Where applicable its effect, as with the other consensus factors, is to annul the party's consent to enter into the contract.

The only other general control on contractual freedom recognised by the Civil Code is the rule\(^59\) prohibiting the enforcement of contracts that are contrary to public policy. This is, in a sense, a separate rule, which is independent both of the protection of private property and the emphasis on freedom of contract.\(^60\)

The manner in which unconscionable contracts fit into the basic civil law scheme has been outlined. Obviously, with the exception of *lésion*, which is a narrower concept than might be expected, the Code has no specific provision on the point.

During the Middle Ages *lésion* became a general doctrine in Europe in that it extended to the sale of moveables as well as immovable and also in some cases protected purchasers. Some modern legal systems have retained the medieval generalised notion\(^61\) but France, by article 1118 of the Civil Code, generally restricts the concept's range of application. Article 1118 states that "*lésion* will only serve to nullify an agreement in the case of certain specified contracts or as between certain specified classes of person."\(^62\) Examples of such special cases are minors' contracts and contracts for the sale of immovable. In the first, *lésion* permits a person under eighteen to rescind a contract if he has suffered or been disadvantaged by it.\(^63\) In respect of real property, *lésion* is

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57 This doctrine is derived from the *laesio enormis* of Roman Law (Cod 4.44, 2 and 8). Under it the seller of immovable property who received less than half its value could recover the property on return of the price received, or receive a reasonable supplement in price from the purchaser.

58 "Il y a *lésion* lorsque le prix d'un bien ou d'un service, tel qu'il a été fixé dans le contrat, s'éloigne sensiblement de la valeur vénale, objective, de ce bien ou de ce service": Starck, *Droit Civil Obligations* (Paris 1972) 479. "There is *lésion* when the price of goods or a service, as stated in a contract, is significantly out of relation to the objective market value of those goods or that service."

59 Articles 6 and 1133. Comparison may be made with art 138 (1) of the BGB. Cf Simitis, *Gute Sitten und Orde Public* (Marburg 1960).

60 This rule is supportive of the other rules restricting contractual freedom but neither in itself nor necessarily in its effect does it provide property protection.

61 Typical of these is Italy with its Civil Code article 1448:

Where there is disproportion between the obligations of the parties and that disproportion results from the need of one party of which the other party has taken advantage, the damaged party can demand the rescission of the contract.

The action for rescission is not admissible unless the *lésion* is more than half the value that the performance made or promised by the damaged party had at the time of contracting.

Though France had a general doctrine of *lésion* before the Revolution, the direct inspiration for article 1448 is more likely to be article 138 of the BGB. (See infra p 317.)

Most European jurisdictions on the French model however have an even less extensive notion of *lésion* than France. Belgium is very similar to France but Spain for instance differs significantly. It admits by arts 1291 and 1293 of its Civil Code 1889 only two cases of *lésion*: those involving the property of incapacitated persons and absentees. Equally what amounts to *lésion* varies, a fairly common figure being a disproportion of a quarter less than current market value (this is also the test prescribed by art 887 of the French Civil Code in relation to the division of an inheritance).\(^64\)

62 "La *lésion* ne vicie les conventions que dans certains contrats ou à l'égard de certaines personnes, ainsi qu'il sera expliqué en la même section."

63 *Code Civil* arts 1304-1314.
governed by articles 1674-1685 of the Civil Code. Under these articles, as elsewhere, the operation of lésion does not depend on the intention or knowledge of the stronger party. The rule is directly protective of property, with the vendor's family being the ultimate beneficiaries of the prohibition on the sale of immoveables for a price of less than seven-twelfths of their value.

In view of the narrowness of article 1118, unconscionable transactions could only be combated successfully by judicial intervention. Lésion could not explicitly provide the basis for an unconscionability concept. The courts have therefore been forced to grant relief, in cases that might otherwise have been decided on the basis of a general doctrine of lésion, by employing other rules and principles. They have for example used the rules on mistake liberally where the considerations furnished by the parties were grossly disproportionate; the unconscionable element in the transaction has in this type of case been used to establish the weaker party's lack of consent.

In other cases the definition of violence was extended beyond outright physical coercion to various types of mental pressure to help meet the needs of those affected by clearly unconscionable transactions. In still other cases the courts have decided that unconscionable bargains should be invalidated on the ground that the gross imbalance in the value of the promises exchanged involved a partial or total absence of cause. An interesting illustration of this is furnished by a case in which the owner of some land and chattels sold his property in return for an inadequate support and sustenance allowance. Setting the contract aside, the Court observed:

At law, the price is one of the essential and constitutive elements of a sale and it is the court's duty to declare that this element is absent in a sale when, in the court's assessment, the income from the thing sold is in itself sufficient to cover the buyer's obligations to the vendor...

This principle has become known as the doctrine of the derisory price. As a derisory price is no price at all there is, simply, no contract of sale. At what stage a price ceases to be derisory and begins to be lesionary, and hence adequate to constitute a cause, is of course hard to determine. However, once the price is no longer derisory, the courts are debarred from controlling the transaction. A recent case illustrates the difficulty. The contract concerned Catalan frescoes which had been sold by illiterate peasants for AF 300,000 to someone who knew that their true value was inestimable. At first instance, the sale was set aside, and the court was clearly influenced by the circumstances and by the gross disproportion in the values given by the parties. The Court of Cassation quashed the decision because the lower court had explicitly referred to

64 In addition, however, to the specific examples in the Civil Code striking down arrangements when there is a disproportionate effect on the patrimonies of the parties there are other legislative enactments providing against lésion, eg salvage L 7 July 1967; agricultural fertiliser L 8 July 1907.


66 For example D 1888 I 263 where the external forces affecting the free consent of a shipwrecked mariner were sand bars and a rising tide.

67 DP 1908 I 480.
68 D 1965 J 217.
69 Approx US$600.
"the exceptional value" of the frescoes. This suggested that the trial judge had resorted to the doctrine of lésion, which, in the light of article 1118, was inapplicable.\textsuperscript{70} Had the judge, instead, explicitly decided to regard the price as "derisory", the decision might well have been upheld.\textsuperscript{71}

The courts have also attempted to use ideas of a lesionary nature, though in a different guise, in some specific branches of the law of contract. One major area of attack was in the field of agents' charges.\textsuperscript{72} Initially, the courts controlled these charges under article 1986\textsuperscript{73} of the Civil Code, which states that "agency is gratuitous unless there is agreement to the contrary". This, though, was a patently bad argument. By 1913 the courts had come to say simply that they had a general power to control such charges under articles 1134 and the general clauses on agency, articles 1984-2002. Thus, in the relevant case,\textsuperscript{74} the courts reduced a fee, charged by an agent who had negotiated the sale of a factory, from F6,000 to F2,000. In 1957,\textsuperscript{75} the same rule was applied to fees charged by arbitrators. This was explained as follows:\textsuperscript{76}

An arbitration contract is an agency agreement and therefore the fees of the arbitrators are those of agents and as such are within the discretionary power of judges to control and vary by reducing the fees in proportion to the services rendered.

A final way in which the French Code controls what might be regarded as unconscionable contracts is by the proscription of certain types of transaction which are regarded as particularly prone to being used for usurious purposes. Suffice it here to give two examples of this type of control. The first is article 2078,\textsuperscript{77} by which a pledgee may not on default by the pledgor ipso facto appropriate to himself the pledged goods. The second is the protection given to a debtor against the abuse of the system of sale with a right of repurchase,\textsuperscript{78} the vente à réméré.

The vente à réméré is a sale in which the vendor retains a right to repurchase the goods upon his returning the price paid and his reimbursing the purchaser for the various costs involved in the sale. The object of such a sale is the raising of money in times of need; its advantages over more frequently encountered financing arrangements are that the vendor may get the full value of the property he would otherwise have given as security for a part-value loan and also that the vendor retains

\textsuperscript{70} See supra n 62.
\textsuperscript{71} Dol may equally have been a successful plea for the naive vendors.
\textsuperscript{72} In the field of professional fees and charges the courts have been similarly active. The public nature of the function many professions fulfil has been a relevant factor and has assisted the courts to find a sure base for their decisions. In the case of notaries and avouées the monopolistic nature of the professions also influenced court reasoning. D 1910 I 368 involving the sale of a notary's office is a good example in this field. In it the appeal court held: "The sale of such an office is a contract sui generis of importance to the public interest which demands that the price represents the exact value of the office. It is a matter for the sovereign appreciation of the courts at first instance whether the price is too high and by how much." Bankers are also within this general control system.
\textsuperscript{73} "Le mandat est gratuit, s'il n'y a convention contraire."
\textsuperscript{74} D 1913 I 408.
\textsuperscript{75} D 1957 J 206.
\textsuperscript{76} Idem.
\textsuperscript{77} "Le créancier ne peut, à défaut de payement, disposer du gage: ... Toute clause qui autoriserait le créancier à s'approprier le gage ou à en disposer sans les formalités ci-dessus est nulle."
\textsuperscript{78} Articles 1658-1673.
the possibility of getting his property back when his finances improve. Though the purchaser is entitled to no interest on the amount paid to the vendor he has the benefit of the revenue from the property from sale till repurchase. The nature of the reimbursement required of a debtor to get back what was his is explicitly spelled out in article 1673. The Code also limits the period for repurchase to five years. 79

The courts generally construe sales with a right of repurchase in a very narrow light. Where the no interest condition is bypassed by an arrangement under which the purchase money received is less than the stipulated sale-repurchase price a court may intervene to protect the seller on the basis that the sale is in fact a loan offending against the usury laws. Equally a court is likely to so act in certain sale and leasing back transactions. If for instance the lease of the property back to the vendor follows immediately after the sale, and the purchaser is known to make a practice of making such purchases and leases-back, the court will treat the contract as a secured loan disguised as a sale in order to evade the laws on pledge or hypothec.

