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Unconscionable Contracts: A Comparative Study of the Approaches in England, France, Germany, and the United States

A.H. Angelo* and E.P. Ellinger**

I. FREEDOM OF CONTRACT AND UNCONSCIONABILITY OF TERMS

The doctrine of sanctity of contracts is entrenched in both the Anglo-American and western European legal systems. The phrase "freedom of contract" originated in the late eighteenth and the early nineteenth centuries,¹ and was based on the natural law principle that it is "natural" for parties to perform their bargains or pacts.² During that period, the doctrine was incorporated into the Prussian Code of 1794 and into the French Civil Code promulgated in 1804. Other continental codifications later adopted this doctrine. During this same period, English law embraced the doctrine as a manifestation of freedom of trade.³ In all probability, the widespread acceptance of "freedom of contract" resulted from the influence of the laissez faire spirit, championed by the rising and eventually triumphant middle class of Europe.⁴ This influence explains why the doctrine continues to be known by a phrase that utilizes the word "freedom."

At present, "freedom of contract" means that the parties to a transaction are free, or "entitled," to agree on, or "to choose," any lawful terms. Accordingly, the courts generally will not interfere with a bargain, and will not reshape its terms. Therefore, a person who

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¹ For emphasis on "freedom," see in particular Jean Domat, Traite des Loix ch. IV: II; Jean-Etienne-Marie Portalis, Discours Preliminaire Fenet II, at 463.
enters into a contract voluntarily is bound by it even if he subsequently finds the contract unacceptable and has valid commercial, though not legal, grounds for seeking to avoid it. As a result, the current emphasis is on the word "contract," rather than the "freedom" aspect of the doctrine.

In contrast, the primary emphasis of the doctrine in its early stages of development was not on the "contract" aspect. Paragraph I 3.1 of the Prussian Code, which exemplifies the importance of freedom, reads: "Undertakings can give rise to [enforceable] rights only insofar as these undertakings are freely given." This provision attempts to ensure that contracts and other dealings will not bind a person who had not freely consented to the terms. Articles 1108 through 1112 of the French Civil Code and articles 116 and 145 of the German Civil Code also emphasize the importance of "freedom of will." As such, the doctrine of freedom of contract aims to ensure freedom of action rather than to consecrate bargains. For a society divided into superior and inferior classes, the doctrine represented a step in the direction of liberalism.

This background explains the tendency of the codes, and likewise the common law, to recognize the absence of "free will" as a defense to actions brought in contract. Examples of this type of defense include duress, undue influence, deceit, and mistake. The codes and the Anglo-American case law of the early nineteenth century reflected the lack of need for additional safeguards. During that period, standard form contracts, which conferred excessive rights on one party while depriving the other of any effective remedy, were not a serious problem.

It is ironic that during the last decades of the nineteenth century and into the twentieth century, the concept of "freedom of contract," which originally was used to invalidate contracts made without the parties' freely given consent, became the very tool used to establish the sanctity of standard form contracts. Numerous cases have held

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5. Author's 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 Dr. Hans Hattenhauer, Introduction to ALLGEMEINES LANDRECHT FÜR DIE PREUSSISCHEN STAATEN 31 (Alfred Metzner Verlag ed., 1970).


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. Of course, judges have commented on the fact that many contracts of this type were not meant to be read and, least of all, to be understood. Nevertheless, it consistently has been held that a party's inability to understand the terms of the "freely made" contract did not negate the party's consent to its terms.

The use of standard form contracts burgeoned in the late nineteenth century, and they have gained popularity ever since. At present, standard form contracts are predominant in most areas of trade and commerce. This is due to the increasing number of situations in which the parties to a contract do not have equal bargaining power. Undoubtedly, certain types of contracts, such as lending and tenancy agreements, have always contained some element of inequality. But, generally speaking, a lawyer in the eighteenth or first half of the nineteenth century had good reason to regard a contract as a bargain between parties having comparable capacities to safeguard their respective rights. In a period in which small traders and artisans competed for customers, the law of supply and demand precluded the introduction of standard form contracts with one-sided terms.

The emergence of large monopolistic companies, such as the early railways, completely changed the balance of power in negotiations. These companies had the power to offer their services on whatever terms they pleased. Any equality of bargaining power between such giants and the average citizen was, and has remained, illusory. The rise of multinational corporations and their subsidiaries in the mid-twentieth century has only aggravated the situation. Typically, even state-controlled bodies, such as state-owned railways, use standard form contracts that give them a decisive advantage.

It would be unreasonable to suggest that the use of standard form contracts is, in itself, objectionable or unconscionable. A large industrial entity has a genuine interest in defining its liability to customers and in standardizing the terms on which it supplies goods or


10. Note the ticket cases such as Parker v. S.E. Ry. Co., [1877] 2 C.P.D. 416 (Eng.).

11. See, e.g., Egan, 47 A.L.J.R. at 140 (standard form contracts used by such a body described as oppressive).
furnishes services. While parties may negotiate some specific terms, such as the price or the date of payment, the standard form usually governs the general terms and conditions related to the supply of goods or to the furnishing of services. Other sectors of the commercial world, such as lending institutions, carriers, and insurers, use the standard form in a similar manner.

Although standard form contracts are not objectionable in the abstract, they do tend to be one-sided documents. Indeed, some contracts of this type release the suppliers from any liability for the quality of the goods or give them discretion to exercise extremely far reaching powers should the other party default or delay performance. The contract may so decisively favor the stronger party that it becomes oppressive. The exact nature of the oppressive or unfair element may vary greatly. An excessive interest rate, a contractual penalty, an onerous provision pertaining to the repossession of goods supplied under a hire purchase agreement, and a particularly wide exemption clause are all examples of oppressive elements of a contract. The common factor found in all these examples is the "unconscionability" of the bargain.

When analyzing these types of contracts and the problems created by them, it is important to distinguish between two methods or strategies the stronger party will employ in an effort to safeguard its position or to enable it to reap the maximum profit. The first strategy incorporates clauses that confer on the stronger party specific rights or protections. An exemption clause that absolves the stronger party from any liability for default in the performance of the contract and a provision for an excessive interest rate or penalties for arrears in payment are typical examples of this strategy. The second strategy relates not so much to the actual terms of the contract but, rather, to the manner in which the stronger party exercises its rights under a clause that may be unobjectionable in itself. For example, a hire purchase agreement might contain a clause that entitles a finance company to seize the goods and to demand payment of the total outstanding balance of the debt if the hirer defaults in the payment of an installment. If the hirer becomes insolvent, this clause may assist the company to gain priority over the hirer's general creditors. The clause in this case serves a legitimate objective. This contrasts with a situation where the company exercises its rights under this clause against a solvent hirer with a good financial record, simply because there is a short delay in the payment of a single installment. Under
these circumstances, it is unjust and commercially unreasonable for the company to use the clause. This is particularly true if the company intends to reinstate the contract after extracting a penalty or "bonus" from the hirer, rather than retain and resell the goods.12

Although the indignation provoked by this type of case ought to be directed at the company's behavior rather than at the clause itself, 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, a more narrowly phrased clause would prevent the company from making its unreasonable demand. At the same time, the inclusion of a clause with such a general scope of application is more practical because it is virtually impossible to foresee every situation for which such a clause may be required.

This Article emphasizes the distinction between unconscionable contract clauses and the harsh and unfair exercise of contractual rights. Part II of the Article will show that both common law and civil law countries have developed specific doctrines to provide suitable remedies in both cases. Although the courts developed some of these doctrines from general contract law principles, the legislatures conducted the bulk of the assault on the citadel of the sanctity of contract. The object of this Article is to compare the approaches to unconscionability in two representative common law systems, England and the United States, and in two civil law jurisdictions, France and Germany. In doing so, this Article shows that, although unconscionability originated from the freedom of contract doctrine, a source common to the four systems, there are marked differences in the devices that each of these countries use to combat abuses. Two systems have developed some general doctrines as a basis for granting relief, while the two remaining ones have used a piecemeal approach.

II. COMPARING THE SYSTEMS

A. Scope of Discussion

The comparative study conducted in this part of the Article concentrates on the development of unconscionability concepts in the common and civil law systems. It does not discuss defenses of a gen-

eral nature, such as duress, undue influence, and mistake, which are distinguishable from unconscionability both conceptually and practically. Conceptually, these defenses seek to protect a non-consenting party to a contract. Unconscionability rules, on the other hand, apply when a party willingly, though foolishly, accepts a bargain that includes oppressive terms, or where the stronger party exercises its rights under the contract in a manner that is harsh or unfair. The practical distinction relates to the remedy. Where duress, undue influence, or mistake are established, the contract is usually voided or set aside. A monetary remedy granted to either party would, therefore, be in tort or restitution. A contract tainted with unconscionability, however, need not be treated as void or 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 variation. This Article will discuss this characteristic of unconscionability, which manifests itself in the common law systems of England and the United States and the civil law systems of France and Germany.

B. Unconscionability in Select Areas of English Law

In England, the sanctity of contract constituted a well-established common law principle by the seventeenth century. Equity, however, intervened in limited situations to grant relief from harsh and unconscionable bargains. These cases are discussed in detail in a study that correlates the assault on harsh and unconscionable contracts with the development of certain contract law principles, such as the setting aside of penalty clauses and the entrenchment of the equity of redemption. The most interesting instance is with respect to the development of unconscionability rules 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. By the end of the seventeenth century, courts were using the rule as the basis for reopening bargains in which young noblemen had sold their expectancies or granted rent-charges against them for inadequate consideration. In the leading case of Earl of

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Ardglasse v. Muschamp,15 Lord Chancellors Keeper, North, and Jeffreys observed that equity would not intervene to set aside or to reopen a bargain into which the parties had entered voluntarily.16 Relief would be granted only if the transaction involved some trading on a weakness of the expectant heir. In Earl of Ardglasse, the transaction was reopened because the young Earl had engaged in wild and riotous living and had signed the agreement while incapable of comprehending the nature of the bargain.17 A few years later, in Wiseman v. Beake,18 the court granted relief to a remainderman who was a Proctor at Doctors Commons because the consideration was so inadequate that it indicated clear fraud,19 and one party had taken advantage of the remainderman's dire need of money in order to extract the harshest terms possible.20

These cases involved more than the granting of a remedy against an oppressive bargain; they involved an attempt to protect the estates of the landed classes. The decision of Lord Chancellor Thurlow in Gwyne v. Heaton21 echoes this element of special protection:

The heir of a family dealing for an expectancy in that family shall be distinguished from ordinary cases, and a bargain made with him shall not only be looked upon as oppressive in the particular instance, and therefore avoided, but as pernicious in principle, and therefore repressed.22

This indeed may have been one of the factors that in due course led to a slanting of the doctrine in favor of the expectant heir.23 By the middle of the nineteenth century, mere inadequacy of consideration had become a sufficient reason for reopening the bargain.24

This modification of the underlying principle created two undesirable consequences. First, courts too easily set aside or modified bargains with expectant heirs, a development that induced Lord

16. Id.
17. Id.
19. Id.
20. Id. at 122.
22. Id. at 953.
24. See Fry v. Lane, 40 Ch. D. 312, 323 (1888) (Eng.) (Kay, J.); Earl of Aylesford v. Morris, [1861-78] All E.R. 300, 302 (Eng. C.A. 1873) (Selborne, L.J.); see also LIONEL A. SHERIDAN, FRAUD IN EQUITY: A STUDY IN ENGLISH AND IRISH LAW 73-86 (1957); Waddams, supra note 13, at 386.
Selborne to observe that at some point the rule had become arbitrary. In an effort to clarify the rule, the legislature re-established in 1868 that a sale of an expectancy or a reversion could be reopened only where the bargain was unconscionable. The second consequence, which resulted directly from the ease with which courts intervened in bargains with expectant heirs, was a growing reluctance to extend the application of the rule. This, in turn, became an impediment to the development of a general doctrine that could have enabled the courts to grant relief against any bargain tainted with unconscionability. Even in cases involving usurious bargains, which became free from legislative controls in 1854, the courts were slow to intervene. Two cases that held that courts could reopen a harsh and unconscionable lending transaction even where the borrower was not an expectant heir were Barrett v. Hartley and Nevill v. Snelling. However, these cases were anomalies and did not lead to the establishment of a general rule. Ultimately, the legislature established the general rule with respect to loans by passing the Money-Lenders Act of 1900.

