

## HARVARD LAW REVIEW

## THE BARGAIN PRINCIPLE AND ITS LIMITS

*Melvin Aron Eisenberg\**

*How far should bargain promises be enforced? The bargain principle — a central thesis of traditional contract law — states that, in the absence of a traditional defense relating to the quality of consent, bargain promises should be enforced to their full extent. Professor Eisenberg argues that it is necessary to rethink the place of that principle in contract law. He first shows that the two justifications of the bargain principle, fairness and efficiency, are entirely persuasive in the classic case of a contract that has been made in a perfectly competitive market and that only one party has performed. Professor Eisenberg maintains, however, that the principle of unconscionability often justifies limitations on the bargain principle when the assumption of a perfect market is relaxed. In particular, he sets out four categories of contracts — involving the exploitation by one party of another's distress, transactional incapacity, susceptibility to unfair persuasion, or ignorance about prices — and shows how the bargain principle falters in those cases because its justifications are not met. Finally, he examines wholly executory contracts and demonstrates how the reach of the bargain principle in such cases depends on a sensitive consideration of the types of parties and commodities involved.*

THE institution of contract is central to our social and legal systems, both as reality and as metaphor. At the present time, however, the institution is in conceptual disarray. In the late nineteenth and early twentieth centuries, scholars and courts constructed a philosophical system of contract law characterized in substantial part by logical deduction from received axioms. This system fell into inevitable decline because it failed to recognize that deduction is a means, not an

\* Professor of Law, University of California, Berkeley. Columbia University, A.B., 1956; Harvard University, LL.B., 1959.

Portions of this article have been in draft for several years, and over that period I have benefited from the comments of a number of people who have either read the manuscript or discussed the ideas and whom I gratefully thank. I am particularly indebted to Guido Calabresi, Robert Cooter, Peter Diamond, James Gordley, Thomas Jorde, Lewis Kornhauser, Mitchell Polinsky, Albert Sacks, Alan Schwartz, and Jan Vetter, all of whom made comments that materially contributed to the analysis, and to Susan Avitzour, Janet Cooper, and Martina Marshall, who provided valuable help as research assistants.

end, and that the purpose of contract law is not simply to create conditions of liability, but also to respond to the social process of promising.<sup>1</sup> As part of this decline, in the last thirty to forty years there has been a wholesome reaction against logical deduction as a dominant mode of contract reasoning. Unfortunately, that reaction has often been accompanied by a wholesale retreat from any conceptualization of contract law — a retreat represented in its extreme forms by suggestions that contract is being absorbed into tort<sup>2</sup> or that there is no institution of contract as such, but only particular transaction-types.<sup>3</sup> These approaches neglect the possibility of reconceptualizing contract law through the development of principles that are intellectually coherent, yet sufficiently open-textured to account for human reality and to unfold over time. This Article is the second of a series attempting such a reconceptualization.<sup>4</sup>

The subject of this Article is the bargain principle and its limits. By bargain, I mean an exchange in which each party views the performance that he undertakes as the price of the performance undertaken by the other. Although parties may barter bargained-for performances without making any promises, contract law is concerned with those bargains that involve a present promise to render a future performance — that is, that involve an exchange over time. By the bargain principle, I mean the common law rule that, in the absence of a traditional defense relating to the quality of consent (such as duress, incapacity, misrepresentation, or mutual mistake),<sup>5</sup> the courts will enforce a bargain according to its terms, with the object of putting a bargain-promisee in as good a position as if the bargain had been performed. Part I of this Article explores

---

<sup>1</sup> See, e.g., C. LANGDELL, A SUMMARY OF THE LAW OF CONTRACTS § 15, at 20-21 (2d ed. 1880) (in formulating the rule regarding when a mailed acceptance is effective, "substantial justice" is "irrelevant").

<sup>2</sup> See G. GILMORE, THE DEATH OF CONTRACT 87-94 (1974).

<sup>3</sup> See Mueller, *Contract Remedies: Business Fact and Legal Fantasy*, 1967 WIS. L. REV. 833, 833-34; cf. G. GILMORE, *supra* note 2 (arguing general collapse of traditional contract doctrine); Friedman & Macauley, *Contract Law and Contract Teaching: Past, Present and Future*, 1967 WIS. L. REV. 805, 812 (fundamental concepts of contract law "too general and abstract to regulate current, socially significant business problems").

<sup>4</sup> See Eisenberg, *Donative Promises*, 47 U. CHI. L. REV. 1 (1979).

<sup>5</sup> The most important of the remaining traditional consensual defenses are palpable unilateral mistake, and misunderstanding in the *Peerless* sense (i.e., subjectively different but equally reasonable interpretations). See *Raffles v. Wichelhaus*, 2 H. & C. 906, 159 Eng. Rep. 375 (Ex. Ch. 1864). Many courts also recognize nonpalpable unilateral mistake as a defense if the promisee has not relied or his reliance can be reimbursed. See *Elsinore Union Elementary School Dist. v. Kastorff*, 54 Cal. 2d. 380, 353 P.2d 713, 6 Cal. Rptr. 1 (1960).

the reasons that support this principle in the context of half-completed bargains. Part II explores the limits that should be placed on the bargain principle under the doctrine of unconscionability. Part III explores the reasons that support the bargain principle in the context of executory bargains and the limits that should be placed on the principle in this context even in the absence of unconscionability.

## I. THE BARGAIN PRINCIPLE

Since the law does not enforce promises as such, a legal analysis of bargain promises must start with the question whether such promises should be enforceable at all. In considering this question, it is easiest to begin with those bargains in which one party's performance is both due and rendered before the other's, so that the bargain has become a half-completed or credit transaction. For convenience, I shall generally call the unperformed promise a half-completed-bargain promise; the party who has already rendered performance the plaintiff; and the party who has bargained for that performance the defendant.

Whether any given type of promise should be legally enforceable turns on both substantive and administrative considerations. As a substantive matter, the state (speaking through the courts) may fairly take the position that its compulsory processes will not be made available to redress every hurt caused by broken promises, but only to remedy substantial injuries, to prevent unjust enrichment, or to further some independent social policy, such as promotion of the economy.<sup>6</sup> As an administrative matter, the state may fairly take into account the extent to which enforcement of a certain type of promise would involve difficult problems of proof. Cutting across both substantive and administrative categories is the question whether the type of promise at issue is normally made in a deliberative manner, so that it fairly reflects the promisor's wants and resources.

Given these considerations, the half-completed-bargain promise presents the strongest possible appeal for legal enforcement. The interests of the plaintiff are typically substantial, because he has incurred the cost of performance and, normally, has seen the defendant enriched to the extent of that performance. The state has independent interests in enforcing such

---

<sup>6</sup> See Hays, *Formal Contracts and Consideration: A Legislative Program*, 41 COLUM. L. REV. 849, 852-53 (1941); Willis, *Rationale of the Law of Contracts*, 11 IND. L.J. 227, 230 (1936).

promises. The very strength of the plaintiff's injury may implicate the state's interest in keeping the peace, because a party who has rendered a bargained-but-unpaid-for performance might resort to self-help if the state refused to act on his behalf.<sup>7</sup> Perhaps more important, the nature of the transaction implicates the state's interest in the smooth functioning of its economy. A modern free enterprise system depends heavily on exchanges over time and on private planning. The extent to which actors will be ready to engage in such exchanges, and are able to make reliable plans, depends partly on the probability that promises to render a bargained-for performance will be kept. Legal enforcement of such promises makes it more likely that they will be kept.<sup>8</sup> Other criteria for enforceability point in the same direction. The fact that a valuable performance has been rendered to an unrelated party helps satisfy the criterion of evidentiary security. The fact that a bargain promise is rooted in self-interest rather than altruism tends to ensure that it will be finely calculated and deliberately made.<sup>9</sup>

The hard question, therefore, is not *whether* half-completed-bargain promises should be legally enforced, but the *extent* to which such promises should be enforced. Three broad possibilities serve as starting points. Such a promise may be enforced: (1) to the extent of the plaintiff's cost, including his opportunity cost (the reliance measure); (2) to the extent of the value conferred upon the defendant (the restitution measure); or (3) to the extent of the value to the plaintiff of the promised performance — that is, the amount required to put the plaintiff in as good a position as if the contract had been performed (the expectation measure). Often these three measures coincide.<sup>10</sup> But what if they do not? Suppose, in

---

<sup>7</sup> The techniques for enforcing debts to gamblers and loan sharks provide contemporary examples of self-help in cases in which the law will not enforce a promise — although it is conceivable that, because of the social structure of the gambling and loan-shark industries, self-help would be employed even if legal enforcement were available.

<sup>8</sup> Of course, promissory transactions might occur regularly even in the absence of such enforcement, since reasons of reputation and morality may often be more important incentives for promise-keeping than legal sanctions. Those reasons, however, operate so unevenly, and data concerning reputation is so difficult to assemble, that a regime dependent solely on reputation and morality would almost certainly be less fair and efficient than an enforcement regime.

<sup>9</sup> When these conditions are not likely to be satisfied, a different rule might be appropriate. See *infra* pp. 763–78.

<sup>10</sup> For example, assume that *P*, a plumber working at full capacity, does a five-hour job for *Q* at \$20/hour, his usual rate and the market price. *Q* fails to pay. *P*'s

particular, that the defendant resists all but restitutionary damages, on the ground that the terms of the bargain were unfair, in the sense that the value of the performance he promised to render exceeded the value he was to receive in exchange.

Generally speaking, the answer of the common law has been to invoke what I have called the bargain principle, which is commonly expressed by such catchphrases as "courts do not inquire into the adequacy of consideration" or "mere inadequacy of consideration will not void a contract."<sup>11</sup> When stated in this way, the principle appears to be substantive, but in large part it is a rule about remedies. What it means is that damages for unexcused breach of a bargain promise should invariably be measured by the value the promised performance would have had to the plaintiff, rather than, and regardless of, the cost or value of the performance for which the defendant's promise was exchanged — a formulation that can be expressed by the concept that a bargain promise should be enforced to its full extent.

If this principle were to be rigorously applied, bargain promises could never be reviewed for fairness of terms. A number of arguments can be made, on the bases of fairness and economic efficiency, that the principle should be so applied, at least in the context of a half-completed bargain.

*First.* The idea of reviewing a bargain for fairness of terms implies that an objective value can be placed upon a bargained-for performance. It can be argued, however, that objective value of a bargained-for performance is not a meaningful concept, because the value of such a performance is that which the parties assign to it.<sup>12</sup> A related argument is that a

expectation is \$100; *P*'s reliance is \$100 (his opportunity forgone); and *P*'s work will normally enrich *Q* by \$100.

Liquidated damages are not considered in this Article, because most contracts do not include a liquidated-damages provision. Specific performance is also not considered, partly because it is usually not a feasible remedy and partly because in those cases in which it is feasible, it is often simply a special technique for putting plaintiff in the position he would have been in if the contract had been performed.

<sup>11</sup> See, e.g., *Schweitzer v. Gibson*, 321 Ill. 336, 151 N.E. 865 (1926); *Batsakis v. Demotsis*, 226 S.W.2d 673 (Tex. Civ. App. 1949); *Westlake v. Adams*, 5 C.B. (n.s.) 248, 265, 141 Eng. Rep. 99, 106 (C.P. 1858); RESTATEMENT (SECOND) OF CONTRACTS § 79 (1979). This rule applies to all bargains, whether or not half-completed.

