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# ADHESION THEORY IN CALIFORNIA: A SUGGESTED REDEFINITION AND ITS APPLICATION TO BANKING

by Richard P. Sybert\*

## I. INTRODUCTION

Form contracts which are offered to the general public on a mass basis play an important part in the modern American economy. It is in fact seldom that a classic "dickered" contract appears today in a consumer setting. From taking a bus to an automobile showroom, to agreeing to purchase a car, to paying for it by check, to buying gas for it with a credit card, to parking it in a lot, the individual's contractual relations and the incidents of daily life are defined by standardized agreements presented to him or her as faits accomplis.<sup>1</sup>

Through advance knowledge on the part of the enterprise offering the contract that its relationship with each individual consumer or offeree will be uniform, standard and fixed, the device of form contracts introduces a degree of efficiency, simplicity, and stability.<sup>2</sup> When such contracts are used widely, the savings in cost and energy can be substantial.<sup>3</sup> An additional benefit is that the goods and services which are covered by these contracts are put within the reach of the general public, whose sheer size might prohibit widespread distribution if the necessary

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1. *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961) (quoting FRIEDMANN, *LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN* 45 (1951)); *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 173 (Iowa 1975) (quoting Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971) [hereinafter cited as Slawson, *Standard Form Contracts*]).

2. Hurd & Bush, *Unconscionability: A Matter of Conscience for California Consumers*, 25 HASTINGS L.J. 1, 9 n.38 (1973) [hereinafter cited as Hurd & Bush]; Comment, *Contracts of Adhesion under California Law*, 1 U.S.F. L. REV. 306, 307 (1967) [hereinafter cited as Comment, *Contracts of Adhesion*] (quoting H. JONES, E. FARNSWORTH, & W. YOUNG, *CASES AND MATERIALS ON CONTRACTS* 150 (1965)); Llewellyn, Book Review, 52 HARV. L. REV. 700, 701 (1939) [hereinafter cited as Llewellyn].

3. Llewellyn, *supra* note 2, at 701-02.

contractual relationships had to be individualized. Transactional costs,<sup>4</sup> and therefore the possible prices of these goods and services, are reduced.

In short, form contracts appear to be a necessary concomitant of a sophisticated, mass-consumption economy. They have social and economic utility.<sup>5</sup>

On the other hand, the terms of form contracts are dictated by the offeror, and just as the parties are spared the time and expense of bargaining, so too are they precluded from it.<sup>6</sup> The obvious danger exists that the party who draws up the contract will do so unfairly to his or her advantage.

What, then, are courts to do when presented with such a dilemma? The impracticality and disutility of simply prohibiting form contracts are manifest. At the opposite end of the spectrum, simply to apply standard contractual analysis and to rule that parties are bound by those terms to which they agreed—at least in theory if not in reality—however one-sided or unbargained-for, would be unjust. Courts must then seek a middle ground of preserving form contracts as a device, while denying them any clearly unfair effect.

A variety of doctrines and devices have been used by judges and legislators to regulate contracts generally. These include strict construction of "ambiguities" and interpretation in general, undue influence, duress, fraud and misrepresentation, mistake, reformation and rescission, and failure or lack of consideration.<sup>7</sup> In the area of form contracts, a

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4. Slawson, *Standard Form Contracts*, *supra* note 1, at 531.

5. Kessler, *Contracts of Adhesion—Some Thoughts about Freedom of Contract*, 43 COLUM. L. REV. 629, 632-33 (1943); Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 504 (1967) [hereinafter cited as Leff]; Slawson, *Standard Form Contracts*, *supra* note 1, at 530; Llewellyn, *supra* note 2, at 701-02.

6. The lack of bargaining in fact raises the larger point of whether form contracts are contracts at all. Slawson, in what appears to be the extreme view, argues they are not. Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S. CAL. L. REV. 1, 12-13 (1974) [hereinafter cited as Slawson, *Lawful Fraud*]; Slawson, *Standard Form Contracts*, *supra* note 1, at 544. The essence of a contract is agreement, "meeting of the minds," and mere acceptance en masse of unilateral, previously-prepared terms may not be easy to so characterize, particularly where little freedom of choice or abstention exists. In a real sense, acceptance of a form contract might be seen as nothing more than the purchase of the good or service it represents, which no more indicates agreement to its specific terms than purchase of a chainsaw indicates "agreement" to or knowledge of its mechanical innards, or waiver of claims based on mechanical defects. Slawson uses the example of a refrigerator. Slawson, *Lawful Fraud*, *supra*, at 17. See also Llewellyn, *supra* note 2, at 700.

7. See, e.g., CAL. CIV. CODE §§ 1565-1579 (West 1954); *id.* §§ 1635-1662, 1688-1689 (West 1973); 3 A. CORBIN, CONTRACTS §§ 532-572 (1960 & Supp. 1971); Ehrenzweig,

number of American courts, prominent among them California, have denominated as "contracts of adhesion" those which are offered to the public on a take-it-or-leave-it basis,<sup>8</sup> and at least one of them, again California, has developed as a corresponding regulatory tool a doctrine that will be referred to here as "adhesion theory."<sup>9</sup>

This article will examine the development and application of this adhesion theory as it now stands in California, consider possible criticisms, and suggest a redefined approach. The suggested approach will then be hypothetically tested on the banking industry and its form contracts, focusing specifically on three examples: service charges, stop-payments on guaranteed checks, and changes in existing contracts such as credit cards.

## II. USE OF EQUITABLE PRINCIPLES TO REGULATE CONTRACTS

The traditional equitable devices used by the courts to regulate contracts obtain generally in California and are now partially imbedded in statutes.<sup>10</sup> These include the doctrines of undue influence,<sup>11</sup> fraud,<sup>12</sup> menace and duress,<sup>13</sup> and mistake.<sup>14</sup> The familiar rules of construction, such as the principle that a contract will be construed against its drafter,<sup>15</sup> give the courts additional regulatory tools.<sup>16</sup> Other methods have been

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*Adhesion Contracts in the Conflicts of Laws*, 53 COLUM. L. REV. 1072, 1090 (1953) [hereinafter cited as Ehrenzweig]; Llewellyn, *supra* note 2, at 702.

8. See cases cited notes 27-28 *infra*.

9. See text accompanying notes 59-106 *infra*.

10. See, e.g., CAL. CIV. CODE §§ 1565-1579 (West 1954); *id.* §§ 1688-1693 (West 1973 & Supp. 1977).

11. *Id.* §§ 1566-1567, 1575 (West 1954); *id.* § 1689(b)(1) (West 1973). See, e.g., *In re Estate of Kohler*, 79 Cal. 313, 315-16, 21 P. 758, 758 (1889); *Smalley v. Baker*, 262 Cal. App. 2d 824, 834-35, 69 Cal. Rptr. 521, 528 (1968); *Odorizzi v. Bloomfield School Dist.*, 246 Cal. App. 2d 123, 130, 54 Cal. Rptr. 533, 538 (1966); *Espinosa v. Stuart*, 52 Cal. App. 477, 481, 199 P. 66, 68 (1921).

12. CAL. CIV. CODE §§ 1566-1568, 1571-1574 (West 1954); *id.* § 1689(b)(1) (West 1973). See, e.g., *Wilke v. Coinway, Inc.*, 257 Cal. App. 2d 126, 137, 64 Cal. Rptr. 845, 852 (1967); *Howland v. Meximerican Co.*, 55 Cal. App. 581, 583-84, 203 P. 1019, 1020 (1921); *Fulmele v. Los Angeles Inv. Co.*, 51 Cal. App. 417, 420, 196 P. 923, 924 (1921).

13. CAL. CIV. CODE §§ 1566-1567, 1569-1570 (West 1954); *id.* § 1689(b)(1) (West 1973).

14. *Id.* §§ 1566-1567, 1576-1579 (West 1954); *id.* § 1689(b)(1) (West 1973). See, e.g., *Verzan v. McGregor*, 23 Cal. 339, 345 (1863); *Crocker-Anglo Nat'l Bank v. Kuchman*, 224 Cal. App. 2d 490, 495-96, 36 Cal. Rptr. 806, 809 (1964).

15. CAL. CIV. CODE § 1654 (West 1973). See, e.g., *Taylor v. J.B. Hill Co.*, 31 Cal. 2d 373, 374, 189 P.2d 258, 259 (1948); *Pacific Lumber Co. v. Industrial Accident Comm'n*, 22 Cal. 2d 410, 422, 139 P.2d 892, 898 (1943); *Blackburn v. Allen*, 218 Cal. App. 2d 30, 33-34, 32 Cal. Rptr. 211, 213-14 (1963); *Neal v. State Farm Ins. Cos.*, 188 Cal. App.2d 690, 695, 10 Cal. Rptr. 781, 784 (1961); *Steeve v. Yaeger*, 145 Cal. App. 2d 455, 463, 302 P.2d 704, 710 (1956).

16. These tools have been criticized as sometimes enabling courts to rewrite contracts without a frank admission of what they are doing, thereby distorting the judicial law-

used: for example, a provision in a bank passbook that released the bank from liability on forged endorsements, unless complained of within a set period, was held to constitute a "trap for the unwary" since it was neither signed nor brought to the attention of the depositor, and therefore was denied effect.<sup>17</sup> Parties are also held to a requirement of fair dealing in performance of contracts.<sup>18</sup> Unconscionability, or something akin to it, is probably also available in California. Although California was the one major commercial state to reject section 2-302 of the Uniform Commercial Code (U.C.C.)<sup>19</sup> on unconscionability, its courts have by no means been unable to deal with unconscionable contract provisions.<sup>20</sup> For one thing, it has been suggested that one of the reasons for rejection was that "unconscionability . . . was already sufficiently developed in California law."<sup>21</sup> For another, since article 2 of the U.C.C. governs only the sale of goods,<sup>22</sup> it might be legitimate to decline drawing general inferences from the rejection to be applied to other contracts. At any rate, cases have been decided on grounds drawn from unconscionability doctrine, whether labeled as "public policy"<sup>23</sup> or as refusal to enforce contracts which "shock the conscience."<sup>24</sup>

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making process, 3 A. CORBIN, CONTRACTS § 540 (1960 & Supp. 1971); Ehrenzweig, *supra* note 7, at 1090; Hurd & Bush, *supra* note 2, at 17; Llewellyn, *supra* note 2, at 702-04; or as affording inadequate consumer protection. Hurd & Bush, *supra* note 2, at 17.

17. Los Angeles Inv. Co. v. Home Sav. Bank, 180 Cal. 601, 613, 182 P. 293, 298 (1919); Frankini v. Bank of America, 31 Cal. App. 2d 666, 675-76, 88 P.2d 790, 796 (1939).

18. *See, e.g.*, Harm v. Frasher, 181 Cal. App. 2d 405, 417, 5 Cal. Rptr. 367, 374 (1960).

19. U.C.C. § 2-302(1) (1958 version) provides: "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

20. California courts have in fact denied enforcement to contracts called "unconscionable." *See, e.g.*, Jacklich v. Baer, 57 Cal. App. 2d 684, 693, 135 P.2d 179, 183 (1943) ("Equity will not . . . enforce contracts which upon their face are so manifestly harsh and oppressive as to shock the conscience; it must be affirmatively shown that such contracts are fair and just."); State Fin. Co. v. Smith, 44 Cal. App. 2d 688, 691-92, 112 P.2d 901, 903 (1941) (gross inadequacy of consideration such as to shock the conscience may amount to proof of fraud, oppression and undue influence). The *Smith* case stands alone among California cases in finding fraud based upon inadequate consideration in a consumer setting; it has therefore been suggested that the case is weak authority for allowing relief from unconscionability in a consumer setting. Hurd & Bush, *supra* note 2, at 41.

21. Hurd & Bush, *supra* note 2, at 5. Other reasons given were that "unconscionability violated freedom of contract [and] was too vague." *Id.* These reasons have been criticized as "invalid." *Id.*

22. U.C.C. § 2-102 (1962 version) (codified at CAL. COM. CODE § 2102 (West 1964)).

23. Tunkl v. Regents of the Univ. of Cal., 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963); Akin v. Business Title Corp., 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968). *See* notes 57-58 *infra* and accompanying text.

24. *See* cases cited note 20 *supra*. Unconscionability has also been criticized as a "covert tool," Leff, *supra* note 5, at 558-59 (quoting Llewellyn, *supra* note 2, at 703), or

A relatively recent addition to the California array of contract-regulating devices is statutory regulation or specification of form contracts covering specific matters.<sup>25</sup> "The general purpose of these statutes is to protect the public from overreaching by persons whose economic power or technical knowledge make bargaining on an equal footing virtually impossible."<sup>26</sup> Not dissimilar in purpose is adhesion theory, another recent addition and the subject of this article.