Outside the Civil Code provisions discussed above, there are some specific commercial contracts that usually give rise to the need for protective measures. Typical examples are provided by credit sale transactions and contracts in restraint of trade. The French have acted predictably in respect of both. The practice tends respectively to favour protecting the purchaser and the economic freedom of the restrained party.

The law on credit sales is found in the Decree of 20 May 1955 as supplemented by Ordinance 30 June 1945 and a Decree of 4 August 1956. The effect of these laws is to deal with all sales involving credit arrangements, to provide minimum sums in down payment for various classes of goods and to set maximum periods for payment of the unpaid balance of the price. The rules also require that the vendor in a credit sale give the purchaser full details in writing of the transaction he is entering into. In practice, creditors seek by express contractual provision to bypass requirements of the general law, such as article 1184, which require notice and time for payment to be given before termination of the credit sale agreement. 80 Such clauses have many advantages for creditors, but are not favoured by the courts. They interpret such clauses restrictively, and, if possible, will say the clause is simply a reference back to article 1184 and apply the general law; if that door is closed to them, they may investigate the circumstances of the purchaser's acceptance or test the contract for usury.

Contracts in restraint of trade are regarded as valid on the general

79 Article 1660. Article 1673 reads: "The seller who implements an agreement for repurchase must reimburse the purchaser not only for the sale price but also for the expenses and reasonable costs of the sale, for necessary repairs to the property, and for those that have increased the value of the property up to the amount of that increase."

80 Article 1184 reads: "A resolutory condition is always presumed in a bilateral contract for the case where one of the parties does not fulfil his obligations. In such a case the contract is not terminated ipso iure. The party in respect of whom the obligation has not been fulfilled has the choice either of compelling the fulfilment of the obligation where that is possible or of seeking termination with damages. Termination must be requested by formal process and the defendant may depending on the circumstances be granted time to perform."
grounds of freedom of contract. This generalisation is, however, subject to certain restrictions. The first is legislative and needs no elaboration. The other main limits are in the general rules which require that a clause restraining competition must not provide an excessive or unnecessary restriction on another basic freedom: the economic freedom of the individual. A clause to trade nowhere in the world would therefore fail. Any restraint must be in specific terms and limited in time or space. Any unreasonable restraint is null on the grounds of public policy.

The place where unconscionability is expressly and rigidly controlled in France is in the law on usury. Early French thinking in the matter was influenced by the biblical directions of the Old and New Testaments. From 1789 to 1807 the matter was unregulated. Low limits for interest rates were set in 1807 and continued in force till 1886 in commercial matters and until 1918 in civil matters. These controls were again followed by a period of freedom which ended in 1935. The law of 8 August 1935 introduced an extremely flexible test of unconscionability. The maximum conscionable rate of interest was to be determined in each case by the average rate charged by lenders in good faith in transactions involving the same risk as the impugned contract. Problems of proof made this test impracticable and it fell into disuse.

The current law is to be found in the law on usury of 28 December 1966. The new system covers not only loans of an ordinary nature but also affects instalment sales and hire purchase transactions. In calculating the rate of interest provided by an agreement the courts are instructed

81 The general contractual freedom to restrain commercial competition is supported by the delictual rules on unfair competition. They are essentially an emanation of abuse of rights thinking and will operate to protect a trader even where the protective clause he has negotiated contractually is held null or where the competitive activity is technically outside the sphere of operation of the contract term. Such would be the case of a trader who sets up business beyond the contractually restricted geographical area but then improperly solicits custom from his competitor's clients who are within the restricted area. (Bull Civ IV 224.)

82 D 1970 J 462.

83 The legal rate of interest, that applicable in the absence of agreement by the parties, is set annually at the discount rate of the Bank of France as on the preceding 15 December: see L 75-619 11 July 1975—D 1975, L 255. Article 1907 of the Civil Code says that contractually agreed interest rates may exceed the legal rates. The freedom is, however, made subject by article 1907 itself to two conditions: that the agreed rate does not exceed any statutorily prescribed limit on interest rates, ie the usury laws, and that the rate agreed is stipulated in writing.

84 This law operates within two limits. The first is a maximum effective rate which must not, at the time of contracting, exceed by more than 25 per cent the mean rate charged in the preceding quarter by banks and registered finance institutions for operations of the same type involving similar risks—le taux effectif moyen. This is the rate applicable in the absence of a limit set by the National Credit Council, and it is published each quarter for the different types of transactions and for high and low levels of risk. Where the National Credit Council has set the rate of return for lenders of specified loans that is the maximum rate that may be agreed by contract. The second limit is an overall ceiling rate which may never be exceeded. It is set at double the average rate of loan transactions in the preceding six months—le double du taux moyen de rendement effectif. This rate is calculated and notified by the National Institute of Statistics and Economic Research. Exceptionally the Minister of Finance may permit a higher ceiling for some transactions, and he has done so for, inter alia, loans on motor cars and household furniture. Additionally special provision is made in article 2 for the calculation of rates where there has been an indexing of the loan to protect the lender against fluctuations in the real value of his loan.
by article 3 of the law to take into account not only the interest expressly stated in the contract but also all fees, commissions, and other payments whether of a direct or indirect nature involved in the obtaining of the loan. Whatever may be the apparent nature of a transaction the courts are empowered to go behind it and to discern its true nature to see if it is in reality a loan of money at interest. The penal sanctions are formidable and operate against all who participate in the charging of a usurious rate.

The French legislature has formulated the usury laws in a specific enactment on that topic. However, because of the nature of usurious practices, commentators have seen the usury laws as just another, albeit special, aspect of a general theory against lesionary transactions. That view is not unhelpful in the present context as it ties the statute in with the earlier analysis of the general law. Here as there the law is intervening in a private contractual relationship essentially on the basis of the grossly disproportionate undertakings of the parties for the purpose of maintaining a reasonable equilibrium between their patrimonies.

In summary it would probably be true to say that the earliest controls on freedom of contract in France were property controls and that these were complemented over the years by usury laws and increasingly broad consensus testing rules. The position now is that freedom and controls are of almost equal importance, and that the field of unconscionable transactions is an area of tension between article 1118 strictly construed and the activities of the courts in controlling improvident and disproportionate bargains.

The French, then, like the English, have some specific rules relating to unconscionability, but do not have a general lesionary doctrine. By way of contrast, German law, discussed in the next Part, has developed a general doctrine of unconscionability. In this context it may be significant that the German Civil Code was promulgated a century later than the French Civil Code.

Unconscionability in German Law

Unlike English and French law, the German civil code—the Bürgerliches Gesetzbuch (known as the BGB)—contains three general provisions pertaining to unconscionability. These are paragraphs 138, 242 and 826. The first combats bargains which are either contrary to public policy or unconscionable; the second requires the observance of good faith in the performance of bargains; the third, a particularly general provision, prohibits the misuse of rights by one person for the purpose of damaging another.

The last provision, paragraph 826, is not included among the provisions on the law of contract; it constitutes, in effect, a principle of the law of torts. This is clear from its language: “A person who wilfully

85 The civil sanction on charging a usurious rate is not nullity but a reduction of interest. Article 5 provides:

Where a contractual loan is usurious, money paid in excess of the lawful amount is ipso iure set off against any ordinary interest then due and subsidiarily against principal.

If the debt is thereby extinguished both as to principal and interest, any money improperly received which remains must be returned to the borrower with interest at the legal rate from the date payment is ordered.

86 For an excellent and detailed treatment of the subject in English see J P Dawson, “Unconscionable Coercion—the German Version” (1976) 89 Harv L Rev 1041.
causes damage to another in a manner contrary to public policy is bound to compensate the other for the damage." The paragraph is, accordingly, outside the scope of this paper. The other two provisions, paragraphs 138 and 242, require a detailed analysis.

Paragraph 138, which is included in the General Part of the BGB, reads:

(1) A legal transaction which is contrary to public policy is void.

(2) A legal transaction is also void whereby a person exploiting the need, carelessness or inexperience of another, causes to be promised or granted to himself or to a third party in exchange for a performance, pecuniary advantages which exceed the value of the performance to such an extent that, under the circumstances, the pecuniary advantages are in obvious disproportion to the performance.

Sub-paragraph (2), which originated in the Usury Law of 1880 was not included in the original draft of the BGB. It was added during its revision, reflecting, in all probability, the progressive ideas of the end of the 19th century. It is known as the "usury [Wucher] clause" and goes far towards the establishment of a general conception of unconscionability. However, it includes a two-tier limitation. First, it applies only where one party to the contract has exploited, or made use of, the need, carelessness or inexperience of the other. Secondly, it is confined to cases in which there is an obvious, or striking, disparity in the value of the respective undertakings of the two parties.

The words "need" [or "state of necessity"], "carelessness" [or "foolhardiness"] and "inexperience" have been given a restrictive construction by the German courts. "Need" has been held to exist where a person's economic or financial position is subject to an immediate and direct threat such as for instance a landowner's need to raise finance in order to prevent a forced sale of his mortgaged property.

87 Translated by Forrester, Goren and Ilgen, The German Civil Code (Oxford 1975). All translations of paragraphs of the German Code cited in this paper are taken from the text. For a discussions of this provision in English see Bolgar, "Abuse of Rights in France, Germany and Switzerland" (1975) 35 Louisiana L Rev 1015.