<sup>12</sup> See T. HOBBS, *LEVIATHAN* \*75 (1651) ("The value of all things contracted for, is measured by the Appetite of the Contractors: and therefore the just value, is that which they be contented to give."); 14 J. LOCÉ, *LA LÉGISLATION CIVILE, COMMERCIALE ET CRIMINELLE DE LA FRANCE* 65 (1828) (remarks of Berlier before the Conseil d'Etat), translated in von Mehren, *The French Doctrine of Lésion in the Sale of Immovable Property*, 49 TUL. L. REV. 321, 325 (1975) ("Things do not in general have a true price, a just price; they are worth less to one person, more to another; the

party who has received a bargained-for performance cannot legitimately object to paying a price that reflects its value to him, and his agreement shows that he valued the performance at least as high as the promised price.

*Second.* If *A* has rendered a bargained-for performance to *B*, we know that *A* was willing to render that performance to *B* for the agreed-upon price. We cannot know whether *A* would have rendered that performance to *B* for any lesser price. It can therefore be argued that, having rendered the performance, *A* cannot legitimately be required to accept any lesser price. Such a requirement would unfairly convert *A* from a voluntary to an involuntary actor, because had he known in advance that the price would be reduced, he might not have contracted and performed.

*Third.* The extent to which private actors are willing to engage in credit transactions (that is, bargains involving exchanges over time) and make plans on the basis of those transactions depends partly on the probability that bargain promises will be kept. It can therefore be argued that failure to enforce bargain promises to their full extent would subvert efficiency by diminishing the willingness of private actors to enter into and plan upon the basis of credit transactions.

*Fourth.* The contract price is normally the most efficient price, in the economist's sense of that term, because permitting the price of a commodity to be determined by the interaction of buyers and sellers will normally move the commodity to its highest-valued uses, as expressed by the amounts competing buyers are willing to pay, and will best allocate the factors necessary for the commodity's production.

These arguments find their fullest justification in what might be called the exemplary case for application of the bargain principle — that is, a half-completed bargain in a perfectly competitive market. Such a market involves four elements: a homogeneous commodity (which may consist of either goods or services); a marketplace at which perfect cost-free information concerning price is readily available (hereinafter referred to as a homogeneous marketplace); productive resources that are sufficiently mobile that pricing decisions readily influence their allocation; and participants whose market share is so small that none can affect the commodity's price, so that each takes the market price as given by outside forces.<sup>13</sup>

---

degree of luxury, the utility, the varying situations of the parties, there are plenty of reasons for different evaluations: but the price is known only by the agreement itself; it establishes the price, and the price should not be sought elsewhere.”).

<sup>13</sup> See E. MANSFIELD, *MICROECONOMICS* 196-97 (3d ed. 1979).

Now assume such a market, and let the parties to a bargain be a plaintiff-seller, *S*, and a defendant-buyer, *B*. Given a homogeneous commodity and a homogeneous marketplace, the contract price will be the market price. A number of reasons support the proposition that this price is fair: (1) The mechanism by which the price is generated, a perfectly competitive market, is generally regarded as a fair mechanism. (2) By normal measures of value, the contract price will be equal to the benefit *S* has conferred upon *B*. (3) *S* would not voluntarily have transferred the commodity to *B* at any lower price, because if *B* had not agreed to pay the market price, *S* could have sold it to another buyer at that price. (4) A party who has performed under a half-completed bargain should usually be entitled at a minimum to enforce the other's promise to the extent of his cost. Because *S* probably could have sold the commodity to another buyer at the market price if *B* had not acquired it, the contract price is likely to equal *S*'s opportunity cost. Given perfect competition, the contract price will also normally approximate *S*'s marginal cost.

The price in a perfectly competitive market is also efficient. If the price does exceed marginal cost, then given that pricing decisions readily influence the allocation of productive resources, the prospect of above-normal profits will provide an incentive to increase supply, leading to an increase in capacity and a new (and lower) equilibrium price that yields only normal profits. In contrast, to the extent the price is kept from rising to the equilibrium or market price, there is an incentive to decrease capacity by reallocating resources to other uses and not replacing depleted capital stock. Moreover, because perfect competition prevails, demand for the commodity would exceed the supply at any price less than the market price. Some mechanism other than price would therefore be required for rationing the supply among competing buyers, and the supply would not be allocated to its highest-valued uses, as measured by the amounts competing buyers are willing to pay — assuming, at least, that income is either distributed optimally or can best be redistributed by techniques other than price, such as taxation and subsidy.<sup>14</sup>

In short, in the exemplary case the bargain principle is supported by considerations of both fairness and efficiency. Indeed, the bargain principle may well have been formulated on the premise that real cases did not materially differ from the exemplary case. In practice, however, such differences frequently arise, and the balance of this Article considers the

---

<sup>14</sup> See I. A. KAHN, *THE ECONOMICS OF REGULATION* 67 (1970).

strength of the bargain principle when the assumptions of the exemplary case are relaxed. Part II shows that if the assumption of a perfectly competitive market is relaxed, the stage is set for invoking limits on the bargain principle based on the quality of the underlying bargain. Part III shows that if the assumption of a half-completed bargain is relaxed, the stage is set for invoking limits on the remedial reach of the principle independent of the quality of the bargain.

## II. THE PRINCIPLE OF UNCONSCIONABILITY

Each of the arguments supporting the bargain principle has considerable force, even outside the context of the exemplary case. Each, however, overstates its claim when it is extended beyond that case. The argument that objective value is neither a meaningful nor an appropriate concept can be countered by observing that the law often measures objective value in bargains that are not made in a perfectly competitive market. For example, off-market contracts between a beneficiary and his trustee<sup>15</sup> or between a fiduciary and his corporation<sup>16</sup> are customarily subject to review for objective fairness.<sup>17</sup> If the

---

<sup>15</sup> *Owens v. Owens*, 196 Va. 966, 86 S.E.2d 181 (1955); RESTATEMENT (SECOND) OF CONTRACTS § 173 & illustration 1 (1979); RESTATEMENT (SECOND) OF TRUSTS § 216(3) (1959) (consent of beneficiary to a transaction between trustee and trust is ineffective unless the transaction is fair and reasonable); 3 A. SCOTT, *THE LAW OF TRUSTS* § 216.3 (1967).

<sup>16</sup> See, e.g., *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 598-602 (1921); *Sisk v. Jordan Co.*, 94 Conn. 384, 389-90, 109 A. 181, 183 (1919); *Globe Woolen Co. v. Utica Gas & Elec. Co.*, 224 N.Y. 483, 121 N.E. 378 (1918); 3 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 918-919 (rev. vol. 1975); Note, *The Fairness Test of Corporate Contracts with Interested Directors*, 61 HARV. L. REV. 335 (1948); see also RESTATEMENT (SECOND) OF CONTRACTS § 15 (1979) (review of contracts entered into by incompetents); 2 S. WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* § 254 (3d ed. 1959) (same); Green, *The Operative Effect of Mental Incompetency on Agreements and Wills*, 21 TEX. L. REV. 554 (1943) (same); Green, *Proof of Mental Incompetency and the Unexpressed Major Premise*, 53 YALE L.J. 271, 303-04, 306-11 (1944) (same).

<sup>17</sup> We may look farther afield: the French and German Civil Codes both contain provisions of central importance that hinge on disparity between agreed-upon price and objective value. The French Code, CODE CIVIL [C. CIV.] art. 1674 (78e ed. Petits Code Dalloz 1978), provides, in effect, that a seller of real property can demand rescission if the sale price of the property is less than 5/12 of its value. The value must be estimated as of the date of the contract. *Id.* art. 1675. The buyer can defeat the action by paying 9/10 of the "just price" — that is, the objective value — calculated as of the date of payment. *Id.* art. 1681; see von Mehren, *supra* note 12, at 324 & n.11. Section 138(2) of the German Civil Code renders a transaction void "when a person [exploits] the distressed situation, inexperience, lack of judgmental ability, or grave weakness of will of another to obtain the grant or promise of pecuniary advantages . . . which are obviously disproportionate to the performance



mechanism by which a contract price was generated is inferior, in a normative way, to some other mechanism available to a court — such as measurement based on market price, cost, or benefit conferred — then resort to the other mechanism may well be in order. This point also helps answer the related argument that a promisor who has received a bargained-for performance cannot legitimately object to paying a price that reflects the value he placed on the performance. A promisee is not necessarily entitled to capture a surplus representing the excess of the promisor's subjective value over a price set in an objectively desirable manner.

The argument that revising a bargained-for price may unfairly convert a party who has rendered a bargained-for performance into an involuntary actor can be countered by a similar objection. If the price was not set by a mechanism that is regarded as fair, such as a competitive market, it may

---

given in return." A. VON MEHREN & J. GORDLEY, *THE CIVIL LAW SYSTEM* 1188 (2d ed. 1977) (translating BÜRGERLICHES GESETZBUCH [BGB] § 138(2) (W. Ger.) (Staudinger 1979)). According to von Mehren and Gordley:

Formerly, Section 138, par. 2 provided that a juristic act is void "when a person takes advantage of the difficulties [sometimes translated 'necessity'], indiscretion, or inexperience of another to obtain the grant or promise of pecuniary advantages for himself or a third party which exceed the value of the performance given in return to such an extent that the disproportion is obvious." The primary change is to replace the words "difficulties, indiscretion, or inexperience" by "distressed situation, inexperience, lack of judgmental ability, or grave weakness of will." The amendment was intended to extend the scope of the statute to kinds of stress which might not amount to objective "difficulties" and kinds of weakness which might not amount to "indiscretion."

*Id.* at 1209. For a searching exposition and analysis of § 138(2), see Dawson, *Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041, 1052 (1976) [hereinafter cited as Dawson, *Unconscionable Coercion*]. For a discussion of both the French and German provisions, see A. VON MEHREN & J. GORDLEY, *supra*, at 822-27, 1024-26; 2 M. PLANIOL, *TREATISE ON THE CIVIL LAW* Nos. 1076(2)-(5), 1586-1597 (11th ed. 1939); Dawson, *Economic Duress and the Fair Exchange in French and German Law* (pt. 1), 11 TUL. L. REV. 345, 370-75 (1937) [hereinafter cited as Dawson, *Fair Exchange I*]; von Mehren, *supra* note 12, at 323. Similar provisions were adopted in several other civil law jurisdictions. See Dawson, *Economic Duress and the Fair Exchange in French and German Law* (pt. 2), 12 TUL. L. REV. 42, 50 n.140 (1937) [hereinafter cited as Dawson, *Fair Exchange II*]; Thayer, *Laesio Enormis*, 25 KY. L.J. 321, 329 (1937).

Article 1674 of the French Civil Code is derived from the Roman and medieval law doctrine of *laesio enormis*, under which performance of a contract could be excused solely on the ground of a large disparity between price and value. Dawson, *Fair Exchange I*, *supra*, at 364-70; Dawson, *Fair Exchange II*, *supra*; von Mehren, *supra* note 12. Consequently, the quality of the seller's consent is not deemed relevant under article 1674. Except where otherwise explicitly provided, however, the French Civil Code expressly rejects the *laesio* doctrine. C. CIV. art. 1313 (78e ed. Petits Code Dalloz 1978). The framers of the German Civil Code also appear to have rejected the doctrine of *laesio*, insofar as it rests solely on a disparity between price and value. See Dawson, *Fair Exchange I*, *supra*, at 375-76; Dawson, *Fair Exchange II*, *supra*, at 50-51.

not be unfair or undesirable to revise it judicially. Many rules of law induce some form of involuntary behavior.