### III. THE DEVELOPMENT OF ADHESION THEORY

#### A. *What is a Contract of Adhesion?*

California case law is replete with definitions of "contract of adhesion." One such judicially adopted definition states that a contract of adhesion is a "standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it."<sup>27</sup> A somewhat longer formulation states:

The term refers to a standardized contract prepared entirely by one party to the transaction for the acceptance of the other; such a contract, due to the disparity in bargaining power between the draftsman and the second party, must be accepted or rejected by the second party on a "take it or leave it" basis, without opportunity for bargaining and under such conditions that the "adherer" cannot obtain the desired product or service save by acquiescing in the form agreement.<sup>28</sup>

Other definitions differ in wording but emphasize the same factors: "A

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as providing inadequate protection for consumers since applied only in the exceptional case. Slawson, *Standard Form Contracts*, *supra* note 1, at 564.

25. *E.g.*, swimming pool sales, retail installment contracts, car purchases. See 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* § 14 (8th ed. 1973 & Supp. 1976).

26. *Id.*

27. *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961), *quoted with approval in Yeng Sue Chow v. Levi Strauss & Co.*, 49 Cal. App. 3d 315, 325, 122 Cal. Rptr. 816, 821 (1975); *Spence v. Omnibus Indus.*, 44 Cal. App. 3d 970, 973, 119 Cal. Rptr. 171, 172-73 (1975); *Player v. George M. Brewster & Son, Inc.*, 18 Cal. App. 3d 526, 533, 96 Cal. Rptr. 149, 154 (1971); *Schmidt v. Pacific Mut. Life Ins. Co.*, 268 Cal. App. 2d 735, 737, 74 Cal. Rptr. 367, 368 (1969). See also *Hamilton v. Stockton Unified School Dist.*, 245 Cal. App. 2d 944, 951-52, 54 Cal. Rptr. 463, 467-68 (1966).

28. *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 882, 377 P.2d 284, 297, 27 Cal. Rptr. 172, 185 (1962) (footnotes omitted); see also *Smith v. Westland Life Ins. Co.*, 15 Cal. 3d 111, 122 n.12, 539 P.2d 433, 441 n.12, 123 Cal. Rptr. 649, 657 n.12 (1975); *Gray v. Zurich Ins. Co.*, 64 Cal. 2d 263, 269, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966); *Vernon v. Drexel Burnham & Co.*, 52 Cal. App. 3d 706, 714-15, 125 Cal. Rptr. 147, 152 (1975); *Lomanto v. Bank of America*, 22 Cal. App. 3d 663, 668, 99 Cal. Rptr. 442, 444 (1972); *Walnut Creek Pipe Distribs. v. Gates Rubber Co. Sales Div.*, 228 Cal. App. 2d 810, 814-15, 39 Cal. Rptr. 767, 771 (1964).

contract is 'adhesive' for one of its parties if the party had no reasonable choice as to its terms."<sup>29</sup> " 'Adhesion contract' is a handy shorthand descriptive of standard form printed contracts prepared by one party and submitted to the other on a 'take it or leave it' basis. The law has recognized there is often no true equality of bargaining power in such contracts . . . ."<sup>30</sup>

The name "contract of adhesion" indicates that the legal transaction is not formulated as a result of the give and take of bargaining where the desires of one party are balanced to those of the other. The customer, by entering the transaction, has to adhere to the terms prescribed by the enterprise and only a very few terms may be open to his determination.<sup>31</sup>

"Obligations arising from such a contract inure not alone from the consensual transaction, but from the relationship of the parties,"<sup>32</sup> namely great disparity of bargaining strength.

In *Madden v. Kaiser Foundation Hospitals*<sup>33</sup> the California Supreme Court, in holding a group medical plan not to be a contract of adhesion, identified three factors in "the characteristic adhesion contract case":<sup>34</sup>

[1] [T]he stronger party drafts the contract, and the weaker has no opportunity . . . to negotiate concerning its terms. . . . [2] In many cases of adhesion contracts, the weaker party lacks . . . also any realistic opportunity to look elsewhere for a more favorable contract; he must either adhere to the standardized agreement or forego the needed service. . . . [3] Finally, in all prior contract of adhesion cases, the courts have concerned themselves with weighted contractual provisions which served to limit the obligations or liability of the stronger party.<sup>35</sup>

29. Slawson, *Lawful Fraud*, *supra* note 6, at 47 (citing *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 101, 383 P.2d 441, 446, 32 Cal. Rptr. 33, 38 (1963)). *See also* Comment, *Contracts of Adhesion*, *supra* note 2, at 306.

30. *Standard Oil Co. of Cal. v. Perkins*, 347 F.2d 379, 383 n.5 (9th Cir. 1965); *see also* *Blakely v. Housing Auth.*, 8 Wash. App. 204, 212-13, 505 P.2d 151, 156 (1973).

31. *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 157 n.4, 70 Cal. Rptr. 287, 290 n.4 (1970) (citing Lenhoff, *Contracts of Adhesion and the Freedom of Contract: A Comparative Study in the Light of American and Foreign Law*, 36 TUL. L. REV. 481 (1962)). *See also* Reith, *Contractual Exculpation from Tort Liability in California—The "True Rule" Steps Forward*, 52 CALIF. L. REV. 350 (1964).

32. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 269, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 882, 377 P.2d 284, 297, 27 Cal. Rptr. 172, 185 (1962); *see also* *Hays v. Pacific Indem. Group*, 8 Cal. App. 3d 158, 162-63, 165, 86 Cal. Rptr. 815, 818-20 (1970); *Tobriner & Grodin*, *The Individual and the Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247, 1253 (1967) [hereinafter cited as *Tobriner & Grodin*].

33. 17 Cal. 3d 699, 552 P.2d 1178, 131 Cal. Rptr. 882 (1976).

34. *Id.* at 711, 552 P.2d at 1185, 131 Cal. Rptr. at 889.

35. *Id.* at 711, 552 P.2d at 1185-86, 131 Cal. Rptr. at 889-90.

In other states the term has been similarly defined, often in reliance on California authority, and emphasis has been laid on the absence of bargaining or negotiation.<sup>36</sup>

The following have been held to be contracts of adhesion in California:<sup>37</sup> standard insurance policies,<sup>38</sup> an employment contract,<sup>39</sup> standardized bills of lading and shipping documents,<sup>40</sup> a release from liability for future negligence imposed on a prospective patient as a condition for admission to a charitable research hospital,<sup>41</sup> a bank trust deed,<sup>42</sup> an escrow agreement,<sup>43</sup> a contractor's agreement with a subcontractor,<sup>44</sup> a home remodeling contract,<sup>45</sup> and a contract for the transport of horses.<sup>46</sup> Outside of California, application of the term appears to have been limited to insurance contracts.<sup>47</sup> Generally it appears in a consumer, rather than commercial, setting<sup>48</sup> since great bargaining disparity is present more often in the former.

36. See *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261-62 n.4 (5th Cir. 1976); *Van Gemert v. Boeing Co.*, 520 F.2d 1373, 1380 (2d Cir. 1975); *Gowing v. Great Plains Mut. Ins. Co.*, 207 Kan. 78, 79-80, 483 P.2d 1072, 1074-75 (1971); *Surface v. Ranger Ins. Co.*, 526 S.W.2d 44, 47 (Mo. 1975); *Magulas v. Travelers Ins. Co.*, 114 N.H. 704, 706, 327 A.2d 608, 609 (1974); *Allen v. Metropolitan Life Ins. Co.*, 44 N.J. 294, 305, 208 A.2d 638, 644 (1965). See also *Corgiatelli v. Globe Life & Accident Ins. Co.*, 96 Idaho 616, 619, 533 P.2d 737, 740 (1975); *McAlear v. Saint Paul Ins. Cos.*, 493 P.2d 331, 335 (Mont. 1972).

37. See also *Hurd & Bush*, *supra* note 2, at 35 n.199.

38. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962); *Allstate Ins. Co. v. Reeves*, 66 Cal. App. 3d 464, 136 Cal. Rptr. 159 (1977); *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 116 Cal. Rptr. 528 (1974); *Young v. Metropolitan Life Ins. Co.*, 272 Cal. App. 2d 453, 77 Cal. Rptr. 382 (1969).

39. *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 10 Cal. Rptr. 781 (1961).

40. *Bauer v. Jackson*, 15 Cal. App. 3d 358, 93 Cal. Rptr. 43 (1971); see also *Chandler v. Aero Mayflower Transit Co.*, 374 F.2d 129 (4th Cir. 1967).

41. *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

42. *Lomanto v. Bank of America*, 22 Cal. App. 3d 663, 99 Cal. Rptr. 442 (1972).

43. *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968).

44. *Player v. George M. Brewster & Son, Inc.*, 18 Cal. App. 3d 526, 96 Cal. Rptr. 149 (1971).

45. *Spence v. Omnibus Indus.*, 44 Cal. App. 3d 970, 119 Cal. Rptr. 171 (1975).

46. *Bauer v. Jackson*, 15 Cal. App. 3d 358, 93 Cal. Rptr. 43 (1971).

47. See, e.g., *National Indem. Co. v. Flesher*, 469 P.2d 360, 365-67 (Alas. 1970); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 294, 127 S.E.2d 53, 58 (1962); *Arrigo's Fleet Serv., Inc. v. Aetna Life & Cas. Co.*, 54 Mich. App. 482, 487, 221 N.W.2d 206, 209 (1974); *General Accident Fire & Life Assurance Corp. v. Shasky*, 266 Or. 312, 317, 512 P.2d 987, 989 (1973). See also *Zurich Ins. Co. v. Rombaugh*, 384 Mich. 228, 232-33, 180 N.W.2d 775, 777-78 (1970); *Jones v. Continental Cas. Co.*, 123 N.J. Super. 353, 359-60, 303 A.2d 91, 94-95 (1973); cases cited note 36 *supra*.

48. *K-Lines, Inc. v. Roberts Motor Co.*, 273 Or. 242, 252-53, 541 P.2d 1378, 1384 (1975). There may be an adhesion contract in a commercial setting, provided the necessary characteristics, such as bargaining disparity, are present. See, e.g., *Player v. George M. Brewster & Son, Inc.*, 18 Cal. App. 3d 526, 96 Cal. Rptr. 149 (1971) (contractor and subcontractor).



Adhesion theory was given its first meaningful judicial expression in 1960 by the New Jersey Supreme Court in the leading case of *Henningsen v. Bloomfield Motors, Inc.*<sup>49</sup> The court, citing articles on contracts of adhesion, identified the "standardized mass contract" as one in which there was an extreme or gross bargaining disparity between parties,<sup>50</sup> and where the weaker party could not bargain because the stronger party had a monopoly or because all competitors used the same contract terms. The stronger party dictated its terms without bargaining, as addressed to all its customers rather than to a particular individual.<sup>51</sup> The New Jersey court declared that where the services offered were of a public or quasi-public nature, the stronger party should be held to a requirement of fair dealing because members of the public generally have no other means of fulfilling the special need represented by the contract.<sup>52</sup> The court indicated automobiles to be of such a nature.<sup>53</sup>

The *Henningsen* court held that the car manufacturer's attempted disclaimer of implied warranties of merchantability and obligations arising therefrom was void as against public policy.<sup>54</sup> This holding was grounded, at least in part, on adhesion theory.<sup>55</sup> The court noted the importance of the doctrine of freedom of contract and that a contract signer who fails to read is bound, but concluded that "in the framework of modern commercial life and business practices, such rules cannot be applied on a strict, doctrinal basis . . . [without] giving due weight to

49. 32 N.J. 358, 161 A.2d 69 (1960). Adhesion theory had previously been specifically discussed in Judge Frank's dissent in *Siegelman v. Cunard White Star*, 221 F.2d 189 (2d Cir. 1955), where the majority, in holding no waiver of the one-year statute of limitations, incidentally upheld the validity of a choice-of-law provision on a steamship ticket. Judge Frank would have held the limitation to have been waived, and wrote:

I call attention to another factor which, while unnecessary to my conclusion, I think supports it: The ticket is what has been called a "contract of adhesion" or a "take-it-or-leave-it" contract. In such a standardized or mass-production agreement, with one-sided control of its terms, when the one party has no real bargaining power, the usual contract rules, based on the idea of "freedom of contract," cannot be applied rationally. For such a contract is "sold not bought." The one party dictates its provisions; the other has no more choice in fixing those terms than he has about the weather.

*Id.* at 204. See also *Bekken v. Equitable Life Assurance Soc'y*, 70 N.D. 122, 293 N.W. 200 (1940).

For the origins of the term "contract of adhesion," see Hurd & Bush, *supra* note 2, at 10 n.38; Leff, *supra* note 5, at 504-05 nn.67 & 68; Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 856 n.96 (1964); Patterson, *The Delivery of a Life Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919).