A similar pattern also emerged in other areas of contract law. Waddams' study demonstrates that the assault on forfeiture and penalty clauses, which aimed at combating their harshness, resulted in the development of doctrines that defined certain clauses that could be set aside. These same doctrines, however, obliterated the underlying question of unconscionability. Exemption clauses serve as a typical example. Although the attack on exemption clauses was motivated by their potential for unconscionable effect, instead of creating criteria based on the unconscionability of disputed clauses, the courts developed specific doctrines, including rules of construction and the controversial doctrine of fundamental breach.

The harsh enforcement of contractual rights also resisted direct use of an unconscionability concept. The rule of de minimis non curat

27. As to an extension of the doctrine in Canada, see Waddams, supra note 13, at 386.
29. 2 L.R.-Eq. 789, 795 (1886) (Eng.).
30. 15 Ch. D. 679, 696-97 (1880) (Eng.).
31. An Act to Amend the Law with Respect to Persons Carrying on Business as Money-Lenders, 1900, 63 & 64 Vict. 155, ch. 51 (Eng.) [hereinafter Money-Lenders Act].
32. See Waddams, supra note 13.
33. Id. at 378.
and the construction of clauses making the purchase of land "subject to finance" illustrate this point.

The rule of *de minimis non curat lex* developed from cases in which a buyer attempted to reject goods due to a minute departure from the prescribed weight or contractual description. The leading case of *Shipton, Anderson & Co. v. Weil Bros. & Co.* held that the buyer could not reject the goods because they exceeded the stipulated maximum of 4950 tons by a mere 55 pounds. In contrast, the decision in *Arcos, Ltd. v. E.A. Ronaasen & Son* entitled the buyer to reject staves of wood that were nine-sixteenths of an inch thick instead of half an inch thick, as prescribed in the contract of sale. The two cases are, of course, easily distinguishable on their facts. The excess of fifty-five pounds in the first case did not burden the buyer; the one-sixteenth inch difference in thickness in the second case could have affected the buyer's intended use for the half-inch staves. Presumably, if the staves were to be ten inches thick and they deviated by one-sixteenth of an inch, the court would have found the discrepancy insignificant and thus applied the *de minimis* rule.

Interestingly, the application of an unconscionability concept would have led to identical results. An insignificant difference in weight, which was meaningless from the buyer's perspective, would not entitle the buyer to reject an otherwise conforming shipment of goods. The buyer's attempt to reject the goods on such a trifling ground would constitute an unjustifiable exercise of contractual rights. The buyer could, on the other hand, plead a minute deviation if it rendered the goods unsuitable for the object for which they were ordered.

The second example, that of contracts for the purchase of land that are subject to the buyer's securing financing, is of more recent origin. Clearly, a financing stipulation is justifiable in countries where mortgage money is scarce. It enables a buyer who is unable to obtain the required loan to withdraw from the contract of sale without incurring a loss. However, some purchasers invoke this type of clause solely because they change their mind about the sale, and never attempt to raise the required financing. The courts have consistently precluded purchasers who are guilty of such conduct from using this

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34. "*De minimis non curat lex*" means that the law does not concern itself with trifling or small matters. *Black's Law Dictionary* 431 (6th ed. 1990).
35. [1912] 1 K.B. 574 (Eng.).
36. 1933 App. Cas. 470 (appeal taken from Eng.).
clause as an escape route. In some cases, courts have held that the contract included an implied term imposing a duty on the purchaser to take reasonable steps to arrange financing.37 In Barber v. Crick-ett,38 however, the court held that "where a contract is conditional on a purchaser raising a mortgage, the purchaser can assert the non-fulfillment of the condition only where it occurs without default on his part."39 Clearly, in Barber, the purchaser's questionable conduct served as the basis of the decision. The same factor would have guided a court applying an unconscionability concept. Nevertheless, courts in other cases typically have sidestepped the issue, achieving the same result by invoking an implied term.

The illustrations discussed thus far reveal the courts' resistance to the development of generally applicable unconscionability rules. If this attitude persists, it will defeat unconscionability rules even where introduced by statute. However, concepts akin to unconscionability have been employed successfully in some areas of contract law, such as restraint of trade and estoppel. The use of a statutory unconscionability concept is illustrated by the Money-Lenders Act of 1900,40 which was superseded by sections 137 through 140 of the Consumer Credit Act of 1974.41

Courts have intervened in restraint of trade contracts for two basic reasons: (1) the public interest in maintaining free competition; and (2) the danger of traders and employees restricting their right to freedom of action. However, these concerns must be balanced against other legitimate interests, such as the interest of a purchaser of a business in precluding the seller from establishing a competing enterprise in the same locality, or, similarly, the interest of a tradesman or professional who trains an apprentice in a highly skilled trade. In determining the validity of specific clauses, courts have applied two tests: (1) whether the restrictive covenant was compatible with the public interest; and (2) whether it was reasonable as between the parties.42 From a practical standpoint, the second test derives from a basic unconscionability concept: whether a specific covenant is reasonable as

41. Consumer Credit Act, supra note 12, §§ 137-140.
42. The leading nineteenth century case elucidating these tests was Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co., 1894 App. Cas. 535 (appeal taken from Eng.).
between the parties depends on whether it involves a restriction that is
no broader than necessary for the covenantee's protection.\textsuperscript{43} The sim-
ilarity between this test and the unconscionability concept was recog-
nized by the House of Lords in \textit{A Schroeder Music Publishing Co. v. Macaulay.}\textsuperscript{44}

Similar references to either fairness or equitability appear in nu-
merous cases concerning estoppel and waiver. These cases typically
involve a situation where one party's conduct has led the other party
to believe that he need not perform a contractual duty on time or in
the manner agreed, and the first party then changes his mind and
insists on performance of that duty. Of course, it would be a mistake
to overlook the specific rules developed in this technical area of law.
But it is noteworthy that in one of the older leading cases on point,
Lord Cairns observed that a person would not be permitted to enforce
his rights "where [doing so] would be inequitable having regard to the
dealings [that] have... taken place between the parties."\textsuperscript{45} This early
reference to an equitable remedy's focus on the specific facts in each
particular case parallels the modern concept of unconscionability.

The last two illustrations suggest that the doctrine of unconscio-
nability need not be used in stealth. Where courts use it openly, un-
conscionability can be just as effective as the devices used to attain the
same object indirectly. Perhaps the best illustrations of the effective
use of the doctrine of unconscionability are the cases decided under
section 1 of the Money-Lenders Act of 1900\textsuperscript{46} and its counterparts in
other acts within the British commonwealth. The Money-Lenders
Act enabled courts to reopen usurious bargains, and to determine in
each case a proper rate of interest with regard to the security fur-
nished, the risk, the period of the loan, and the amount advanced.\textsuperscript{47}
Indeed, the usefulness of this provision of the Money-Lenders Act
was recognized by the drafters of the Consumer Credit Act of 1974\textsuperscript{48}
when they adopted the earlier Money-Lenders Act into sections 137

\textsuperscript{43} Herbert Morris, Ltd. v. Saxelby, [1916] 1 App. Cas. 688, 707 (appeal taken from
Scot.).

\textsuperscript{44} [1974] 1 W.L.R. 1308, 1315 (Eng. H.L.).

from Eng.). These words are echoed in D. & C. Builders Ltd. v. Rees, [1966] 2 Q.B. 617 (Eng.
C.A. 1965).

\textsuperscript{46} Money-Lenders Act, \textit{supra} note 31.

\textsuperscript{47} \textit{CLIFFORD L. PANNAM, LAW OF MONEYLENDERS IN AUSTRALIA AND NEW ZEALAND}
(1965). \textit{But see} A. Kelly, Ltd. v. Scott, 1981 I.C.R. 281 (Eng.) (upholding a rate of
48% per annum in a loan secured over land).

\textsuperscript{48} Consumer Credit Act, \textit{supra} note 12.
through 140 of the Consumer Credit Act. Under section 137 of the Consumer Credit Act, the courts have the power to reexamine any credit transactions that they consider extortionate.

In view of the courts' effective applications of the unconscionability concept in limited areas of contract law, there is some question as to why it is not applied in an equally open manner in other types of cases. The answer, presumably, can be found in the reluctance of the courts and the legislature to depart in an open manner from the laissez faire concept of contracts.

This "hands-off" approach was understandable in the nineteenth century and in the first decades of the twentieth century, when laissez faire was at its zenith. However, the position has changed during the twentieth century. The laissez faire spirit, and with it the freedom of contract doctrine, has eroded in substantial branches of contract law, such as hire-purchase, carriage of goods, restrictive trade practices, and, most recently, in the field of consumer credit. This gradual abrogation of freedom of contract in specific fields has impacted the attitude of the courts. Thus, an early decision that set aside a bargain because one party's poverty and ignorance led him to accept a completely inadequate price for a share in an estate was applied in a modern case that voided a wife's agreement to transfer, without consideration, the matrimonial home into her husband's name in the course of divorce proceedings. Indeed, a number of modern cases suggest that the English courts were favorably inclined to the notion of developing a general doctrine of setting aside unconscionable bargains.