The argument based on the need to facilitate credit transactions and private planning depends for its weight on the strength of the policy behind facilitation, which in turn depends in part on the quality of the market in which the contract is made. In any event, not all types of credit transactions are necessarily to be encouraged,<sup>18</sup> not all bargains involve planning,<sup>19</sup> and in some transactions occurring off competitive markets a party might not be deterred from contracting by the prospect of a reduction in price.<sup>20</sup>

The argument based on the efficiency of contract price is fully effective only to the extent that the relevant market does not materially differ from a perfectly competitive market. In fact, however, many contracts are made in markets that are highly imperfect.

In short, while the arguments supporting the bargain principle are weighty and suggest that limits on the principle should be imposed cautiously, they are not conclusive. Always, therefore, there has been a strong countercurrent against the bargain principle.<sup>21</sup> Equity courts have long reviewed contracts for fairness when equitable relief has been sought.<sup>22</sup> Within recent years the principle has emerged — first in section 2-302 of the Uniform Commercial Code,<sup>23</sup> then in the cases,<sup>24</sup> and later in section 208 of the *Restatement (Second) of Con-*

---

<sup>18</sup> See *infra* pp. 763-85.

<sup>19</sup> See *infra* pp. 755-61.

It might also be argued that, if sellers thought that buyers' promises were enforceable according to their terms only if the buyer had received fair value in the eyes of a factfinder, they might sell only for cash. As a practical matter, however, the choice between a cash and a credit transaction is seldom likely to turn on the prospect of judicial review for fairness: businessmen have other things to worry about. Furthermore, if the law can review a price that is yet unpaid, it could also review a price already paid. Indeed, this is precisely the result under C. civ. art. 1764 (78e ed. *Petits Code Dalloz*) and BGB § 138(2) (Staudinger 1979), which draw no distinction between executed and executory transactions.

<sup>20</sup> See *infra* pp. 754-63.

<sup>21</sup> See, e.g., *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948); *McClure v. Raben*, 133 Ind. 507, 33 N.E. 275 (1893); *Richey v. Richey*, 189 Iowa 1300, 179 N.W. 830 (1920); *Baltimore Humane Impartial Soc'y v. Pierce*, 100 Md. 520, 60 A. 277 (1905); *Mersereau v. Simon*, 225 A.D. 997, 8 N.Y.S.2d 534 (1938); *Dawson, Economic Duress — An Essay in Perspective*, 45 MICH. L. REV. 253 (1947).

<sup>22</sup> See, e.g., *Loeb v. Wilson*, 253 Cal. App. 2d 383, 61 Cal. Rptr. 377 (1967); *Schlegel v. Moorhead*, 170 Mont. 391, 553 P.2d 1009 (1976); *McKinnon v. Benedict*, 38 Wis. 2d 607, 157 N.W.2d 665 (1968). See generally *Schwartz, The Case for Specific Performance*, 89 YALE L.J. 271, 273 & n.8, 299-303 (1979).

<sup>23</sup> U.C.C. § 2-302 (1977). The direct forerunner of § 2-302 was introduced in the 1948 draft of the Uniform Commercial Code. See *Leff, Unconscionability and the Code — The Emperor's New Clause*, 115 U. PA. L. REV. 485, 494 (1967). The full

tracts,<sup>25</sup> other uniform acts,<sup>26</sup> and the *Restatement (Second) of Property*<sup>27</sup> — that law courts too may limit or deny enforcement of a bargain promise when the bargain is “unconscionable.”

To understand the significance of this principle, it is useful to invoke the concept of a paradigm, in the sense developed by Thomas Kuhn in *The Structure of Scientific Revolutions*. As used by Kuhn, a paradigm is a model, principle, or theory that explains most or all phenomena within its scope, but is sufficiently open-ended to leave room for the resolution of further problems and ambiguities.<sup>28</sup> At the time of its formation, a paradigm looks both backward and forward. Looking backward, the paradigm permits and indeed requires the reconstruction of prior explanations. Looking forward, the paradigm will be applied and extended, by further articulation and specification, to resolve additional problems and ambiguities and to uncover new or previously disregarded phenomena. But as the paradigm is applied and extended in this manner, it typically happens that anomalies — phenomena the paradigm does not account for — are uncovered. These anomalies may eventually lead to the formation of an entirely new paradigm.<sup>29</sup>

The history of contract law, read retrospectively, suggests that the bargain principle, while long implicit,<sup>30</sup> at some point emerged as a controlling paradigm in the area of consideration.<sup>31</sup> Since that time, the law of consideration has been

text of the then-final version of the Code became available in 1952. See Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 798-800 (1958).

<sup>24</sup> See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

<sup>25</sup> RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979).

<sup>26</sup> See UNIF. CONSUMER CREDIT CODE § 5.108 (1974); UNIF. CONSUMER SALES PRACTICES ACT § 4 (1971); UNIF. RESIDENTIAL LANDLORD AND TENANT ACT § 1.303(a)(1) (1972).

<sup>27</sup> RESTATEMENT (SECOND) OF PROPERTY § 5.6 (1977) (expansion or contraction of landlord's obligations or tenant's remedies is valid and binding unless unenforceable because unconscionable or significantly against public policy).

<sup>28</sup> T. KUHN, *THE STRUCTURE OF SCIENTIFIC REVOLUTIONS* 10, 23, 181-87 (2d ed. 1970).

<sup>29</sup> *Id.* at 6, 7, 27, 29, 52-65 & *passim*.

<sup>30</sup> See L. FULLER & M. EISENBERG, *BASIC CONTRACT LAW* 44-47, 81-84 (4th ed. 1981).

<sup>31</sup> Legal paradigms differ from scientific paradigms in a number of respects, although Kuhn himself draws on the model of legal reasoning in explaining his theory. See T. KUHN, *supra* note 28, at 23. For example, a scientific paradigm may be formulated by a single person at a discrete point in time. In contrast, legal paradigms, such as the bargain principle, normally must, by their very nature, be developed over long periods by a number of actors.

concerned to a great extent with the articulation and specification of that paradigm. For example, courts and scholars have analyzed over the years such problems as why executory bargains should be enforceable<sup>32</sup> and how to treat bargains involving a performance that was already legally required,<sup>33</sup> transactions that are bargains in form but not in substance,<sup>34</sup> bargains in which one of the promises is illusory,<sup>35</sup> and unbargained-for reliance.<sup>36</sup>

When the concept of unconscionability was first made explicit by the Uniform Commercial Code, the initial effort was to reconcile it with the bargain principle. A major step in this direction was a distinction, drawn in 1967 by Arthur Leff, between "procedural" and "substantive" unconscionability.<sup>37</sup> Leff defined procedural unconscionability as fault or unfairness in the bargaining *process*; substantive unconscionability as fault or unfairness in the bargaining *outcome* — that is, unfairness of terms. The effect (if not the purpose) of this distinction, which influenced much of the later analysis,<sup>38</sup> was to domesticate unconscionability by accepting the concept insofar as it could be made harmonious with the bargain principle (that is, insofar as it was "procedural"), while rejecting its wider implication that in appropriate cases the courts might review bargains for fairness of terms. Correspondingly, much of the scholarly literature and case law concerning unconscionability has emphasized the element of unfair surprise, in which a major underpinning of the bargain principle — knowing assent — is absent by hypothesis.

Over the last fifteen years, however, there have been strong indications that the principle of unconscionability authorizes a review of elements well beyond unfair surprise, including, in appropriate cases, fairness of terms. For example, comment c to section 208 of the *Restatement (Second) of Contracts* states that "[t]heoretically it is possible for a contract to be oppressive

---

<sup>32</sup> See, e.g., C. LANGDELL, *supra* note 1, §§ 81-89; Ames, *Two Theories of Consideration* (pt. 2), 13 HARV. L. REV. 29 (1899); Langdell, *Mutual Promises as a Consideration for Each Other*, 14 HARV. L. REV. 496 (1901); Williston, *Successive Promises of the Same Performance*, 8 HARV. L. REV. 27 (1894).

<sup>33</sup> See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 73 (1979).

<sup>34</sup> Compare RESTATEMENT [FIRST] OF CONTRACTS § 84 illustration 1 (1932) (form of a bargain sufficient) with RESTATEMENT (SECOND) OF CONTRACTS § 71 illustration 4 (1981) (form of a bargain not sufficient).

<sup>35</sup> See, e.g., 1 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 103B (rev. ed. 1936); Corbin, *The Effect of Options on Consideration*, 34 YALE L.J. 571, 574 (1925).

<sup>36</sup> See Eisenberg, *supra* note 4, at 18-31.

<sup>37</sup> Leff, *supra* note 23, at 486-87.

<sup>38</sup> See, e.g., Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975).

taken as a whole, even though there is no weakness in the bargaining process."<sup>39</sup> Similarly, section 5.108(4)(c) of the Uniform Consumer Credit Code lists as a factor to be considered in determining whether a transaction is unconscionable "gross disparity between the price of the property or services . . . [and their value] measured by the price at which similar property or services are readily obtainable in credit transactions by like consumers."<sup>40</sup> And a number of cases have held or indicated that the principle of unconscionability permits enforcement of a promise to be limited on the basis of unfair price alone.<sup>41</sup>

As these phenomena have accumulated, it has become clear that they constitute anomalies under the bargain principle, and

<sup>39</sup> RESTATEMENT (SECOND) OF CONTRACTS § 208 comment c (1979). According to the Uniform Commercial Code:

The basic test is whether . . . the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. . . . The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.

U.C.C. § 2-302 comment 1 (1977). Although this language is admittedly delphic, *see* Dawson, *Unconscionable Coercion*, *supra* note 17, at 1043, the references to one-sidedness and oppression suggest that a review for fairness of terms is contemplated.

<sup>40</sup> UNIF. CONSUMER CREDIT CODE § 5.108(4)(c) (1974). An illustration in the official commentary indicates that § 5.108 would be applicable in the case of "a home solicitation sale of a set of cookware or flatware to a housewife for \$375 in an area where a set of comparable quality is readily available on credit in stores for \$125 or less." *Id.* comment 4.

UNIF. CONSUMER SALES PRACTICES ACT § 4(c)(2) (1972) and the official comment follow UNIF. CONSUMER CREDIT CODE § 4.108(4)(c) & comment 4; *see also* UNIF. RESIDENTIAL LANDLORD AND TENANT ACT § 1.303 comment (1972) ("The basic test is whether, in light of the background and setting of the market, the conditions of the particular parties to the rental agreement . . . are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the agreement . . .").