50. 32 N.J. at 389-90, 403, 161 A.2d at 86-87, 94.

51. *Id.* at 389-90, 161 A.2d at 86-87.

52. *Id.* at 399, 161 A.2d at 92.

53. *Id.* at 387, 161 A.2d at 85.

54. *Id.* at 408, 161 A.2d at 97.

55. *Id.* at 389-90, 161 A.2d at 86-87.

. . . the mass production methods of manufacture and distribution to the public, and the . . . bargaining position occupied by the ordinary consumer in such an economy.’’<sup>56</sup>

In California the first important judicial statement on adhesion contracts came in 1963 in *Tunkl v. Regents of the University of California*.<sup>57</sup> In that case the California Supreme Court invalidated, under Civil Code section 1668, an attempted exculpatory release provision in a hospital admission form. The court discussed factors that would be considered in determining whether a transaction reached the public interest and therefore could not contain an exculpatory provision. The fourth and fifth of these went to adhesion theory:

As a result of the essential nature of the service, in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks his services. In exercising a superior bargaining power the party confronts the public with a standardized adhesion contract of exculpation, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence.<sup>58</sup>

## B. *Application of Adhesion Theory in California*

### 1. “Reasonable Expectations” of the Adherer

The heart of California’s adhesion theory is that a contract of adhesion will be interpreted by a court to meet the reasonable expectations of the weaker party;<sup>59</sup> that is, the court will determine what an ordinary “adher-

56. *Id.* at 386, 161 A.2d at 84.

57. 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

58. *Id.* at 99-101, 383 P.2d at 445-46, 32 Cal. Rptr. at 37-38 (footnotes omitted). The court’s discussion of the other factors may also be seen as relevant in light of further discussion *infra*:

[T]he attempted but invalid exemption involves a transaction which exhibits some or all of the following characteristics. It concerns a business of a type generally thought suitable for public regulation. The party seeking exculpation is engaged in performing a service of great importance to the public, which is often a matter of practical necessity for some members of the public. The party holds himself out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards. . . . As a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or his agents.

*Id.* at 98-101, 383 P.2d at 445-46, 32 Cal. Rptr. at 37-38 (footnotes omitted).

59. *Madden v. Kaiser Foundation Hosps.*, 17 Cal. 3d 699, 710, 552 P.2d 1178, 1185, 131 Cal. Rptr. 882, 889 (1976); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 269-70, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 107-08 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 868-69, 377 P.2d 284, 288, 27 Cal. Rptr. 172, 176 (1962); *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 995, 116 Cal. Rptr. 528, 532 (1974); *Young v. Metropolitan Life Ins. Co.*, 272 Cal. App. 2d 453, 460-61, 77 Cal. Rptr. 382, 387 (1969); *Tobriner & Grodin*, *supra* note 32, at 1273. *See also* *Atlantic Nat’l Ins. Co. v. Armstrong*, 65 Cal. 2d 100, 112,

er" would reasonably expect he or she was contracting for, and will give effect to that determination.<sup>60</sup> The weaker party is protected at the expense of the stronger-positioned draftsman<sup>61</sup> when necessary to avoid the injustice or unfair imposition which would result if literal effect were given the terms of the contract.<sup>62</sup>

A careful examination of the cases, however, reveals that in almost all instances, the purported giving of effect to reasonable expectations came in the guise of contract interpretation or lack of disclosure.<sup>63</sup> The familiar rule that ambiguities will be construed against the drafter of a document is simply declared to be applicable with particular force in the case of adhesion contracts.<sup>64</sup> And a number of cases have stated flatly that terms in an adhesion contract, if they are unambiguous and are brought home to the adherer, are effective.<sup>65</sup>

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416 P.2d 801, 809, 52 Cal. Rptr. 569, 577 (1966); *Hays v. Pacific Indem. Group*, 8 Cal. App. 3d 158, 164-65, 86 Cal. Rptr. 815, 819 (1970); Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967-68 (1970) [hereinafter cited as Keeton].

60. See cases cited note 59 *supra*. See also Kessler, *supra* note 5, at 637 ("In dealing with standardized contracts courts have to determine what the weaker contracting party could legitimately expect by way of services according to the enterpriser's 'calling,' and to what extent the stronger party disappointed reasonable expectations based on the typical life situation.").

61. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 270-72, 491 P.2d 168, 172-73, 54 Cal. Rptr. 104, 108-09 (1966); *Employers Cas. Ins. Co. v. Foust*, 29 Cal. App. 3d 382, 386, 105 Cal. Rptr. 505, 508 (1972).

62. *Spence v. Omnibus Indus.*, 44 Cal. App. 3d 970, 973-74, 119 Cal. Rptr. 171, 172-73 (1975); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 672, 97 Cal. Rptr. 811, 813 (1971).

63. See *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 271-72, 419 P.2d 168, 173, 54 Cal. Rptr. 104, 109 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 869, 377 P.2d 284, 288, 27 Cal. Rptr. 172, 176 (1962); *Spence v. Omnibus Indus.*, 44 Cal. App. 3d 970, 975, 119 Cal. Rptr. 171, 174 (1975); *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 994-95, 116 Cal. Rptr. 528, 532 (1974); *Young v. Metropolitan Life Ins. Co.*, 272 Cal. App. 2d 453, 460-61, 77 Cal. Rptr. 382, 387 (1969); *Schmidt v. Pacific Mut. Life Ins. Co.*, 268 Cal. App. 2d 735, 738, 74 Cal. Rptr. 367, 369 (1969).

A number of other cases have also turned on ambiguities in contract language or on lack of notice as to provisions not to be reasonably expected. See *Bauer v. Jackson*, 15 Cal. App. 3d 358, 370, 93 Cal. Rptr. 43, 50 (1971) (provision in a contract for transportation of race horses limiting liability to \$200 per horse; with respect to standardized adhesion contracts between parties of unequal bargaining strength, court held that exclusionary clauses and provisions limiting liability were ineffective in the absence of "plain and clear notification to the public" and "an understanding consent"); *Hays v. Pacific Indemn. Group*, 8 Cal. App. 3d 158, 164-65, 86 Cal. Rptr. 815, 819 (1970) (term in comprehensive liability policy purchased by contractor excluding coverage for liability for products hazard in operations which had not yet been completed or abandoned); *Hertzka & Knowles v. Salter*, 6 Cal. App. 3d 325, 336, 86 Cal. Rptr. 23, 30 (1970) (language of insurance policy relating to "measure of loss").

64. *Player v. George M. Brewster & Son*, 18 Cal. App. 3d 526, 533-34, 96 Cal. Rptr. 149, 153-54 (1971); *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 695, 10 Cal. Rptr. 781, 784 (1961).

65. *Yeng Sue Chow v. Levi Strauss & Co.*, 49 Cal. App. 3d 315, 325-26, 122 Cal. Rptr.

## 2. Ambiguous Terms Construed Against Drafting Party

As noted in the previous section, the California adhesion cases may be interpreted as applications of the rule that ambiguities will be construed against the party drafting a contract or as applications of a notice requirement, or both.<sup>66</sup> This section examines cases relevant to ambiguity.

In *Spence v. Omnibus Industries*<sup>67</sup> the court stated that the contract in question was one of adhesion and therefore any *ambiguity* would be resolved against the draftsman if the terms were not brought home to the adherers.<sup>68</sup> In *Employers Casualty Insurance Co. v. Foust*<sup>69</sup> the court held that it must interpret an insurance contract to meet the insured's reasonable expectation of coverage under the term "bodily injury" absent *express exclusion*.<sup>70</sup> In *Gray v. Zurich Insurance Co.*<sup>71</sup> the court rendered its decision on the basis of interpretation of the contract language, noting, "No one can determine whether the third party suit does or does not fall within the indemnity coverage of the policy until that suit is resolved; . . . this uncertainty . . . could have been clarified by the language of the policy . . . ."<sup>72</sup>

In *Yeng Sue Chow v. Levi Strauss & Co.*<sup>73</sup> the plaintiff employee's wife made an unsuccessful attempt to rescind a stock repurchase plan by relying upon adhesion theory. The court emphasized that the result of characterizing a contract as adhesive is only to permit a construction of uncertain or ambiguous terms in favor of the weaker party; the contract is valid and, in the absence of uncertainty or ambiguity, enforceable according to its terms: "[D]espite the fact that *contracts of adhesion* are the product of mass production and afford the party to whom they are tendered little, if any, room in which to bargain, they are *perfectly valid and, in the absence of ambiguity, are enforced according to their terms.*"<sup>74</sup>

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816, 821-22 (1975); *Schmidt v. Pacific Mut. Life Ins. Co.*, 268 Cal. App. 2d 735, 738, 74 Cal. Rptr. 367, 369 (1969); *California School Employees Ass'n v. Willits Unified School Dist.*, 243 Cal. App. 2d 776, 787, 52 Cal. Rptr. 765, 771 (1966) (handbook issued to school employees; no ambiguity, and therefore no relevance in consideration of contracts of adhesion).

66. See note 63 *supra*. See also *Lachs v. Fidelity & Cas. Co.*, 306 N.Y. 357, 365-66, 118 N.E.2d 555, 559 (1954).

67. 44 Cal. App. 3d 970, 119 Cal. Rptr. 171 (1975).

68. *Id.* at 974, 119 Cal. Rptr. at 173.

69. 29 Cal. App. 3d 382, 105 Cal. Rptr. 505 (1972).

70. *Id.* at 386-87, 105 Cal. Rptr. at 508.

71. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

72. *Id.* at 271-72, 419 P.2d at 173, 54 Cal. Rptr. at 109.

73. 49 Cal. App. 3d 315, 122 Cal. Rptr. 816 (1975).

74. *Id.* at 325, 122 Cal. Rptr. at 822 (emphasis in original).

### 3. Notice Required if Limitations Placed on Reasonable Expectations

In addition to construing ambiguities against the drafting party, California courts have also emphasized the necessity of notice and disclosure of terms or conditions in adhesion contracts which would not normally fall within the reasonable expectations of the adherer.<sup>75</sup>

In *Steven v. Fidelity & Casualty Co.*<sup>76</sup> Justice Tobriner, writing for the court, held that noncoverage under an insurance policy, in a situation in which the public would reasonably expect coverage, must be "conspicuous, plain and clear."<sup>77</sup> In this case, the decedent bought a standardized air traveller insurance policy from a vending machine in an airport; the policy did not insure for unscheduled flights. The traveller was subsequently killed in an air accident when he took a small chartered airplane in place of his scheduled flight, all scheduled carriers being grounded due to bad weather. The court found coverage. Justice Tobriner noted that the question of clear notice of noncoverage would be evaluated in light of several factors: "[1] the purpose and intent of the parties in entering the contract, [2] the adherer's knowledge and understanding as a reasonable layman, [3] his normal expectation of the extent of coverage, and [4] the effect, if any, of the substitution of the transportation upon the risk undertaken by the insurer."<sup>78</sup>

In *Schmidt v. Pacific Mutual Life Insurance Co.*,<sup>79</sup> the court stated that in the absence of ambiguity, adhesion contracts are enforced according to their terms,<sup>80</sup> but that two additional rules apply in interpretation, especially if the adhesion contract is one of insurance. First, the contract must be interpreted in the light of the reasonable and normal expectations of the parties as to the extent of the coverage, and second, (and here the court cited *Steven*) if the insurer deals with the public on a mass basis, notice of noncoverage must be "conspicuous, plain and clear" where the public may reasonably expect coverage.<sup>81</sup>

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75. See cases cited note 63 *supra*.

76. 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962).

77. *Id.* at 878, 377 P.2d at 294, 27 Cal. Rptr. at 182.

78. *Id.* at 869, 377 P.2d at 288, 27 Cal. Rptr. at 176. Chief Justice Traynor dissented on the ground that a purchaser would not reasonably believe the coverage to go to other than scheduled air carriers. See text accompanying notes 124-27 *infra*.

79. 268 Cal. App. 2d 735, 74 Cal. Rptr. 367 (1969).

80. *Id.* at 737-38, 74 Cal. Rptr. at 369. The court wrote:

If a contract of adhesion is found to be ambiguous, the same well recognized rules of construction are applied to it as are applied to other contracts. . . . (1) Any ambiguity or uncertainty in the contract is to be resolved against the insurer; (2) if semantically permissible, the contract will be given such construction as will fairly achieve its object of securing indemnity to the insured for losses to which the insurance relates; and (3) if the insurer uses language which is uncertain, any reasonable doubt will be resolved against it.