In the first of these cases, Lloyds Bank Ltd. v. Bundy, a guarantee was set aside because the beneficiary, Lloyds Bank, had failed to comply with a fiduciary duty that it owed to the guarantor, who was one of its clients. However, Lord Denning appeared prepared to base his judgment on an additional ground, which he explained as follows:

Gathering all together, I would suggest that through all these in-

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49. Id. §§ 137-140; see also Hire-Purchase Act, 1960, No. 33, § 32 (N.S.W.); Hire-Purchase Act, 1971, No. 147, § 37 (N.Z.).
51. Evans v. Llewelin, 29 Eng. Rep. 1191 (Ch. 1787), followed in Fry v. Lane, 40 Ch. D. 312 (1888) (Eng.).
stances there runs a single thread. They rest on "inequality of bargaining power." By virtue of it, the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other. When I use the word "undue" I do not mean to suggest that the principle depends on proof of any wrongdoing. The one who stipulates for an unfair advantage may be moved solely by his own self-interest, unconscious of the distress he is bringing to the other. I have also avoided any reference to the will of the one being "dominated" or "overcome" by the other. One who is in extreme need may knowingly consent to a most improvident bargain, solely to relieve the straits in which he finds himself.\textsuperscript{54}

In a second case, \textit{A Schroeder Music Publishing Co. v. Macaulay},\textsuperscript{55} a publisher engaged the services of a composer for five years and acquired the exclusive right of publishing all works composed by him during that period. However, the contract, which was in a standard form used by the publisher, did not impose on him a duty to publish the composer's works. The House of Lords set aside the contract, with Lord Diplock observing:

\begin{quote}
[W]hat your Lordships have in fact been doing has been to assess the relative bargaining power of the publisher and the song writer at the time the contract was made and to decide whether the publisher had used his superior bargaining power to extract from the song writer promises that were unfairly onerous to him.\textsuperscript{56}
\end{quote}

His Lordship observed that in the nineteenth century the \textit{laissez faire} doctrine induced the courts to discontinue the granting of remedies based on "public policy" considerations as a general relief against unconscionable contracts.\textsuperscript{57} Public policy as a concern remained applicable only in specific fields. In the case of contracts in restraint of trade, Lord Diplock believed that, although the reasoning of nineteenth century judges appeared to abide by contemporary economic doctrines, the courts did strike down bargains if they considered them

\textsuperscript{54} \textit{Id. at} 339 (Lord Denning, M.R.).
\textsuperscript{55} \textit{[1974]} 1 \textit{W.L.R.} 1308 (Eng. H.L.).
\textsuperscript{56} \textit{Id. at} 1315 (Diplock, L.J.).
\textsuperscript{57} \textit{Id.}
to be unconscionable.58 The real test employed appeared to be whether the bargain was fair. His Lordship emphasized the difference between freely negotiated contracts and standard form contracts offered on a "take it or leave it" basis, and suggested that in the latter there was greater need for vigilance on the part of the courts to see that these forms were not used to facilitate unconscionable bargains.59

The A Schroeder Music Publishing Co. decision was followed by a third case, Clifford Davis Management Ltd. v. W.E.A. Records Ltd.,60 which concerned another publishing agreement involving an element of restraint of trade executed on a standard form proffered by the entrepreneurs.61

Read on their own, these decisions can be considered to have laid the foundation for a general doctrine combatting unfair bargains on the ground of their unconscionability. Later decisions, however, show that the movement lost its momentum. The case of Alec Lobb (Garages) Ltd. v. Total Oil (Great Britain) Ltd.62 concerned a gas station lease that required the lessee to purchase his supplies solely from the lessors for a considerable period of time. The court of appeal refused to regard the inequality of the parties' bargaining powers as a ground for setting aside the transaction. The court's decision was partially influenced by the fact that the lessee had obtained independent legal advice. The court did, however, discredit the doctrine proposed by Lord Denning in Lloyds Bank Ltd. v. Bundy.63 In the words of Lord Justice Dillon:

Inequality of bargaining power must anyhow be a relative concept. It is seldom in any negotiation that the bargaining powers of the parties are absolutely equal. Any individual wanting to borrow money from a bank, building society or other financial institution in order to pay his liabilities or buy some property he urgently wants to acquire will have virtually no bargaining power; he will have to take or leave the terms offered to him. So, with house property in a seller's market, the purchaser will not have equal bargaining power with the vendor. But Lord Denning M.R. did not

58. Id.
59. See id. at 1316 (Diplock, L.J.); see also id. at 1314-15 (Reid, L.J.).
envisage that any contract entered into in such circumstances would, without more, be reviewed by the courts by the objective criterion of what was reasonable. . . . The courts would only interfere in exceptional cases where as a matter of common fairness it was not right that the strong should be allowed to push the weak against the wall.64

The criterion supported in this passage focuses on the "stronger" party's unconscionable behavior rather than on the direct effect of the imbalance of bargaining powers. A similar approach can be discerned in Hart v. O'Connor,65 in which property was sold for below market value by a vendor who was of unsound mind. The purchaser had been unaware of this condition, however, and no improper behavior could be attributed to him. Reversing the decision of the New Zealand Court of Appeal, the Judicial Committee of the Privy Council held that the contract should not be set aside. Lord Brightman summarized this rationale:

If a contract is stigmatized as "unfair," it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this "procedural unfairness." It may also, in some contexts, be described . . . as "unfair" by reason of the fact that the terms of the contract are more favorable to one party than to the other. In order to distinguish this "unfairness" from procedural unfairness, it will be convenient to call it "contractual imbalance." The two concepts may overlap. Contractual imbalance may be so extreme as to raise a presumption of procedural unfairness, such as undue influence or some other form of victimization. Equity will relieve a party from a contract which he has been induced to make as a result of victimization. Equity will not relieve a party from a contract on the ground only that there is contractual imbalance not amounting to unconscionable dealings.66

This passage clearly demonstrates the court's disapproval of an unconscionability doctrine based merely on the inequality of the parties' bargaining powers or the "contractual imbalance" reflected in the terms. An even stronger disagreement with Lord Denning's test is found in the House of Lords' decision in National Westminster Bank
Given the circumstances, it seems unlikely that the English courts will establish a general doctrine of unconscionability in the foreseeable future. Undoubtedly, a contract could be set aside or possibly modified by a court where the weaker party was induced to enter into the contract by means such as undue influence, economic duress, or misrepresentation. But intervention on the basis of what was described by Lord Brightman as "contractual imbalance" appears unlikely except in isolated cases. Furthermore, there is no suggestion that an English court would be willing to rely on the concept of unconscionability in order to stop a party from exercising its contractual rights in a harsh or oppressive manner. The doctrine will continue to operate only in its traditional areas, such as in consumer credit contracts or the granting of relief against penalty clauses.

Further, it is unlikely that the legislature will initiate the introduction of a general unconscionability doctrine. The Unfair Contract Terms Act of 1977 ("Unfair Terms Act") indicates that unconscionability concepts will continue to be invoked, if at all, on a piecemeal basis. While a detailed analysis of the Unfair Terms Act is outside the scope of this Article, a short review is appropriate.

The title of the Unfair Terms Act creates a misleading impression regarding its scope. The Unfair Terms Act does not provide a remedy against all unfair contractual terms. Its primary function is to protect consumers against clauses that either exonerate one party from liability for negligence or the non-performance of the contract, or that restrict this liability. In certain cases involving death or personal injuries resulting from negligence, the exemption clause is rendered ineffective. In other cases, the clause is enforceable only if it is

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67. [1985] 1 App. Cas. 686, 708 (appeal taken from Eng.).
68. The doctrine of unconscionability replaced the provisions of the Money-Lenders Act in consumer credit transactions.
70. See Unfair Terms Act, supra note 69, §§ 3, 4, 6(2), 7(2) (applicable only when one party is dealing as a consumer), 12 (defining the phrase "deals as consumer"), 5 (applicable only where goods are in consumer use); cf. id. §§ 2 (concerning exemption from negligence), 6(3), 7(3) (concerning certain warranties in nonconsumer transactions), 8 (concerning misrepresentations). For dealings as consumers, see Rasbora Ltd. v. J.C.L. Marine Ltd., [1977] 1 Lloyd's Rep. 645 (Eng. Q.B.); R. & B. Customs Brokers Co. v. United Dominions Trust Ltd., [1988] 1 W.L.R. 321 (Eng. C.A.) (holding that a firm can deal as a consumer).
71. See Unfair Terms Act, supra note 69, §§ 2(1), 6(1) (concerning an exclusion of the
"reasonable." The Unfair Terms Act provides guidelines for determining the reasonableness of a clause. Factors to be considered 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 should have known of the existence of the exemption clause.

It is clear that the new Unfair Terms Act applies mainly to exemption clauses in standard form contracts. Further, its scope is primarily confined to clauses involving "business liability." However, an exception is provided by section 8, which governs clauses purporting to exempt a party from liability for misrepresentation. Section 8 has a general scope of application and renders such clauses effective only where they are reasonable.

There is an obvious conceptual similarity between the "reasonableness" test of the Unfair Terms Act and the "harsh and unconscionable" doctrine of the Money-Lenders Act, which was applied to harsh and unfair credit contracts under sections 134 through 137 of the Consumer Credit Act. Moreover, both acts focus on the offending clause and ignore the manner in which it is utilized by the stronger party. In addition, each of the acts only applies the unconscionability concept to specified types of contractual clauses. The major distinction between the two systems pertains to the remedy. The Money-Lenders Act confers on the courts the discretion to reshape an unconscionable bargain. In contrast, the Unfair Terms Act renders an
offending clause inoperable. The departure of the Unfair Terms Act from the spirit of unconscionability suggests that a general doctrine of this type, which would be applicable across the board, is not currently favored by the legislature.79

C. Unconscionability in French Law

The treatment of unconscionable contracts at French law is today affected by the basic principles of the French Civil Code and by the case law that has developed around specific consumer protection legislation of recent years. These recent developments are discussed later in this section.

In the nineteenth century, the dominant principles were freedom of contract and protection of family property. The first principle, freedom of contract, supports the sanctity of contract in the same manner as it does in English law. The second principle, protection of family property, pulls in the opposite direction for reasons similar to those that led English courts to set aside unconscionable bargains with expectant heirs.

Freedom of contract is articulated in article 1134 of the French Civil Code: “An agreement legally entered into is law for those who made it.”80 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 has, therefore, been given a high place in the French system. At a practical level, however, it is essential to see what limitations positive law and procedures place on this freedom. The existence in article 1134 of the rule that contracts “must be performed in good faith”81 gives a general hint as to the sort of controls the law exercises over contractual undertakings.

The second principle, protection of family property, is more difficult to isolate. It is, however, explicitly expounded in the rules regarding the sale of immovable property and the sharing of a succession. It is also implicit in the rules relating to the compulsory

78. See Unfair Terms Act, supra note 69.
79. Presumably, concern exists about the wide discretion that an unconscionability doctrine, based on the reshaping of a bargain by judicial decision, confers on the courts.
81. Id. (“[Les conventions] doivent être exécutées de bonne foi.”); see also id. art. 1135.
portion of an heir in a succession, the bias against gifts, the traditional rules of civil delict, and the law of quasi-contract. The French Civil Code's emphasis is not so much on the assiduous protection of the property of an individual, but rather on the protection and maintenance of family property. Even though wealth may have changed its general character from immoveable to moveable assets, the French Civil Code's principle remains the same. The abiding theme remains the keeping of balance between patrimonies and the retention of wealth within a narrow family group.