88 The provision has been amended by the First Law on the Combating of Commercial Crime of 29 July 1976 (the "1. WikG"). The second paragraph now reads: "... the distressed situation, inexperience, lack of judgmental ability or great weakness of will of another to obtain the grant or promise of pecuniary advantages for himself or a third party which are obviously disproportionate to the performance given in return." (Translated by von Mehren and Gordley, The Civil Law System (2nd ed 1977) 1188; and see ibid at 1209.) The object of this amendment was to widen the scope of the provision but the basic framework appears to have remained unaltered. There remains a need for the exploitation of a "weakness" of the one party by the other, who must make a "disproportionate" gain. Cf Müller-Emmert and Maiers, "Das Erste Gesetz zur Bekämpfung der Wirtschaftskriminalität" Neue Juristische Wochenschrift (1976) 1657, 1664; Sturm, "Die Neufassung des Wuchertatbestandes und die Grenzen des Strafrechts" Juristenzeitung (1977) 84 (both articles deal mainly with the criminal law aspects of the new Act). The original text is cited and discussed in this paper because the relevant case law pertains to it.

89 B Mugdan, Gesammten Materialien zum BGB (Berlin 1899) vol 1, 1013.

90 It appears to have been added at the stage of the deliberations of the 12th Commission of the Reichstag [viz the German Parliament] in June 1896; Mugdan, ibid at 969-970, 1003ff. The debate in the Reichstag appears to have been heated!

91 RG JW 1911 576 as explained in Das Burgerliches Gesetzbuch—Kommentar Von Reichsrichtern und Bundesrichtern (cited as BGB-RGRK) (11th ed) Part I, vol 1, 445; cf Dawson, supra n 86 at 1057.
of necessity, such as one arising from a threat to a person’s health or well-being, does not constitute “need” within the meaning of paragraph 138 (2).\(^{92}\) Moreover, the state of necessity must be such as to deprive the debtor of any choice except to go ahead with the unequal bargain. This occurs mainly where he faces the danger of economic collapse or of the loss of an important asset, but not where his “need” arises in respect of a transaction involving the expansion of his business or the acquisition of a new asset. Thus, in a case decided in 1957 by the Bundesgerichtshof (the highest court in civil matters), a businessman, who wanted to expand his business in a town in which there was an acute shortage of leasehold property, entered into an onerous lease in which he undertook, inter alia, not to raise any claims concerning the state of the premises. It was held that this case did not involve “need” within the meaning of paragraph 138 (2),\(^ {93}\) as there had been no imminent threat to the businessman’s existing economic position.

“Carelessness”, or “foolhardiness”, within the meaning of paragraph 138 (2), occurs where a person enters into a bargain without attempting to assess its implications and consequences.\(^ {94}\) His carelessness must, of course, relate directly to the transactions in question. “Inexperience” may relate either to a general lack of familiarity with business or to ignorance of the particular trade in question. An interesting case concerning both carelessness and inexperience is cited by Dawson.\(^ {95}\) A retired railroad inspector paid a patentee an exorbitant amount for an exclusive franchise for the sale of some lighting equipment in a foreign country. The contract was set aside on the ground of the inspector’s inexperience, although all the elements of carelessness were also present. Presumably, the court resolved to rest its decision on “inexperience” in view of the stigma attached to a finding of “foolhardiness”. Another case concerned a bargain between a father and his children from his first marriage, who had just come of age. As the bargain conferred a disproportionate benefit on the father and his second wife, the court set it aside on the ground of the children’s inexperience.\(^ {96}\) English law would, undoubtedly, have reached the same conclusion by invoking the doctrine of undue influence.

The mere “need”, “carelessness” or “inexperience” of the weaker party is not, in itself, a sufficient ground for setting the bargain aside. The stronger party must have exploited or traded upon this weakness. The word “exploitation” is given a rather wider construction than the words “need”, “carelessness” and “inexperience”. Thus, it is not necessary to establish that the stronger party had the intention of exploiting the weakness in question or, indeed, that he had a hand in creating it. It is sufficient to show that the stronger party was familiar with the facts. Basically, there is “exploitation” where the stronger party takes advantage of a known weakness of the other party.\(^ {97}\) It follows that, whilst a finding of need, of carelessness or of inexperience has to be based on the actual circumstances of the weaker party, the existence of exploitation depends on the state of mind of the stronger

92 BGH BB 54, 175.
93 BGH NJW 1957, 1274 where the tenant signed a contract in which he undertook not to raise any claims relating to the condition of the premises.
94 BGB-RGRK, supra n 91 at 446.
95 RG, LZ 24, 652, cited by Dawson, supra n 86 at 1060-1061.
96 RG, JW 1937, 25.
97 RGZ, 60, 9; 86, 300; BGH, NJW 51, 397; 66, 1451.
party. In other words, whether or not the stronger party has exploited a “weakness” depends, in the final analysis, on a subjective test. This is to be contrasted with the second requirement of paragraph 138 (2)—the existence of a striking disparity in the value of the considerations furnished by the parties—which is governed by an objective test.

The words “obvious disparity” are defined neither in the Code nor in the leading commentaries. The prevailing view is that whether or not the considerations furnished by the parties are strikingly disproportionate depends on the circumstances of each case. Thus, in a period of galloping inflation, rates of interest of up to 96 per cent per annum were held not to involve a strikingly disproportionate gain and were therefore not considered usurious. Similarly, a high rate of interest was considered justifiable where a loan was extended in respect of a speculative transaction. In ordinary transactions, though, loans involving rates of 45 per cent per annum and of 39.56 per cent per annum were treated as usurious. Moreover, in cases of this type the courts usually take into account the rate at which the loan involved could have been obtained from other sources. A similar test, of comparing the transaction under consideration with terms available elsewhere, applies to sales: if the price differs substantially from the market price, the transaction involves an “obvious disparity” of the considerations furnished. However, in some cases, where the goods may be hard to sell, the disparity is difficult to establish. Thus, in one case a transaction was held not to involve an obvious disparity, although the price amounted to only two-thirds of the market value. One important point concerning the method of comparison has been resolved in a decision of the Bundesgerichtshof of 1964: the value of the two considerations furnished is to be compared as at the date of the making of the contract.

When a transaction runs counter to paragraph 138 (2), the contract is void, so that neither party is under a duty to perform his bargain. Moreover, at one stage, the Reichsgericht (the predecessor of the Bundesgerichtshof) held that the stronger party had no remedy whatsoever, which meant that he stood to lose both capital and profits. A change in policy occurred in 1939, when the same court resolved that a lender, who had granted a usurious loan to a borrower, was entitled to recover the amount lent (but not any interest) by means of an action in restitution under paragraph 812. It appears that a similar remedy is available in transactions other than loans. Thus, a leading commentary suggests that in the case of a sale invalidated under paragraph 138 (2),

98 BGB-RGRK, supra n 91 at 447.
1 RG, JW 1909, 215; cf Oldbg, MDR 52, 36 in which 2 per cent per month were regarded as permissible. Dawson, supra n 86 at 1063, cites examples in which rates of up to 10 per cent per day were upheld.
2 BGH, Bctr 56, 326 and BHG, BB 62, 56 respectively. In BGH, Bctr 67, 677 it was said that 90 per cent per annum would, in any event, be excessive or “obviously disproportionate”.
3 BGH, LM (Ba) Nr 4.
4 BGH, NJW 64, 1787.
5 RGZ 57, 95; 72, 63; 109, 2001; 154, 152. Note that different rules of avoidance apply in cases other than those decided under para 138 (2); BGB-RGRK, supra n 91 at 440.
6 RGZ 151, 70.
7 RGZ 161, 52.
the stronger party is entitled under paragraph 817 BGB to recover the chattels supplied by him. Similar actions in restitution are available to the weaker party.

Two shortcomings of paragraph 138 (2) will have become apparent at this point. The first is that the paragraph contemplates the avoidance of the entire transaction—a drastic effect in respect of contracts involving several undertakings only one of which is tarnished. Fortunately, a solution is provided by paragraph 139 which reads:

If part of a legal transaction is void the entire legal transaction is void, unless it may be assumed that it would have been entered into even if the void part had been omitted.

Thus, where the tainted undertaking is severable from the remaining ones, the court can uphold the rest of the bargain. The second difficulty emerges most clearly from a comparison of paragraph 138 (2) with section 1 of the Moneylenders Act 1900 (UK). The German provision does not confer on the court a power to re-open the transaction with a view to determining an appropriate rate of interest or price. One commentary argues that such a remedy may, nevertheless, be sanctioned by paragraph 139. Presumably, the suggestion is that a transaction, such as a sale or a loan, is avoided under paragraph 138 (2) only to the extent that the price or the interest rate is “disproportionate”. The excess, in other words, is to be severed from the market price or from the usual interest rate. However, the availability of such a remedy has been doubted in a judgment of the Bundesgerichtshof.

Paragraph 138 (2) has, nevertheless, proved to be an effective weapon in cases involving both the exploitation of one party’s weakness (need, carelessness or inexperience) by the other and a disparity in the value of the considerations furnished. It has, for example, been used to combat labour agreements, imposing on the employee a heavy penalty in the event of his giving notice before the end of the prescribed period of employment. Another illustration is provided by contracts in which an author grants an exclusive option over all his future works to a publisher, who does not give any undertaking to publish them. It is interesting to note that, in setting aside clauses and contracts of this type, the German courts have granted a remedy similar to that available in such cases in English law.