81. *Id.*

In *Logan v. John Hancock Mutual Life Insurance Co.*,<sup>82</sup> another insurance adhesion case, the court noted that ambiguity was not a concern per se, and that an unambiguous provision could still give rise to the fatal defect of no notice if the insured did not see the provision.<sup>83</sup> Refusing to give effect to language in an accidental death insurance policy that excluded coverage when the insured was intoxicated,<sup>84</sup> the court stated that it gleaned from *Steven* and its "progeny" cases a "general principle of public policy as follows: In the case of standardized insurance contracts, exceptions and limitations on coverage that the insured could reasonably expect, must be called to his attention, clearly and plainly before the exclusions will be interpreted to relieve the insurer of liability or performance."<sup>85</sup> It held that the insured would not have reasonably expected noncoverage in case of death while intoxicated.<sup>86</sup>

In *Young v. Metropolitan Life Insurance Co.*,<sup>87</sup> the court invalidated a limitation on death benefits until after the insured received a physical examination, since his reasonable expectation would be that coverage would begin immediately. The court held that the insurer, as the dominant and expert party in the field, must not only draft such contracts in unambiguous terms but must bring to the attention of the insured all provisions and conditions which create exceptions or limitations on the coverage.<sup>88</sup>

### C. Establishment and Application of Adhesion Principles

#### 1. General Principles Established by the Cases

Bearing in mind that cases do not always lend themselves to tidy formulae, and that judges as well as facts are not uniform, it is submitted that the California adhesion decisions previously discussed support the following general principles:

The adhesion theory rationale is that the stronger party may not limit its liability or performance, as defined either by law or by its representations,<sup>89</sup> and towards this end,

- (1) Any ambiguity in an objectionable adhesive term will be seized

82. 41 Cal. App. 3d 988, 116 Cal. Rptr. 528 (1974).

83. *Id.* at 995, 116 Cal. Rptr. at 532.

84. *Id.* at 996, 116 Cal. Rptr. at 533.

85. *Id.* at 995, 116 Cal. Rptr. at 532 (emphasis in original).

86. *Id.* at 996, 116 Cal. Rptr. at 533. See text accompanying note 125 *infra*.

87. 272 Cal. App. 2d 453, 77 Cal. Rptr. 382 (1969).

88. *Id.* at 460-61, 77 Cal. Rptr. at 387.

89. See Tobriner & Grodin, *supra* note 32 (written with respect to insurance companies and banks, but with language of general applicability): "[T]he heart of the concept of the public service institution . . . [is] its insistence that the institution, as a public functionary, perform the basic undertaking that it holds itself out as doing." *Id.* at 1277 (footnote omitted).

upon and construed most strictly against the drafter;<sup>90</sup>

- (2) An unusual or unexpected term in an adhesion contract which falls outside the weaker party's "reasonable expectations" will be denied effect against him, unless it has been brought to his attention by express notice, as by clear, plain and conspicuous language on the face of the contract;<sup>91</sup>
- (3) If an unreasonable adhesive term is unambiguous and has been brought to the attention of the weaker party, a court may still delete it on equitable grounds, as against public policy.<sup>92</sup>

## 2. Application of the Principles

Three points appear in a survey of the adhesion cases. The first is that they are mostly insurance cases<sup>93</sup> and that, outside California, adhesion theory is mentioned and applied *only* in insurance cases.<sup>94</sup> This is probably no accident. Although Professor Keeton has criticized "the favorite generalization, . . . the ambivalent, suggestive and wholly unsatisfactory aphorism: 'it's an insurance case,'"<sup>95</sup> the generalization may nevertheless contain a kernel of truth. Insurance situations present the context precisely most appealing for the application of adhesion theory: on the one hand there is the faceless insurance company, awash in cash; on the other hand there is the hapless individual. There is no

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90. *Player v. George M. Brewster & Son*, 13 Cal. App. 3d 526, 533, 96 Cal. Rptr. 149, 154 (1971); *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 695, 10 Cal. Rptr. 781, 784 (1961). See also cases cited note 63 *supra*. For a view of the courts' treatment of ambiguity in an insurance context, see Comment, *The Adhesion Contract of Insurance*, 5 SANTA CLARA LAW. 60 (1964):

The strict view is that where provisions are definite and certain there is no room for interpretation and the courts will not indulge in a forced construction in order to cast a liability upon an insurer which is not assumed. . . . The more liberal view appears to rely on ambiguity to justify sweeping alterations of the contracts.

*Id.* at 64-65 (footnotes omitted).

91. See, e.g., *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 868-69, 377 P.2d 284, 288, 27 Cal. Rptr. 172, 176 (1962); *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 995, 116 Cal. Rptr. 528, 532 (1974); *Bauer v. Jackson*, 15 Cal. App. 3d 358, 370, 93 Cal. Rptr. 43, 50 (1971). See also cases cited note 63 *supra*.

92. See, e.g., *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963); *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 87 (1968). But see cases cited note 65 *supra*, stating adhesion contracts are effective absent ambiguity or lack of notice. To bring a case within this third rationale it may be necessary to find additional factors. See text accompanying notes 103-06 *infra*.

93. See, e.g., *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962); *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 116 Cal. Rptr. 528 (1974); *Hays v. Pacific Indem. Group*, 8 Cal. App. 3d 158, 86 Cal. Rptr. 815 (1970); *Young v. Metropolitan Life Ins. Co.*, 272 Cal. App. 2d 453, 77 Cal. Rptr. 382 (1969); *Schmidt v. Pacific Mut. Life Ins. Co.*, 268 Cal. App. 2d 735, 74 Cal. Rptr. 367 (1969); *Lagomarsino v. San Jose Abstract & Title Ins. Co.*, 178 Cal. App. 2d 455, 3 Cal. Rptr. 80 (1960).

94. See cases cited note 47 *supra*.

95. Keeton, *supra* note 59, at 961.

bargaining and probably little difference between available policies. *Not* finding coverage, when the insured has suffered an arguably insured loss, will result in (1) complete frustration and negation of what the policyholder bought the insurance for in the first place, and (2) an effective forfeiture, since the company will keep the premiums while paying out nothing. While adhesion theory in California has not been limited to insurance cases, their predominance may indicate that application of the theory is to be confined in practice to the more egregious situation, as outlined above.

The second point, a related one, is that the majority of cases, insurance and non-insurance, which use adhesion theory to strike down contract provisions or interpret language concern contract terms whereby the stronger party either attempted to excuse its liability for negligence, or to limit materially what the weaker party would normally expect the stronger party's contractual obligation to be.<sup>96</sup> Thus, in *Tunkl*<sup>97</sup> and *Henningsen*,<sup>98</sup> both cases grounded substantially in adhesion theory,<sup>99</sup> an exculpatory provision and a warranty disclaimer, respectively, were denied effect. In *Steven*<sup>100</sup> and *Logan*,<sup>101</sup> limitations on the obligation to provide insurance coverage were invalidated.<sup>102</sup>

The third point is that in some of the more important adhesion cases,

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96. See *Bauer v. Jackson*, 15 Cal. App. 3d 358, 370, 93 Cal. Rptr. 43, 50 (1971) (between parties of unequal bargaining strength adhesive exclusionary clauses and provisions limiting liability ineffective absent "plain and clear notification to the public" and "an understanding consent"). *Accord*, *Tobriner & Grodin*, *supra* note 32, at 1264 ("The cases illustrate judicial reluctance to enforce two types of contractual provisions: First, those relieving the enterprise from liability for negligence in performing obligations based on its relationship with the other party; and second, those restricting the kind of obligation owed to the consuming public." (footnote omitted)); see also *id.* at 1277-78. Justice Tobriner has written many of the important California adhesion cases.

For cases invalidating exculpatory provisions, see, e.g., *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960); *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963); *Bauer v. Jackson*, 15 Cal. App. 3d 358, 93 Cal. Rptr. 43 (1971); *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968).

For cases invalidating obligation limitations, see, e.g., cases cited note 93 *supra*.

97. *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

98. *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960).

99. See text accompanying notes 49-58 *supra*.

100. *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962).

101. *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 116 Cal. Rptr. 528 (1974).

102. Possibly insurance cases predominate in the adhesion field, see text accompanying notes 93-94 *supra*, because they frequently involve these coverage provisions; *i.e.*, although adhesion theory was not developed specifically for insurance cases, insurance cases happen to be especially appropriate for application of the theory.



those from the California Supreme Court, adhesion theory is presented with, or buttressed by, other factors.<sup>103</sup> Thus, in *Steven*<sup>104</sup> reference is made to the air traveller's having to buy the insurance policy before being able to read it. In *Tunkl*<sup>105</sup> the specific holding is grounded in a statute,<sup>106</sup> and the adhesive nature of the transaction appears in a list of factors.

#### IV. POSSIBLE CRITICISMS OF ADHESION THEORY

There are several possible criticisms of adhesion theory: adhesion theory may (1) constitute nonmandated judicial regulation of the economy, (2) impair freedom of contract, (3) be inherently unfair and unpredictable because of the subjective nature of "reasonable expectations," (4) impose transactional costs, and (5) be unnecessary if other equitable doctrines are adequate to deal with adhesion contracts.

##### A. *Economic Regulation*

Adhesion theory may be susceptible of abuse in that the courts, in setting contours of the "reasonable expectations" of members of the public, could substantially regulate any given industry or economic sector. This danger exists because the concept of "reasonable expectations" logically goes to the entire substance of a transaction, unlike unconscionability, which affects only the more extreme substantive aspects,<sup>107</sup> or other doctrines such as mistake, misrepresentation, and consideration, which speak to the *process* of contract formation rather than content.<sup>108</sup> Thus, courts could use adhesion theory to interpose themselves more deeply into economic relationships than they do at present.

This result might be undesirable for the following reasons: (a) courts have neither the expertise nor the time for involvement in large-scale economic regulation; (b) interference in the *substance* of private economic relationships, other than in the extreme situation,<sup>109</sup> has been

103. Slawson, *Lawful Fraud*, *supra* note 6, at 49.

104. 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962).

105. 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

106. See CAL. CIV. CODE § 1668 (West 1973), which provides: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law."

107. Courts often discuss unconscionable provisions in contracts as being those so harsh and oppressive that they "shock the conscience." See *Jacklich v. Baer*, 57 Cal. App. 2d 684, 693, 135 P.2d 179, 183 (1943); *State Fin. Co. v. Smith*, 44 Cal. App. 2d 688, 691-92, 112 P.2d 901, 903 (1941).

108. See generally 1 A. CORBIN, CONTRACTS §§ 103-107, 109-151 (1963 & Supp. 1971); 3 *id.* § 599 (1960).

109. See note 107 *supra*.

reserved in our system of government to the legislative—and through it, the administrative—branch;<sup>110</sup> (c) it might result in the imposition of transactional costs;<sup>111</sup> and (d) it might constitute interference with free economic forces.<sup>112</sup>

There has been no indication that the state judiciary is on the verge of any such wholesale or extreme use of adhesion theory, or of applying it to its theoretical limits. But the mere possibility of such application, if the above concerns are given any weight, might justify limiting the theory or abolishing it altogether if other approaches served those limited purposes to which the theory has so far been put.

Of course it may be argued that adhesion theory really addresses contract procedure and that differences in contract terms will not render a transaction any more or less adhesive since adhesive character is determined by the *status* relationship of the parties.<sup>113</sup> Such an argument, however, misses the point: precisely because parties *cannot* alter the adhesive nature of their relationship,<sup>114</sup> to use adhesive nature as justification for application of a specialized regulating device, adhesion theory, necessarily means that the device will be substantively-oriented. In other words, the courts cannot change the adhesive character of contract formation in a given relationship any more than the parties can; therefore, any regulation *must* go to substance. An exception to this logic is recognized when the stronger party does not make sufficiently clear to the weaker party what it is the latter is adhering to; in this case, the court can order better notice without addressing substance.

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110. The legislature has enacted regulatory measures affecting the making of insurance contracts, the very area of the economy in which the use of adhesion theory by the California courts has been most marked. See CAL. INS. CODE §§ 12919-12977 (West 1972 & Supp. 1977) (powers and duties of Insurance Commissioner). Contracts in other “public service industries,” where use of adhesion theory would also be likely, Tobriner & Grodin, *supra* note 32, at 1277-78, have also been addressed by the legislature. See, e.g., CAL. FIN. CODE §§ 200, 210 (West Supp. 1977) (State Banking Department and Superintendent of Banks).

Note also that the legislature has shown itself willing and able to regulate form contracts specifically. See notes 25-26 *supra* and accompanying text. This is precisely the purpose for which adhesion theory might be used.

Additionally, it is offensive to the notions of representative government and separation of powers for the courts to regulate contracts because of any judicial feeling that the legislature has “failed”—because, for example, the antitrust laws have not equalized economic strengths.

