The constitutionalisation of the law of contract

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This article, originally prepared as an address to the New Zealand Society of Legal Philosophy, considers the increasing relevance to the operation of the law of contract of principles and rules developed as part of public law. These developments, which are reflected both in statute and in judicial attitudes, are illustrated with reference to American and other foreign jurisdictions as well as to this country. The author concludes by questioning the implications of "constitutionalisation" for the health of contract law.

Two types of contract dominate both commercial reality and the case law. On the one hand there are standardised form contracts. These compilations of pre-formulated written terms are drafted by one party in advance for use in an indefinite number of similar transactions and are presented to the other party as a non-negotiable condition of doing business. On the other hand, there are public-private contracts, those contracts between a private party and the state or one of its agencies. In the private sector, sales of goods, rental agreements and credit transactions are usually documented by standardised forms. In many jurisdictions, the state comprises the single largest employer, landlord and supplier of services.

In all but a few exceptional situations, standardised and public-private transactions occur without the exercise of private autonomy on the part of the non-drafter and private party respectively. This results from the gross disparity in bargaining power between the contrahents as well as from the fact that the weaker party usually perceives the transacted goods or services as a personal or economic necessity. The individual non-drafter has no real choice whether to contract, with whom to contract or on what terms to contract. The absence of freedom of contract severely distorts the operation of traditional doctrines of contract law such as the matching ribbon approach to contract formation, the parol evidence rule and the canons of construction. As applied to standardised contracts, they convert the institution of contract from a device for bilateral realisation of interests (Pareto optimality) into one which enables one socio-economic class to dominate other socio-economic classes for a profit. As applied to public-private contracts, they enable the state to subvert the constitutionally secured rights of its citizens.

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Over the last two decades, legislatures in most Western legal systems have reacted in diverse ways to regulate abuses inherent in the use of standardised forms. More rigorous anti-trust laws seek to promote economic competition and ensure non-drafting parties a modicum of choice. Protection of the collective bargaining process and enhanced enforcement of the resulting agreements combat bargaining power disparity in the labour market. Disclosure and "plain language"[1] statutes — particularly in contracts for credit, security, and insurance — facilitate comparative shopping. Legislative normalisations of specific contractual relationships,[2] coupled with prohibitions against contracting out, erect a formidable barrier against the enforcement of one-sided standardised terms. At least one jurisdiction, West Germany, has enacted a comprehensive statute regulating the use of standardised forms.[3] In others, the legislature has authorised the judiciary to police one-sided contracts and dubious contracting practices by reference to general constraints such as unconscionability and unreasonableness.[4] The judiciary has shown little hesitation in utilising these powers while, at the same time, it expands the ambit of tort liability so as to further erode the legal effectiveness of standardised terms.[5] All these developments — sometimes described as the "death of contract"[6] — as well as the underlying abuses have been extensively mooted in the academic journals, submissions, and judicial opinions.

In another and less recognised related development, contractual autonomy has been further limited by the importation of fundamental public law precepts into the jurisprudence of contract law. Perhaps the most obvious example of this development is the so-called anti-discrimination or equal rights legislation. Twenty years ago, few questioned the legality of wage differentials for male and female employees or the legality of a landlord's refusal to let to blacks or Jews. These anti-discrimination statutes, generally enacted in the late sixties and early seventies, subject private parties in their exchange transactions to the same prohibitions against discrimination as apply against the state. The statutes generally prohibit discrimination by reference to sex and race.[7] Others also forbid discrimination by reference to religion and age.[8] The statutes apply, depending upon the jurisdiction, to a longer or shorter list of specific contractual relationships,[5] including most commonly those for employment, rental and access to facilities. In jurisdictions such as the USA these statutes import, in one quick stroke, into the law of private contract decades of equal protection jurisprudence generated under constitutional norms.