The somewhat uneasy coexistence of the two principles of contractual freedom and property protection has left its mark on the French law of contract. For a discussion of the problems that arise and of ways of handling unconscionability, the rules relating to the formation of a contract provide a convenient beginning. These rules on formation are found, along with the other general contractual rules, in title 3 of book 3 of the French Civil Code, which is entitled "On different ways of acquiring property." 82 Book 3 emphasizes property notions. Article 711, 83 the introductory article to book 3, ties those notions of property to obligations. Contracts as voluntary obligations are thus directly affected.

Article 1108 84 provides a base for the bargaining stance of the contracting parties and, from an unconscionability point of view, introduces requirements of equality. Parties to a contract must have capacity, they must agree to the obligation placed on them, their obligation must relate to definable property, and there must be a lawful cause or reason for them to undertake 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 French Civil Code elaborates the rules relating to formation in articles 1109 through 1133. Initially, it deals with the question of agreement. No agreement occurs where the consent has been ob-

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82. Id. bk. 3 ("Des différentes manières dont on acquiert la propriété.").
83. "Ownership is acquired and transferred by succession, by donation inter vivos, by will, and by a contract." Id. art. 711 ("La propriété des biens s'acquiert et se transmet par succession, par donation entre vifs ou testamentaire, et par l'effet des obligations.").
84. "In order that a contract should be valid, it must comply with four conditions. There must be consent by the party bound; the person must be capable of contracting; the subject matter of the contract must be certain; the "cause" of the contract must be lawful." Id. art. 1108 ("Quatre conditions sont essentielles pour la validité d'une convention: Le consentement de la partie qui s'obligé; Sa capacité de contracter; Un objet certain qui forme la matière de l'engagement; Une cause licite dans l'obligation.").
tained by mistake, duress, or fraud. 85 The effect of the French Civil Code's rules 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. In these cases, the contracts are held to be ineffective. Also falling under the rubric of consent is lésion. 86 Lésion is usually dealt with as the loss that results from a serious imbalance or disproportion in the reciprocal obligations of the parties to a contract. 87 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 recognized in the French Civil Code is the rule prohibiting the enforcement of contracts that are contrary to public policy; 88 this is, in a sense, a separate rule that is independent both of the protection of private property and the emphasis on freedom of contract. 89

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 French Civil Code has no specific provision directly on point.

During the Middle Ages, lésion became a general doctrine in Europe. It extended to the sale of moveables as well as immovable, and in some cases protected purchasers. Although some modern legal systems have retained the medieval generalized notion, 90 France,
through 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 people. Examples of such special cases are minors' contracts and contracts for the sale of immovable assets. In the first situation, *lésion* permits a person under eighteen to rescind a contract if he has suffered or has been disadvantaged by it. Articles 1674 through 1685 of the French Civil Code govern the concept of *lésion* in real property contracts. Under these articles, as elsewhere, the operation of *lésion* does not depend on the intention or knowledge of the stronger party. The rule directly protects property and prohibits the sale of immovable assets for a price of less than seven-twelfths of their value.

In view of the narrow scope 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. For example, they have used the rules on mistake liberally where the considerations furnished by the parties were grossly disproportionate. In this type of case, the unconscionable element in the transaction has been used to establish the weaker party's lack of consent.

CODICE CIVILE [C.C.] art. 1448, translated in *The Italian Civil Code* (Mario Beltramo et al. trans., 1991). Though France had a general doctrine of *lésion* before the Revolution, the direct inspiration for Italian Civil Code article 1448 is more likely article 138 of the German Civil Code. Most European jurisdictions on the French model, however, have an even less extensive notion of *lésion* than does France. Spain, for instance, admitted only two cases of *lésion* through the Spanish Civil Code, the *Código Civil* [C.Civ.] arts. 1291, 1293 (those involving the property of incapacitated persons and absentees). Equally, what amounts to *lésion* varies; a fairly common figure is a disproportion of a quarter less than current market value. This is also the test prescribed by article 887 of the French Civil Code in relation to the division of an inheritance. C. civ. art. 887.

91. C. civ. art. 1118 ("La lésion ne vicie les conventions que dans certains contrats ou à l'égard de certaines personnes, ainsi qu'il sera expliqué [aux articles 1304 à 1314 du présent Code].").
92. *Id.* arts. 1304-14.
93. *Id.* arts. 1674-85.
94. In addition, however, to the specific examples in the French 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*, including Loi 67-545 du 9 Juillet 1967 [Law 67-545 of July 9, 1967], 1967 J.O. 6867(1), 1967 D.S.L. 258-60; Loi du 8 Juillet 1907 [Law of July 8, 1907], 2 Sirey Lois Annotées 238-40.
95. See Judgment of May 4, 1956, Cass. civ. soc., 1957 Recueil Dalloz [D. Jur.] 313 note P. Malaurie (Fr.); see also 6 *Marcel Planiol & George Ripert, Traité pratique de
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.

In setting aside the contract, 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. It is difficult to determine at what stage a price ceases to be derisory and begins to be lesionary, and hence adequate to constitute a cause. However, once the price is no longer derisory, the courts are prohibited from controlling the transaction. A recent case illustrates the difficulty. In that case, the contract concerned Catalan frescoes that had been sold by illiterate peasants for AF 300,00000 to someone who knew that their true value was inestimable. At first instance, the sale was set aside, the court clearly being 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 "the exceptional value" of the frescoes. This suggested that the trial judge had resorted to the doctrine of lésion, which, in light of article 1118, was inapplicable. Had the judge instead explicitly decided to regard the price as "derisory," the

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DROIT CIVIL 259 (2d ed. 1952-60); 3 HENRI MAZEAUD, LEÇONS DE DROIT CIVIL para. 893 (2d ed. 1966); STARCK, supra note 87, para. 1616.

96. See, e.g., Judgment of Feb. 20, 1988, Cass. req., 1988 Recueil Sirey [D.P.] I 263 (Fr.) (where the external forces affecting the free consent of a shipwrecked mariner were sand bars and a rising tide).

97. Judgment of May 27, 1908, Cass. req., 1908 Recueil Dalloz [D.P.] I 480 (Fr.).

98. Id.


100. This amounts to approximately $600 in the United States.

101. See supra note 83.
decision might well have been upheld.\textsuperscript{102}

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{103} Initially, the courts controlled these charges under article 1986\textsuperscript{104} of the French Civil Code, which states that "agency is gratuitous unless there is agreement to the contrary."\textsuperscript{105} This, however, was a patently bad argument. By 1913, the courts had concluded that they had a general power to control such charges under article 1134 and the general clauses on agency, articles 1984 through 2002. Thus, in a relevant case,\textsuperscript{106} the courts reduced the fee charged by an agent who had negotiated the sale of a factory from F6,000 to F2,000. In 1957, the same rule was applied to fees charged by arbitrators.\textsuperscript{107} The court explained that "[a]n 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."\textsuperscript{108}

Finally, the French Civil Code controls unconscionable contracts by proscribing certain types of transactions that are particularly prone to being used for usurious purposes. Two examples reveal the operation of this control. Article 2078\textsuperscript{109} of the French Civil Code provides that a pledgee may not, on default by the pledgor, \textit{ipso facto} appropriate to himself the pledged goods. The second example of protection is

\textsuperscript{102} \textit{Dol} may equally have been a successful plea for the naive vendors.

\textsuperscript{103} In the field of professional fees and charges, the courts have been similarly active. The public nature of the function that many professions fulfill has been a relevant factor and has assisted the courts in finding a secure basis for their decisions. In the case of notaries and \textit{avoué\textsc{ë}}s, the monopolistic nature of the professions also influenced judicial reasoning. The Judgment of June 13, 1910, Cass. req., 1910 Recueil Dalloz [D.P.] II 368 (Fr.), involving the sale of a notary's office, is a good example of this area. In that case, the appellate 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." \textit{Id.} Bankers are also included within this general control system.

\textsuperscript{104} C. civ. art. 1986.

\textsuperscript{105} \textit{Id.} ("Le mandat est gratuit, s'il n'y a convention contraire.").

\textsuperscript{106} Judgment of Mar. 11, 1913, Cass. req., 1913 Recueil Dalloz [D.P.] I 408 (Fr.).

\textsuperscript{107} Judgment of Feb. 6, 1957, Cour d'appel, Colmar, 1957 Recueil Dalloz [D. Jur.] 206 (Fr.).

\textsuperscript{108} \textit{Id.}

\textsuperscript{109} C. civ. art. 2078 ("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.").
the debtor's right of repurchase, the vente à reméré.\textsuperscript{110} The vente à reméré allows the vendor to retain a right to repurchase the goods. Upon exercising this right, the vendor must return the price paid and reimburse the purchaser for the various incidental costs of the sale. Through this type of sale, the vendor can raise money in times of need. Its advantages over typical financing arrangements are that the vendor may get the full value of the property that would have otherwise been given as security for a part-value loan, and also that the vendor retains the possibility of repossessing the property when his finances improve. Though the purchaser is not entitled to interest on the amount paid to the vendor, the purchaser does have the benefit of the property's revenue from sale until repurchase. Article 1673 explicitly sets forth the nature of the debtor's reimbursement.\textsuperscript{111} The French Civil Code limits the period for repurchase to five years.\textsuperscript{112}

Courts generally construe sales with a right of repurchase narrowly. The parties may provide in an agreement that the purchase money received is less than the stipulated sale-repurchase price. A court may, however, intervene to protect the seller on the basis that the sale is in fact a loan in violation of usury laws. A court is also likely to intervene in certain sale and lease-back transactions. If, for instance, the lease of property back to the vendor follows immediately after sale and the purchaser commonly makes purchase and lease-back sales, the court will treat the contract as a secured loan disguised as a sale in order to prevent the vendor from evading pledge or hypothecation laws.

Outside of these French Civil Code provisions exists an important body of law on clauses abusives and some specific commercial contracts that usually require protective measures. Typical examples of the latter are credit sale transactions and contracts in restraint of trade. The French have acted predictably with respect to both instances, tending to favor protecting the purchaser and the economic freedom of the restrained party, respectively.

The law on credit sales is found in the Decree of May 20, 1955, as supplemented by the Ordinance of June 30, 1945 and the Decree of

\textsuperscript{110} Id. arts. 1658-73.

\textsuperscript{111} Id. art. 1673 ("The seller who implements an agreement for repurchase must reimburse the purchaser not only for the sale price but also for the senses 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.").

\textsuperscript{112} Id. art. 1660.
August 4, 1956. These laws deal with all sales involving credit arrangements, provide minimum sums in down payment for various classes of goods, and set maximum periods for payment of the unpaid balance of the purchase price. They further require that the vendor in a credit sale give the purchaser full details in writing of the transaction into which he is entering. In practice, creditors often seek by express contractual provision to bypass the general law, such as article 1184, requiring notice and time for payment to be given before termination of the credit sale agreement. Such clauses have many advantages for creditors, but are not favored by the courts. Thus, courts interpret such clauses restrictively, and, if possible, will hold that the clause refers back to article 1184 and will apply the general law. Alternatively, courts may investigate the circumstances of the purchaser's acceptance or test the contract for usury.