When one of the elements required under paragraph 138 (2) is absent, for example when there is no obvious disparity in the value of the under-

8 Staudinger, Kommentar zum BGB (11th ed) vol I, 828; the commentary, though, refers to some authorities suggesting that no recovery is possible. In one decision, the Reichsgericht suggested that such recovery would not be allowed before the end of the contract period: RGZ 161, 57; see also BGB-RGRK, supra n 91 at 448, Anm 27.
9 BGB-RGRK, supra n 91 at 441, Anm 10 and p 448, Anm 27.
10 BGH, BB 1954 172, 174; BGB-RGRK, supra n 91 at 440, Anm 8.
11 BGB-RGRK, supra n 91 at 441, Anm 10. Presumably where the buyer is the stronger party the court could, on this view, raise the price. It is, however, difficult to see how such a course can be sanctioned by para 139.
12 BGHZ 44, 158 at 162. See also BGH, NJW 1938 1772 where a monopoly holding seller fixed a disproportionately high price for his goods; it was held that the entire contract was void and that there was no room for the determination of an appropriate price.
13 RG, IW 1904, 481; 1910, 5 and, generally, BGB-RGRK, supra n 91 at 453.
14 BGHZ, 22, 347.
15 Supra p 308.
takings of the parties, the court may resolve to grant a remedy by invoking paragraph 138 (1). It will be recalled that this provision is clear and terse: “A legal transaction which is against public policy is void.” This provision has, for example, been used to annul unfair covenants in restraint of trade. The test employed in these cases, though, reflects the spirit of sub-paragraph (2). The courts grant relief where the restrictive clause unduly limits the covenantor’s freedom of action, or where it sets out to protect the interests of the one party without any regard to the needs of the other. Relief is most readily available if the restrictive covenant is coupled with a heavy penalty for breach or if it remains in force even where the covenantor is entitled to withdraw from the remaining parts of the contract.

Paragraph 138 (1) has also been invoked in cases involving contracts known in Germany as Knebelungsverträge. The phrase, which is hard to translate, means contracts in which one party succeeds in controlling the economic freedom of the other to such an extent that the former may be regarded as having obtained a stranglehold over the latter. A well-known instance of such contracts are beer franchises granted by breweries to innkeepers. In contracts of this type the brewery frequently extends the innkeeper a loan to enable him to finance the acquisition of the business. As a quid pro quo the innkeeper undertakes to purchase all his supplies from the brewery. Occasionally, the contract binds the innkeeper for a long period of time and the beer is supplied to him at an unfavourable price. It is difficult for the courts to intervene under paragraph 138 (2), as the rate of interest charged by the brewery is usually not above the market rate. An obvious disparity in the values of the considerations furnished by the parties is, therefore, hard to establish. Relief against such contracts has, however, been granted under paragraph 138 (1). The test used by the courts is, basically, whether or not the innkeeper loses his economic freedom as against the brewery. The courts take into account the extent of the restriction and, in particular, whether or not it appears to be excessive or unfair. The unconscionability concept of paragraph 138 (2) is, undoubtedly, reflected in these considerations.

Another instance of “stranglehold” occurs in transactions involving excessive security. German law sanctions the assignment by way of security of future book debts and of future assets including their proceeds. Thus, a German bank or finance company is able to obtain an assignment of all present and future “receivables” of a client [Sicherungsübereignung]. Similarly, a German manufacturer, who supplies goods on credit, is able to acquire a security interest over

16 RGZ 53, 156; 68, 229; BGH, NJW 64, 2203. Note is taken of the location and of the period stipulated in respect of the covenant.
17 RG, JW 1913, 592; 1915, 191; BGH, NJW 64, 2203.
18 RGZ 68, 229; 74, 332; 78, 258.
19 RGZ 59, 76; and see BGB-RGRK, supra n 91 at 454, Anm 39.
20 So explained in BGB-RGRK, supra n 91 at 449. The term is suggested by Dawson, supra n 86 at 1071ff and n 71, who gives an excellent account of such contracts and who uses the term “shackling”. Murray, “Priority Problems in Private Financing—the German Experience and the UCC Compared” (1970) 11 BC Ind & Com L Rev 355 uses the term “fettering”.
21 See authorities cited in BGB-RGRK, supra n 91 at 450.
22 RG, JW 1936, 569 and also authorities cited in BGB-RGRK, supra n 91, Anm 31.
23 BGHZ 54, 145; BGH, NJW 70, 2243; 74, 2089. These authorities were drawn to our attention by Professor Dawson’s article.
all the goods to be supplied by him to a customer as well as over their proceeds.24 A series of decisions of the Reichsgericht and of the Bundesgerichtshof have, however, established that such a transaction will be set aside if it gives the financier complete economic control of the debtor's affairs.25 The provision invoked for this purpose, as may be expected, is paragraph 138 (1). The test employed by the courts in such a case is, again, one of fairness or of conscionability.26 One commentary explains:27

A security agreement, which restricts the debtor's economic freedom of movement to an excessive extent and which deprives him almost entirely of his financial flexibility, is contrary to public policy. This is particularly the case where the creditor assumes a one sided stance, having regard solely to his security interest, and ignores the valid interests of the debtor.

When a contract of this type is set aside, the benefit is usually reaped by the debtor's general creditors or by a competing secured creditor. In effect, paragraph 138 (1) assists, in this instance, in determining questions of priorities.

It is important to emphasise that the foregoing discussion of paragraph 138 is far from complete. It does, however, highlight some of the useful roles played by this provision in German law. Before attempting to reach conclusions about its efficacy, it is advisable to discuss the second unconscionability provision of the BGB—paragraph 242—and the use of the unconscionability concept in respect of certain clauses found in standard form contracts.

Paragraph 242, which relates to the performance of contractual undertakings, reads:28

The debtor is bound to effect performance according to the requirements of good faith, having regard to common usage.

The word "debtor", in this paragraph and generally in the BGB, has a wide meaning: it may be more accurate to translate it as "promisor". Paragraph 242 is, thus, a general provision of the German law of obligations. It provides that a contract has to be performed in a manner compatible with good faith and in accordance with the commands of good business mores.

In practice, the paragraph constitutes a double-edged sword. On the one hand, it aids the promisor if the promisee raises technical points respecting the promisor's performance of the contract. By way of illustration, take a case in which a buyer purports to reject the goods by reason of a minute shortage in the quantity delivered or because of defects in an insignificant proportion of the goods supplied. Under paragraph 242 such behaviour militates against "good mores".29 On the other hand, the paragraph may occasionally impose on the promisor a duty to do more than is required under the express terms of the contract. The most famous instance in which paragraph 242 was invoked for such a purpose occurred during the disastrous inflation which followed the First World War. During that period the German currency lost its value

24 This is, in all probability, one of the most over-written subjects in German law. For an excellent account in English see Murray, supra n 20.
25 The case law is enormous; see, generally, Staudinger, supra n 8 at 807-809.
26 RGZ 143, 48; RG, JW 1936, 1955; cf BGHZ 19, 12.
27 BGB-RGRK, supra n 91 at 450, Anm 32. The agreement is more readily set aside if it may have the effect of misleading third parties.
28 For a useful discussion of this provision see W Fikentscher, Schultrecht (4th ed) 109ff; Soergel-Knopp, BGB (10th ed) vol 2, para 241ff.
29 BGHZ 1, 4; BGH BB 1957, 92.
to such an extent that the repayment of debts on the basis of nominalism\textsuperscript{30} meant that the creditor had to sustain an enormous loss. The Reichsgericht decided that, under paragraph 242, debtors were under a duty to pay back amounts which would compensate creditors for the loss of the purchasing power of the currency. This process, which became known as revalorisation, was, eventually, sanctioned by an Act.\textsuperscript{31}

The usefulness of paragraph 242 is most readily demonstrated by a review of cases decided under it. For reasons of space it is necessary to confine the discussions to three specific groups.

The first group comprises cases involving the misuse of contractual rights by a promisee. Usually this occurs where the promisee attempts either to escape liability or to invoke a sanction by relying on an insignificant defect in the performance of the promisor's bargain. Cases of this type include, for example, an attempt by a creditor to invoke a penalty or a forfeiture clause by reason of a short delay in the payment of an instalment due under a lending transaction\textsuperscript{32} and the cancellation of a charterparty on the ground of a short delay in the arrival of the ship in port.\textsuperscript{33} Under paragraph 242, a person who adopts such an attitude is regarded as not acting in good faith. For the same reason an insurer is not entitled to cancel a policy merely because there has been a short delay in the payment of a small portion of the premium.\textsuperscript{34} However, not every delay is excused under paragraph 242, as was discovered by an assured, who had failed to remit the premium by the end of a period of grace granted to him by the insurance company, but who hurried to pay it immediately thereafter... when his car was damaged in a collision.\textsuperscript{35}

A misuse of rights can, likewise, occur where one party unreasonably denies some rights to the other. Thus, a tenant, who is denied permission to use the premises for a legitimate purpose, may obtain a remedy under paragraph 242, provided the proposed use does not cause loss to the landlord. The remedy is available even if the use in question is prohibited by a clause in a standard form lease signed by the parties.\textsuperscript{36}

The second group of cases involves the inconsiderate use of rights. This occurs mainly where a promisee seeks a specific remedy, although another one would cause a smaller loss to the promisor. Thus, a promisee is not justified in withdrawing from an entire contract when his rights can be equally safeguarded by some other means, such as the repair of goods supplied.\textsuperscript{37} Similarly, a landowner is not entitled to claim damages from an architect if he can equally obtain satisfaction by minor repairs made by the builder.\textsuperscript{38}

The third group comprises cases in which a party, who leads the other to believe that there is no need to comply with a given contractual term, changes his mind on this point. By way of illustration, take an insurance company which, in the course of negotiations for the settlement of a claim, indicates that it will not make use of a clause which limits the

\textsuperscript{30} Under the nominalistic principle a currency unit, such as one DM or one NZ $, is treated as having the same, unchanged value, regardless of its parity with other currencies and regardless of the money's purchasing power.

\textsuperscript{31} RGZ, 107, 78; cf BGHZ 2, 150; 2, 383; 4, 162. An Act passed in 1924.

\textsuperscript{32} RGZ 152, 251, 258.

\textsuperscript{33} RGZ 117, 354.

\textsuperscript{34} BGHZ 21, 123, 136.

\textsuperscript{35} Soergel-Knopf, supra n 28 at 71, Anm 250.

\textsuperscript{36} Ibid, Anm 251.