These statutes have had a far greater social and economic impact upon contracting practices than the sum total of consumer protection legislation, unconscion-

1 See s.5-702, New York General Obligations Law (McKinney, 1982).
2 See Magnuson-Moss Warranty Act 1975 (U.S.), 15 U.S.C.A. ss.2301-2312 (1982) (consumer product quality conditions); Petroleum Practices Marketing Act 1978 (U.S.) 15 U.S.C.A. ss.2801-2806 (1982) (petroleum product distributorships); Reisevertragsgesetz (West Germany), [1979] Bundgesgesezblatt I, Nr. 73 incorporated as ss.651a-651k of West German Civil Code.
3 Gesetz zur Regelung Rechts der Allgemeinen Gaschaeftsbedingungen, [1976] Bungesgesetzblatt I, s.3317.
4 See ss.6,7,20 and 21, Unfair Contract Terms Act 1977 (U.K.); s.7, Contracts Review Act 1980 (N.S.W.); s.2-302, Uniform Commercial Code (U.S.).
5 See, most recently, *Junior Brooks Ltd.* v. *Veitchi Co. Ltd.* [1983] 1 A.C. 520.
6 G. Gilmore *The Death of Contract* (Ohio State University Press, Columbus, 1974) 87-94.

ability and unreasonableness doctrines, and legislative normalisation of specific contractual relationships. Statutes such as the New Zealand Credit Contracts Act 1981, the West German Form Contracts Act 1976, or the Uniform Commercial Code section 2-302 entail, in my experience, relatively little disruption to business activity. The client simply buys well drafted documents, provides some instruction to its employees as to their deployment and goes merrily on his way. In contrast, enforcement of anti-discrimination statutes has resulted in massive reorganisation of governmental departments and manufacturing concerns.[9] The statutes have given the public black managers, women on the killing floor of freezing works and preferential employment of minorities.[10]

The anti-discrimination statutes have confronted the courts with issues of contract enforcement which, in terms of human and legal complexity, are surely unique. It is one thing for a court to test a warranty disclaimer against a conspicuousness requirement or a reasonable standard. It is quite another when the court must determine whether the anti-discrimination statute is violated by a retirement scheme (affecting hundreds of public employees) which keys premiums and benefits to actuarial differences in life expectancy of men and women.[11] Both decisions require the court to test a contract term against a legislative standard. However, in the discrimination cases the calculus of mutual assent and private autonomy has no relevance whatsoever. The enforceability of contract turns on tenets such as equality which heretofore appeared only in the public law context.

Public-private contracts have undergone constitutionalisation quite apart from the impact of the anti-discrimination statutes. Whereas the anti-discrimination statutes usually import only specific rights into certain public and private contracts, public-private contracts between the citizen and the state are potentially subject to the full panoply of substantive and procedural rights arising under a jurisdiction's public law. As the most important result of this development, public bodies can no longer discriminate — either in the decision to contract or in the terms of the contract — by reference to any of the constitutionally recognised individual rights including most significantly those respecting expression and association. In the private sector, cheekiness of an employee remains insubordination, a legitimate ground for discharge or refusal to deal. In the public sector, it rises to an exercise of free speech which permits sanction only within narrowly defined limits.[12] Of

7 See Race Relations Act 1971 (N.Z.); Equal Employment Opportunity Act 1964 (U.S.), 42 U.S.C.A. s.200e (1981); Fair Housing Act 1968 (U.S.), 42 U.S.C.A. ss.3612-3631 (1977); Race Relations Act 1965 (1968, 1976) (U.K.); Sex Discrimination Act 1975 (U.K.).

8 See Age Discrimination in Employment Act 1967 (U.S.), 29 U.S.C.A. ss.621-634 (1975).

9 *Equal Employment Opportunity Commission* v. *American Telephone and Telegraph Co.* 556 F.2d 167 (3rd Cir., 1977) (decree affecting thousands of workers of one of country's largest employers).

10 See *Human Rights Commission* v. *Ocean Beach Freezing Co. Ltd.* (1980) 2 N.Z.A.R. 415 (Equal Opportunities Tribunal) and *United Steelworkers of America AFL-CIO-CLC* v. *Weber* 443 U.S. 193 (1979).

11 See *Los Angeles Department of Water and Power* v. *Manhart* 435 U.S. 702 (1978).

12 See *Mount Healthy City Board of Education* v. *Doyle* 429 U.S. 274 (1979); *R.* v *Home Secretary, Ex p. Benwell* [1984] 3 W.L.R. 843; *Rigg* v. *University of Waikato* [1984] N.Z.L.R. 149, 198-208 (Visitor of Waikato University).

equal significance, public employment and reputation constitute "liberty interests" for the purpose of the natural justice and due process doctrines with the result that any detrimental change must be accompanied by procedural safeguards such as prior notice, hearing and confrontation.[13] Although the US courts, when pressed, tend to speak of this area of the law and its remedies as being "basically in tort",[14] the fact remains that the underlying relationships are contractual in nature and the litigated issue alway involves the permissibility of specific contract practices.