Contracts in restraint of trade are valid on the general grounds of freedom of contract. However, this generalization is subject to certain restrictions. The principal limits, based on the economic freedom of the individual, require that a clause restraining competition must not provide an excessive or unnecessary restriction on another basic freedom. Thus, clauses that restrict trade in all countries of the world would fail. To be valid, any restraint must have specific terms and be limited in time or space. Any unreasonable restraint is void on the grounds of public policy.

Unconscionability is expressly and rigidly controlled in France in the area of usury law. The biblical directions of the Old and New
Testaments influenced early French thinking regarding usury. From 1789 to 1807, interest rates were left unregulated. Low limits for interest rates were set in 1807, and continued in force until 1886 in commercial matters, and until 1918 in civil matters. These controls were followed by a period of freedom that ended in 1935. The law of August 8, 1935, introduced an extremely flexible test of unconscionability. The standard used to determine the maximum conscionable rate of interest was 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. Thus, it was rarely used and was finally repealed in 1975.

The Law on Usury of December 28, 1966, established the current law. The new system covers not only loans of an ordinary nature, but also affects installment sales and hire-purchase transactions. In calculating the rate of interest provided by an agreement, the courts are instructed by article 3 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 obtaining the loan. Whatever the apparent nature of a transaction, courts are empowered to go beyond the stated purpose in order to discern its true nature and to discover if it is a disguised loan. The penal sanctions are formidable and operate against all who participate in the charging of a usurious rate.

The French legislature formulated a specific enactment on usury. However, because of the nature of usurious practices, commentators have interpreted the usury laws as another, albeit special, aspect of a general theory against lesionary transactions. That view is helpful in

on interest rates, and that the agreed rate is stipulated in writing. For 1991, the legal rate was fixed at 10.26%.

118. Decree on Usury, 1934 D.P. IV 225.
119. Id. art. 1.
120. 1975 D.L. 619 art. 5.
121. 1966 D.L. 1010.
122. This provides for a maximum effective rate that must not, at the time of contracting, exceed by more than 30% the mean rate charged in the preceding quarter by lending finance institutions for similar transactions involving similar risk, as defined by Ministerial order given after consultation with the National Credit Council. The civil sanction for charging a usurious rate is not nullity but a reduction of interest. Article 5 of the Law on Usury provides:

[W]here a contractual loan is usurious, money paid in excess of the lawful amount is ipso jure 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.

Id. art. 5.
the present context as it connects the present statute with the earlier analysis of the general law. In both, the law intervenes in a private contractual relationship largely because of the grossly disproportionate bargaining positions of the parties. The law does this to maintain a reasonable equilibrium between their patrimonies.

Major development of case law in the late 1980s and early 1990s overshadows these specific legislative rules. Building on the consumer protection law of 1978 on *clauses abusives* and on the legislative policy implicit in that law, the Court of Cassation appears, with its decision of May 14, 1991, to have established a general rule effecting the nullity of *clauses abusives* in contracts.¹²³

The French statute of January 10, 1978, was enacted "for the protection of consumers against unconscionable clauses" and aimed at striking down clauses imposed on consumers by "an abuse of the economic power of the other party and which give that party an excessive advantage."¹²⁴ This forbade any abuse of position by one party that affected the exercise of the will of the other. It was not limited to contracts of a particular type or a particular form, nor only to contracts for goods, services, or real property. As Ghestin stated in commenting on the statute, "This law...introduces for the first time, for the benefit of consumers, provisions of a general kind which could apply to all contracts."¹²⁵

Significantly, the law left the definition of the specific types of clauses affected to subordinate legislation. The Conseil d'Etat, acting on the recommendation of the Commission on Unconscionable Clauses, duly prescribed some clauses by the Decree of March 24, 1978.¹²⁶ There have been no further decrees to extend the application of the statute. The courts, however, have been active, and the culmination of this activity is the decision of the Court of Cassation of May 14, 1991.¹²⁷

In that decision, the first civil chamber of the court, following the thrust of its own earlier decisions, upheld the judgment of the lower

¹²⁴. 1978 D.L. 86 art. 35.
court that had found abusive the clause in a contract for the development of a film that excluded all responsibility of the laboratory for loss of the film. The clause in question was not one of those listed in the Decree of 1978. The Court of Cassation held that "the clause obtained an excessive advantage for the defendant company . . . and that the latter by virtue of its economic position was able to impose the condition on its clientele." The judgment does not refer expressly to any particular law, though it uses the language of the statute of 1978. It does, however, clearly treat unconscionable clauses as void whether or not they are covered by a specific decree.

In generalizing the rules on clauses abusives in this way, the decision allows expansion of the law to protect against unfair contract clauses generally. Ghestin, in his note on the judgment, suggests that public policy may well justify the rule. The court need only broaden its interpretation slightly to apply this rule to parties who are not consumers.

In summary, the earliest controls on freedom of contract in France were property controls, which were augmented over the years by usury laws and by increasingly broad rules. Currently, in the field of unconscionable clauses at least, the courts have been willing to control improvident and disproportionate bargains.

The French, then, like the English, have a number of specific rules relating to unconscionability, and although they have no general lesionary doctrine, they are moving rapidly toward a general rule on unconscionability. In contrast, German law, as discussed in the next section, has already developed a general doctrine of unconscionability. However, it is significant that the German Civil Code was promulgated a century after the French Civil Code.

D. Unconscionability in German Law

Unlike English and French law, the German Civil Code, the Bürgerliches Gesetzbuch ("BGB"), contains three general provisions pertaining to unconscionability: articles 138, 242, and 826. Article
138 combats bargains that are either contrary to public policy or unconscionable. Article 242 requires the observance of good faith in the performance of bargains. Finally, article 826, a particularly general provision, prohibits the misuse of rights by one person for the purpose of damaging another.

Article 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 causes damage to another in a manner contrary to public policy is bound to compensate the other for the damage." Because the article is based on tort law, it is outside the scope of this Article. The other two provisions, articles 138 and 242, require a more detailed analysis.

Article 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. Subsection 2, which originated in the Usury Law of 1880, was not included in the original draft of the BGB. It was added during the BGB's revision, reflecting, in all probability, the progressive ideas

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132. BGB art. 826.

133. *Id.* art. 138. The provision was amended by the Erste Gesetz zur Bekämpfung der Wirtschaftskriminalität (First Law on the Combating of Commercial Crime) [I. WikG] 1976 BGB1.1 2034. The second paragraph now states that a legal transaction is void when a person exploits "the distressed situation, inexperience, lack of judgmental ability or grave 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." *Id.*, translated in Arthur Taylor von Mehren & James Russell Gordley, *The Civil Law System* 1188, 1209 (2d ed. 1977). The amendment aimed 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 one party by the other, who must make a "disproportionate" gain. Cf. A. Müller-Emmert & B. Maier, *Das Erste Gesetz zur Bekämpfung der Wirtschaftskriminalität, Neue Juristische Wochenschrift* [NJW] 1657, 1664 (1976); R. Sturm, *Die Neufassung des Wuchteratbestandes und die Grenzen des Strafrechts*, Juristenzeitung 84 (1977) (both dealing mainly with the criminal law aspects of the new Act).

134. 1 Benno Mugdan, *Die gesamten Materialien zum BGB* 1013 (1899).

135. It appears to have been added at the stage of the deliberations of the 12th Commis-
at the end of the nineteenth century. The clause is known as the "usury [Wucher] clause," and goes far toward establishing a general concept of unconscionability. However, it includes a two-tiered limitation. First, the clause applies only where one party to the contract has exploited, or made use of, the need, carelessness, or inexperience of the other. Second, 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 German courts have given the terms "need," "carelessness," and "inexperience" a restrictive construction. "Need" has been held to exist where a person's economic or financial position is subject to an immediate and direct threat, such as a landowner's need to raise finance in order to prevent a foreclosure sale of his or her mortgaged property. Other types of necessity, such as one arising from a threat to a person's health or well-being, do not constitute "need" within the meaning of article 138(2). Moreover, the state of necessity must be one that leaves the debtor with no choice but to go ahead with the unequal bargain. This occurs mainly where the debtor faces the danger of economic collapse or the loss of an important asset, but not where the debtor's "need" arises with respect to a transaction involving the expansion of a business or the acquisition of a new asset. Thus, in a case decided in 1957 by the Bundesgerichtshof, a businessman who sought to expand his business in a town where an acute shortage of leasehold property existed entered into an onerous lease. In this lease, he pledged not to raise any claims concerning the state of the premises. The court held that this case did not involve "need" within the meaning of article 138(2), as there had been no imminent threat to the businessman's existing economic position.

"Carelessness" or "foolhardiness" within the meaning of article 138(2) occurs when a person enters into a bargain without attempting...
to assess its implications and consequences. The carelessness must relate directly to the transactions in question. "Inexperience" may relate either to a general lack of business sophistication or to ignorance of the particular trade in question. Dawson cites an interesting case concerning both carelessness and inexperience. In that case, a retired railroad inspector paid a patentee an exorbitant amount for the exclusive franchise to sell lighting equipment in a foreign country. The court set aside the contract on the ground of the inspector's inexperience, although all of 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. A court applying 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, by itself, a sufficient ground for setting aside a bargain. The stronger party must have exploited or traded upon this weakness. Courts interpret the word "exploitation" more broadly than the words "need," "carelessness," and "inexperience." It is not necessary to establish that the stronger party intended to exploit the weakness in question or even had a hand in creating it. Rather, it is sufficient to show that the stronger party was familiar with the facts. Thus, there is "exploitation" where the stronger party takes advantage of a known weakness of the other party.

It follows that, while a finding of need, carelessness, or inexperience must be based on the actual circumstances of the weaker party, the existence of exploitation depends upon the stronger party's state of mind. In other words, whether or not the stronger party has exploited a "weakness" depends on a subjective test. In contrast, the second requirement of article 138(2) of the BGB, providing relief

141. See BGB-RGRK, supra note 136, at 446.
143. See id.
when there is a striking disparity in the value of the considerations furnished by the parties, is governed by an objective test.