<sup>41</sup> *See, e.g.*, *Murphy v. McNamara*, 36 Conn. Supp. 183, 416 A.2d 170 (Super. Ct. 1979); *American Home Improvement, Inc. v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1964); *Shell Oil Co. v. Marinello*, 63 N.J. 402, 307 A.2d 598 (1973), *cert. denied*, 415 U.S. 920 (1974); *Kugler v. Romain*, 58 N.J. 522, 279 A.2d 640 (1971); *Toker v. Westerman*, 113 N.J. Super. 452, 274 A.2d 78 (Union County D. Ct. 1970); *Toker v. Perl*, 103 N.J. Super. 500, 247 A.2d 701 (Law Div. 1968), *aff'd per curiam on other grounds*, 108 N.J. Super. 129, 260 A.2d 244 (App. Div. 1970); *Vom Lehn v. Astor Art Galleries, Ltd.*, 86 Misc. 2d 1, 380 N.Y.S.2d 532 (Sup. Ct. 1976); *Jones v. Star Credit Corp.*, 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969); *Central Budget Corp. v. Sanchez*, 53 Misc. 2d 620, N.Y.S.2d 391 (Civ. Ct. 1967); *State v. ITM, Inc.*, 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966); *Frostifresh Corp. v. Reynoso*, 52 Misc. 2d 26, 274 N.Y.S.2d 757 (Nassau County D. Ct. 1966), *reversed on issue of damages*, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (App. Term 1967). For comparable recent English cases, *see* *A. Schroeder Music Publishing Co. v. Macauley*, [1974] 3 All E.R. 616 (H.L.); *Clifford Davis Mgmt. Ltd. v. W.E.A. Records Ltd.*, [1975] 1 W.L.R. 61 (C.A. 1974). The facts in many of these cases suggest that they may have involved some form of high-pressure selling, but most of the cases do not develop the issue and none rests upon it.

can be explained only on the basis of an expanded, paradigmatic concept of unconscionability that is not limited to procedural elements such as unfair surprise. This new paradigm does not replace the bargain principle, which is based on sound sense and continues to govern the normal case. Rather, the new paradigm creates a theoretical framework that explains most of the limits that have been or should be placed upon that principle, based on the quality of the bargain. What lies ahead is to articulate and extend the unconscionability paradigm through the development of specific norms, other than unfair surprise, that can guide the resolution of specific cases.<sup>42</sup> The balance of Part II is devoted to the development of four such norms, relating to exploitation of distress, transactional incapacity, susceptibility to unfair persuasion, and price-ignorance.

It is not the purpose of Part II to exhaust the concept of unconscionability. Quite the contrary: a basic thesis of this Article is that unconscionability is a paradigmatic concept that can never be exhaustively described. It is, however, a major purpose of Part II to suggest a methodology by which specific unconscionability norms should be developed. Accordingly, the norms described in this Part are important not only in themselves, but also as demonstrations of that methodology. Three general propositions underlie the methodology, and should be stated at the outset: (1) Since the bargain principle rests on arguments of fairness and efficiency, it is appropriate to develop and apply a specific unconscionability norm whenever a class of cases can be identified in which neither fairness nor efficiency support the bargain principle's application. (2) The development and application of specific unconscionability norms is closely related to the manner in which the relevant market deviates from a perfectly competitive market. (3) The distinction between procedural and substantive unconscionability is too rigid to provide significant help in either the development or the application of such norms.<sup>43</sup>

### *A. Distress*

Suppose that *A* makes a bargain with *B* at a time when, through no fault of *B*, *A* is in a state of necessity that effectively compels him to enter into a bargain on any terms he can get — a condition that I shall refer to as distress. The condition evokes various images — for example, *A* is stranded in the desert, and *B* comes upon him; *A* needs a lifesaving

<sup>42</sup> See Dawson, *Unconscionable Coercion*, *supra* note 17, at 1044.

<sup>43</sup> See 1 ONTARIO LAW REFORM COMM'N, REPORT ON SALE OF GOODS 157 (1979).

operation that only *B* can perform. At first glance these images may seem similar. In fact, however, each raises different problems, and together they illustrate most of the major issues raised by the case of distress. I shall therefore analyze those issues through an exploration of hypotheticals built upon these images.

*The Desperate Traveler.* *T*, a symphony musician, has been driving through the desert on a recreational trip, when he suddenly hits a rock jutting out from the sand. *T*'s vehicle is disabled and his ankle is fractured. He has no radio and little water, and will die if he is not soon rescued. The next day, *G*, a university geologist who is returning to Tucson from an inspection of desert rock formations, adventitiously passes within sight of the accident and drives over to investigate. *T* explains the situation and asks *G* to take him back to Tucson, which is sixty miles away. *G* replies that he will help only if *T* promises to pay him two-thirds of his wealth or \$100,000, whichever is more. *T* agrees, but after they return to Tucson he refuses to keep his promise, and *G* brings an action to enforce it.

Under traditional contract doctrines, *T*'s promise would be enforceable to its full extent. He has made a bargain, and none of the orthodox contract defenses apply. The defense of duress might seem apposite, but traditionally that defense has required not only that the promisor was in distress, but that he was put in distress by a wrongful act or threat of the promisee.<sup>44</sup> *G* did not put *T* in distress, and because the common law imposes no duty on strangers to rescue persons in distress even when life is at stake,<sup>45</sup> *G*'s threat of refusing aid would probably not constitute a wrongful act within the meaning of this rule.

It seems clear, however, that a promise to pay an unfair price, extracted through the promisee's exploitation of the promisor's distress, should not be enforced to its full extent. Neither fairness nor efficiency, the two major props of the

<sup>44</sup> See, e.g., RESTATEMENT [FIRST] OF CONTRACTS § 492 (1932); Note, *Contracts: Restitution and Rescission: Economic Duress and Business Compulsion in California*, 40 CALIF. L. REV. 425, 426 (1952).

<sup>45</sup> See *Buttersworth v. Swint*, 53 Ga. App. 602, 186 S.E. 770 (1936); *Hurley v. Eddingfield*, 156 Ind. 416, 59 N.E. 1058 (1901); W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 56, at 340 (4th ed. 1971). A different rule obtains in many civil law jurisdictions. See Dawson, *Negotiorum Gestio: The Altruistic Intermeddler* (pt. 2), 74 HARV. L. REV. 817, 1073, 1101-06 (1961). For an update on American law and a brief look at the socialist approach, see Note, *Stalking the Good Samaritan: Communists, Capitalists, and the Duty of Rescue*, 1976 UTAH L. REV. 529.

bargain principle, supports its application in such a case. In terms of fairness, our society posits, as part of its moral order, some degree of concern for others. In *The Desperate Traveler*, *G* has acted wrongly in treating *T* as simply an economic object.

The efficiency argument also fails. When a commodity is sold under perfect competition, the doctrine of distress would usually have no application, even to contracts for necessities. A sale at a perfectly competitive price would normally not be regarded as exploitive, because the price is generated by a mechanism that is conventionally regarded as fair, and normally equals the seller's opportunity cost and approximates the seller's marginal cost. Furthermore, traditional economic analysis suggests that such a price normally allocates supply to its highest-valued uses and encourages the appropriate amount of investment in productive capacity. *G*, however, is not a perfect competitor, but a monopolist.<sup>46</sup> Full enforcement of promises like that made by *T* is not required to move rescue services to their highest-valued uses, and would have no measurable effect on the allocation of resources to rescue-capacity, since the rescue is adventitious, there are no other bidders for the rescue services at the time of the rescue, and prior to the accident there was no market on which the victim could have purchased a contingent contract to rescue. Indeed, there is an argument that full enforcement would be inefficient. If it were known that persons in distress could be required to pay the price demanded for adventitious rescue, however high, people either might be reluctant to engage in activity in which rescue is sometimes necessary or might spend on precautions an aggregate amount exceeding the cost of adventitious rescue.<sup>47</sup>

Moreover, while the common law might have enforced *T*'s promise to its full extent, other mature legal systems do allow the courts to review bargains made under distress for fairness of terms. For example, section 138(2) of the German Civil Code provides that a transaction is void "when a person [ex-

---

<sup>46</sup> Technically, the relationship between *G* and *T* is a bilateral monopoly — that is, a market which effectively consists of a single seller and a single buyer. However, the existence of a bilateral monopoly is not inconsistent with extremely disproportionate bargaining power. Here *T* is bargaining for his life, while *G* is bargaining for a windfall profit. A bilateral monopoly characterized by extreme inequality of bargaining power can lead to inefficiency, because the stronger party can induce a price far in excess of cost.

<sup>47</sup> See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 133–34 (2d ed. 1977); Diamond & Mirrlees, *On the Assignment of Liability: The Uniform Case*, 6 BELL J. ECON. & MGMT. SCI. 487, 512 (1975); Landes & Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83, 91–93 (1978).



ploits] the distressed situation, inexperience, lack of judgmental ability, or grave weakness of will of another to obtain the grant or promise of pecuniary advantages . . . which are obviously disproportionate to the performance given in return."<sup>48</sup> French law is in accord.<sup>49</sup> At home, it is well established in admiralty law that a contract for salvage services — that is, a contract to rescue a vessel or its cargo — is reviewable for fairness of terms if entered into while the promisor is in distress. For example, in *Post v. Jones*,<sup>50</sup> the whaling ship *Richmond* had run inextricably aground on a barren coast off the Arctic Ocean. Several days later three other whaling ships came on the scene. These ships did not have full cargoes and the *Richmond* had more whale oil than they could take. At the instance of one of their captains, the *Richmond's* captain held a sale of his oil in the form of an auction. One captain bid \$1/barrel for as much as he needed, the two others bid \$.75/barrel, and each took enough oil at the bid price to complete his cargo. The three vessels then returned to port with the *Richmond's* oil and its crew. In an action by the owners of the *Richmond*, the sale of the oil at the bid prices was set aside:

The contrivance of an auction sale, under such circumstances, where the master of the *Richmond* was hopeless, helpless, and passive — where there was no market, no money, no competition — . . . is a transaction which has no characteristic of a valid contract.

. . . Courts of admiralty will enforce contracts made for salvage service and salvage compensation, where the salvor has not taken advantage of his power to make an unreasonable bargain; but they will not tolerate the doctrine that a salvor can take the advantage of his situation, and avail himself of the calamities of others to drive a bargain . . .<sup>51</sup>

---

<sup>48</sup> A. VON MEHREN & J. GORDLEY, *supra* note 17, at 1188 (translating BGB § 138(2) (Staudinger 1979)); see Dawson, *Unconscionable Coercion*, *supra* note 17, at 1054-60; *supra* note 17.

<sup>49</sup> Judgment of Apr. 27, 1887, Cass. Req., Fr., 1888 Recueil Périodique et Critique I 263 note, translated in A. VON MEHREN & J. GORDLEY, *supra* note 17, at 1029; 2 M. PLANIOL, *supra* note 17, No. 1076; 1 M. POTHIER, A TREATISE ON THE LAW OF OBLIGATIONS 115-17 (W. Evans trans. 3d ed. 1853); Dawson, *Fair Exchange II*, *supra* note 17, at 353-57 & n.39.

One reason that was given for making article 1674 of the French Civil Code, see *supra* note 17, applicable to sellers but not buyers was that a seller but not a buyer might act out of necessity. See 12 J. LOCRIÉ, *supra* note 12, at 188-96 (remarks of Bigot-Preameneu), translated in A. VON MEHREN, THE CIVIL LAW SYSTEM — CASES AND MATERIALS FOR THE COMPARATIVE STUDY OF LAW 530-32 (1957).

<sup>50</sup> 60 U.S. (19 How.) 150 (1857).

<sup>51</sup> *Id.* at 159-60.