\textsuperscript{37} RGZ 61, 92; 87, 337; 91, 110.

\textsuperscript{38} BGHZ 39, 261, 265.
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time for instituting an action. Under paragraph 242, the company is precluded from invoking this clause if the negotiations break down and the assured commences proceedings after the end of the prescribed period of limitation.39 Similarly, a surety is not allowed to plead a defect of form in his guarantee, if he has told the promisor that, being a man of honour, he will not raise such a technicality.40 A decision of the Bundesgerichtshof applied the same principle when an employer induced an employee to waive a required notarial verification of an agreement by saying: "My word is as good as a notarial act."41 In English law, some of these cases might be resolved, in a similar spirit, under the doctrine of waiver or of promissory estoppel.

The cases demonstrate that paragraph 242 serves a function different from that of paragraph 138. The latter provision is used to combat unconscionable terms; the former condemns the unconscionable use of contractual rights. However, the two provisions are complementary. In some instances they are, indeed, used side by side: the most topical example in point is that of standard form contracts.

The German courts, like their English counterparts, commenced the assault on unfair clauses in standard form contracts by resorting to rules of construction. The Bundesgerichtshof's approach is succinctly summarised by Professor Dawson:42

If the draftsmen of the document show concern only for the interests of one side of a two-sided transaction, this disregard of others contradicts fairness and justice. The provisions of a document prepared and duplicated for widespread use must therefore be interpreted so that justice and fairness will be served, and if its language does not permit this the unjust and unfair provisions will be unforeseeable by the disadvantaged party, offensive to good morals (para 138), and also perhaps provide ground for damage liability for harm intentionally caused (para 826).

The German courts are particularly firm in assailing clauses, included in standard form contracts, in which a monopoly or some other strength of bargaining position is utilised in order to make the agreement one-sided.43 In addition to paragraph 138, the courts have resorted in certain instances of this type to paragraph 242. One case in point concerned the General Terms and Conditions of the German Banks, which excluded liability for incorrect banking references and incorrect information respecting investments. It was held that, if a bank supplied an inaccurate reference, or gave unsound advice, from which it derived any direct or indirect advantage, it was precluded from relying on the exemption clause.44 Another illustration is provided by standard form building contracts prepared by the builder: a clause which entitles the builder to deny liability for his own gross carelessness or default can be subject to attack under paragraph 242.45

It seems reasonably clear that the German courts have employed paragraphs 138 and 242 for useful purposes. Undoubtedly, the courts have adopted a conservative approach, motivated by a wish to avoid uncer-

39 RGZ 148, 300; 155, 106; BGH Vern R 1963, 640.
40 Fikentscher, supra n 28 at 123.
41 BGHZ 48, 396.
42 Supra n 86 at 1108.
43 BGB-RGRK, supra n 91 at 449, Anm 29.
44 BGH WM 55, 2230, 234; 70, 632, 633. See also J Schmidt-Salzer, Allgemeine Geschäftsbedingungen (1971) 166-167.
45 BGHZ 62, 251.
tainty in the law. Paragraphs 138 and 242 have nevertheless introduced a certain flexibility that is absent in the treatment of comparable problems in English and in French law. The American experience supports this conclusion.

**Unconscionability under the Uniform Commercial Code (USA)**

Provisions similar to those of the BGB are included in the Uniform Commercial Code of the United States. Section 1-203, under which "every contract or duty . . . imposes an obligation of good faith in its performance or enforcement" and which is, thus, similar to paragraph 242 BGB, has not given rise to a great deal of litigation. The prominent role in the field of unconscionability has been played by section 2-302, which serves a function resembling that of paragraph 138 BGB. This section reads:

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.
2. When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

There are four major distinctions between this section and paragraph 138 BGB. In the first place, paragraph 138 is included in the General Part of the German Code and has, therefore, a general scope of application. In particular, it applies throughout the entire German law of contract. Section 2-302, on the other hand, is a provision of article 2 of the UCC which concerns sales. Thus, it appears that, on its face, section 2-302 has a much narrower scope of application than paragraph 138. Whilst some decisions emphasise this limitation of section 2-302, it has nevertheless been applied to transactions other than sales, such as guarantees and leases of chattels. The explanation for this extension of the principle is that the section was derived from a body of pre-Code case law which was not confined to sales. It seems likely that the trend of employing the section in areas other than sales will continue.

The second distinction between paragraph 138 and section 2-302 relates to the remedy. Here the German provision is the narrower one. It will be recalled that the only remedy envisaged by paragraph 138 is the setting aside of the entire contract. A re-opening of the transaction

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47 Two other provisions are ss 5-108 and 6-111 of the Uniform Consumer Credit Code; for reasons of space it is impossible to discuss these provisions in detail.


49 *Blount v Westinghouse Credit Corp* 432 SW 2d 549, 554 (Tex 1968).

50 *Electronics Corp of America v Lear Jet Corp* 286 NYS 2d 711 (1967).

51 See, generally, Official Comment 1 to s 2-302; cf Ellinghaus, supra n 46 at 808-809. Note that the scope of article 2 is, in any event, somewhat wider than sales stricto sensu as s 2-102 applies it to transactions in goods generally.
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is, in all probability, unavailable under the paragraph. Section 2-302, on the other hand, makes provision for several measures, including the re-opening of the transaction. Thus, in *Frostifresh Corp v Reynoso* a seller, who obtained an exorbitant price for a refrigeration unit by taking advantage of the buyer’s ignorance, was allowed to retain the net cost of the article plus a reasonable profit and trucking and service charges. The balance of the price was ordered to be refunded to the buyer, who was, thus, able to retain the unit by paying a reasonable amount. It seems clear that this type of solution is preferable to that available in German law, in which, after the setting aside of the contract, the stronger party would be confined to seeking restitution under paragraphs 812 or 817. Another remedy available under section 2-302 would, probably, be the re-writing of a penalty or liquidated damages clause, so as to preclude the stronger party from recovering more than his loss. However, section 2-302 does not provide for damages to be awarded to a person who, unwittingly, has entered into an unconscionable agreement. Whilst such a remedy is equally unavailable under paragraph 138 BGB it may, occasionally, be allowed under paragraph 826.

The third demarcation between the two provisions is to be found in section 2-302 (2), under which the parties to a dispute involving an unconscionability issue “shall be afforded a reasonable opportunity to present evidence as to [the contract’s] commercial setting, purpose and effect...” The importance of this provision has been highlighted by a number of decisions. Whilst paragraph 138 does not have a comparable sub-clause, it would appear that German courts have the power to call similar evidence. This is an outcome of the German rules of civil procedure, under which the court takes a far more active role in proceedings than in the Anglo-American systems.

The fourth and most significant difference between paragraph 138 and section 2-302 relates to the respective philosophies employed by the draftsmen. It will be recalled that paragraph 138 spells out the instances in which a transaction is to be set aside for unconscionability. Sub-paragraph (1) empowers the court to intervene where a transaction offends against public policy. Sub-paragraph (2)—the *Wucher* or usury clause—affects cases in which the guilty party trades on a weakness (need, carelessness or inexperience) of the other in order to make an “obviously disproportionate” gain. When one of these elements is missing, and the transaction is not contrary to public policy, the weaker party is left without a remedy unless the court is able to invoke either paragraph 242 (good faith in performance) or 826 (abuse of rights). Section 2-302 is of a far more general nature: it enables the court to step

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52 281 NYS 2d 964 (1967) (Sup Ct) reversing 274 NYS 2d 757 (Dist Ct 1966) which denied seller any allowance for profits and charges. But note that if a contract is executory when the action is brought, the tendency is to set it aside: *American Home Improvement Inc v MacIver* 201 A 2d 886 (NH 1964).
54 *Block v Ford Motor Credit Co* 286 A 2d 228, 233 (DC Ct App 1972); *Mitchell-Hunten Co v Lawson* 377 F Supp 661 (1973); *Darden v Ogle* 310 So 2d 182 (Ala 1975).
55 This impression is gained from an examination of many of the German cases in point; it is quite clear that the German courts familiarise themselves with the specific facts and with the setting of the transaction assailed.
in whenever a transaction is found to be “unconscionable”.\textsuperscript{56} It is significant that this key word is not defined in the Code. The guidance given by Official Comment 1 is, likewise, rather general:

This section is intended to allow the court to pass judgment 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.

This Comment, like the section itself, is of a general nature. That the determination of an unconscionability issue is a matter of law emerges, in any event, from the language of sub-section (1). That, in deciding the issue, the court is expected to have regard to the commercial background and setting of the transaction is apparent from the closing words of sub-section (2). The only supplementary guidance given by the Comment is, first, that the court is to consider the extent to which the bargain is one-sided; secondly, that a mere inequality in bargaining power is not in itself an adequate reason for condemning the bargain; and, thirdly, that the presence of an element of surprise or of oppression is of paramount importance.

None of the guidelines set out in the Comment, or indeed in section 2-302 itself, is as definitive as paragraph 138 BGB. One author suggests that the distinction, in essence, is that section 2-302 is a general clause whilst the German provision, in particular subparagraph (2), is not.\textsuperscript{57} Another way of explaining the difference is to focus on the extent of the discretion conferred by the two provisions on the respective courts. A German court has to satisfy itself that a transaction, which it is asked to set aside, falls either within subparagraph (1) by being contrary to public policy or that it is usurious within the meaning of subparagraph (2). The court’s function, therefore, is mainly one of applying the paragraph. An American court has a much wider discretion than that. In the final analysis it has the power to decide what is meant by the word “unconscionable”. This role is far more creative than that of the German courts.