Neither the BGB nor the leading commentaries define the phrase "obvious disparity." The prevailing view is that whether the considerations furnished by the parties are strikingly disproportionate depends on the circumstances of each case.\textsuperscript{146} Thus, in a period of accelerating inflation, interest rates of ninety-six percent per annum were held not to involve a strikingly disproportionate gain and therefore were not considered usurious.\textsuperscript{147} Similarly, a high interest rate was considered justifiable where a loan was extended in the context of a speculative transaction.\textsuperscript{148} In ordinary transactions, though, loans with rates of forty-five percent per annum and of thirty-nine percent per annum were treated as usurious.\textsuperscript{149} Moreover, in cases of this type, the courts usually consider the rate at which the loan involved could have been obtained from other sources. A similar analysis, which compares the transaction under consideration with terms available elsewhere, applies to sales. Under this test, if the contract price differs substantially from the market price, the transaction involves an "obvious disparity" in furnished consideration. However, where there is no ready market for the goods, the disparity is difficult to establish. Thus, in one case, a court held that the transaction did not involve an obvious disparity, although the price amounted to only two-fifths of the market value.\textsuperscript{150} A 1964 decision of the Bundesgerichtshof resolved one important aspect of this method of comparison. According to the court, any comparison should be based on the prices in effect at the time the contract is made.\textsuperscript{151}

When a transaction runs counter to article 138(2), the contract is rendered void, so that neither party is under a duty to perform.\textsuperscript{152} In

\begin{itemize}
\item \textsuperscript{146} See BGB-RGRK, supra note 136, at 447.
\item \textsuperscript{147} Judgment of Oct. 9, 1926, RG, 1926 Werneyar 151, cited in Dawson, supra note 130, at 1063.
\item \textsuperscript{148} Judgment of Feb. 25, 1909, RG, 38 JW 215; cf. Oldbg, 52 MDR 36 (two percent per month regarded as permissible). See Dawson, supra note 130, at 1063, for examples where rates of up to 10% \textit{per day} were upheld.
\item \textsuperscript{149} Judgment of Nov. 11, 1961, BGH, 17 BB 156; Judgment of Feb. 15, 1956, BGH, 11 BB 318. The court held that 90% \textit{per annum} would, in any event, be excessive or "obviously disproportionate." Judgment of Feb. 9, 1967, BGH, 76 Der Betrieb 677.
\item \textsuperscript{150} Judgment of May 2, 1969, BGH, 1969 Lindenmaier-Möhring 1447.
\item \textsuperscript{151} Judgment of May 25, 1964, BGH, 17 NJW 1787.
\item \textsuperscript{152} Judgment of Feb. 19, 1904, RG, 57 RGZ 95; Judgment of Oct. 19, 1909, RG, 72 RGZ 63; Judgment of Nov. 18, 1924, RG, 109 RGZ 201. Note that different rules of avoidance apply in cases other than those decided under article 138(2). BGB-RGRK, supra note 136, at 440.
\end{itemize}
fact, the *Reichsgericht*, which was the predecessor of the *Bundesgerichtshof*, held that the stronger party had no remedy whatsoever, which meant that he faced potential losses of both capital and profits.¹⁵³ This policy changed in 1939, when the same court held that a lender who had loaned to a borrower at usurious rates was entitled to recover the amount lent, but not any interest, through an action in restitution under article 812.¹⁵⁴ A similar remedy appears available in transactions other than loans. A leading commentary suggests that when a sale is invalidated under article 138(2), the seller is entitled under article 817 of the BGB to recover the chattels supplied by him.¹⁵⁵ Similar actions in restitution are available to the weaker party.¹⁵⁶

Article 138(2) has two apparent shortcomings. First, the article contemplates the avoidance of the entire transaction. This provision would drastically affect contracts involving several promises, only one of which violates article 138(2). Fortunately, article 139 provides a solution: "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."¹⁵⁷ Thus, where the tainted undertaking is severable from the remaining ones, the court can uphold the rest of the bargain.¹⁵⁸

The second difficulty emerges most clearly from a comparison of article 138(2) with article I of the United Kingdom's *Money-Lenders Act of 1900*.¹⁵⁹ The German provision does not confer on the court any power to reopen the transaction to determine an appropriate rate of interest or price. Nevertheless, one commentary has argued that article 139 may sanction such a remedy.¹⁶⁰ Presumably, the suggestion is that a transaction, whether a sale or a loan, can be avoided under article 138(2) only to the extent that the price or the interest

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¹⁵³. Judgment of Mar. 27, 1936, RG, 151 RGZ 70.
¹⁵⁵. 1 JULIUS VON STAUDENTER, KOMMENTAR ZUM BGB 828 (11th ed.). However, the commentary refers to some authorities suggesting that no recovery is possible. *Id.* In one decision, the *Reichsgericht* suggested that such recovery would not be allowed before the end of the contract period. 161 RGZ 52; see also BGB-RGRK, supra note 136, at 448, note 27.
¹⁵⁶. BGB-RGRK, supra note 136, at 441, note 10, 448, note 27.
¹⁵⁷. BGB art. 139.
¹⁶⁰. BGB-RGRK, supra note 136, at 441, note 10. Presumably, where the buyer is the stronger party, the court could increase the price. However, it is difficult to see how such a course can be sanctioned by article 139.
rate is "disproportionate." The excess is to be severed from the market price or from the usual interest rate. However, a judgment of the Bundesgerichtshof\(^{161}\) has questioned the availability of such a remedy.

Article 138(2) has proven, nevertheless, to be an effective weapon in cases involving both the exploitation of one party's weakness, defined as "need," "carelessness," or "inexperience," by the other and a disparity in the value of the considerations furnished. It has, for example, been used to resolve labor problems by imposing a heavy penalty on the employee for giving notice before the end of the prescribed period of employment.\(^{162}\) Contracts in which an author grants an exclusive option over all of his future works to a publisher who makes no promises to publish them provide another illustration of uses for article 138(2).\(^{163}\) In setting aside clauses and contracts of this type, German courts have granted a remedy similar to that available in such cases under English law.

When one of the elements required under article 138(2) is absent, as, for example, when there is no obvious disparity in the value of the parties' contributions, the court may grant a remedy by invoking article 138(1).\(^{164}\) This provision has been used to annul unfair covenants in restraint of trade. However, the test employed in these cases reflects the spirit of subsection 2. The courts grant relief where the restrictive clause unduly limits the covenantor's freedom of action,\(^{165}\) or where it seeks to protect the interests of only one of the parties.\(^{166}\) The court is more likely to grant relief if the restrictive covenant is coupled with a heavy penalty for breach,\(^{167}\) or if it remains in force even where the covenantor is entitled to withdraw from the rest of the

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161. Judgment of July 12, 1965, BGH, 44 BGHZ 158, 162. In Judgment of May 30, 1958, BGH, 11 NJW 1772, a monopoly-holding seller fixed a disproportionately high price for his goods. The court invalidated the entire contract and held that no method existed for the determination of an appropriate price.


164. This provision is clear and terse: "A legal transaction which is against public policy is void." BGB art. 138(1).


contract.\textsuperscript{168}

Article 138(1) has also been invoked in cases involving contracts known in Germany as \textit{Knebelungsvertrag}. The term refers to contracts in which one party controls the economic freedom of the other to the point that he has obtained a stranglehold over the other party.\textsuperscript{169} A good example of such contracts is a beer franchise granted by a brewery to an innkeeper. In this type of contract, the brewery frequently extends the innkeeper a loan to finance the acquisition of the business. In return, the innkeeper agrees to purchase all necessary supplies from the brewery. Occasionally, the contract binds the innkeeper for an unusually long period of time and the brewery supplies the beer at an unfavorable price. It is difficult for the courts to intervene under article 138(2) because the interest rate charged by the brewery is usually not above the market rate. Therefore, it is difficult to establish an obvious disparity in the values of the considerations furnished by the parties. However, relief from such contracts has occasionally been granted under article 138(1).\textsuperscript{170} The test that the courts use is basically whether or not the innkeeper loses his economic freedom in relation to the brewery.\textsuperscript{171} The courts consider the extent of the restriction and whether it appears to be excessive or unfair.\textsuperscript{172} The unconscionability concept of article 138(2) is undoubtedly reflected in these considerations.

Another instance of "stranglehold" occurs in transactions that involve excessive security. German law sanctions the assignment, by way of security, of future book debts and 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 \textit{[Globalzession]}. Similarly, a German manufacturer who supplies goods on credit is able to acquire a security interest \textit{[Sicherungsüber- eignung]} in all goods supplied to the customer, as well as in their pro-

\textsuperscript{168} Judgment of Oct. 14, 1904, RG, 59 RGZ 76; see also BGB-RGRK, \textit{supra} note 136, at 454, note 39.

\textsuperscript{169} See BGB-RGRK, \textit{supra} note 136, at 449. The term is suggested by Dawson, \textit{supra} note 130, at 1071-74, who gives an excellent account of such contracts, and who uses the term "shackling." Peter L. Murray, \textit{Priority Problems in Private Financing—The German Experience and the UCC Compared}, B.C. INDUS. & COM. L. REV. 355 (1970) uses the term "fettering."

\textsuperscript{170} See BGB-RGRK, \textit{supra} note 136, at 450.

\textsuperscript{171} Judgment of Sept. 26, 1933, RG, 65 JW 569; see also BGB-RGRK, \textit{supra} note 136, note 31.

ceeds. However, a series of decisions by the Reichsgericht and the Bundesgerichtshof has established that such a transaction will be set aside if it gives the financier complete economic control over the debtor's affairs. The courts in such a case, invoking article 138(1), use a test of fairness or conscionability. One commentary explains:

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 when the creditor assumes a one-sided stance, having regard solely to his security interest, and ignores the valid interests of the debtor.

When a court sets aside this type of contract, the debtor's general creditors or a competing secured creditor usually reaps the benefit. In effect, article 138(1) assists, in this instance, in determining questions of priorities.

It is important to emphasize that the foregoing discussion of article 138 is far from complete. The discussion 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, article 242, and the use of the unconscionability concept with respect to certain clauses found in standard form contracts.

Article 242 governs the performance of contractual undertakings and provides that “[t]he debtor is bound to effect performance according to the requirements of good faith, having regard to common usage.” The word “debtor,” as used in this article and throughout the BGB, has been interpreted broadly. As such, it may be more accurately translated as “promisor.” Article 242 is thus a general provision of the German law of obligations. It provides that every contract must be performed in good faith and in accordance with good business mores.

In practice, article 242 constitutes a double-edged sword. On the
one hand, it aids the promisor if the promisee raises technical points with regard to the promisor's contractual performance. One example is where a buyer purports to reject delivered goods because of a minute shortage in quantity, or due to defects in an insignificant proportion of the goods supplied. Under article 242, such behavior violates "good business mores." On the other hand, the article occasionally imposes on the promisor a duty to do more than that which is required under the express terms of the contract. For example, article 242 was invoked for such a purpose during the disastrous inflation following World War I. During that period, the German currency declined in value such that debt repayment based on nominalism saddled creditors with enormous losses. The Reichsgericht decided that, under article 242, debtors had a duty to repay amounts that would compensate creditors for the loss of the currency's purchasing power. This process became known as revalorization and was eventually sanctioned by an act passed in 1924. The usefulness of article 242 emerges most readily from a review of the cases decided under it. These cases can be divided into three specific groups.

The first group is comprised of cases involving the misuse of contractual rights by a promisee. Usually this occurs where the promisee attempts to escape liability or invoke a sanction by relying on an insignificant defect in the promisor's performance. Cases of this type include, for example, a creditor's attempt to invoke a forfeiture clause for a short delay in an installment payment under a lending transaction or a charter party's cancellation based on a short delay in the ship's arrival in port. Under article 242, such behavior is considered not acting in good faith. For the same reason, an insurer may not cancel a policy merely because of a short delay in the payment of a small portion of the premium.