Similarly, in *Magnolia Petroleum Co. v. National Oil Transport Co.*,<sup>52</sup> the barge *Bolikow* had been left anchored at sea by its tug, which had been forced to go back to port for more fuel. The tug had failed to return, the *Bolikow*'s fires were out, its fresh water was gone, and there was a threat of storm. At this point the vessel *Greer* happened by, and the *Bolikow* asked for a tow to port. The *Greer* was itself headed to port, and under the prevailing weather conditions the tow involved a simple operation. After a brief discussion, the master of the *Greer* said he would leave unless the *Bolikow*'s master promised to pay \$15,000 for the tow. The latter agreed, afraid to risk vessel and crew by staying out at sea any longer. The court refused to enforce the bargain:

I think it clear that this case is ruled by the general principle . . . that there is a clear right in the courts to set aside a salvage agreement, when made on the high seas under compulsion or hardship, morally or otherwise, when such agreement is unconscionable and inequitable, as this agreement plainly is.<sup>53</sup>

---

<sup>52</sup> 281 F. 336 (S.D. Tex. 1922).

<sup>53</sup> *Id.* at 340; see also *The Sirius*, 57 F. 851 (9th Cir. 1893); *Higgins, Inc. v. The Tri-State*, 99 F. Supp. 694 (S.D. Fla. 1951); *The Don Carlos*, 47 F. 746 (N.D. Cal. 1891); *The Jessomene*, 47 F. 903 (N.D. Cal. 1891); *The Young America*, 20 F. 926 (D.N.J. 1884); *The Port Caledonia & The Anna*, 1903 P. 184 (Adm.); G. GILMORE & C. BLACK, *THE LAW OF ADMIRALTY* 579 (2d ed. 1975); A. KENNEDY, *CIVIL SALVAGE* 309-13 (K. McGuffie 4th ed. 1958).

Landes and Posner, *supra* note 47, agree that rescue contracts should be reviewable, but attempt to rest their analysis on efficiency grounds only, arguing that the courts in such cases attempt to reconstruct a putative competitive price. This proposition is unsupported by case law. For example, the authors correctly point out that a court using their analysis would review rescue-at-sea contracts to ensure that the rescuer's price is not too low, and go on to claim that courts do make such a review. *Id.* at 101 n.39. As far as a moderate search could determine, however, neither the reasoning nor the holdings of American admiralty cases support that claim, nor do the English cases with the possible exception of one or two cases decided by Dr. Lushington, an admiralty judge in the mid-19th century. See *The Phantom*, 1 L.R.-Adm. & Eccl. 58 (Adm. 1866); *The Henry*, 16 L.T.R. 553, 15 Jurist 183 (Adm. 1851). The Landes & Posner approach also fails to explain why, if the law does indeed follow their approach, the courts take into account, in determining the amount of salvage awards, such elements as the value of the property saved and the no cure, no pay rule, which makes a salvage award contingent on success.

For example, Landes and Posner admit that, "in a competitive market, price equals marginal cost rather than the value to the buyer, which will exceed marginal cost for all but the marginal buyer," so that "[i]t might appear that 'fairness' would explain the emphasis on the value saved." Landes & Posner, *supra* note 47, at 103. In response, they argue that fairness could not really explain this element, because "systems of price discrimination — i.e., of making price vary in accordance with value rather than cost — are not generally applauded as fair." *Id.* In the context of

Of course, German, French, and admiralty law provide support for a doctrine of distress only by analogy.<sup>54</sup> The lack of direct common law support is not critical, however, since the very function of the unconscionability principle is to permit the courts to develop new rules of contract law based on sound analysis rather than on authority. Under this principle the courts are therefore free to go beyond the traditional doctrine of duress and deny full enforcement of a promise that results from the exploitation of distress, whether or not that condition was created by the promisee. Where, as in *The Desperate Traveler*, a promisee has adventitiously achieved a monopoly over a commodity essential to relieve a condition of distress, his refusal to deal except on unfair terms is a wrongful threat (in the language of traditional doctrine) or an unconscionable

---

a reward for benefit conferred, however, that argument is completely wrong: think of real estate commissions, tips, rewards for lost property, and finder's fees.

The authors further argue:

[T]he value of the property saved provides for estimating the level of inputs that would be devoted to the rescue in a competitive market. The law's attempts to monitor the rescuer's inputs directly are bound to be imperfect. Since the optimal purchase of inputs . . . is positively related to the value of the property saved, a court can utilize the latter to approximate the victim's demand for rescue inputs if transactions were feasible . . .

*Id.* at 104.

It may be that *before* a ship is in distress the amount an owner would be willing to invest in safety is related to the value of the property. Once rescue is actually necessary, however, the owners would be willing to spend the entire value of the property, minus \$1.00, on rescue inputs. In any event, there is no way to reconstruct a hypothetical demand schedule on this basis, and the courts do not try to do so.

Similarly, Landes and Posner attempt to reconcile the no cure, no pay rule with their approach by arguing that, "[b]y limiting salvage awards to successful rescues, the number of legal proceedings may be cut down, while the courts can, by adjusting the award, compensate the salvors for their unsuccessful attempts." *Id.* at 104 (footnote omitted). However, the courts cannot "by adjusting the award, compensate the salvors for their unsuccessful attempts" when the salvors are adventitious rescuers who may very well never engage in rescue again. Landes and Posner also argue that "in rescues at sea, where the award is made after the event, the costs of monitoring effort and energy are obviously high, and here the cost advantage is likely to lie with monitoring the output of which success is a crucial ingredient." *Id.* This contention, however, ignores the fact that other accepted elements of salvage awards, such as the value of the property the salvor employed and the salvor's time and labor, require precisely the monitoring that Landes and Posner argue the no cure, no pay rule is meant to avoid.

<sup>54</sup> Some support for reviewing a contract in a case like that in *The Desperate Traveler* for fairness in the exchange may also be given by RESTATEMENT (SECOND) OF CONTRACTS § 176(2)(c) (1979), which provides that a threat is improper "if the resulting exchange is not on fair terms, and . . . what is threatened is otherwise a use of power for illegitimate ends." *Id.* The comment to this section does not provide much guidance on when a threat constitutes "a use of power for illegitimate ends." *Id.* comment f. According to an illustration, the phrase would cover a threat by a municipal water main company to refuse water to a developer except at a price greatly

exploitation of distress (in the language of the new paradigm).<sup>55</sup>

This still leaves open how to measure the promisee's recovery in such cases. Financial cost is one possibility. Such a solution, however, would often fail to recognize adequately the benefit conferred upon the promisor. Furthermore, a financial-cost rule might not provide a sufficient incentive to act. In *The Desperate Traveler*, for example, *G*'s financial cost is close to zero. Assuming *G* is under no legal duty to rescue *T*, he would have no economic incentive to perform the rescue if his recovery were limited to financial cost. The need for an economic incentive in such cases should not be overemphasized; most individuals in *G*'s position would be likely to rescue *T* whether they had an economic incentive to do so or not. Nevertheless, an economic incentive would probably be helpful at the margin. Admiralty again suggests a solution. Although it will not enforce unfair rescue contracts, it does provide ample compensation for rescuers under the principle of salvage. Recovery under this principle is viewed both as a reward and as an inducement.<sup>56</sup> Accordingly, in measuring recovery the courts take into account the degree of danger to the rescued property; the value of the rescued property; the risk incurred by the salvors; their promptness, skill, and energy; the value of the property the salvor employed; the degree of

---

in excess of that charged to those similarly situated. *Id.* illustration 16. However, a publicly owned utility may be legally obliged not to discriminate between similarly situated customers. (In the case from which the illustration was derived, *S.S. & O. Corp. v. Township of Bernards Sewerage Auth.*, 62 N.J. 369, 301 A.2d 738 (1973), the result was based in large part on a statute that required municipal sewerage authorities to charge equal rates to similarly situated customers.) The illustration therefore leaves ambiguous whether a refusal to deal could constitute "a use of power for illegitimate ends" in the absence of a legal obligation to provide service.

Under § 176(2)(a), a threat is also improper if the resulting exchange is not on fair terms and "the threatened act would harm the recipient and would not significantly benefit the party making the threat." RESTATEMENT (SECOND) OF CONTRACTS § 176(2)(a) (1979). According to the commentary, subsection (a) is concerned with cases in which if, "the maker of the threat were to do the threatened act, it would . . . be done maliciously and unconscionably, out of pure vindictiveness. A typical example is a threat to make public embarrassing information concerning the recipient unless he makes a proposed contract." *Id.* comment f. Subsection (a) therefore may not cover cases like *The Desperate Traveler*, because the "threatened act" is simply to continue a course of conduct that *G* was pursuing in any event (completing his journey in the same way he began — without *T*).

<sup>55</sup> Cf. RESTATEMENT (SECOND) OF CONTRACTS § 208 comment d (1979) ("[G]ross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, . . . may show that the weaker party had no meaningful choice, no real alternative . . .").

<sup>56</sup> See *The Blackwall*, 77 U.S. (10 Wall.) 1, 14 (1869).

danger to that property; and the salvor's time and labor.<sup>57</sup> In more general terms, the recovery in distress cases involving an adventitious rescuer should not only compensate the promisee for all costs, tangible and intangible, but should also include a generous bonus to provide a clear incentive for action and compensation for the benefit conferred. Recovery measured in this way admits of no great precision, but that is not fatal in situations in which, by hypothesis, planning is not important. The viability of this approach is evidenced by the fact that it has stood the test of time in an area in which distress and adventitious rescue are common occurrences.<sup>58</sup>

*The Desperate Patient.* *P*, a business executive, is dying of a fatal disease. A new operation that will cure him has been developed by *S*, a surgeon, at a cost to *S* of \$100,000, measured by forgone opportunities and out-of-pocket costs. At the moment no one but *S* can perform the operation, and by the time others perfect the surgical technique involved, *P* will have died. *P* asks *S* to operate. *S* (who has the capacity to perform many more of these operations than he is currently doing) replies that he will do so only if *P* promises to pay \$300,000, his standard fee for the operation. *P* agrees, but after *S* performs the operation, *P* refuses to keep his promise, and *S* brings an action to enforce it.

As in *The Desperate Traveler*, the promisor in *The Desperate Patient* is in distress, and the promisee has exploited that distress by charging an apparently exorbitant price for rescue. However, there is a significant difference between the two cases. The surgeon *S*, unlike the geologist *G*, has achieved his bargaining power not through adventitious circumstances, but through diligence and skill, and the prospect of deriving ex-

<sup>57</sup> *Id.* at 13-14; *B.V. Bureau Wijsmuller v. United States*, 1979 Am. Maritime Cas. 2331, 2351-52 (S.D.N.Y.); *G. GILMORE & C. BLACK, supra* note 53, § 8-8; *A. KENNEDY, supra* note 53, at 161-225. Overriding these individual elements is the principle that the reward is to be computed generously in the light of "the fundamental public policy at the basis of awards of salvage — the encouragement of seamen to render prompt service in future emergencies." *Kimes v. United States*, 207 F.2d 60, 63 (2d Cir. 1953) (Clark, J.); *see also* *The Telemachus*, 1957 P. 47, 49 (Adm. 1956) ("I have to arrive at such an award as will . . . in the interests of public policy, encourage other mariners in like circumstances to perform like services."); *The "Industry"*, 3 Hagg. Adm. 203, 204, 166 Eng. Rep. 381, 382 (Adm. 1835) (in accord).

<sup>58</sup> Indeed, under modern shipping practice salvors typically leave the payment terms of their contracts open, for determination after the event by negotiation or through arbitration. *A. KENNEDY, supra* note 53, at 302. Furthermore, under the Lloyd's form salvage contract that is in almost universal use, if a fixed amount is agreed upon in advance, it may be objected to thereafter, in which event compensation is fixed by arbitration. *Id.*

orbitant gains may have been precisely what led *S* to forgo other opportunities and develop the new operation. It can therefore be argued that promises made to persons like *S* should be enforced to their full extent to encourage desirable investment.