The law relating to standard form contracts also increasingly reflects the influence of public-law reasoning. Consider, for example, the doctrine of unconscionability. As an institution of contemporary contract law, this concept ostensibly traces to Uniform Commercial Code section 2-302. In its inception[15] as well as current application, this provision operates as a constraint chiefly upon the enforceability of standardised terms. In construing and applying the unconscionability doctrine, courts frequently refer to Professor Leff's distinction between procedural and substantive unconscionability,[16] although it finds no support in either the text of or the official comments to the Uniform Commercial Code.[17] What accounts for the local popularity of Professor Leff's distinction is, in my view, its ostensible similarity to another well established distinction of US law: the distinction between procedural and substantive due process. For nearly fifty years, the due process clause in the 14th Amendment to the Constitution enabled the judiciary to police both the conduct and substantive work product of legislative and administrative bodies.[18]

Transposed to the law of contracts and attached to the undefined notion of unconscionability, the distinction gave the legal community eo ipso a device to police the enforceability of contracts by reference to the manner of their formation and enforcement as well as by reference to their substantive content. As applied to standardised terms, the doctrine had the additional advantage that it permitted policing without reference, except in a negative sense, to traditional matters — such as bargain, mutual assent and freedom of contract — factors which have little significance in the standardised form contracting environment.[19]

In its inception, the distinction between procedural and substantive unconscionability may have tracked the constitutional distinction between procedural and substantive due process merely as a fortuitous slip of Professor Leff's pen. However, subsequent development of the distinction by the courts and commentators displays remarkable parallels to the jurisprudence of due process. Procedural unconscionability is most commonly defined as requiring proof of either outright chicanery

13 *Owen* v. *City of Independence* 445 U.S. 622 (1980). Compare *Murdoch* v. *New Zealand Milk Board* [1982] 2 N.Z.L.R. 108 (H.C.).
14 See *Carey* v. *Piphus* 435 U.S. 247, 253-259 (1978).
15 The draft version of s.2-302 applied only to form clauses. See s.23, Uniform Revised Sales Act (American Law Institute, Philadelphia, 1944).
16 Leff "Unconscionability and the Code — The Emperor's New Clause" (1967) U. Pa. L. Rev. 485.
17 See R. Dugan "Standardized Forms: Unconscionability and Good Faith" (1979) 14 New England L. Rev. 711, 730-735.
18 See L. Tribe *American Constitutional Law* (Foundation Press, Mineola, 1978) 421-446.
19 See *Schroeder (A.) Music Publishing Co. Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308 (H.L.).

(not often present in the standardised form contracting environment) or, more often, a combination of disparity in bargaining power and a lack of meaningful choice.[20]

The requirement of bargaining power disparity predicates operation of the unconscionability concept upon a sufficient degree of subordination between the contracting parties. It has a direct counterpart in the jurisprudence of procedural due process where an act cannot be challenged unless there is a sufficient degree of subordination between plaintiff and defendant.[21] The second requirement — the lack of meaningful choice — usually degenerates into an inquiry whether or not the non-drafter had adequate notice of the proposed terms.[22] The adequacy of notice also plays, of course, a pivotal role in any application of the procedural due process or natural justice doctrines. Also taken into consideration in connection with this prong of the procedural unconscionability test are factors such as whether or not the non-drafter enjoyed legal assistance and whether he had an opportunity to influence the making of the contract, factors which also figure predominantly in the application of the procedural due process doctrine.

Whereas courts have had a relatively easy time implementing the notion of procedural unconscionability, substantive unconscionability has, like its counterpart, substantive due process, proven to be a much less tractable concept. Professor Leff could not define substantive unconscionability and doubted whether, in a commercial context, the substance of contract terms would ever justify judicial intervention in the absence of procedural unconscionability.[23] For ten years, courts and commentators tended to follow that view and substantive unconscionability remained defined in terms of equally vague synonyms such as harshness, oppressiveness, and unreaonableness.

More recently, both substantive due process and substantive unconscionability have acquired new meaning. With the decision in *Griswold* v. *Connecticut*,[24] the US Supreme Court embarked upon what has been termed a revival of the substantive due process doctrine.[25] The Supreme Court now routinely polices various forms of economic and social regulation, not by reference to the due process clause but rather by reference to the "emanations" of the other constitutional mandates, be they the contracts clause or the commerce clause of the Constitution itself or specific provisions of the Bill of Rights.[26]

20 See *Williams* v. *Walker-Thomas Furniture Co.* 350 F.2d 445 (D.C. Cir., 1965); J. White and R. Summers *Handbook of the Law under the Uniform Commercial Code* (West, Minneapolis, 1972) 118-119.