In practice, though, the difference between the roles of the German and of the American courts in determining unconscionability issues is considerably less pronounced than is suggested by the theoretical comparison. Up to a point, this is due to the fact that paragraph 138 does not exist in isolation. It is augmented by paragraphs 242 and 826, which confer a substantial discretion on the German courts. So, indeed, does the public policy principle enshrined in paragraph 138 (1). More-

\textsuperscript{56} Some authorities attempt to define unconscionability but without adding much to the factors emphasised in Official Comment 1. See Williams v Walker-Thomas Furniture Co 350 F 2d 445, 449 (DC 1965) (stressing the element of no choice); Central Budget Corp v Sanchez 279 NYS 2d 391, 393 (1967); Blount v Westinghouse Credit Corp 432 SW 2d 549, 559 (Tex 1968) (suggesting as a test that the bargain ought to be one “no man in his senses . . . would enter into and which no honest and fair person would accept”); Gimbel Bros Inc v Swift 307 NYS 2d 952 (1970) (transaction must “affront the sense of decency”); Kugler v Romain 279 A 2d 640, 651-2 (NJ 1971) (suggests links with fraud).

\textsuperscript{57} Dawson, supra n 46 at 1042, 1052. This remains the case even in respect of the amended version of para 138 (2), as to which see supra n 88.
over, despite the wide discretion conferred by section 2-302 on the American courts, a note of caution runs through the American decisions. This is demonstrated by a review of the cases concerning the major elements of unconscionability: the parties' inequality of bargaining power, the disparity in the considerations furnished, the trading on a party's weakness by the other and public policy. A specific topic of interest is the application of section 2-302 to exemption clauses in standard form contracts.

Official Comment 1 suggests that a mere inequality in the parties' bargaining power is an inadequate reason for branding a transaction unconscionable. The cases bear this out. Thus, some authorities indicate that, where the weaker party is aware of the nature of the bargain and is familiar with the trade in question, an intervention under section 2-302 is unjustified despite his inferior bargaining position. Similarly, there is no room for a finding of unconscionability if the parties conducted genuine negotiations. A fortiori, unconscionability is ruled out if the parties are of an equal bargaining capacity and of an equal commercial expertise.

The position differs where the stronger party exploits his superior position in order to extract an exceedingly one-sided bargain. An American court has the jurisdiction to set aside or to re-open a contract in which the considerations furnished are disproportionate. Thus, in *American Home Improvement Inc v MacIver* a contract, in which a consumer agreed to pay a total of $2568.60 (which included a "sale commission" of $800 and a finance charge of $809.60) for goods and services worth $959, was held to be unconscionable. Later cases confirm that a contract may be unconscionable because of the extortionate price alone. In this respect, the American courts have been less restrained than the German courts, which have to find an element of exploitation of a party's "weakness" in addition to a disparity of the considerations. However, one American court has warned against reducing section 2-302 to a "mathematical ratio formula" and emphasised that the courts will intervene only where the excess in price is gross. By and large, the American courts have invoked the section where the price was at least two and a half times above the market value. They are, likewise, prepared to reduce highly excessive interest rates.

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58 See, in particular, *Copen Association Inc v Dan River Inc* 18 UCC Reptg Serv 62 (NY Sup Ct 1975).
64 *Jones v Star Credit Corp* 298 NYS 2d 264 (1969).
65 This emerges from *Mobile America Corp v Howard* 307 So 2d 507 (Fla 1975). Cf *Singer Co v Gardner* 296 A 2d 562 (NJ 1972); but note that usually where the unconscionable transaction is a consumer credit contract a remedy is, at present, available under the UCC (supra n 47).
Like their German counterparts, and in harmony with Official Comment 1 to section 2-302, the American courts take into account, when considering an unconscionability issue, any exploitation of one party’s weakness by the other. In *Williams v Walker-Thomas Furniture Co* the Circuit Court of Appeals for the District of Columbia thought that one component of unconscionability was “an absence of meaningful choice on the part of one of the parties.” Obviously, there is some similarity between such “absence of choice” and the element of “need” or of a “state of necessity” mentioned in paragraph 138 (2) BGB, although the American formulation is wider. The trading on a party’s ignorance was held to be unconscionable in *Frostifresh Corp v Reynoso*, in which a Spanish-speaking buyer, who had a limited command of the English language, was induced to sign an onerous contract of sale which had not been translated to him.

Instances of the exploitation of a party’s carelessness or foolhardiness occurred in cases involving “referral franchises” or “pyramid selling schemes”. Thus, in *Lefkowitz v ITM Inc* goods were sold to a purchaser at a price of up to six times their cost. The purchaser was induced to enter into this bargain by a promise that he would be paid a commission of $50 or more for every new customer to be introduced by him and by an assurance that the profits so made would suffice to cover the price of his own purchases. It was held that this transaction was unconscionable under section 2-302.

A further similarity between the treatment of unconscionability by a German and by an American court is that both have the power to grant a remedy under the respective unconscionability provision where a bargain is contrary to public policy, for example, where it contains an unduly wide exemption clause. In both countries the courts have stressed that the unconscionability concept does not furnish the means for a general assault on exemption clauses in standard form contracts. Such a term may, nevertheless, be struck down where this is warranted by the commercial background and setting of the contract and by the extravagant nature of the exemption clause.

Before concluding the discussion of section 2-302, it is important to reiterate that there has been no attempt to define “unconscionability”. Indeed, the very nature of section 2-302 renders such an attempt a difficult task. The policy of the Uniform Commercial Code has been summed up succinctly by the Supreme Court of New Jersey in *Kugler v Romain*.

67 274 NYS 2d 757 (1966) reversed on a different point; 281 NYS 2d 964 (1967).
68 See also *Jefferson Credit Corp v Marciano* 302 NYS 2d 390 (1969).
69 275 NYS 2d 303, 321-322 (1966); see also *Frostifresh Corp v Reynoso*, supra n 62.
70 For another type of “pressure” see *Abbott v Abbott* 195 NW 2d 204 (Neb 1972).
71 Unico *v Owen* 232 A 2d 405, 418 (NJ 1967).
72 See, generally, *Haynie v A & H Camper Sales Inc* 208 SE 2d 354 (Ga 1974); *Kleven v Geigy Agricultural Chemicals* 227 NW 2d 566 (Minn 1975). As regards German law, see supra pp 317-326.
73 326 A 2d 90 (NJ 1974) (s 2-320 applied in respect of a contract between businessmen); see also *Zabriskie Chevrolet Inc v Smith* 240 A 2d 195 (NJ 1968); *Metro Chrysler-Plymouth Inc v Jacobs* 188 SE 2d 250 (Ga 1972); *Chrysler Corp v Wilson Plumbing Co Inc* 208 SE 2d 321 (Ga 1974).
74 279 A 2d 640, 652 (1971)—emphasis added; note similarity between “material departure” and “disparity of price”.

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68 See also *Jefferson Credit Corp v Marciano* 302 NYS 2d 390 (1969).
69 275 NYS 2d 303, 321-322 (1966); see also *Frostifresh Corp v Reynoso*, supra n 62.
70 For another type of "pressure" see *Abbott v Abbott* 195 NW 2d 204 (Neb 1972).
71 Unico *v Owen* 232 A 2d 405, 418 (NJ 1967).
72 See, generally, *Haynie v A & H Camper Sales Inc* 208 SE 2d 354 (Ga 1974); *Kleven v Geigy Agricultural Chemicals* 227 NW 2d 566 (Minn 1975). As regards German law, see supra pp 317-326.
73 326 A 2d 90 (NJ 1974) (s 2-320 applied in respect of a contract between businessmen); see also *Zabriskie Chevrolet Inc v Smith* 240 A 2d 195 (NJ 1968); *Metro Chrysler-Plymouth Inc v Jacobs* 188 SE 2d 250 (Ga 1972); *Chrysler Corp v Wilson Plumbing Co Inc* 208 SE 2d 321 (Ga 1974).
74 279 A 2d 640, 652 (1971)—emphasis added; note similarity between "material departure" and "disparity of price".
The standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing. The need for application of the standard is most acute when the professional seller is seeking the trade of those most subject to exploitation—the uneducated, the inexperienced and the people of low incomes. In such a context, a *material departure* from the standard puts a badge of fraud on the transaction and here the concept of fraud and of unconscionability are interchangeable.

This quotation spells out the main criteria used by an American court to adjudicate an unconscionability issue. It is believed that the comparison undertaken in the foregoing pages shows that, in practice, these issues are determined in a similar manner both in Germany and in the United States. It will, nevertheless, be useful to consider which of the two approaches—that of the Uniform Commercial Code or that of the *Bürgerliches Gesetzbuch*—is to be preferred. This question is discussed in the next Part of this paper, which also discusses whether or not the adoption of an unconscionability concept is a better solution than the practice prevailing in England and in France.

### III AUSTRALASIAN PROPOSALS IN THE LIGHT OF COMPARATIVE STUDY

It will be recalled that the object of the comparative study of Part II was to prepare the ground for a discussion of the desirability of the introduction of a general unconscionability concept into the legal systems of Australia and New Zealand. In Australia such a reform has been proposed in the *Report on Harsh and Unconscionable Contracts* submitted by Professor John R Peden to the Minister of Consumer Affairs of New South Wales in October 1976.74 In New Zealand, the Contracts and Commercial Law Reform Committee recommended in February 1977, in its *Report on Credit Contracts*,75 the introduction of unconscionability rules in respect of lending and of other credit transactions. Before discussing the Australasian proposals in detail it will, however, be convenient to draw some general conclusions from the experience gained in the four jurisdictions discussed above.

#### A Utility of Unconscionability Concept

It is submitted that the comparison of the laws of England and of France with those of Germany and of the United States demonstrates the merits of a general unconscionability concept. Our study suggests that, regardless of whether or not such a concept is applicable in a given system, the courts will endeavour to grant relief against an unfair or harsh bargain. Where the courts cannot do so openly, by relying on provisions such as section 2-302 of the UCC or paragraphs 138 and 242 BGB, they strive to attain their object indirectly. The enunciation of the derisory price rule in France and the remarkable development of promissory estoppel in English law are telling illustrations in point.