111. See notes 128-31 *infra* and accompanying text.

112. See notes 115-21 *infra* and accompanying text.

113. See note 32 *supra* and accompanying text.

114. See Slawson, *Lawful Fraud*, *supra* note 6, at 47 (“The party to a contract who has the superior bargaining power cannot help having it.”).

### B. Freedom of Contract

At first blush freedom of contract might not seem apropos to any criticism of adhesion theory. It is, after all, the seeming *lack* of that freedom which led to development of the theory.<sup>115</sup>

This view, however, may miss the forest for the trees. Another possible approach is to note that the freedom to contract is the freedom to *enter into* private economic transactions, not necessarily the freedom to determine *how* they shall be made. As such, freedom to contract is part and parcel of our system's general bias in favor of a private ordering of society; it need not require that the ordering be between parties of equal strength or that economic relationships be effected through bargaining. The *private nature* of the transaction, rather than the mechanism by which it is consummated, is the value inherent in the freedom.

Inequality of bargaining power to the point of nonexistence is the natural result of a society with parties of differing wealth and circumstances. It is the inevitable concomitant of a free enterprise economy. In short, our value system suffers or tolerates that persons be *unequal* in their actual, if not legal, stations. For courts to hold that parties cannot exercise the unequal power that comes with those unequal stations would be to go against the grain of the parent society.

On the other hand, the approach described above, just as Professor Slawson's view,<sup>116</sup> is in some respects extreme. Notions of freedom and individualism are rooted in a time before the advent of the corporate state. Rousseau's social contract is radically different from that made between General Motors and John Doe. Jefferson's small farmers are not the Central Valley's agribusinesses.

It is not unreasonable that contract common law take into account real changes in society. Although our system is hardly statist, it may fairly be described as increasingly institutional or corporate; government, corporations, blocs, groups and associations are displacing the individual as the moving force in our lives.<sup>117</sup> Surely it is not impolitic for the courts to consider this reality in dispensing justice.

Yet the judicial system is not designed to remake the fabric of society. It cannot undo the adhesive nature of a contract because it has no power to equalize bargaining strength to the point of ensuring genuine negotiation. It cannot break General Motors down to the economic level of John Doe. The only way the same result can be reached is on an ex post

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115. See generally Kessler, *supra* note 5; notes 27-58 *supra* and accompanying text.

116. See Slawson, *Lawful Fraud*, *supra* note 6, at 12-13.

117. See, e.g.; Tobriner & Grodin, *supra* note 32, at 1247, 1252.

contractu basis, with the court substantively rewriting the adhesion contract to approximate what it might have been had the parties truly bargained. For all the reasons stated in the previous section,<sup>118</sup> that might be an undesirable process.

The problem with present adhesion theory is that it offers no logical stopping point. Where the courts are dealing in unconscionability, a provision must be really extreme, must "shock the conscience,"<sup>119</sup> before it is excised. Adhesion theory, where the goal is effectuation of the weaker party's "reasonable expectations,"<sup>120</sup> could, as a doctrinal matter, go to the entire contract. In other words, adhesion theory could enable a court to rewrite contract terms that, while not descending to the level of unconscionability, were less than fair. It is a more sweeping device, in contemplation if not yet in actual practice; as such, it could be more susceptible of abuse. And, even as to unconscionability, the legislature expressed a general fear of giving the courts overfree rein to substantively rewrite contracts.<sup>121</sup>

### C. "Reasonable Expectations"

Ostensibly, however, the adhesion test is whether a contract term meets the weaker party's reasonable expectations, not whether it is fair. In practice this may not be so. In the leading adhesion case of *Steven v. Fidelity & Casualty Co.*,<sup>122</sup> discussed above, Justice Tobriner wrote for the majority that the air traveller, who bought an adhesion insurance policy from an airport dispenser and who then was killed on an unscheduled carrier when all scheduled carriers had been grounded by bad weather, would have reasonably expected coverage in such a situation.<sup>123</sup> Justice Traynor stated in dissent that a purchaser would not reasonably believe the coverage went to other than scheduled air carriers.<sup>124</sup>

118. See notes 107-14 *supra* and accompanying text.

119. *Jacklich v. Baer*, 57 Cal. App. 2d 684, 693, 135 P.2d 179, 183 (1943); *State Fin. Co. v. Smith*, 44 Cal. App. 2d 688, 691-92, 112 P.2d 901, 903 (1941).

120. See notes 59-65 *supra* and accompanying text.

121. See, e.g., Cal. State Bar Committee on the Commercial Code, *The Uniform Commercial Code*, 37 J. St. B. CAL. 117 (1962):

The final recommendation of the Advisory Committee [to the California Senate Judiciary Committee] and the decision to delete this section [U.C.C. § 2-302 on unconscionability] . . . was based upon the belief that giving courts unqualified power to strike down terms they might consider "unconscionable" could result in the renegotiation of contracts in every case of disagreement with the fairness of provisions the parties had accepted.

*Id.* at 135-36.

122. 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962). See notes 76-78 *supra* and accompanying text.

123. 58 Cal. 2d at 868, 377 P.2d at 288, 27 Cal. Rptr. at 176.

124. *Id.* at 885, 377 P.2d at 298, 27 Cal. Rptr. at 186.

The majority's conclusion in *Steven* raises a question. Is it really reasonable to expect that a standard flight insurance form contract will provide coverage for an unscheduled carrier when the regular airlines say it is unsafe to fly? Particularly when a reasonable person who stopped to think would realize that the vast majority of those buying such policies would not be taking such a flight? It seems to this writer that Justice Traynor made a bona fide attempt in *Steven* to apply the "reasonable expectations" measure, whereas Justice Tobriner's opinion was more result-oriented. The holding in *Logan*<sup>125</sup> that the insured would not have reasonably expected noncoverage in case of death while intoxicated is open to similar criticism. Moreover, it is fair to say that the ordinary layperson's reasonable expectations in most situations are at best ill-defined. The reasonable expectations test, then, while seemingly consonant with the consensual theory of contract<sup>126</sup> (*i.e.*, what did the adherer reasonably think he or she was agreeing to?), may be only a covert tool to reach what a court considers a "fair" result. This is ironic, since adhesion theory has been praised as a franker judicial approach to contracts than traditional equitable devices.<sup>127</sup>

#### D. Transactional Costs

A further possible criticism of adhesion theory is that in practice it imposes transactional costs in areas of the economy without any popular or legislative mandate to do so. If a court makes a specific ruling on an adhesion contract which increases costs for the offering enterprise (as, for example, where an insurance company is required to extend its coverage), obviously those increased costs will eventually be passed on to *all* the enterprise's customers in the form of higher rates or prices. Yet the bulk of those customers might prefer lower costs without the judicially-ordered modification.<sup>128</sup> Moreover, the mere fact that businesses may have to carry on contractual relationships in an air of uncertainty over what the courts will do to each term and provision will increase legal and administrative costs for both the enterprises and their customers. Of course, this is also true for rulings based on public policy<sup>129</sup> or uncon-

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125. 41 Cal. App. 3d 988, 116 Cal. Rptr. 528 (1971).

126. *See, e.g.*, CAL. CIV. CODE § 1550 (West 1954), which provides in relevant part: "It is essential to the existence of a contract that there should be . . . consent . . . ." Llewellyn, *supra* note 2, at 700.

127. *See, e.g.*, Ehrenzweig, *supra* note 7, at 1090.

128. And note that "[t]he cost of judicial . . . intervention to perfect a market may exceed the benefits such protection brings." Kornhauser, *Unconscionability in Standard Form Contracts*, 64 CALIF. L. REV. 1151, 1156 (1976) [hereinafter cited as Kornhauser].

129. *E.g.*, *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal.

scionability.<sup>130</sup> But since it can be applied more broadly,<sup>131</sup> adhesion theory can cost more.

### E. *Is Unconscionability Available?*

As noted, California rejected U.C.C. section 2-302 on unconscionability in contracts for the sale of goods.<sup>132</sup> In letter if not in spirit that rejection cannot be said to go to other contracts. Further, one of the reasons given for the rejection was that the concept of unconscionability was already sufficiently developed in California law.<sup>133</sup> In any event, a stronger showing will no doubt be required to convince the California bench that it is without power to act on terms which "shock the conscience,"<sup>134</sup> and properly so. In the case of transactions which reach the public interest, contract terms may be deleted on grounds of public policy. It is suggested that all contracts of a "truly adhesive" nature, *i.e.*, where there is no choice as to the transaction *or* the terms,<sup>135</sup> qualify as reaching the public interest,<sup>136</sup> and that public policy<sup>137</sup> be available to strike down unconscionable terms. If for some reason unconscionability is *not* available as a doctrine, then adhesion theory is less defensible since it may constitute covert unconscionability.<sup>138</sup>

Rptr. 33 (1963); *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1967).

130. *E.g.*, *Jacklich v. Baer*, 57 Cal. App. 2d 684, 135 P.2d 179 (1943); *State Fin. Co. v. Smith*, 44 Cal. App. 2d 688, 112 P.2d 901 (1941).

131. *See* notes 107-14 *supra* and accompanying text.

132. *See* note 19 *supra* and accompanying text. The use of adhesion theory, definitely more pronounced in California than elsewhere, *see* notes 93-94 *supra* and accompanying text, might be a judicial reaction to that state's lonely rejection of U.C.C. § 2-302.

133. *See* note 21 *supra* and accompanying text.

134. *See* cases cited note 130 *supra*.

135. Slawson refers to such a situation as "coercion in the 'total' sense." Slawson, *Standard Form Contracts*, *supra* note 1, at 549.

136. *See Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

137. *See id.*; *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968), although note that the holding in the former was based on CAL. CIV. CODE § 1668 (West 1973).

138. There are several indications that adhesion theory may be covert unconscionability. Cases in which adhesive factors played a part have been decided on the ground of "public policy." *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963); *Akin v. Business Title Corp.*, 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968). Similarly, an appellate court of a sister state has held that "[t]he characterization of a lease as an adhesion contract because exacted by reason of a gross disparity in bargaining power is to enable the court to protect the injured party from an unconscionable contract provision." *Blakely v. Housing Auth.*, 8 Wash. App. 204, 212-13, 505 P.2d 151, 156 (1973). Further, Corbin states that "[s]tandardized contracts such as insurance policies, drafted by powerful, commercial units and put before individuals on the 'accept this or get nothing' basis, are carefully scrutinized by the courts for the purpose of

## V. ANALYSIS AND SUGGESTED APPROACH

Are "reasonable expectations," or "fair," concepts inherently more difficult to apply than "shocking to the conscience"? Don't judges always have to draw lines, even difficult ones, and doesn't the justice system ultimately have to rely on the reasonableness of the persons who staff it? And is it not true that in a civilized society, no one can be heard to complain that he or she is required to meet standards of honesty, integrity and fair dealing? Is it not true that members of the public should not be bullied by misuse of economic power?

The answer to all these questions must be yes. So what is wrong with adhesion theory?

Basically, what is wrong is that, as it has been elucidated, adhesion theory may afford courts leeway to go further than they should. It offers the possibility of more substantive rewriting of contracts, heavier imposition of transactional costs, and extended judicial interference in non-judicial processes. It is suggested that adhesion theory be redefined as strictly a notice requirement, without reference to "reasonable expectations."

A. *The Question of Agreement*

Because parties to a contract will usually be of different, if not markedly different, bargaining strengths, "agreement" on any term will, for one party, contain elements of "coercion." A lack of bargaining power, or of bargaining, cannot therefore be said to negate an inference of agreement, or consent, which is necessary to formation of a contract.<sup>139</sup> What is crucial is that the weaker party assent to the transaction *qua* transaction, by agreeing it should be entered into. One who does not have to enter into a given relationship, but who nevertheless does so, can fairly be said to have agreed to the terms even if he or she has no option to vary them.

It is where the weaker party has no choice as to terms, and *no realistic choice as to the transaction itself*, that he or she can truly be said to be "coerced." It is in this situation that agreement can in no way be inferred; it does not exist. The situation is "truly adhesive." Slawson is correct to this extent when he states that absence of choice rather than absence of bargaining is the key in analysis of form contracts.<sup>140</sup>

avoiding enforcement of 'unconscionable contracts.' " 6A A. CORBIN, CONTRACTS § 1376 (1962); *see also* C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 168, 180 (Iowa 1975); RESTATEMENT (SECOND) OF CONTRACTS § 234, Comment a at 107 and Comment d at 111 (Tent. Draft No. 5, 1970).