21 See *Lugar* v. *Edmonson Oil Co.* 457 U.S. 922 (1982); *Jackson* v. *Metropolitan Edison Co.*, 419 U.S. 345 (174) ("state action"); *R.* v. *E. Berks Authority, Ex p. Walsh.* [1984] 3 W.L.R. 818 (C.A.) (whether nurse's contract with health authority sufficiently involves public so as to entitle her to judicial review of termination of employment).

22 See *A & M Produce Co.* v. *FMC Corp.* 186 Cal. Rptr. 114, 124-125 (App. 1982).

23 Supra n.16, 515-516, 523-528.

24 381 U.S. 479 (1965).

25 See G. Gunter *Constitutional Law* (Foundation Press, Mineola, 1975) 616.

26 See *Edgar* v. *Mite Corp.* 457 U.S. 624 (1982) (state takeover statute held unconstitutional); *Bellotti* v. *Baird* 443 U.S. 622 (1979) (state statute requiring assent for minor's abortion held unconstitutional).

Substantive unconscionability is gradually acquiring a similar significance. As early as the New Jersey Supreme Court's 1960 decision in *Henningsen* v. *Bloomfield Motors Inc.*,[27] the judiciary has felt a certain disquiet in the face of standardised terms which seek to displace or vary for an indefinite class of non-drafters the protection conferred by statutory normalisation of specific contractual relationships. Within the last five years, an increasing number of courts are holding that a standardised term which deprives a non-drafter of a benefit secured by otherwise dispositive law without conferring an adequate offsetting benefit is suspect as a matter of substantive unconscionability.[28] This test, formally adopted by section 9 of the West German Form Contracts Act 1976,[29] also appears in the Unfair Contract Terms Act 1977 (U.K.). There the reasonableness test is generally keyed into operation whenever a consumer contract or standard contract negates a breaching party's liability arising under the otherwise dispositive law; one factor in applying the reasonableness test under Schedule 2 is whether the non-drafter received an inducement to agree to the term.[30]

Parallel developments of natural justice and unconscionability should come as no surprise. Standardised forms, like statutes, comprise pre-formulated legal organons which seek to impose uniform regulation upon an indefinite number of transactions. As such, they have the potential to displace, with little or no involvement by the individuals affected, higher level legal mandates such as those found in a juridiction's statutes or constitution.[31] Standardised terms promulgated by any one of the hundred largest business concerns in the USA define more contracts than do the statutory normalisation of those relationships promulgated by many state legislatures. These private statutes ignore the interests of the individual non-drafters and pose much the same type of threat to a system of constitutional democracy as do the statutes and administrative acts scrutinised by reference to what is euphemistically called the new substantive due process. Under such circumstances procedural unconscionability, like procedural due process, seeks to protect the interests of the individual. Substantive unconscionability, like the new substantive due process, seeks to protect the integrity of higher order legal mandates.

The influence of public law jurisprudence is not limited to implementations of general constraints such as unconscionability and harshness. It also appears in recent modifications of the rules governing contract formation and interpretation. Consider for instance section 211(2) of the *Restatement (second) Contracts* which requires that standardised forms be interpreted as treating alike all those similarly situated, without regard to their knowledge or understanding of the standardised terms of the writings. Unlike traditional doctrine which sought to interpret con-

27 161 A.2d 69 (N.J. 160).
28 See, most recently, *Durham* v. *CIBA-Geigy Corp.* 315 N.W. 2d 696 (S.D. 1982).
29 "General rule: Provisions in standardised contracts are unenforceable if they impose an unreasonable burden on the non-drafter. An unreasonable burden is presumed to exist whenever a provision cannot be reconciled with the essential purpose of the statutory rule varied by the term . . . ."
30 Section 3(2); schedule 2 s.2(b).
31 See Slawson "Standard Form Contracts and Democratic Control of Law-Making Power" (1971) 84 Harv. L. Rev. 529.

tracts in accordance with the putative intent of the specific parties to the exchange, the rule in section 211(2) acknowledges that standardised terms are intended, like statutes, to achieve a uniform regulation of an indefinite number of cases and should be construed accordingly.