Nevertheless, in this case too, full enforcement is not supported by efficiency considerations. In a perfectly competitive market, the long-run price of a commodity will equal its long-run cost. Accordingly, all consumers who are willing to pay the cost of production will be able to purchase the commodity. Cases like *The Desperate Patient*, however, involve a price in excess of cost, thereby choking off the demand of some consumers who would be willing to purchase the commodity at cost. A practice of nonenforcement of such promises might lead to underinvestment in the capacity to relieve from a condition of a distress, but a practice of full enforcement might lead to overinvestment in rescue-avoidance measures, to choking off demand for relief, or both.<sup>59</sup> Accordingly, a practice of judicial review, coupled with extremely liberal recovery, would not only reflect conventional notions of fairness, but would be just as likely as a practice of full enforcement — and perhaps more likely — to result in a preferable allocation of resources.

Once more, this is precisely the line taken in admiralty. Admiralty courts review salvage contracts for fairness of terms, not only when the promise is made to a nearby vessel whose rescue capacity results from adventitious circumstances, but also when it is made to a professional salvor whose rescue capacity results from planned investment. The two classes of rescuers are treated differently, however, as regards recovery. To encourage the provision and maintenance of rescue equipment, awards for rescue by professional salvors are deliberately set at a higher level than awards to nonprofessionals.<sup>60</sup> In

---

<sup>59</sup> See sources cited *supra* note 47.

<sup>60</sup> Thus, in *Salvage Chief* — S.T. Ellin, 1969 Am. Maritime Cas. 1739 (S.D. Cal. 1966), the court stated:

[O]ne who maintains an expensive salvage vessel with expensive salvage equipment thereon . . . is entitled to a more liberal salvage award than the mere casual salvor. Were it not so, there would be no encouragement to the owner of such professional salvage vessel to provide such available salvage equipment and to maintain it always in available status. . . . [T]he *Salvage Chief* is called upon to perform salvage services only from time to time as the need arises; nevertheless the cost of maintenance of the *Salvage Chief*, with her crew, and in a state of readiness, goes on, day after day.

*Id.* at 1740; see *W.E. Rippon & Son v. United States*, 348 F.2d 627 (2d Cir. 1965); *The Lamington*, 86 F. 675, 683-84 (2d Cir. 1898); *B.V. Bureau Wijsmuller v. United States*, 1979 Am. Maritime Cas. 2331, 2354-55 (S.D.N.Y.); *The "Glengyle,"* 1898 A.C. 519 (H.L.); A. KENNEDY, *supra* note 53, at 168-73. An interesting recent

more general terms, the recovery in cases like *The Desperate Patient* should parallel that in professional rescue at sea, and therefore should include an appropriate share of the cost of developing and maintaining rescue capacity, together with a premium to reflect the risk that the investment might not have been fruitful and to induce similar risk-taking in the future.

Needless to say, the two hypothetical cases discussed in this Section are intended to be suggestive, not exhaustive. Although both concern human life, the doctrine of distress is clearly applicable when other personal interests are involved,<sup>61</sup> and admiralty law suggests its applicability even when the only interests at stake are economic.

### *B. Transactional Incapacity*

Suppose that we vary the perfectly competitive market by assuming not that the promisor is in a state of distress, but that the subject matter of the bargain is highly complex, rather than homogeneous. The significance of this variation is that an individual may be of average intelligence and yet may lack the aptitude, experience, or judgmental ability to make a deliberative and well-informed judgment concerning the desirability of entering into a given complex transaction. I shall refer to such inability as transactional incapacity.<sup>62</sup> Assume now that *A*, who knows or has reason to know of *B*'s inability to deal with a given complex transaction, exploits that inca-

---

example is *Nicholas E. Vernicos Shipping Co. v. United States*, 349 F.2d 465 (2d Cir. 1965). Here the services performed by the tugs of a professional salvor consumed only a day and did not appear to involve exceptional hazard, but Judge Friendly approved a generous award calculated as twice the salvor's monthly expenses for maintaining the tugs. *See id.* at 472.

The effect of the rule of liberal salvage awards is that the cost of creating and maintaining professional rescue capacity, which benefits all who engage in hazardous activity, is borne only by the victims. *See The Glengyle*, 1898 P. 97, 102-03 (C.A.) (lower court opinion). Except for the problem of transaction costs, the ideal regime might therefore be to levy a worldwide tax on all carriers and shippers, and pay rescuers out of the proceeds.

<sup>61</sup> For example, in the New York City blackout of July 1977, many taxi drivers asked \$50 and \$60 for rides from Manhattan to Brooklyn and Queens. Some sellers of candles, flashlights, transistor radios, and batteries also charged many times the normal price. *Wall St. J.*, July 15, 1977, at 1, col. 4.

<sup>62</sup> There is an obvious parallel between the doctrine of transactional capacity and the doctrine of partial or diminished responsibility in the criminal law. Under the latter doctrine, a distinction is drawn between a lack of capacity so complete that it constitutes a defense to any crime, and a lack of capacity to form the mental state constituting an element of a specified crime, such as the premeditation or deliberate intent requisites for first-degree murder. *See W. LAFAVE & A. SCOTT, HANDBOOK ON CRIMINAL LAW* § 42, at 326-28 (1972); Weihofen & Overholser, *Mental Disorder Affecting the Degree of a Crime*, 56 *YALE L.J.* 959 (1947).

capacity by inducing *B* to make a bargain that a person who had capacity to deal with the transaction probably would not make, as in the following hypothetical:

*Artless Heir.* *N* is a twenty-two-year-old high-school graduate, employed in a stockroom. *N*'s great-aunt, who owns a commercial building, dies on June 1. In her will she bequeaths to her fifty-year-old sister, *Y*, a life interest in the building. The remainder interest is bequeathed to *Y*'s fifty-year-old husband, if he survives her, otherwise to *N*.

*T* is a major tenant in the building and holds a third mortgage on it for \$370,000 and a second mortgage on a movie theater for \$330,000. The third mortgage pays 11% interest and the second pays 9%. Both have fifteen years to run. On June 15, *T*, who has learned of the bequest to *N*, approaches her and offers to make a deal under which *T* will assign the two mortgages to her in exchange for her promise to transfer her contingent remainder. *T* points out that under this agreement *N* will derive an immediate annual income of more than \$70,000; that this income will continue for fifteen years, and that in fifteen years she will receive \$700,000 cash. In contrast, *N* will get no immediate income from the contingent remainder and may never see a dollar from it. Even if she becomes the owner, that may not happen for a long time, and by then the building may have declined in value.

Most real estate appraisers would agree that, based on life expectancy tables, applicable discount rates, and the building's value, *N*'s contingent remainder has a present fair value of \$870,000–\$950,000 to a nonspeculative buyer (such as *Y* or her husband); that if no such buyer could be found, a speculative buyer could be readily found in the \$650,000–\$900,000 price range; and that *T*'s two mortgages have a total present value of not more than \$350,000. *T* knows that a person with *N*'s background does not have the ability to value either the contingent remainder or the mortgages, and also knows that no one who had that ability would enter into the deal. *N* signs a contract, and *T* assigns the mortgages to her. Later, the estate's lawyer learns of the deal and advises *N* to refuse to transfer her interest to *T* and to offer to reassign the mortgages to *T*. *N* follows the lawyer's advice.



If traditional contract rules were strictly applied, *N*'s promise would be enforceable to its full extent. She has made a bargain, and none of the traditional contract defenses apply.<sup>63</sup> The defense of incompetence might seem apposite, but traditionally that defense has required what might be called general incapacity (indeed, near-insanity), consisting of an inability to understand the nature and consequences of one's acts.<sup>64</sup> However, it seems clear that the reasons for applying the bargain principle are inapplicable to a case like *Artless Heir*. Fairness does not support the principle's application. A party (the "promisee") who induces another (the "promisor") to make a bargain on unfair terms by exploiting the latter's incapacity has acted in a manner that violates conventional moral standards. This is true even though the promisor has the competence to understand ordinary transactions, and even if his lack of capacity stems from limitations in experience or training rather than from emotional instability or below-average intelligence.

Efficiency considerations also fail to support application of the bargain principle in such cases. The maxim that a promisor is the best judge of his own utility can have little application: by hypothesis, the promisor is not able to make a well-informed judgment concerning the transaction. The promisee, on his part, has engaged in activity that the economic system has no reason to encourage. Indeed, quite the contrary. Economic theory is predicated in large part on the concept that knowledgeable consumers, contracting freely, will move commodities to their highest-valued uses. In cases involving the exploitation of transactional incapacity, the promisee may very well move the commodity, at least temporarily, *away* from the

---

<sup>63</sup> English courts of equity gave special protection to expectant heirs at least through the 19th century, but American courts rejected this approach except in transactions involving pure expectancies. See Dawson, *supra* note 21, at 267-76.

<sup>64</sup> See 2 S. WILLISTON, *supra* note 16, § 256.

Many cases and authorities describe mental incapacity in language that looks on its face like a doctrine of transactional incapacity. See, e.g., *Cundick v. Broadbent*, 383 F.2d 157, 160 (10th Cir. 1967) ("[M]ental capacity to contract depends on whether the allegedly disabled person possessed sufficient reason to enable him to understand the nature and effect of the act in issue." (emphasis added)), *cert. denied*, 390 U.S. 948 (1968); *Peterson v. Ellebrecht*, 205 Cal. App. 718, 721, 23 Cal. Rptr. 349, 351 (1962) ("[T]he test is whether or not the party was mentally competent to deal with the subject before him with a full understanding of his rights." (emphasis added)); Comment, *Mental Illness and the Law of Contracts*, 57 MICH. L. REV. 1020, 1027-28 (1959). The discussion that follows these statements, however, is almost invariably pitched to the issue whether and how far the party fell below general standards of sanity and lucidity.

knowledgeable consumer who would value it most highly, and thereby frustrate the market mechanism.<sup>65</sup>

The strict nature of the traditional test for incapacity may have stemmed in part from the drastic consequences of its application: general incapacity usually renders the transaction voidable by the promisor. In contrast, while a court may grant rescission in cases of transactional incapacity, the application of this doctrine might merely call for an adjustment in price. Similarly, under one line of authority general incapacity constitutes a defense even if the competent party neither knew nor had reason to know of the incompetent's condition.<sup>66</sup> Transactional incapacity, on the other hand, should not be a defense unless the fully competent party knew or had reason to know of the incapacity, and exploited it.<sup>67</sup> In the absence of these elements there is no unfair conduct and therefore no unconscionability.

Some support for a doctrine of transactional incapacity can be found even in existing legal materials. Abroad, section 138(2) of the German Civil Code, quoted earlier in the discussion of distress,<sup>68</sup> provides such a doctrine. Even in the common law, courts have often avoided the bite of the traditional capacity test by stretching the doctrine of undue influence.<sup>69</sup> As formulated in the first *Restatement of Contracts*, that doctrine makes a transaction voidable "where one party is under the domination of another, or by virtue of the relation between them is justified in assuming that the other party will not act in a manner inconsistent with his welfare, [and the transaction is] induced by unfair persuasion of the latter."<sup>70</sup>

---

<sup>65</sup> See Dawson, *supra* note 21, at 281.