139. CAL. CIV. CODE § 1550 (West 1954).

140. Slawson, *Lawful Fraud*, *supra* note 6, at 48.

*B. Substance and Procedure: Notice*

When there is no choice, and hence no agreement, courts are properly concerned to prevent overreaching by the stronger party and to "carve" the terms of the transaction into some semblance of decency.<sup>141</sup> It is suggested, however, that California courts should limit their "carving" to only the clearly objectionable aspects of a transaction which could be called unconscionable.<sup>142</sup> Limiting the type of terms subject to deletion would minimize judicial interference with private transactions: if one judge thinks a term is unconscionable, the odds are that those judges who disagree will think it is at least less than fair, whereas disagreement that a term is unfair or is not reasonably expected probably expresses a feeling that it *is* fair or *is* reasonably expected. In other words, limiting the area of inquiry to grossly inequitable provisions is more likely to lead to a consensus that the provision in question is ill-advised and that judicial action toward it is appropriate. For all the reasons stated above,<sup>143</sup> wholesale substantive regulation of mass transactions should be left to the legislature; if it "fails" to regulate to the satisfaction of the judges, so be it.<sup>144</sup>

*Procedural* regulation by the courts of no-choice, no-bargaining transactions<sup>145</sup> is theoretically more acceptable because it presumably goes not to economic power, nor to the use thereof, but to the *manner* of use. That is, it is two steps isolated from the full-scale judicial reworking of the economy that no one has suggested is appropriate. A direct attack on the existence of economic power, as for example divestiture in an antitrust suit, has not been suggested in an adhesion context (and, indeed, there would be no statutory or common law basis for it). The *use* of economic power is closer to or in the target area of adhesion theory. If a party has great superiority of economic strength, and hence, bargaining power, it may not be permitted to use it and thereby obtain contract terms that fully reflect the disparity, *i.e.*, those which are shockingly one-sided. This is substantive use of the theory. Development of a specialized *procedure* in adhesion settings, as has been the inclination with respect to notice,<sup>146</sup> says to the stronger party: without referring to the substantive content of your terms, what terms you *do* set must be set in certain defined ways.

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141. Llewellyn, *supra* note 2, at 703 n.7.

142. *See generally* Jacklich v. Baer, 57 Cal. App. 2d 684, 135 P.2d 179 (1943); State Fin. Co. v. Smith, 44 Cal. App. 2d 688, 112 P.2d 901 (1941).

143. *See* notes 107-14 *supra* and accompanying text.

144. *See* note 110 *supra*.

145. *I.e.*, the "truly adhesive" transactions referred to earlier. *See* text accompanying note 140 *supra*. Slawson speaks of coercion in the "total" sense. Slawson, *Standard Form Contracts*, *supra* note 1, at 549.

146. *See* notes 75-88 *supra* and accompanying text.



How are the courts to decide which situations are truly adhesive? By what yardstick are judges to determine if there is really no choice as to whether to enter into a transaction? For example, we all have to eat, but does that mean we have no choice but to buy groceries at the largest supermarket chain? The answer must be no; clearly there are alternative sources of supply, such as other food markets. The availability of real alternatives is a factor which may simply deny any "truly adhesive" character to a transaction.<sup>147</sup> Conversely, the *absence* of such alternatives—as where the stronger party is a monopolist or has monopoly power in its field—may indicate that a transaction *is* adhesive.

Thus, monopoly or monopoly power in the stronger party to a contract claimed to be adhesive may be one signal to the judicial troops to give the transaction special scrutiny. The same signal might be raised where all the supposed "alternatives" in a contractual setting feature the same overreaching terms although the true problem may then be that the antitrust laws do not satisfactorily address oligopoly.

The other signal to the courts that special scrutiny may be advisable is a legislative determination of the "public" character of an enterprise. This signal would be the same one which would satisfy the first requirement in *Tunkl* that a transaction concern "a business of a type generally thought suitable for public regulation,"<sup>148</sup> before it be deemed to reach the public interest and, therefore, not allowed to contain an exculpatory provision. Or, more comprehensively, it might be required that a number of the six *Tunkl* factors be fulfilled so as to have the transaction in question reach the "public interest."<sup>149</sup> Such a signal could be institution of permanent administrative regulation of scrutiny of an industry, such as by the Insurance Commissioner,<sup>150</sup> Banking Department and Superintendent,<sup>151</sup> or Public Utilities Commission.<sup>152</sup>

The specialized procedural regulation could be cast entirely in terms of notice; all material terms must be brought to the attention of the weaker party by "conspicuous, plain and clear" language.<sup>153</sup> In short, the "truly

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147. *Bauer v. Jackson*, 15 Cal. App. 3d 358, 93 Cal. Rptr. 43 (1971); *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960); *Hurd & Bush*, *supra* note 2, at 68; *Kornhauser*, *supra* note 128, at 1163. *Cf. Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) ("Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties . . .").

148. *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 98, 383 P.2d 441, 445, 32 Cal. Rptr. 33, 37 (1963).

149. *Id.* at 98 & n.9, 99-101, 383 P.2d at 445 & n.9, 446, 32 Cal. Rptr. at 37 & n.9, 38.

150. CAL. INS. CODE §§ 12900-12940 (West 1972).

151. CAL. FIN. CODE §§ 200, 210 (West 1968).

152. CAL. HEALTH & SAFETY CODE §§ 100, 102 (West 1970).

153. *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 878, 377 P.2d 284, 294, 27 Cal. Rptr.

adhesive” nature of a transaction would trigger a Truth-in-Contracting regime. As to the *substantive* content of “truly adhesive” terms, only those the equivalent of unconscionable would be excised once notice was deemed effective.

### C. Proposal

The proposal, then, is to confirm the utility of a specialized approach to contracts that are truly adhesive—those transactions which the weaker party realistically *must* enter and whose terms he *must* accept—and to redefine or confirm the nature of that approach, adhesion theory, as essentially procedural and as one going to notice.

This proposal might be set forth as follows:

1. Standard rules for construction and interpretation of contracts, including the rule construing ambiguities against the drafter, apply to truly adhesive contracts exactly as they do to any others.

2. Terms in truly adhesive contracts of a public nature<sup>154</sup> that shock the conscience will be stricken on grounds of public policy applicable to such contracts particularly, or on grounds of unconscionability applicable to all contracts. A truly adhesive contract will be deemed to be of a public nature if it satisfies the first or a number of the *Tunkl* criteria,<sup>155</sup> or has been assigned that status by non-adhesion theory judicial decision (*e.g.*, antitrust determination of monopoly) or by legislative indication.

3. All terms in truly adhesive contracts of a public nature must be presented to the weaker party in a clear, understandable and noticeable way, such that a reasonable person would be apprised of them.

4. If there has been no effective notice of a given term, and it is not reasonable, the adherer will not be bound by it.

### D. Possible Criticisms of the Proposal and Rebuttals of the Criticisms

1. It would leave untouched adhesion contracts that are not of a public character.

First of all, these contracts would be subject to the same standard rules as any others; the courts have not been noticeably without means to deal with clearly inequitable aspects of such garden variety transactions.<sup>156</sup>

172, 182 (1962); *see also* Logan v. John Hancock Mut. Life Ins. Co., 41 Cal. App. 3d 988, 992-93, 116 Cal. Rptr. 528, 530-31 (1974); Schmidt v. Pacific Mut. Life Ins. Co., 268 Cal. App. 2d 735, 738, 74 Cal. Rptr. 367, 369 (1969).

154. These contracts will invariably be form contracts offered to the public on a mass basis.

155. *See* Tunkl v. Regents of the Univ. of Cal., 60 Cal. 2d 92, 98-101, 383 P.2d 441, 445-46, 32 Cal. Rptr. 33, 37-38 (1963).

156. *See* notes 10-26 *supra* and accompanying text.

Second, and more importantly, most adhesion contracts are consumer form contracts prepared for the public on a mass basis. Further, the mark of a "truly adhesive" transaction is that the weaker party has no choice but to enter it, *i.e.*, there is a real need for the goods or services in question.<sup>157</sup> These factors together make it very likely that an adhesion contract *will* be found to be of a public nature, since they indicate that a given transaction represents a real need for large numbers of the public.

2. "Notice" and "unconscionable" are concepts just as elusive as "fair" or "reasonable expectations."

This may be so, but it is submitted they are *better* elusive concepts. There is more likely to be agreement that an allegedly *unconscionable* provision is at least *unfair*, than that an allegedly unfair provision is in fact so. That is, since "unconscionable" is a stronger classification than just plain "unfair," there would be more certainty that a term which is attacked as unconscionable is ill-advised.

As to "notice," in a sense it is a concept which simply casts "reasonable expectations" into an explicitly procedural mold. If you park your car in a lot, and receive a stub which says in large red letters, "This is your contract. Read it!" you should be found to have a reasonable expectation that it is more than an identifying tag for your car, since you have been given notice.

Similarly, requiring realistically effective notice in a truly adhesive contract deprives a weaker party of any claim that he reasonably expected something other than what he got. The judicial inquiry, "would a reasonable person have been alerted to and have understood these terms?" is a more workable concept than "what terms would a person have reasonably expected" because it focuses on only a single facet of a contract. Of course, the latter inquiry may also focus on only a single term, but even then, notice appears a more easily ascertainable fact than an expectation because its sufficiency can be defined legally without reference to a party's subjective intentions. The rejoinder is that the same could be said of a "reasonable" expectation, but before continuing ad infinitum, let us conclude that at bottom "notice" is better because it deliberately steps away from substantive review, which has been deemed inadvisable in prior discussion.<sup>158</sup>

3. What good is a "notice" requirement in a truly adhesive transaction, since by definition the weaker party has to enter the transaction and accept the terms anyway?

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157. See note 145 *supra*.

158. See notes 107-14 *supra* and accompanying text.

This requirement serves three beneficial purposes: (a) it imposes a degree of procedural decency on stronger parties, which is an end in itself; (b) it permits courts to attack unfair terms if that procedural decency has not been accorded; and (c) it enlightens the adhering weaker party as to what exactly he is getting into, which should improve his basis for judgment and planning. Note that *unconscionable* provisions would be stricken, even if disclosed at the time the transaction is entered into, under either the *Tunkl-Akin* public policy reasoning,<sup>159</sup> using present adhesion theory, or under step (2) of the suggested approach.<sup>160</sup> One should hardly be able to immunize conduct shockingly objectionable or offensive to the state simply by informing one's victim in advance that the scaffold is being readied.

Thus the judicial result in such situations could be the same—and probably would be—under present adhesion theory or under the suggested approach. The latter has the advantage, however, of going in straightforward fashion to the heart of the matter and saying, “This is *wrong*.” Present adhesion theory can, of course, do the same, but it also offers the avenue of covert manipulation of a “reasonable expectations” analysis, which for reasons stated<sup>161</sup> should be avoided.

Taking these proposed rules, this article now seeks to test them through hypothetical application to an industry as yet largely untouched by adhesion theory: banking.

## VI. TEST APPLICATION TO BANKING

### A. *Are Bank Contracts Adhesive?*

The formalized relationships that banks offer to individual members of the public appear to have all the characteristics of contracts of adhesion. Arrangements for checking and savings accounts, loans, credit cards, check-cashing cards, safety deposit boxes, and other services are all likely to be embodied in standardized form contracts, whether by reference, incorporation, or actual primary documents.

For example, when a depositor opens a checking or savings account with a California bank, he generally signs a signature card, which is a very short printed form with a space for the depositor's signature beneath a short statement by the bank.<sup>162</sup> This statement invariably incorporates

159. See notes 23, 57-58 *supra* and accompanying text.

160. See text accompanying notes 154-55 *supra*.

161. See notes 107-14 *supra* and accompanying text.

162. One such signature card reads:

The undersigned enters into this bank-depositor agreement with [the Bank] . . . and agrees that this account shall be carried by said Bank as a [checking or savings]

by reference the bank's rules and regulations.<sup>163</sup> The depositor also gives pertinent information (address, birthplace, occupation, and the like) on the card. In general, the courts accept that the signature card is the contract between bank and depositor.<sup>164</sup>

This contract is certainly one of adhesion. It is embodied in a standard form which is offered to all comers. There is extreme disparity of bargaining power between the bank and the depositor. The latter is confronted with a standardized signature card which incorporates standardized bank rules and is given no opportunity to bargain as to what is offered him. The transaction is proffered on a take-it-or-leave-it basis and written by a more powerful bargainer for its own needs.<sup>165</sup> Although California courts have neither ruled nor apparently had the opportunity to rule that a bank/depositor agreement is a contract of adhesion, the supreme court has held that ambiguities in a standardized contract drafted and selected by a bank that occupies the superior bargaining position between the involved parties will be interpreted against the bank.<sup>166</sup>

Standard bank forms other than deposit agreements would similarly fall within the adhesion category. Thus, a bank trust deed has been held to be a contract of adhesion.<sup>167</sup> It is a fairly safe proposition that charge card agreements would be similarly classified.<sup>168</sup> A bank guarantee form

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account and that all funds on deposit in said account shall be governed by said Bank's bylaws, all future amendments thereof, all regulations passed or hereafter to be passed by its Board of Directors pursuant to said bylaws, and by all rules and practices as to interest and service charges of said Bank relating to said account. Undersigned authorizes said Bank to endorse checks, when presented for deposit to said account, if presented unendorsed. Undersigned further agrees that this agreement shall be governed by the National Banking laws and the laws of the State of California.