Nevertheless, some delays are not excused under article 242. This was discovered by an assured who failed to remit his insurance premium by the end of a grace period and hurried to pay it immediately after the grace period had expired. The court decided that this behavior was not excused under article 242.

179. Under the nominalistic principle, a currency unit has the same value regardless of its parity with other currencies and regardless of its purchasing power.
ately after his car sustained damage in a collision. A misuse of rights likewise occurs where one party unreasonably denies some rights to the other. For example, a tenant who is denied permission to use the premises for a legitimate purpose may obtain a remedy under article 242, provided that the proposed use causes no loss to the landlord. The remedy is available even if the proposed use is prohibited under a duly signed standard form lease.

The second group of cases involves the inconsiderate use of rights. An inconsiderate use occurs mainly when a promisee seeks a specific remedy, although an alternate remedy would cause a smaller loss to the promisor. Thus, a promisee may not simply withdraw from a contract when his rights can be equally safeguarded by less drastic means, such as the repair of the goods supplied. Similarly, a landowner possesses no right to claim damages from an architect if the landowner can obtain equal satisfaction through minor repairs by the builder.

The third group consists of cases in which one party leads the other to believe that there is no need to comply with a given contractual term and then later enforces the term. One example is where an insurance company indicates in the course of settlement negotiations that it will not enforce a clause limiting the time for instituting an action. Under article 242, the company is precluded from invoking this clause if the negotiations fail and the assured commences proceedings after the end of the prescribed period. Similarly, a surety may not plead a defect of form in his guarantee if the surety tells the promisor that, being a person of honor, he will not raise such a technicality. Furthermore, 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.” In English law, some of these cases might be resolved in a similar manner through the doctrines of waiver or promissory estoppel.

The German cases demonstrate that article 242 serves a function

184. See SOERGEL, supra note 177, at 71 n.250.
185. Id. n.251.
189. FIKENTSCHER, supra note 177, at 123.
different from that of article 138. The latter provision combats unconscionable terms; the former condemns the unconscionable use of contractual rights. However, the two provisions are complementary: In certain instances, most notably those involving standard form contracts, the provisions are used simultaneously.

The German courts, like their English counterparts, commenced the assault on unfair standardized terms by resorting to the rules of formation and construction. Inconspicuous terms could be excluded from the contract unless they were brought to the non-drafter's attention; ambiguous terms could be construed against the drafter; and negotiated terms could be given priority over standardized terms. Where a term reflected misuse of the drafter's monopoly power or superior bargaining position, it was subject to challenge under article 138.191 However, from the mid-1950s, the courts policed, under article 242, the enforceability of standardized terms by reference to their content. Where a standardized term negated a statutory protection that remedied defective performance or a cardinal obligation associated with the particular type of contract, the term was held to contravene article 242 unless the non-drafter received a sufficient off-setting benefit. In one of the seminal decisions, the court held that article 242 invalidated a standardized term excluding liability for product defects unless the contract entitled the buyer to a right of repair, and, in the event such repair failed, to withdraw from the contract.192 Another case in point concerned the general terms and conditions of the German banks, which excluded liability for incorrect banking references and incorrect information regarding investments. It was held that, if a bank supplied an incorrect reference, or gave unsound advice from which it derived any direct or indirect advantage, it was precluded from relying on the exemption clause.193 The extensive case law was consolidated into statute by the Standard Terms Act of 1976.194 The Standard Terms Act of 1976 sets forth the general rules for incorporation and construction of standardized terms, employs the good faith requirement of contractual balance as the general substantive con-

191. BGB-RGRK, supra note 136, at 449, note 29.
192. Judgment of Oct. 29, 1956, BGH, 22 BGHZ 90; see also Judgment of Jan. 10, 1974, BGH, 62 BGHZ 83 (striking down a standardized term that excluded liability for product defects and provided a right of repair, but excluded the buyer's right to withdraw from the contract).
straint, declares unenforceable a wide range of specific standardized
terms used in consumer and non-consumer transactions, and regu-
lates the consequences of unenforceability.

It is reasonably clear that German courts have employed articles
138 and 242 for useful purposes. Undoubtedly, German courts have
adopted a conservative approach, motivated by a desire to avoid un-
certainty in the law. Articles 138 and 242 have nevertheless intro-
duced a certain flexibility that is absent in the English and French
treatments of comparable problems. The United States' experience
supports this conclusion.

E. Unconscionability Under the United States' Uniform
Commercial Code

The Uniform Commercial Code ("U.C.C.") of the United States
includes provisions similar to those of the BGB. Section 1-203
states that "every contract or duty . . . imposes an obligation of good
faith in its performance or enforcement." This section, which re-
sembles article 242 of the BGB, has not instigated a great deal of
litigation. The U.C.C.'s prominent section governing unconsciona-
ability is section 2-302, which serves a function similar to that of article
138 of the BGB. Section 2-302 provides:

(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 en-
force 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 af-
forded a reasonable opportunity to present evidence as to its com-
mercial setting, purpose and effect to aid the court in making the

195. Substantial literature addresses this provision. See, e.g., Arthur A. Leff,
Unconscionability and the Code—The Emperor's New Clause, 115 U. PA. L. REV. 485 (1967);
M.P. Ellinghaus, In Defense of Unconscionability, 78 YALE L.J. 757 (1969); John P. Dawson,
Unconscionable Coercion: The German Version, 89 HARV. L. REV. 1041 (1976); E. Allan
Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed
Negotiations, 87 COLUM. L. REV. 217 (1987); John Monaghan, Comment, Extending the Bad

two other provisions resembling the BGB. See UNIF. CONSUMER CREDIT CODE §§ 5-108, 6-
111 (final draft 1974).

197. U.C.C. § 1-203.
There are four major distinctions between this section and article 138 of the BGB. First, article 138 is included within the General Part of the German Code, and it therefore has a general scope of application. In particular, article 138 applies throughout German contract law. In contrast, U.C.C. section 2-302 is included in the article governing sales. Thus, section 2-302 apparently commands a much narrower application than does BGB article 138. While some decisions emphasize the limited applicability of section 2-302, it has nevertheless been used in transactions other than sales, such as guarantees, insurance contracts, and leases of chattels. This extension of the principles of section 2-302 originates from a body of pre-U.C.C. case law dealing with various transactions not confined to sales. This trend of applying the section in areas other than sales will likely continue.

The second distinction between BGB article 138 and U.C.C. section 2-302 relates to the remedy. Here, the German provision is the narrower one. The only remedy envisaged by BGB article 138 is the setting aside of the entire contract. Reopening the transaction is not possible under article 138. U.C.C. section 2-302, on the other hand, provides for several measures, including reopening the transaction. Thus, in *Frostifresh Corp. v. Reynoso*, a seller who obtained an exorbitant price for a refrigeration unit by exploiting the buyer's ignorance was allowed to retain the net cost of the article plus a reasonable

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198. Id. § 2-302.
203. See generally U.C.C. § 2-302 cmt. 1. Note that article 2 of the U.C.C. extends beyond sales, as section 2-102 applies to transactions in goods generally.
profit, as well as trucking and service charges. The court ordered a refund of the balance to the buyer, enabling him to retain the unit by paying a reasonable amount. This type of solution is clearly preferable to that available in German law, which would entail setting aside the contract and confining the stronger party to seeking restitution under articles 812 or 817.

Another remedy available under U.C.C. section 2-302 is the setting aside of a penalty or liquidated damages clause to preclude the stronger party from recovering more than his actual loss. However, section 2-302 fails to provide damages for a person who enters into an unconscionable agreement unwittingly. While such a remedy is equally unavailable under BGB article 138, it occasionally arises under BGB article 826.

The third demarcation between the two provisions arises in U.C.C. section 2-302(2), under which the parties to a dispute involving unconscionability "shall be afforded a reasonable opportunity to present evidence as to [the contract's] commercial setting, purpose and effect." A number of decisions highlight this provision's importance. Although BGB article 138 contains no comparable subclause, it appears that German courts possess the power to call similar evidence. This, however, is an outcome of the German rules of civil procedure, under which the court takes a far more active role in the proceedings than in the Anglo-American systems.

The fourth and most significant difference between BGB article 138 and U.C.C. section 2-302 relates to the contrast in the respective philosophies employed by their drafters. Article 138 of the BGB sets forth the instances in which a transaction is to be set aside for unconscionability. Subsection 1 empowers the court to intervene when a transaction offends public policy. Subsection 2, also called the


207. U.C.C. § 2-302(2).


209. The German courts familiarize themselves with the specific facts and with the setting of the assailed transaction.

210. BGB art. 138.

211. Id. art. 138(1).
Wucher or usury clause, affects cases in which one party trades on a weakness, defined as need, carelessness, or inexperience, of the other party to achieve an "obviously disproportionate" gain.\textsuperscript{212} 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 article 242, dealing with good faith in performance, or article 826, concerning abuse of rights.\textsuperscript{213} The character of U.C.C. section 2-302 is far more general and enables the court to step in whenever a transaction is found to be unconscionable.\textsuperscript{214} It is significant that the key word, "unconscionable," is not defined in the U.C.C. The guidance given by Official Comment 1 to section 2-302 is similarly 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.\textsuperscript{215}

The U.C.C. comment, like section 2-302 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 subsection 1. It is apparent from the closing words in section 2-302(2) that the court will consider the commercial background and setting of the transac-

\textsuperscript{212} Id. art. 138(2).
\textsuperscript{213} Id. arts. 242, 826.
\textsuperscript{215} U.C.C. § 2-302 cmt. 1.
tion. The only additional guidance given by the comment is, first, that the court is to consider the extent to which the bargain is one-sided; second, that mere inequality of bargaining power is not sufficient to overturn the bargain; and, third, that the presence of surprise or oppression is of paramount importance.

None of the guidelines set out in the comment, or in section 2-302 itself, is as definitive as BGB article 138. One author suggests that the distinction, in essence, is that section 2-302 is a general clause, and the German provision, in particular subsection 2, is not.216 Another way of explaining the difference is to focus on the extent of discretion conferred by the two provisions. A German court has to satisfy itself that a transaction that it is asked to set aside falls either within subsection 1 by being contrary to public policy, or that it is usurious within the meaning of subsection 2. The German court's function, therefore, is principally to apply the article's rule. A United States court has much more discretion, having the power to define what constitutes "unconscionable." This is a far more creative role than that assigned to the German courts.

The difference between the roles of the German and United States courts in determining unconscionability issues is considerably less pronounced in practice than in theory. This is due in large part to the fact that BGB article 138 does not operate in isolation. It is augmented by articles 242 and 826, which confer substantial discretion on the German courts, as does the public policy principle enshrined in article 138(1). Moreover, despite the wide discretion conferred by U.C.C. section 2-302 on the United States courts, an undercurrent of caution runs through the decisions. This is demonstrated by a review of the authorities that have defined the major elements of unconscionability: the parties' inequality of bargaining power, disparity in the considerations furnished, 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 mere inequality in the parties' bargaining power is an inadequate reason to brand a transaction unconscionable. Substantial case law supports this statement.217 Thus, some authorities indicate that where the weaker party is aware of the

216. Dawson, supra note 130, at 1042, 1052. This remains the case even with respect to the amended version of article 138(2).

nature of the bargain and is familiar with the trade in question, intervention under section 2-302 is unjustified despite the weaker party's inferior bargaining position. Similarly, there is no chance of a finding of unconscionability if the parties conducted genuine negotiations. A fortiori, unconscionability is not possible where the parties have equal bargaining capacity and commercial expertise.