<sup>66</sup> See, e.g., *Verstandig v. Schlaffer*, 296 N.Y. 62, 64, 70 N.E.2d 15, 16 (1946) (per curiam); cf. RESTATEMENT (SECOND) OF CONTRACTS § 15(2) (1979) (if the competent party does not know of the incompetent's mental defect and the contract is fair, the incompetent's power of avoidance terminates to the extent that the contract has been wholly or partly performed, or the circumstances have so changed that avoidance would be unjust).

<sup>67</sup> It might be appropriate to restrict the doctrine of transactional incapacity to cases in which the fully competent party had actual knowledge of the transactional incapacity; however, a promisee with reason to know has at least some culpability, and more important, a standard requiring actual knowledge might be too difficult to administer. When the evidence demonstrates a lack of actual knowledge, the lesser culpability might be taken into account in fixing the remedy.

<sup>68</sup> See Dawson, *Unconscionable Coercion*, *supra* note 17, at 1060-62; *supra* pp. 756-57.

<sup>69</sup> See Green, *Fraud, Undue Influence and Mental Incompetency*, 43 COLUM. L. REV. 176, 190-96 (1943).

<sup>70</sup> RESTATEMENT [FIRST] OF CONTRACTS § 497 (1932); see *infra* note 93.

A striking case along those lines is *Lloyds Bank Ltd. v. Bundy*, decided by the English Court of Appeal in 1974.<sup>71</sup> Herbert Bundy was an elderly man whose home was at Yew Tree Farm. Herbert, his son, and MJB, a corporation owned by his son, all banked at a local branch of Lloyds Bank. MJB had gotten into difficulty, and in 1966 and 1969 Herbert guaranteed loans that Lloyds made to the corporation, and secured those loans by mortgages on Yew Tree Farm. Shortly after the second guarantee and mortgage, MJB's affairs worsened. An assistant bank manager went with the son to see Herbert at his home, and told Herbert that Lloyds would only continue to support MJB if Herbert increased the guarantee and mortgage up to £11,000, which apparently was the full value of Yew Tree Farm. The bank manager had brought guarantee and mortgage forms ready for signature. Herbert signed the papers on the spot, apparently without realizing there was little or no benefit to be derived in return, because there was little or no chance that MJB's affairs would become viable and Lloyds was not promising to stay its hand.

All three judges of the Court of Appeal agreed that the last guarantee and mortgage were unenforceable. Sir Eric Sachs (with whom Lord Justice Cairns concurred) rested his conclusion on the existence of a "confidential relationship" between the bank and Herbert, but made clear that the real vice of the transaction was that the bank had led a relatively unsophisticated person into a transaction with a severe though not readily apparent potential for unfairness, without pointing out the need for expert advice.<sup>72</sup> Lord Denning rested his decision on broader grounds:

No bargain will be upset which is the result of the ordinary interplay of forces. . . .

Yet there are exceptions to this general rule. There are cases in our books in which the courts will set aside a contract, or a transfer of property, when the parties have not met on equal terms — when the one is so strong in bargaining power and the other so weak — that, as a matter of common fairness, it is not right that the strong should be allowed to push the weak to the wall.

. . . .  
Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on "inequality of bargaining power." By virtue of it, the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or

---

<sup>71</sup> 1975 Q.B. 326 (C.A. 1974).

<sup>72</sup> *Id.* at 345.

transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other.<sup>73</sup>

Moreover, at least a few American cases have adopted a rule very close to the doctrine of transactional incapacity. For example, in *Morgan v. Reaser*,<sup>74</sup> the Reasers, who owned a ranch, entered into a complex three-cornered transaction with Morgan and Morgan's broker, involving the Reasers' ranch, an apartment complex owned by Morgan, and other consideration. It quickly became apparent that the apartment complex was a losing proposition, and when Morgan brought an action for specific performance, the Reasers counterclaimed for rescission. The court held for the Reasers. While the court recognized that "Reaser was not without some experience in the purchase and sale of real estate nor . . . completely lacking in understanding," it concluded that he "was without understanding of a transaction of this nature and magnitude."<sup>75</sup>

Also providing support to the doctrine of unfair persuasion is the Uniform Consumer Credit Code. Section 5.108(1) of this

<sup>73</sup> *Id.* at 336-37, 339.

<sup>74</sup> 87 S.D. 138, 204 N.W.2d 98 (1973) (per curiam).

<sup>75</sup> *Id.* at 149-50, 204 N.W.2d at 104. For comparable cases, see *Vincent v. Superior Oil Co.*, 178 F. Supp. 276, 283 (W.D. La. 1959) (applying Louisiana law); *Thatcher v. Kramer*, 347 Ill. 601, 607-10, 180 N.E. 434, 436-37 (1932); *Hinkley v. Wynkoop*, 305 Ill. 115, 122, 137 N.E. 154, 158 (1922); *Succession of Molaison*, 213 La. 378, 397-98, 34 So. 2d 897, 903 (1948).

Two classic cases of the early common law, *James v. Morgan*, 1 Lev. 111, 83 Eng. Rep. 323 (K.B. 1623), and *Thornborow v. Whitacre*, 2 Ld. Raym. 1164, 1165, 92 Eng. Rep. 270, 271 (K.B. 1705), appear to turn on exploitation of the promisor's lack of sophistication. *James v. Morgan* was an action to enforce a promise "to pay for a horse a barley-corn a nail, doubling it every nail." 1 Lev. at 111, 83 Eng. Rep. at 323. The promisor defended on the ground that "there were thirty-two nails in the shoes of the horse, which being doubled every nail, came to five hundred quarters of barley." *Id.* Chief Justice Hyde directed the jury to give the plaintiff only the value of the horse in damages. *Thornborow* was comparable to *James*. These cases were discussed in *Hume v. United States*, 132 U.S. 406, 413 (1889), in which the Court said that they "were plainly cases in which one party took advantage of the other's ignorance of arithmetic to impose upon him." *Id.* at 413.

Such concerns also seem to have lain behind the traditional rule that the courts will review for fairness a contract between seaman and master. "Every court should watch with jealousy an encroachment upon the rights of seamen, because they are unprotected and need counsel; because they are thoughtless and require indulgence; because they are credulous and complying; and are easily overreached." *Harden v. Gordon*, 11 F. Cas. 480, 485 (C.C.D. Me. 1823) (No. 6047). For modern applications of this rule, see *Newton v. Gulf Oil Corp.*, 1950 Am. Maritime Cas. 624 (3d Cir.); *Pioneer*, 1955 Am. Maritime Cas. 1366, 1369-70, 1374-76 (S.D. Cal.).

Code is comparable to section 2-302 of the Uniform Commercial Code. Section 5.108(4)(e) provides that:

In applying subsection (1), consideration shall be given to . . . the fact that the seller, lessor, or lender has knowingly taken advantage of the inability of the consumer or debtor reasonably to protect his interests by reason of . . . mental infirmities, *ignorance*, illiteracy, inability to understand the language of the agreement, or *similar factors*.<sup>76</sup>

While the Uniform Consumer Credit Code is directly applicable only to consumer credit transactions, the principles it embodies, like those of the Uniform Commercial Code, may be applied to other cases by analogy. Furthermore, the language of section 5.108(4)(e) is paralleled in comment d to section 208 of the *Restatement (Second) of Contracts* ("Unconscionable Contract or Term"), which of course is applicable to contracts of all kinds.<sup>77</sup>

In any event, it is not critical whether the doctrine of transactional incapacity is supported by traditional case law or statutes. The unconscionability principle allows the courts to adopt, on analytical grounds alone, a rule denying full enforcement of promises induced by exploitation of the promisor's intellectual, experiential, or judgmental inability to deal competently with the transaction at hand.

It might be argued against the doctrine of transactional incapacity, as applied to cases like *Artless Heir*, that its introduction would lead to uncertainty in contracting. That problem, however, is inherent in every contract defense. Admittedly, the principle of unconscionability introduces somewhat more uncertainty than many other defenses, but in accepting that principle contract law has in effect bargained away some

---

<sup>76</sup> UNIF. CONSUMER CREDIT CODE § 5.108(4)(e) (1974) (emphasis added).

<sup>77</sup> Also instructive is § 16:

A person incurs only voidable contractual duties by entering into a transaction if the other party has reason to know that by reason of intoxication

(a) he is unable to understand in a reasonable manner the nature and consequences of the transaction, or

(b) he is unable to act in a reasonable manner in relation to the transaction.

RESTATEMENT (SECOND) OF CONTRACTS § 16 (1979).

The *Restatement* reporter states that the approach of § 16 is more akin to unconscionability than to incapacity in the traditional sense "because the critical factor appears to be the conduct of the sober party, rather than the inability of the drunkard." *Id.* note. But having once shifted the spotlight to the promisee in the case of intoxication, must not the light remain there in the case of incapacity? Has the promisee acted any less unconscionably if he has reason to know that the other party is "unable to understand in a reasonable manner the nature and consequences of the transaction" because of ignorance, inexperience, or lack of capacity for good judgment, rather than because of alcohol?

of its certainty to augment its fairness. In reviewing that jurisprudential bargain, as it applies to the doctrine of transactional incapacity, it is therefore important to examine with precision the problem of uncertainty. So examined, the problem seems relatively minor. First, the doctrine would almost never be applicable to contracts between merchants concerning commodities in which they regularly deal, because a merchant can fairly presume that other merchants have capacity to practice their trade. Second, a promisee with a high regard for certainty could normally avoid application of the doctrine by advising an unsophisticated party to a complex transaction that he should get competent advice.<sup>78</sup> Third, if, as seems to be the case, the courts even today often covertly apply something like a doctrine of transactional incapacity (as in *Lloyds Bank*), open recognition of the doctrine could actually increase certainty, by eliminating covert elements in judicial decision-making and thereby facilitating prediction by lawyers.

In many and perhaps most cases, the remedy for exploitation of transactional incapacity would be rescission. How should recovery be measured where the competent party has completed his side of the bargain and rescission is not in order? If the competent party transferred a highly differentiated commodity, his out-of-pocket cost is obviously not a very useful measure, since the value of such a commodity often lies in elements such as uniqueness, strategic location, or beauty, which may be completely unrelated to out-of-pocket cost. Instead, recovery should normally be measured by the competent party's opportunity cost — that is, the value of the commodity in its next-best use. This, in turn, will normally be equal to market value — that is, the price at which the commodity would have been sold in a bargain between willing and informed parties of adequate capacity — and market value will normally be equivalent to the benefit conferred.

---

<sup>78</sup> Cf. *Morgan v. Reaser*, 87 S.D. 138, 150, 204 N.W.2d 98, 104 (1973) (per curiam) ("There is such a lack of competency on the part of the defendants as to have made it necessary that they should have had protection and advice . . ."), discussed at *supra* p. 768; *Lloyds Bank Ltd. v. Bundy*, 1975 Q.B. 326, 345 (C.A. 1974) (opinion of Sir Eric Sachs) ("Over and above the need any man has for counsel when asked to risk his last penny on even an apparently reasonable project, was the need here for informed advice as to whether there was any real chance of the company's affairs becoming viable if the documents were signed."), discussed at *supra* pp. 767-68.

If a party who is urged, fairly and in good faith, to seek advice fails to do so, the doctrine of transactional capacity would normally not apply, because the element of exploitation would be lacking. A distinction might be drawn, however, when the party lacks even the transactional capacity sufficient to allow him to understand the importance of getting advice.