This trend furnishes a strong argument in support of the adoption of unconscionability rules of a general nature. It is objectionable to force the courts to do justice by stealth. A judge, who is able to say: "this transaction is hereby set aside because it is unconscionable", speaks his mind; a judge who, to set the same transaction aside, has to find some excuse for placing it within one of the tight compartments available under the applicable system, resorts—in the final analysis—to fiction.

74 Professor Peden at p 3 of the *Report* refers to a *Memorandum Relating to a Harsh and Unconscionable Contracts Ordinance for the Australian Capital Territory* prepared by a Working Party on Consumer Protection Laws. This paper, unfortunately, is not available to us.

75 It is understood that a Bill is currently being drafted.
If this conclusion is correct, it substantiates another telling argument in support of unconscionability rules. Whilst fiction may occasionally be a useful substitute for statutory reform, it has the harmful side-effect of introducing artificiality into the law. By way of illustration, take the French distinction between a "derisory price", which entitles the court to set the contract of sale aside, and a "lesionary price" which is not contestable per se. The artificiality of this distinction and the difficulties posed by it are highlighted by the Frescoes case. It may be countered that German law has a similar distinction, under paragraph 138 (2), between an "obvious disproportion" in the considerations furnished and a lesser disparity. This comparison, however, is unsound. The German provision lays down a perfectly clear test, which has to be applied by a court when it determines an issue under paragraph 138 (2). In contrast, the French principle introduces a vague element by employing the emotive term "derisory". This unclear word is being used in order to support the fictitious contention that a very low (or a "derisory") price is no price at all and that, on this basis, the relevant contract of sale is without cause.

A particular merit of a general unconscionability concept, such as paragraphs 138 and 242 BGB or section 2-302 of the UCC, is that it allows for a certain flexibility. A court can apply it in a specific case without modifying the entire law governing the transaction in question. For this reason, there is no need to exclude unconscionability rules from any specific area of the law of contract. Their true effect is to confer a supervisory power or jurisdiction on the courts.

It may be suggested that, even in legal systems which have not adopted the concept, the courts exercise such a supervisory jurisdiction by means of specific rules, such as the rule against penalties. It is, however, undeniable that these specific rules are of much narrower application than a general doctrine. It is equally undeniable that there are cases in which a remedy, available under general unconscionability rules, is unavailable in a system which has not adopted them. The French Frescoes case is, again, a good example in point. In French law—which regarded the price as "lesionary" but not as "derisory"—the sellers lost out. English law, in all probability, would have led to a similar outcome. German and American courts would have been in a much better position to grant a remedy, as all the elements of unconscionability were present in this case. The sellers were illiterate and simple-minded and the buyers exploited this weakness to pay an obviously low or "disproportionate" price. Thus, German and American law would have enabled a court to grant the very remedy which the French tribunal, despite its sympathy for the sellers, felt itself unable to provide. Another illustration is furnished by pyramid sales. It will be recalled that American courts were able to combat these unwholesome schemes under section 2-302. It is significant that in some other common law jurisdictions, in which the unconscionability concept was inapplicable, the legislature found it necessary to pass special Acts in order to outlaw these devices. Presumably, no common law remedy would have been available in these jurisdictions to gullible victims of pyramid sales.

It is believed that the comparative study of the legal systems of Eng-

76 D 1965 J 217; see supra p 313.
77 An escape route might have been provided by the undue influence doctrine.
78 See eg the Commerce Act 1975 (NZ) s 31ff.
land, of France, of Germany and of the United States confirms that the unconscionability concept is capable of serving a useful function. Moreover, the experience gained in Germany and in the United States demonstrates that unconscionability rules do not introduce uncertainty into the law of contract. The fact is that both the American and the German courts have been cautious and conservative in exercising their powers under the unconscionability rules applicable in their respective systems. Indeed, in both countries the courts tend to compare the terms of transactions assailed under the unconsonability rules with the terms available for such deals from other sources. The courts have shown themselves to be strongly disinclined to intervene in a transaction which is on ordinary terms. The use of unconscionability rules for the purpose of a general assault on standard form contracts employed in a given trade or business can, therefore, be ruled out.\textsuperscript{79}

It is submitted that unconscionability rules are of sufficient merit and importance to warrant their introduction into the legal systems of Australia and of New Zealand. Whilst they do not provide a general answer to the problems of one-sided contracts, and whilst they cannot possibly replace statutes, such as a Consumer Transactions Act, which regulate an entire branch of law, unconscionability rules confer a desirable supplementary power on the courts. In other words, unconscionability is a residual though essential concept. Having reached this conclusion, it remains to be seen which type of provision—that of the UCC or those of the BGB—is to be preferred.

It will be recalled that the main difference between the American approach to unconscionability, as manifested in section 2-302 UCC, and the German one, as highlighted by paragraph 138 (2) BGB, is that the former does not attempt to define the concept whilst the latter provides a clear test. It is submitted that the American solution, which confers a wide discretion on the courts, is to be preferred. The German provision can, on occasion, force the courts to resort to the same type of artificial approach employed by their English and French counterparts. This can, for example, occur in a transaction which involves a striking disparity in the considerations furnished (or a "usurious price") but which does not present an element of the exploitation of one party’s weakness by the other. If the court wishes to grant relief on the ground of unconscionability, it has to invent such a weakness or, artificially, to invoke the public policy provision of paragraph 138 (1). The court may face a similar dilemma, of refusing a remedy or resorting to fiction, if there has been an exploitation of one party’s weakness but the value of the considerations is substantially rather than strikingly disproportionate. It is believed that, if the courts are given power to grant relief against unconscionable bargains, it is best to leave the ultimate decision as to what constitutes unconscionability in their hands.

The American experience, as has been seen, proves that this approach to unconscionability does not introduce uncertainty into the law of contract. Moreover, section 2-302 has not led to inconsistency in decisions reached by different judges and courts. Two factors contribute to this harmonious outcome. The first is the existence of the law reports.

\textsuperscript{79} It is significant that the German Legislature found it necessary to pass a special Law on the Regulation of Standardised Contract Terms: \textit{Gesetz zur Regelung des Rechts den allgemeinen Geschäftsbedingungen} of 9 December 1976 (AGB-Gesetz) discussed briefly by von Mehren and Gordley, \textit{The Civil Law System} (2nd ed 1977) 1207ff.
Whilst courts do, on occasion, express disapproval of existing cases and take an independent stand, they are, by and large, inclined to be persuaded by existing precedents, even if these are not binding. Secondly, the Official Comment provides guidelines describing the factors that a court ought to take into account in determining unconscionability issues. Whilst these guidelines are neither exhaustive nor binding, they have assisted the courts in reaching their conclusions and, in this way, have contributed to the attainment of uniformity in the case law concerning section 2-302. It is believed that the provision of guidelines of this sort is desirable. They are preferable to the setting of exact boundaries for “unconscionability” as found in paragraph 138 (2).

Another advantage of the American provision, as compared with the German, is in the variety of the remedies available under section 2-302 as opposed to the inflexibility of paragraph 138, which provides solely for the setting aside of the contract or of the offending clause. It is in the interests of both parties to an unconscionable contract that the courts be authorised to grant the most suitable remedy. Thus, where a loan is usurious, it is best if the court has the power to determine a suitable rate; the setting aside of the entire contract is contrary to the interests of both parties. Moreover, it is conceptually sound to suggest that if the courts are given the power to intervene in transactions which they consider unconscionable, they should likewise be given a wide discretion regarding the remedy to be granted in such cases. The courts should, therefore, have the power to set aside the unconscionable bargain in its entirety, the power to delete from the contract any unconscionable clauses and the power to re-open and to re-shape the bargain. They should equally have the power to order restitution of money paid and of property delivered under the unconscionable bargain. All these remedies are, of course, available under section 2-302. In addition, there is much to be said for granting the courts the additional power to make, in appropriate cases of this type, an order for the payment of damages.

Whilst the American approach appears to provide better guidance for reform than the German, there is one aspect in which the provisions of the BGB are superior to those of the UCC. Section 2-302 is explicitly confined in its application to cases involving unconscionable bargains. The unconscionability of the contract, or of some of its terms, must therefore be present at inception. Although this applies with equal force to paragraph 138 BGB, the German courts have been able to augment this provision by a skilful manipulation of paragraph 242. It will be recalled that, under this paragraph, the courts are able to combat the unfair use of contractual rights, even where the clause, which confers these rights, is not unconscionable per se. Section 1-203 of the UCC, which resembles paragraph 242 in its language, has not been put to a similar use by the American courts. It appears clear that a provision, such as paragraph 242, is complementary to a provision, such as paragraph 138 BGB or section 2-302 UCC, which combats unconscionable terms. It is submitted that the inclusion of such a supplementary provision in a modern enactment of an unconscionability concept is of paramount importance. Moreover, it ought to be set out in language clearer than that of paragraph 242.
B The Peden Report

The conclusions from the comparison of the approach to the unconscionability concept in the four legal systems discussed in Part II will form the basis of the review of the proposals made in Professor Peden's Report, referred to above.

Professor Peden proposes the enactment of a Contracts Review Act, which would entitle the courts to re-open and review any type of contract alleged to be harsh or unconscionable. Three measures are, however, recommended in order to preclude the introduction of uncertainty into the law of contract. The first is a limitation of the scope of the application of the Act. It is proposed that no remedy under the Act be available to public corporations or to the Crown, meaning, in this context, government departments. The second is the prescribing of "factors which, to the extent that they are relevant to the circumstances, should be taken into account" in determining whether or not a transaction is unconscionable. The third measure is the inclusion, among these factors, of "the commercial or other setting, purpose, and effect of the contract" and "whether or not and when independent legal advice was obtained by the party seeking relief." Each of these proposals requires brief discussion.