In respect to formation requirement, *Tilden Rent-A-Car* v. *Glendenning*,[32] subsections 211(1) and (3) of the *Restatement (second) Contracts* and section 2 of the West German Form Contracts 1976 demonstrate the extent to which adequate notice has overtaken mutual assent as the basis for threshhold enforceability of contract terms. Under the Uniform Commercial Code section 2-207(3), a court must apply the law of contract even in the presence of an express conflict between the written terms of exchanged forms. At least in respect of standardised terms, it is today safe to say that the applicability of contract law is predicated upon adequate notice and partial or full performance without any or only perfunctory regard to actual or even fictive assent.

In the near future, the legal community will confront a number of difficult questions along the borderline of contract and constitutional law. Common Law courts will have to decide whether otherwise dispositive law is the appropriate standard for defining substantive unconscionability and what extent of state involvement suffices to key into contractual relationships the protections conferred by the natural justice doctrine. The courts will be called upon to adjudicate the enforceability of private sector contracts which limit the exercise of the freedom of expression, travel and procreation. Sooner or later, New Zealand courts will have to explain and presumably delimit their willingness to apply the natural justice doctrine in the context of private sector relationships.[33] The New Zealand Parliament will have to decide whether to accompany any eventual bill of rights by a provision such as 42 U.S.C.A., section 1983,[34] which in the USA has served as the vehicle for the constitutionalisation of public-private contracts.

As a more general matter, the legal community must consider whether further constitutionalisation is compatible with the function of contract as an institution for the private ordering of legal relationships.[35] Personally, I am convinced that most rules of traditional contract law are wholly inappropriate for application to public-private and standardised form contracts, the two most significant categories of

32 (1978) 83 D.L.R. (3d) 400 (Ont. C.A.).

33 See *Stininato* v. *N.Z. Boxing Assn* [1978] 1 N.Z.L.R. 1 (C.A.) (natural justice doctrine applied to cancellation of licence by a voluntary domestic association); *Re Northwestern Autoservices Ltd.* [1980] 2 N.Z.L.R. 302, 308 (C.A.) (natural justice doctrine implied by Cooke J. as possibly applicable to removal of company director).

34 "Every person who, under color of any statute . . . subjects . . . any . . . person . . . to the deprivation of any rights, privileges or immunities secured by the Constitution . . . shall be liable to the party injured in an action at law . . ." Compare s.24(1), Canadian Charter of Rights and Freedoms: "Anyone whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain such remedy as the court considers appropriate and just in the circumstances." See *Crossman* v. *The Queen* (1984) 9 D.L.R. (4th) 588 (Fed. Ct.) ($500 awarded to person who was wrongly denied access to counsel).

35 See Canaris "Grundrechte und Privatrecht" (1984) 184 Archiv fuer die Civilistische Praxis 201.

contracts in today's society. Freedom of contract and mutual assent — the factual referents for traditional contract law — simply cannot be made to operate in these transactions. On the other hand, I have the gravest doubts about the wholesale replacement of that system by the reasoning of public law jurisprudencee.

The concept of notice which plays such a key role in contract formation and procedural unconscionability, although easy to deploy, lacks any meaningful normative content. Notice of standardised terms does not in any way ensure that the terms can be understood by the non-drafter or the drafting party's representatives in the transaction. As criteria for threshhold enforceability, the notice requirement is no more satisfactory than the mutual assent approach of traditional contract law. Applied to one-sided or mass contracts, both approaches leave the threshold enforceability of contract terms wholly within the control of the drafting party and fail to provide satisfactory criteria for determining when and when not the law of contract should apply to a particular transaction. It is difficult to understand why the use of a certain size of type should justify the application of contract law rather than, say, the law of tort or restitution.

Even more questionable is the ever increasing *Drittwirkung* of public law norms. With little or no discussion, they have been incorporated as terms of contracts or else serve as a standard for defining substantive unconscionability or reasonableness, not only in public sector contracts but also in respect to standardised forms. While this may result in a more balanced set of terms than provided by the typical standardised form, it squeezes the last vestige of private autonomy out of the contracting process. On the one hand, it limits the contractual autonomy of the drafting party and, on the other hand, it invites industry to seek passage of detailed legislation which, in effect, elevates into statute a set of terms acceptable to the industry.[36] In the last ten years, legislatures have promulgated such statutes in respect of a wide variety of consumer and commercial contracts. This legislation poses a far greater threat to the vitality of contract law than does the judicial expansion of tort law.

36 Supra n.2.