Another reads: "This account with [the bank] . . . shall be governed by applicable banking laws, customs and Clearing House regulations and by the rules printed in the bank book; and shall be subject to the service charge schedule of the Bank."

163. *Id.*

164. *Bennett v. First Nat'l Bank*, 443 F.2d 518 (8th Cir. 1971); *Blackmon v. Hale*, 1 Cal. 3d 548, 463 P.2d 418, 83 Cal. Rptr. 194 (1970); *Larrus v. First Nat'l Bank*, 122 Cal. App. 2d 884, 266 P.2d 143 (1954); *Smith v. Blubaugh*, 199 Kan. 89, 427 P.2d 443 (1967); *Lerbakken v. Twin City Fed. Sav. & Loan Ass'n*, 230 N.W.2d 596 (Minn. 1975); *Welch v. North Hills Bank*, 442 S.W.2d 98 (Mo. Ct. App. 1969); *Radelman v. Manufacturers Hanover Trust Co.*, 61 Misc. 2d 669, 306 N.Y.S. 638 (App. Term 1969); *David v. Manufacturers Hanover Trust Co.*, 59 Misc. 2d 248, 298 N.Y.S.2d 847 (App. Term 1969); *Koutsis v. Zion's Sav. Bank & Trust Co.*, 63 Utah 354, 225 P. 339 (1924) (by implication).

165. See notes 27-32 *supra* and accompanying text.

166. *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d 11, 480 P.2d 320, 92 Cal. Rptr. 704 (1971). The Oregon Supreme Court has been confronted with this exact issue, and has ruled that a bank/depositor agreement is a contract of adhesion. *Greenwood v. Beeson*, 253 Or. 318, 321, 454 P.2d 633, 636 (1969).

167. *Lomanto v. Bank of America*, 22 Cal. App. 3d 663, 99 Cal. Rptr. 442 (1972).

168. The highest court in Massachusetts has so held. *Lechmere Tire & Sales Co. v. Burwick*, 360 Mass. 718, 277 N.E.2d 503 (1972).

has been held *not* to be a contract of adhesion, partially because the allegedly weaker party was experienced, but also because the contract of guarantee in its essential parts created rather than limited a liability on the part of the bank, and because "anyone reading, with a fair degree of attention, this agreement . . . would be warned [of the liability]." <sup>169</sup>

There have been banking cases in California which may be read as precursors of adhesion theory. In *Los Angeles Investment Co. v. Home Savings Bank*, <sup>170</sup> a 1919 case, and *Frankini v. Bank of America*, <sup>171</sup> decided in 1939, under the rubric of "trap for the unwary" or inadequate disclosure, California courts invalidated bank/depositor passbook terms that sought to alter the traditional common law rule—which now also finds expression in the Uniform Commercial Code<sup>172</sup>—that the bank is liable to the depositor on a forged check drawn on the depositor's account.<sup>173</sup> Other cases used the same rationale to strike down broadly drawn bank exculpatory provisions regarding stop-payment orders.<sup>174</sup> These early bank cases are consonant with the notion that the courts appear to limit their use of adhesion theory to exculpatory provisions and terms materially limiting the stronger party's reasonably expected contractual obligation.<sup>175</sup>

In addition, Tobriner and Grodin note that the courts have held that banks, as public service institutions, cannot enforce contractual provisions that would limit liability in a manner not expected by, and not clearly communicated to, the depositor:<sup>176</sup> "The depositor expects the bank to perform its 'usual obligations' and courts will not enforce the

169. *Oakland Bank of Commerce v. Washington*, 6 Cal. App. 3d 793, 799, 86 Cal. Rptr. 276, 280 (1970).

170. 180 Cal. 601, 182 P. 293 (1919).

171. 31 Cal. App. 2d 666, 88 P.2d 790 (1939).

172. CAL. COM. CODE § 3404 (West 1964) (codifying U.C.C. § 3-404 (1962 version)).

173. *Union Tool Co. v. Farmers' & Merchants' Nat'l Bank*, 192 Cal. 40, 218 P. 424 (1923); *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 P. 293 (1919); *Frankini v. Bank of America*, 31 Cal. App. 2d 666, 88 P.2d 790 (1939); *Sommer v. Bank of Italy*, 109 Cal. App. 370, 293 P. 98 (1930). *See also* *Sabatino v. Curtiss Nat'l Bank*, 446 F.2d 1046 (5th Cir. 1971); *Ellis Weaving Mills v. Citizens & S. Nat'l Bank*, 91 F. Supp. 943 (W.D.S.C. 1950); *United States v. Washington Loan & Trust Co.*, 47 F. Supp. 25 (D.D.C. 1942), *aff'd*, 134 F.2d 59 (D.C. Cir. 1943); *Cooper v. Union Bank*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1 (1973); *Basch v. Bank of America*, 22 Cal. 2d 316, 139 P.2d 1 (1943); *Hensley-Johnson v. Citizens Nat'l Bank*, 122 Cal. App. 2d 22, 264 P.2d 973 (1953); *Wussow v. Badger State Bank*, 204 Wis. 467, 234 N.W. 720 (1931).

174. *Grisinger v. Golden State Bank*, 92 Cal. App. 443, 268 P. 425 (1928); *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 P. 947 (1926).

175. Tobriner & Grodin, *supra* note 32, at 1264; *see also* *Union Bank v. Ross*, 54 Cal. App. 3d 293, 126 Cal. Rptr. 646 (1976); *Oakland Bank of Commerce v. Washington*, 6 Cal. App. 3d 793, 86 Cal. Rptr. 276 (1970) (bank guarantee form held not to be an adhesion contract partially because it created rather than limited a bank liability).

176. Tobriner & Grodin, *supra* note 32, at 1278.

bank's attempt to avoid such responsibility."<sup>177</sup> There is thus the emphasis on notice which it has been suggested be made explicit in adhesion theory.

### B. *Are Bank Contracts "Truly Adhesive"?*

Those transactions that *must* be entered into, *and* whose terms must be accepted, are "truly adhesive;" there is no choice. If either of those characteristics is absent, the "adherer" cannot be said to be without choice. Of course, this is a test which must be applied realistically; the opportunity to make or find insubstantial variations in terms, or the possibility of "choosing" to go without something which is really a necessity in a modern society, should not preclude a transaction from being characterized as "truly adhesive."

It must be conceded that banking services are a necessity in our lives. Vast numbers of people have checking accounts, and cash has ceased to be a factor in many transactions (as indeed checks may do if and when electronic transfer comes to pass). Bank services are usually indispensable in purchasing a home (mortgages), vacationing (travellers' checks), making major capital outlays (loans), and in saving money (savings accounts). A less conservative view might even include credit cards as increasingly one of the necessities of personal finance. In brief, mattress-stuffing and payment in specie are ideas whose time has passed.

However, the terms of these various arrangements may not necessarily be invariable. There are a lot of banks around, not to mention a host of other financial institutions, such as savings and loan associations, credit unions, financial companies, and the like. As noted, the availability of genuine alternatives, of meaningful choice, may negate an inference of adhesion.<sup>178</sup> For example, with regard to service charges on checking and savings accounts, it is fairly well known, as a matter of general observation, that different institutions offer different service charge schedules. Throughout California, especially in the large metropolitan areas, smaller local banks may offer lower service charges or even free accounts to attract business. If a potential depositor found a particular bank's service rate schedule oppressive, could he or she not shop around among competing banks?

The "truly adhesive" test should be applied however, not only realistically but even compassionately. Do we mean to require a consumer to survey all the parking lots downtown to find the one with the least onerous bailment terms? Should we require that a depositor ferret out the

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177. *Id.*

178. See note 147 *supra* and accompanying text.

local bank with the most attractive terms when there are branches of statewide monoliths in every neighborhood, before we will hold the latter to consumer-oriented review standards? Perhaps so, and perhaps this is not a decision for the courts. But in applying a test of true adhesion, it is submitted that the rule of thumb for determining whether the adherer has a real choice is whether he has a *reasonably convenient and meaningful opportunity to avail himself* of that choice. The answer to this inquiry may vary with the given banking situation.

### C. Is Banking of a "Public" Nature?

In *Krueger v. Wells Fargo Bank*<sup>179</sup> the California Supreme Court held that banking is affected, or "tinged," with a public interest.<sup>180</sup> Justice Tobriner, the chief architect of California's adhesion theory,<sup>181</sup> stated for the court that "[b]anking corporations owe their legal existence to state law, derive their right to practice banking from government license, are subject to extensive state and national regulation, fulfill important economic functions often performed by government agencies, and exert great influence upon the economic health of the nation."<sup>182</sup>

Certainly banking has met the first of the *Tunkl* criteria, that a business be shown to be the type generally thought suitable for public regulation:<sup>183</sup> banking is already extensively supervised by both federal<sup>184</sup> and state<sup>185</sup> instrumentalities. Banking also appears to satisfy a number of the other *Tunkl* criteria for public policy review: banks hold themselves out as willing to perform their services for any member of the public (at least those meeting impersonal requirements), and the property—money—of

179. 11 Cal. 3d 352, 521 P.2d 441, 113 Cal. Rptr. 449 (1974).

180. *Id.* at 365-66, 521 P.2d at 448-49, 113 Cal. Rptr. at 456-57.

181. See note 96 *supra*.

182. 11 Cal. 3d at 364-65, 521 P.2d at 448, 113 Cal. Rptr. at 456. The court held, in determining that a bank cannot use a set-off against an account composed of unemployment compensation funds or state disability benefits because to do so would defeat the state policy of providing daily living expenses to the recipient, that the bank is not a state instrument and that its action is not state action for purposes of the fourteenth amendment of the Federal Constitution. However, the tone of Justice Tobriner's opinion did not indicate that he would be unhappy the day when, if ever, banks and other "public service enterprises" were subjected to the requirements of constitutional due process. *Id.* at 365-67, 521 P.2d at 448-50, 113 Cal. Rptr. at 456-58.

183. See *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 98, 383 P.2d 441, 445, 32 Cal. Rptr. 33, 37 (1963).

184. See generally, *e.g.*, 12 U.S.C. § 1 (1970) (Bureau of the Comptroller of the Currency); 12 C.F.R. §§ 1.1-.2 (1977) (regulations of Comptroller of Currency).

185. See, *e.g.*, CAL. FIN. CODE §§ 200, 210 (West 1968) (State Banking Department; Superintendent of Banks).



the member of the public is under the control of the bank; the bank also performs a service of great importance to the public and usually possesses a decisive advantage in bargaining strength.<sup>186</sup>

#### D. Test Application to Specific Examples

Assuming, then, for example's sake only, that bank form contracts merit "full" application of the suggested approach to adhesion contracts—*i.e.*, they are "truly adhesive," and banking is of a sufficiently "public" nature, let us select three banking situations for a test application: service charges, stop-payments on guaranteed checks, and changes in existing contracts such as credit cards.

##### 1. Service Charges

Service charges generally are imposed pursuant to agreement in the signature card,<sup>187</sup> which, without specifying the exact service charge schedule, grants the bank power to apply whatever the service charge may be.<sup>188</sup> In addition, the writer's personal experience and observation are that when a depositor opens a checking or savings account, the relevant service charges for each available account plan are for the most part spelled out in detail; the depositor then elects one.

Now suppose a depositor sues the bank, claiming that a given service charge pattern is oppressively costly and therefore, not within his reasonable expectations. Could a court use adhesion theory to rewrite the bank's charges, deleting old ones and inserting new ones?

The proposition is dubious on its face; the relatively petty dollar amount involved, as well as the degree of judicial rewriting of the service charge schedule which would be necessary, highlights the fact that this is not the sort of exculpatory provision or material limitation on performance with which California courts have been primarily concerned.<sup>189</sup> Moreover, given the agreement in the signature card and the procedure at the opening of the account,<sup>190</sup> it seems unlikely that a service charge that

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186. See *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal. 2d 92, 98-101, 383 P.2d 441, 445-46, 32 Cal. Rptr. 33, 37-38 (1963).