The first measure is, in a sense, a compromise. Ideally, Peden would wish to apply the unconscionability rules to any type of transaction. The exclusion, however, aims to ensure that substantial business contracts remain outside the scope of the Act. Peden rejects the alternative of introducing an exemption based on the monetary value of the transaction, as this would involve difficulties of defining the ambit of the transactions excluded. An exemption of all business contracts, which would confine the unconscionability concept to consumer transactions, is equally rejected by implication. Peden is, undoubtedly, right in thinking that the denial of a remedy to public corporations and to government departments is the least harmful compromise. But it may be asked why any compromise of this sort is necessary. As one of the factors that the courts are required to take into account involves a consideration of the commercial setting and purpose of the contract and the availability of legal advice during the negotiations, it is difficult to see why any blanket exclusion remains necessary. In the vast majority of cases both public corporations and government departments take legal advice before entering into a transaction which is out of the ordinary. In view of this fact, as well as in view of the financial and bargaining power of public corporations and of government departments, a court is highly unlikely to grant them a remedy based on unconscionability rules even if they are not expressly precluded from seeking a remedy. Undoubtedly, there may be exceptional circumstances in which a public corporation may find itself in dire need of ready cash and, as a result, in a poor bargaining position. However, if this weakness is exploited by a financier in order to drive an extortionate bargain, why should the corporation be denied a remedy available to private companies or to individuals?

80 Report pp 16-17. The first measure is given effect to in clause 5 of the draft Bill.
81 Ibid at 17-18.
82 Ibid at 18.
83 Ibid at 16.
84 Contrast Report p 16.
The second and third measures, proposed by Peden, may be discussed together as both involve the introduction of factors, or guidelines, to be taken into account by the courts when an unconscionability question is in issue. The proposed guidelines are, it is believed, to be welcomed. In particular, Peden highlights the need to consider the commercial or other setting, purpose and effect of the contract and whether or not legal advice was obtained by the weaker party. These two factors are, of course, closely connected. The first has been given some prominence by American and by German courts determining unconscionability issues, and both factors are of importance in determining whether or not a transaction contravenes ordinary principles of fair dealings.™

The remaining factors which, according to Peden's Report, ought to be taken into account by the courts are the relative bargaining strengths of the parties, their states of mind and ability to protect themselves, their respective economic circumstances and educational background, the language in which a contract in writing is expressed, the circumstances in which the contract or any acknowledgement relating to it was signed, and whether or not its meaning was explained to the weaker party by an independent outsider. In addition, it is proposed that the courts be required to consider whether or not any pressure tactics were employed, and the conduct of the parties since the signing of the contract and in previous or similar deals.™ The draft Bill makes it clear that these factors are not conclusive and stresses that in determining an unconscionability issue "a court shall have regard to the public interest and to all the circumstances of the case including such consequences of the contract as were reasonably foreseeable at the time it was made."™

The Report proposes that jurisdiction to determine issues of unconscionability be conferred on the courts and on tribunals™ and that a wide range of remedies be available. It is argued that the courts or tribunals be authorised to refuse to enforce the contract, to declare it void in toto, to enforce the remainder of the contract without the offending provision, to vary the contract in whole or in part and to grant ancillary orders for the payment of money, for the return or repair of goods and for the supply of services.™ These remedies include, in effect, an order for the payment of money by way of compensation which is similar to an order to pay damages. A court or tribunal, the Report proposed, should also have the power to grant an injunction restraining "the continued or likely future implementation of any course of conduct which might have the effect of negating in whole or in part any order" made to combat an unconscionable bargain.

It is, with respect, submitted that Peden's proposals are a step in the right direction and that they strike the correct balance between the need to combat unconscionable contracts and the maintenance of certainty within the law of contract. Moreover, the guidelines and the remedies proposed in the Report appear unexceptionable and ought to serve their task. The Legislature may, however, be advised to consider two further matters. The first is the question of making some provision to combat

85 See also the Consumer Credit Act 1974 (UK) s 138.
86 Clause 8 (2) of the draft Bill.
87 Clause 8 (1) of the draft Bill.
88 See also clause 3 and definition of "proceedings" in clause 2; the tribunals, on which the jurisdiction is to be conferred, are expected to be nominated in a proclamation.
89 Report pp 26-27 and clause 7 (1) of the draft Bill.
Unconscionable Contracts

the harsh and unconscionable exercise of rights conferred by clauses which, in themselves, may be unobjectionable. The second relates to the assignment of unconscionable contracts and the rights conferred under them. Both problems are discussed in the Report on Credit Contracts of the New Zealand Contracts and Commercial Law Reform Committee.

C The New Zealand Report

The proposals for the enactment of unconscionability rules, made in the Report of the Contracts and Commercial Law Reform Committee, are confined to credit contracts. The reason for this is to be found in the Committee's terms of reference. The Committee's proposals are, nevertheless, wider in scope than the provisions for the re-opening of usurious transactions of the Moneylenders Act 1908, as the proposed Credit Contracts Act is meant to apply to all types of credit transactions and not only to moneylending contracts. It is clear that the Committee's proposals are of a narrower scope than Peden's.

The Committee's basic approach to unconscionability, based on its Working Paper of 1971,90 is similar to Peden's, except that it proposes that a remedy be made available to any debtor, including — unlike under the draft Bill proposed by Peden — public corporations.91 A striking similarity between the two Reports is the attempt to formulate factors, or guidelines, to be taken into account by a court in determining an issue involving unconscionability. However, the Committee's Report — by reason of its scope—focuses on criteria relevant to credit transactions.92

In order to avoid repetition, it is advisable to concentrate on the aspects in which the Committee's Report differs from the Peden Report. First and foremost of these is the discussion, in the Committee's Report, of the harsh and unconscionable use of contractual rights. The Committee's thoughts about the topic are best explained in its own words:93

We think that much of the difficulty in applying any rule invalidating unconscionable transactions would be alleviated by recognising a clear distinction between unconscionable contracts on the one hand, and unconscionable conduct under unexceptional contracts on the other hand. It may be "excellent to have a giant's strength" by obtaining wide-reaching terms in the contract itself, but it may be "tyrannous to use it as a giant" by unconscionably applying such terms. So it is not always easy to decide whether the fault lies in the terms or in the application of the terms. For this reason we consider that it is desirable that the court should be furnished with jurisdiction not only to review contracts which contain unconscionable terms, but also to grant relief against the unconscionable exercise of contractual rights and powers in particular cases.

Two specific instances involving the misuse of rights, which are discussed by the Committee, are a creditor's unreasonable demands when the debtor offers the early repayment of the amount due and the creditor's insistence on retaining all securities furnished to him even when, as a result of the repayment of a substantial portion of the debt, these become excessive.94 The Committee has further recommended the accept-

92 Ibid at para 7.27ff.
93 Ibid at para 7.22, p 67.
94 Ibid at paras 7.40-7.42 and 7.43-7.44 respectively.
ance of a general guideline concerning the unconscionable use of rights, which reads: 95

Where it appears to the court that a financier under a credit contract has exercised or intends to exercise in a harsh and unconscionable manner:

(a) Any power of forfeiture of property; or
(b) Any power of sale of property; or
(c) Any power to take possession of property; or
(d) Any right conferred on the financier in the credit contract, then, and in any such case, the court may grant relief under this Act.

It is submitted that a similar type of provision ought to be introduced, with the required modifications, into a general Act concerning unconscionability. The usefulness of such a provision is demonstrated by paragraph 242 BGB.

The second major aspect in which the Committee's Report differs from Peden's is in the inclusion of proposals concerning the position of assignees and of third parties. It is recommended that a court be empowered to grant the debtor a remedy against an assignee or other third party who has shared in the profits of the creditor. The Committee has further suggested that the general principles of the law of assignment, which enable the debtor to raise against the assignee any equities available against the assignor, remain unaltered in respect of contracts tainted with unconscionability. At the same time, it would, in the Committee's view, be wrong to enable the debtor to obtain against the assignee a specific order based on the unconscionability of the contract. The reason for this proposal is that "the re-opening of a transaction is based on a purely personal claim available to the debtor against the lender. If the assignee is unaware of the usurious nature of the transaction, he should not be answerable for the personal claims of the debtor against the creditor." 96 In this way, whilst an innocent assignee would not be in a better position to enforce the contract than the assignor, he would not be personally answerable for the latter's acts. By way of illustration, a claim against the assignor in respect of money paid or property furnished by the debtor would not be enforceable against the assignee. However, where the assignee is familiar with the nature of the transaction, it is recommended that he be treated as being in the assignor's shoes.

There are two further points which are covered in the Report on Credit Contracts but not in the Peden Report. The first is a recommendation that all defences available to the debtor be equally available to his guarantors. 97 Presumably, this result would, in any event, be sanctioned by the general principles of the law of contract. It is, however, advisable to provide for it explicitly and also, as is recommended in the New Zealand Report, to permit the guarantor to raise the matter in an action for a declaration. The second point is the inclusion of a time limit, of twelve months from the discharge of the contract, for the institution of proceedings for the review of an unconscionable transaction. 98 It is believed that such a provision is of major importance as it is an additional safeguard against uncertainty in the law of contract.

95 Ibid at para 7.46, p 82.
96 Ibid at para 11.05, p 170, and see also paras 11.04 and 11.06.
97 Ibid at para 7.50.
98 Ibid at para 7.52.
It is believed that the proposals made in the *Peden Report*—when augmented by the additional provisions recommended in the *Report on Credit Contracts*—furnish a suitable model for the enactment of general rules relating to unconscionable contracts in both Australia and New Zealand. The usefulness of such a general doctrine is well established by the American and German experience.