The situation differs when the stronger party exploits his superior position in order to extract an exceedingly one-sided bargain. A United States court has the jurisdiction to set aside or to reopen 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 "sales 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 held unconscionable on the basis of price alone. In this respect, the United States courts have shown less restraint than the German courts, which require exploitation of a party's "weakness" in addition to a disparity in consideration. However, one United States court cautioned against reducing section 2-302 to a "mathematical . . . formula," and emphasized that courts should intervene only where the price is grossly excessive. United States courts have invoked section 2-302 where the price was at least two and one-half times above the market value. They are, likewise, prepared to attack highly excessive interest rates.


Like their German counterparts, and in harmony with Official Comment 1, United States courts consider any exploitation of one party’s weakness by the other. In *Williams v. Walker-Thomas Furniture Co.*,225 the Circuit Court of Appeals for the District of Columbia proposed that one component of unconscionability was “an absence of meaningful choice on the part of one of the parties.”226 Obviously, some similarity exists between “absence of choice” and the element of “need” or of a “state of necessity” mentioned in BGB article 138(2). Trading on a party’s ignorance was held to be unconscionable in *Frostifresh Corp. v. Reynoso*,227 where a buyer with limited command of the English language was induced to sign an onerous contract that had never been translated to him.

Cases involving “referral franchises” or “pyramid selling schemes” provide examples of the exploitation of a party’s carelessness. Thus, in *Lefkowitz v. ITM Inc.*,228 goods were sold at prices up to six times their actual cost. The purchaser was induced to enter this bargain by a promise that the purchaser would be paid a commission of fifty dollars or more for every new customer he introduced, and by an assurance that the profits he made would cover the price of his own purchases. The court held this transaction unconscionable under U.C.C. section 2-302.229

Another similarity between German and United States unconscionability analyses is that the courts have the power to grant a remedy where the bargain is contrary to public policy.230 In both countries, the courts have stressed that the unconscionability concept will not support a general assault on exemption clauses in standard form contracts.231 An exemption clause may, nevertheless, be struck

228. 275 N.Y.S.2d 303, 321-22 (Sup. Ct. 1966); see also *Frostifresh*, 281 N.Y.S.2d at 964.
230. One example is where a contract contains an unduly wide exemption clause. *See* *Unico v. Owen*, 232 A.2d 405, 418 (N.J. 1967).
down if justified by the commercial background and setting of the contract and by the extravagant nature of the exemption clause.\textsuperscript{232}

It is important to reiterate that no attempt has been made to define "unconscionability." Indeed, the very nature of section 2-302 renders such an attempt a difficult task. The policy of the U.C.C. was stated succinctly by the Supreme Court of New Jersey in \textit{Kugler v. Romain}:

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 \textit{material departure} from the standard puts a badge of fraud on the transaction and here the concepts of fraud and of unconscionability are interchangeable.\textsuperscript{233}

This quotation spells out the main criteria used by a United States court to adjudicate an unconscionability issue. 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 U.C.C. or that of the BGB, should be preferred. This question is answered in the next part of this Article, which also discusses whether the adoption of an unconscionability concept is a better solution than the practices prevailing in England and in France.

**III. COMPARATIVE ANALYSIS**

The foregoing comparison of the laws of England and France with those of Germany and the United States demonstrates the merits of a general unconscionability concept. This Article suggests that the courts will endeavour to grant relief against an unfair or harsh bargain, regardless of whether or not such a concept is applicable in a given system. Where the courts cannot do so openly, by relying on provisions such as U.C.C. section 2-302 or BGB articles 138 and 242, they strive to attain their objective indirectly. The judicial extension


\textsuperscript{233} 279 A.2d at 652 (emphasis added) (note the similarity between "material departure" and "disparity of price").
of the abusive clauses legislation in France and the remarkable development of promissory estoppel in English law are telling illustrations on point.

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

If this conclusion is correct, it substantiates another argument in support of a general unconscionability doctrine. Fiction may occasionally be a useful substitute for statutory reform, but it has the harmful side effect of introducing artifice into the law. By way of illustration, take the French distinction between a "derisory price," which entitles the court to set aside the contract of sale, and a "lesionary price," which is per se uncontestable. The arbitrariness of this distinction and the difficulties posed by it are highlighted by the Judgment of January 25, 1965.\textsuperscript{234} It may be countered that German law has a similarly dubious distinction. Under BGB article 138(2), the difference between an "obvious disproportion" in the considerations furnished and a lesser disparity seems artificial. This comparison, however, is unsound. The German provision lays down a perfectly clear test, which must be applied by a court when it determines an issue under article 138(2). The French principle, in contrast, introduces a vague element by employing the emotionally charged term "derisory." This unclear word was used to support the fictitious contention that a derisory, or very low, price is no price at all and that, on this basis, the contract of sale is without cause. However, what constitutes a low price is an inadequate test.

A particular merit of a general unconscionability concept is that it creates room for 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 contract law. The effect of a general doctrine is to confer a supervisory power or jurisdiction on the courts, which will not upset the stability of any individual area.

It may be suggested that even in legal systems that have not

\textsuperscript{234} Cass. civ. 1re, 1965 Recueil Dalloz [D.S. Jur.] 217 (Fr.); see supra text accompanying notes 99-102.
adopted the unconscionability concept, the courts continue to exercise 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 that has not adopted them. The Judgment of January 25, 1965, a case concerning Catalan frescos, is, again, a good example. In French law, which regarded the price as "lesionary" but not as "derisory," the sellers lost.\textsuperscript{235} English law, in all probability, would have led to a similar outcome.\textsuperscript{236} German and United States courts would have been in a much better position to grant a remedy, as all of the elements of unconscionability existed in the frescos case. The sellers were illiterate and simple-minded, and the buyers exploited this weakness by purchasing at an obviously low or "disproportionate" price. Thus, German and United States law would have enabled a court to grant the very remedy that the French tribunal, despite its sympathy for the sellers, was unable to provide. Another illustration is pyramid sales schemes. United States courts were able to combat these unwholesome devices with section 2-302. It is significant that in some other common law jurisdictions where the unconscionability concept was inapplicable, the legislature had to pass special acts to outlaw these devices.\textsuperscript{237} Presumably, no common law remedy was available in these jurisdictions to gullible victims of pyramid sales.

The foregoing comparative study of the legal systems of England, France, Germany, and the United States confirms that the unconscionability concept serves a useful function. Moreover, the experience gained in Germany and in the United States demonstrates that a general unconscionability doctrine does not introduce uncertainty into the law of contract. The fact is that both the United States 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 unconscionability rules with the terms available for such deals from other sources. The courts have been strongly disinclined to intervene in a transaction founded on ordinary terms. Therefore, the danger of unconscionabil-

\textsuperscript{236} The undue influence doctrine might have provided an escape route.
\textsuperscript{237} See, e.g., Commerce Act, 1975, § 31 (N.Z.).
It is submitted that unconscionability rules contain sufficient merit and importance to warrant their introduction into any modern legal system. While they do not provide a general answer to the problems of one-sided contracts, and while they cannot possibly replace statutes that regulate an entire branch of law, such as consumer protection measures, 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 U.C.C. or those of the BGB, is to be preferred.

The main difference between the United States' approach to unconscionability, as seen in U.C.C. section 2-302, and the German one, as highlighted by BGB article 138(2), is that the former does not attempt to define the concept, and the latter provides a clear test. It is submitted that the United States' solution, which confers wide discretion on the courts, is preferable. The German provision can, on occasion, force the courts to resort to the very type of artificial approach employed by their English and French counterparts. This can occur in a transaction involving a striking disparity in the considerations furnished, or a "usurious price," but which does not contain an element of exploitation of one party by the other. If the court wishes to grant relief on the ground of unconscionability, it has to invent such a weakness, or artificially invoke the public policy provision of article 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. 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 United States' experience proves that this approach to unconscionability does not introduce uncertainty into contract law. Moreover, section 2-302 has not led to inconsistency among decisions reached by different courts. Two factors contribute to this harmoni-

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238. It is significant that the German legislature found it necessary to pass a special Law on the Regulation of Standardized Contract Terms: Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen of December 9, 1976 (AGBGe). See THE CIVIL LAW SYSTEM, supra note 133, at 1207.

239. The long-term impact of the EEC must not be overlooked or underestimated. There will be an equal impact on legal development in three of the jurisdictions studied here.
Unconscionability Law Compared

ous outcome. The first is the existence of the law reports. On occasion, courts do express disapproval of existing cases and take an independent stand. However, they are inclined to follow existing precedent, even if these cases are not binding. Second, the Official Comment provides guidelines describing the factors that a court ought to take into account in determining unconscionability issues. These guidelines are neither exhaustive nor binding, but they do assist the courts in reaching a conclusion. In this way, the Official Comment has contributed to the attainment of a fair degree of uniformity in the case law concerning section 2-302. The provision of guidelines of this sort is desirable and constitutes a better approach than setting exact boundaries for "unconscionability," as found in BGB article 138(2).

Another advantage of the United States' provision, as compared with Germany's, is in the variety of remedies available under section 2-302, as opposed to the inflexibility of article 138, which provides solely for the setting aside of the contract or offending clause. It is in the interests of both parties to an unconscionable contract that the courts be authorized 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; setting aside 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 that they consider unconscionable, they should likewise be given wide discretion regarding the remedy to be granted in any given case.

The courts should, therefore, have the power to set aside the unconscionable bargain in its entirety, to delete from the contract any unconscionable clauses, and the power to reopen and to reshape the bargain. They should also have the power to order restitution of money paid and the return of property delivered under the unconscionable bargain. All of these remedies are available under U.C.C. section 2-302. In addition, there is much to be said for granting the courts the additional power to make an order for the payment of damages.

While the United States' approach appears to provide better guidance for reform than Germany's approach, there is one aspect in which the provisions of the BGB are superior to those of the U.C.C. 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 BGB article 138, the German courts
have been able to augment this provision by skillful manipulation of article 242. It will be recalled that, under this article, the courts are able to combat the unfair use of contractual rights, even where the clause conferring these rights is not unconscionable per se. Section 1-203 of the U.C.C., which resembles BGB article 242 in its language, has not been put to a similarly extensive use by the United States courts. A provision such as article 242 is complementary to a provision such as BGB article 138 or U.C.C. section 2-302, 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 BGB article 242. Finally, it is believed that courts, which are able to combat unconscionable bargains and dealings by resorting to the two types of provision, are in the best position to supervise the commercial integrity of contracting parties.