187. See examples note 162 *supra*.

188. *Id.*

189. See *Tobriner & Grodin*, *supra* note 32, at 1277; notes 93-106 *supra* and accompanying text.

190. See notes 162-64 *supra* and accompanying text. Note also, first, that one who signs a contract without reading it is normally bound, *Palmquist v. Mercer*, 43 Cal. 2d 92, 272 P.2d 26 (1954); *Heidlebaugh v. Miller*, 126 Cal. App. 2d 35, 271 P.2d 557 (1954); *Larrus v. First Nat'l Bank*, 122 Cal. App. 2d 884, 266 P.2d 143 (1954); 14 CAL. JUR. 3D *Contracts* § 43 (1974), and second, that the signature card text is brief and simple. Note further that one California court has held that the allegedly weaker party could not claim that bank

was short of being really outrageous could be termed not within the depositor's reasonable expectations. Similarly, under the suggested approach in this article, the service charges would stand because (1) they were not unconscionable (*i.e.* "really outrageous") or against public policy, and (2) they were effectively disclosed to the depositor.

## 2. Stop-Payments on Guaranteed Checks<sup>191</sup>

Certain banks offer depositors a checking plan that includes a check guarantee card, by which the bank guarantees the depositor's check to a merchant in return for the merchant's acceptance of payment by check. Since the bank guarantees the check at issuance, it naturally wishes and expects to have the depositor waive his normal stop-payment prerogatives,<sup>192</sup> and accordingly includes such a waiver in the deposit agreement.<sup>193</sup>

Consider that a depositor, having opened a checking account and signed the deposit agreement, then makes a purchase by check and casually shows his guarantee card to the merchant. The depositor is unaware of the card's legal effect and believes it to be a mere identification card, not having paid a great amount of attention to the details of his bank agreement. Suppose that the depositor subsequently requests that the bank stop payment on that check, and the bank honors the request without yet knowing the check is guaranteed since it has not yet been received. When the check does come in, the bank sees that it is guaranteed and pays. May the bank now charge the depositor's account?

There is nothing in the Uniform Commercial Code itself that prohibits such a contractual variance of the stop-payment right; indeed, section 1-102 (3) states that "[t]he effect of provisions of this code may be varied by agreement . . . ." Accordingly, a court could hold that the depositor's waiver in the case above was valid, and that the bank could charge the depositor's account. On the other hand, the court could hold

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guarantees on a promissory note were contracts of adhesion because (1) he did not read the contract, and (2) he did not attempt to renegotiate the term claimed to be adhesive, *i.e.*, the bank's right to waive the creditor's obligation to sell collateral sufficient to retire the debt upon the debtor's demand. *Union Bank v. Ross*, 54 Cal. App. 3d 290, 296, 126 Cal. Rptr. 646, 649-50 (1976). Query, however, if this approach is applicable or realistic with respect to more usual banking contracts.

191. I am indebted to Assistant Professor Hal S. Scott of Harvard Law School for suggesting this example.

192. CAL. COM. CODE §§ 4303, 4403 (West 1964).

193. One bank's Check Guarantee Card Agreement reads in part: "Bank is irrevocably authorized to pay and charge to Holder's checking account all checks guaranteed by means of the card and Holder waives the right to stop payment on any and all such checks." The Guarantee Card itself states in part: "Upon compliance with the conditions of its check guarantee card plan, . . . Bank will guarantee payment . . . ."

the waiver invalid, using the present adhesion theory to conclude that the waiver was not within the depositor's reasonable expectations.

"Reasonable expectations," however, is just another way of saying "notice;" one must reasonably expect that of which he has been effectively notified. "Reasonable expectations," moreover, is a phrase that ostensibly deals with substantive terms of a contract, while the real concern on this set of facts is procedural: whether the bank should have issued the check guarantee card in the first place without bringing home to the customer its full legal impact and significance or, in other words, whether the bank had a responsibility effectively to disclose this special feature. In a "truly adhesive" situation, the answer to this question is yes,<sup>194</sup> and if in fact a person cannot cash a check without a guarantee card, then the contract is of such a nature.

Otherwise, the guarantee card may not be truly adhesive, and the customer would be bound to what he signed. On the other hand, under current adhesion theory, a court can perhaps attack the guarantee agreement as an adhesion contract even if the transaction need not have been entered into.<sup>195</sup> The suggested approach, then, shows itself not only to be cleaner theoretically, but it also draws a tighter rein on the courts in choosing those contract terms which may be substantively deleted or rewritten.

Under either current adhesion theory or the suggested approach, the bank has an absolute defense if it has given effective notice to the customer of the terms of the guarantee card agreement. This defense is available because the contract term waiving stop-payment rights cannot fairly be said to be unconscionable or against public policy.<sup>196</sup> Such a

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194. See text accompanying notes 155-56 *supra*.

195. A court will have to judge for itself how understanding it should be in determining this question. The objective theory of contracts, *i.e.*, that contracts will be judged by reasonable interpretations of a party's outward manifestations of intent, would seem to require that little weight be given to whether the individual adherer *subjectively felt* that he or she *had* to enter the transaction. The crucial inquiry would be whether the "reasonable person" would subjectively feel that way, or, to be even less kind to the adherer, whether the "reasonable person" *objectively did* have to make the contract. For example, in *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962), can it truthfully be said, without using hindsight, *Yeng Sue Chow v. Levi Strauss & Co.*, 49 Cal. App. 3d 315, 325, 122 Cal. Rptr. 816, 822 (1975) (whether contract is one of adhesion must be determined as of time it was made), that the air traveller realistically had to buy flight insurance? Most air travellers do not, as a matter of common observation, whereas most people do mortgage their homes, enter a hospital when ill, maintain a checking account, and so forth. To ask the stronger party in an allegedly adhesive situation to be on guard for the individual traits of each customer, *e.g.*, the nervous air passenger who feels he or she *must* have insurance, is to require that the stronger party possess a considerable, perhaps unwarranted, degree of prescience.

196. See text accompanying note 155 *supra*.

term cannot be said to shock the conscience or offend the state; the bank through the guarantee card enlarges its own liability in order to aid the depositor in his or her merchant-consumer relations and in check-cashing. Although the bank immediately passes on a corresponding liability to the depositor, the latter is rendered a service at no spectacular profit to the bank.

### 3. Changes in Existing Contracts Such as Credit Cards

This example concerns subsequent changes made in existing bank contracts. Deposit agreements, for instance, generally incorporate by reference the bank rules and regulations.<sup>197</sup> What are the consequences of a subsequent change in rules, regulations or terms? An examination of this question will set the background for consideration of other types of bank transactions.

Even without a written contract, it has been held in *State v. San Francisco Savings & Loan Society*<sup>198</sup> that a depositor, "by dealing with the bank . . . adopts its regulations which are in existence at the time . . . ."<sup>199</sup> In the usual case, the signature card serves as the written contract<sup>200</sup> and incorporates by reference the bank's rules and regulations. It is standard contract law in California and elsewhere that matters may be incorporated into a contract by reference, even though the accepting party does not know the precise terms of incorporation.<sup>201</sup> An offeree, without knowing all the contract's terms, may accept whatever terms it contains.<sup>202</sup>

However, a problem is presented should the bank's rules be changed so as to alter materially the bank/depositor relationship after the account has been opened. While a depositor *without* a signature card or other written contract is governed by the by-laws existing at the time the account was opened, he must be notified of a change in the by-laws that materially alters the contract if he is to be bound by the change.<sup>203</sup> A by-

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197. See *Larrus v. First Nat'l Bank*, 122 Cal. App. 2d 884, 888-90, 266 P.2d 143, 147-48 (1954); note 162 *supra*.

198. 66 Cal. App. 53, 225 P. 309 (1924).

199. *Id.* at 61, 225 P. at 312.

200. See note 162 *supra*.

201. 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* § 88 (8th ed. 1973 & Supp. 1976). This has been specifically held with respect to a bank signature card incorporating the bank rules. *Larrus v. First Nat'l Bank*, 122 Cal. App. 2d 884, 889, 266 P.2d 143, 147 (1954).

202. 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* § 88 (8th ed. 1973 & Supp. 1976). *Cf., e.g., Hunter v. Sparling*, 87 Cal. App. 2d 711, 725, 197 P.2d 807, 815 (contract for payment of pension benefits not unenforceable for uncertainty because employee did not know its exact terms).

203. *State v. San Francisco Sav. & Loan Soc'y*, 66 Cal. App. 53, 61, 225 P. 309, 312 (1924).

law provision authorizing an amendment of the by-laws cannot give the bank the power to amend them so as to change the deposit contract materially without the depositor's knowledge.<sup>204</sup> This would constitute a "trap for the unwary."<sup>205</sup> It is reasonable that such analysis would also be used where there is a written deposit contract.

In our example, the contract in question is a credit card agreement between bank and customer whereby the customer enjoys a thirty-day period free of interest following a given credit purchase. Suppose that the bank decides to change that practice and start charging interest immediately on any charge; it mails the customer a new charge card with the revised rules. The customer pockets the card, disposes of the accompanying written material without reading it, and continues nonchalantly on his illiquid way.

Conceivably this situation could be resolved by a court without resort to adhesion theory at all. It could instead extend the *San Francisco Savings* rationale to other than deposit contracts, and hold that the withdrawal of the interest-free period worked a material change in the credit card agreement. In that case, the relevant inquiry under *San Francisco Savings* would be notice of the change. As a question of fact, was the change adequately disclosed to the customer through the information supplied with the new card? Would a reasonable customer have been alerted to the change? If so, the change is effective. If not, the change is not effective. The court might, in light of ordinary consumer behavior, expand upon what constitutes adequate disclosure.

Under present adhesion theory, assuming the credit card agreement were found to be adhesive, the inquiry would be whether the change was within the credit card holder's reasonable expectations. Presumably this would require determining if (1) the holder had originally agreed to let the bank make subsequent changes, and (2) the notice of the change was sufficient ("conspicuous, plain, and clear").<sup>206</sup> In other words, the approach would be very similar to the one described in *San Francisco Savings*, which strengthens the earlier suggestion that the old bank cases are precursors of adhesion theory.<sup>207</sup>

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204. *Id.*; see also *Bennett v. Hibernia Bank*, 47 Cal. 2d 540, 552, 305 P.2d 20, 28 (1956); *Spencer v. Hibernia Bank*, 186 Cal. App. 2d 702, 737, 9 Cal. Rptr. 867, 889-90 (1960); *Société de Bienfaisance St. Jean Baptiste de Millbury v. Peoples Sav. Bank*, 117 N.E.2d 921, 922-23 (Mass. 1917).

205. *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 613, 182 P. 293, 298 (1919); *Frankini v. Bank of America*, 31 Cal. App. 2d 666, 675, 88 P.2d 790, 795 (1939).

206. *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 878, 377 P.2d 284, 294, 27 Cal. Rptr. 172, 182 (1962). *Cf.* *Logan v. John Hancock Mut. Life Ins. Co.*, 41 Cal. App. 3d 988, 994, 116 Cal. Rptr. 528, 532 (1974) ("clear and plain").

207. See notes 170-71 *supra* and accompanying text.

The problem with present adhesion theory in this example, however, is that its "reasonable expectations" test offers the possible invitation to a court so inclined to declare, as a substantive matter, that the elimination of the interest-free period was unfair and impermissible, and therefore not within the credit card holder's reasonable expectations.

Very possibly such use is unlikely. But its mere possibility argues for a redefinition of adhesion theory so as to bar that approach. Under the suggested approach,<sup>208</sup> it would first be asked if the credit card agreement were "truly adhesive." This need not be a harsh test; the inquiry could be whether the average consumer found a credit card to be reasonably necessary to daily life. If the agreement were not truly adhesive, then it would be analyzed as any other contract, and so a court would fall back upon the general contract law found in *San Francisco Savings* and discussed above. If the agreement were truly adhesive, the suggested approach analysis would *still* be the same, focusing on effective notice, but without the theoretical potential for covert manipulation latent in current adhesion theory. On the example's set of facts, there would be no grounds for *substantive* setting-aside of the change; it simply is nowhere near unconscionable or contrary to public policy for a bank to charge its customer for the full period of a credit loan, nor does it even seem unfair.

## VII. CONCLUSION

"Contracts of adhesion" are those which are offered on a take-it-or-leave-it basis, with no bargaining and no choice. They are usually standard form consumer contracts which have come to play a dominant and useful role in our modern economy. Beyond the traditional equitable doctrines available in contract law, California courts have developed a specialized "adhesion theory" that may invalidate any term in an adhesion contract not within the weaker party's "reasonable expectations." To date, its use has been largely confined to invalidating exculpatory provisions and terms materially limiting the stronger party's expected performance, primarily in insurance cases.

Because of the potential for abuse of the "reasonable expectations" test to extend judicial rewriting of substantive terms, adhesion theory might be redefined to cast it as primarily a specialized notice device requiring effective disclosure of terms in those contracts that are "truly" adhesive—where the weaker party must enter the transaction and must accept its terms, and limiting substantive review to terms that are unconscionable or against public policy.

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208. See text accompanying notes 154-55 *supra*.