It might be objected that a highly differentiated commodity typically does not have a market value, since its very differentiation excludes it from the class of commodities actively traded on a market. But "market value" in the legal sense has never been restricted to the latter type of commodity. Legal market value is typically an idealized construct based on extrapolation from the price at which comparable commodities are bought and sold on actual markets. In this sense even the most highly differentiated commodity has a legal market value, consisting of the price that analogous sales suggest a willing and informed buyer would probably have paid to a willing and informed seller.<sup>79</sup> This approach to remedy further moderates the problem of uncertainty. Unless the promisor can show not only that he lacked transactional capacity, but that a person who had such capacity would not have made the contract, he will normally lose. Even if he can make such a showing, the competent party will get back either what he transferred (if rescission is granted) or its fair value.

The doctrine of transactional capacity is not limited to cases where a promisor lacks capacity to understand the value of the performances to be exchanged; it also applies to cases in which the promisor can understand the value of the performance called for but lacks capacity to understand the meaning of contractual provisions governing the parties' rights in the event of nonperformance. This application is most likely to occur in transactions involving form contracts prepared by relatively sophisticated sellers who deal regularly with relatively unsophisticated buyers. Such transactions raise a special problem. A wide range of buyers are likely to use any given form. Some will be capable of understanding virtually any provision, while others will not. Of those who do not, some might have refused to enter into the contract if they had understood the provision, while others would have gone ahead. Because the agent of the seller who deals with a given buyer may not know the category into which the buyer falls, how should the doctrine of transactional incapacity be applied in form contract cases?

The answer is, if a provision changes the rights that a buyer would otherwise have on nonperformance in a manner the seller knows or should know many buyers would probably not knowingly agree to, it is unconscionable to word the provision in language the seller knows or should know many buyers will lack capacity to understand. For example, in the

---

<sup>79</sup> See C. McCORMICK, *HANDBOOK ON THE LAW OF DAMAGES* § 44, at 166 (1935); *id.* § 46, at 177-178.

well-known case of *Williams v. Walker-Thomas Furniture Co.*,<sup>80</sup> the buyer regularly purchased furniture and home appliances from the seller on installment credit. The purchase agreements were printed contracts in the form of chattel leases, which contained the following provision:

[T]he amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills, or accounts; and all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts due the Company by [purchaser] at the time each such payment is made.<sup>81</sup>

The effect of this provision was that until the buyer was completely out of debt to the seller, no item she had ever purchased from it would be completely paid off, even though the balances due on some of the items might be worked down (as they were in *Williams*) to a few cents.<sup>82</sup> As a result, no such item would be immune from procedures for summary recovery under replevin statutes, or would fall within the protection of statutes exempting defined classes of property from attachment to satisfy judgments. The seller certainly knew or should have known that many (indeed almost all) buyers would lack capacity to understand the effect of this provision, and probably knew or should have known that if buyers had understood that effect, many would have refused to sign. Under traditional legal rules, the provision would probably have nevertheless bound the buyer on the theory that she had a duty to read the contract and be aware of its contents.<sup>83</sup> Indeed, this was just what happened in *Williams* in the lower court.<sup>84</sup> If such a provision was inconspicuous, most modern courts would probably not enforce it, under the unconscionability norm of unfair surprise. Thus, in its opinion remanding the case, the United States Court of Appeals for the District of Columbia Circuit emphasized the importance of determining whether the term was "hidden in a maze of fine print."<sup>85</sup> But such a provision should be deemed unconscionable, under the

---

<sup>80</sup> 350 F.2d 445 (D.C. Cir. 1965).

<sup>81</sup> *Id.* at 447.

<sup>82</sup> See Skilton & Helstad, *Protection of the Installment Buyer of Goods Under the Uniform Commercial Code*, 65 MICH. L. REV. 1465, 1476-77 (1967).

<sup>83</sup> See, e.g., *Rossi v. Douglas*, 203 Md. 190, 199, 100 A.2d 3, 7 (1953); *Sardo v. Fidelity & Deposit Co.*, 100 N.J. Eq. 332, 134 A. 774 (N.J. 1926); *Calamari, Duty to Read — A Changing Concept*, 43 FORDHAM L. REV. 341, 341-42 (1974).

<sup>84</sup> *Williams v. Walker-Thomas Furniture Co.*, 198 A.2d 914 (D.C. 1964).

<sup>85</sup> 350 F.2d at 449.



doctrine of transactional incapacity, even if it is conspicuous to the eye. Thus, in *Gerhardt v. Continental Insurance Cos.*,<sup>86</sup> the court struck down an obscurely worded exception to a comprehensive insurance policy on the ground that it was "neither conspicuous *nor* plain and clear."<sup>87</sup> In *Weaver v. American Oil Co.*,<sup>88</sup> involving a complex and legalistically phrased provision under which the operator of an Amoco gas station indemnified Amoco against Amoco's own negligence, the court said: "The party seeking to enforce such a contract has the burden of showing that the provisions were explained to the other party and *came to his knowledge* and there was in fact a *real and voluntary meeting of the minds and not merely an objective meeting.*"<sup>89</sup>

What should be the remedy in such cases? Ordinarily, the balance of the contract should stand, but the rights of the parties should be those that would have prevailed in the absence of the relevant term — unless the seller shows either that he explained the term, that it was conspicuous and the buyer had the capacity to understand its effect, or, perhaps, that if the buyer had understood it he would nevertheless have signed. The remedy hardly seems severe, since its only effect is that the parties are governed by a presumably fair rule of law, and the seller can avoid even this effect by writing the term in plain English and presenting it in a manner that avoids unfair surprise.

### C. Unfair Persuasion

In a perfectly competitive market, persuasion ordinarily plays little or no role in contract formation: buyers and sellers either take the uniform market price of a homogeneous commodity, or they do not.<sup>90</sup> Away from such a market, however, persuasion may play an important role. This opens the possibility that a party who is normally capable of acting in a deliberative manner may be rendered temporarily unable to do so by unfair persuasion.

First, a definition: by "unfair persuasion" I mean the use of bargaining methods that seriously impair the free and com-

---

<sup>86</sup> 48 N.J. 291, 225 A.2d 328 (1966).

<sup>87</sup> *Id.* at 298, 225 A.2d at 332 (emphasis added).

<sup>88</sup> 257 Ind. 458, 276 N.E.2d 144 (1971).

<sup>89</sup> *Id.* at 464, 276 N.E.2d at 148 (emphasis in original); cf. N.Y. GEN. OBLIG. LAW § 5-702 (McKinney Supp. 1981) ("plain English" statute).

<sup>90</sup> Comment, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151, 1154 (1976).

petent exercise of judgment<sup>91</sup> and produce a state of acquiescence that the promisee knows or should know is likely to be highly transitory.<sup>92</sup> Suppose, in such a case, that the promisor changes his mind as soon as the unfair influence is removed and he is given scope for deliberation, as in the following hypothetical:

*Troubled Widow.* *W* owns in her own name, and manages, a small clothing boutique. On January 5, her husband, *H*, dies of a sudden stroke. At the time of his death, *H* owed \$60,000 to *D*, represented by a note and secured by all of the stock in *C* Corporation. Although originally prosperous, the corporation had run into major difficulties, and the stock is now worth only \$500–\$2500. On January 9, *D* goes to *W*'s house, bringing with him the note and the stock, and tells *W* that *H*'s memory will be permanently dishonored unless his debts are paid. *W* says she does not want to talk about such things now, and asks *D* to come back at another time. *D*, however, goes on, talking about *W*'s ethical obligations and pounding away at the repugnance of dying with a dishonored reputation. *W* pleads with him to stop, but *D* relentlessly continues. After two hours *W* agrees that in exchange for the note and stock (which *D* assigns to her) she will pay *D* \$60,000. The next day *W* has second thoughts, tells *D* she will not pay the \$60,000, and offers to return the note and the stock.

If traditional contract rules were strictly applied, *W*'s promise would be fully enforceable. She has made a bargain, and none of the traditional contract defenses appears to apply. Undue influence, which might otherwise seem in point, traditionally requires a preexisting relationship between the parties.<sup>93</sup> It seems clear, however, that unfair persuasion should be a defense to a bargain promise whether or not the parties

---

<sup>91</sup> This phrase is drawn from RESTATEMENT (SECOND) OF CONTRACTS § 177 comment b (1979).

<sup>92</sup> See Cuming, *Consumer Protection — The Itinerant Seller*, 32 SASK. L. REV. 113, 114–15 (1967).

Conceivably, it could be deemed unconscionable to use bargaining methods that seriously impair the free and competent exercise of judgment even though there is no reason to believe the promisor's acquiescence will be merely transitory. However, if individuals are persuaded to form long-term beliefs that they are freely willing to plan and act upon, the courts should probably not become involved in reviewing the quality of the persuasion.

<sup>93</sup> For example, the *Restatement [First]* provided that:

Where one party is under the domination of another, or by virtue of the relation between them is justified in assuming that the other party will not act

had a preexisting relationship. Application of the bargain principle is not supported by the argument of fairness. A promisee who extracts a promise by the use of a bargaining method that seriously impairs the free and competent exercise of the promisor's judgment and creates a state of acquiescence that the promisee knows or should know is highly transitory, is as much at fault as a promisee who exploits a promisor's transactional incapacity. Indeed, he is more at fault, since he deliberately *creates* a kind of transactional incapacity.

Nor is application of the bargain principle supported by considerations of efficiency. That principle rests in substantial part on the premises that a bargain context induces a deliberative state of mind, and that a promisor cannot complain if he is required to pay a price that at least equals his subjective utility as revealed by the terms of his promise. These premises do not hold, however, when the promisee has used techniques calculated to move the promisor out of a deliberative frame of mind and to change the promisor's utility function in a way the promisee knows or has reason to know is only transitory. There is no efficiency reason for encouraging the production of manipulative talk.

Although the principle of unconscionability allows the courts to adopt the doctrine of unfair persuasion on analytical grounds alone, some support for the doctrine can be found even in existing case law. A good example is *Odorizzi v. Bloomfield School District*,<sup>94</sup> decided by the California District Court of Appeal in 1966. According to the complaint, Odorizzi, an elementary school teacher, had been arrested on criminal charges of homosexual activity. After he had been questioned by the police, booked, released on bail, and gone forty hours without sleep, two school district officials came to his

---

in a manner inconsistent with his welfare, a transaction induced by unfair persuasion of the latter, is induced by undue influence and is voidable.

RESTATEMENT [FIRST] OF CONTRACTS § 497 (1932). The commentary explained:

The protection given parties of the class included under the rule stated in this Section is broader than that given where parties bear no such relation to one another. . . . The relationships that ordinarily fall within the rule are those of parent and child, guardian and ward, husband and wife, physician and patient, attorney and client, clergyman and parishioner. In each of these cases, however, it is a question of fact whether the relationship in a particular case is such as to give one party dominance over the other, or put him in a position where words of persuasion have undue weight; and even though none of the relations enumerated above exist, if the relationship in fact was such that there was dominance or justifiable trust and confidence, the result is the same as if it were based on one of the relationships enumerated above.

*Id.* comment a; see also Green, *supra* note 69, at 180 ("Fraud may be . . . practiced upon a perfect stranger. Undue influence can exist only where one party occupies a position of dominance over the other." (footnote omitted)).

<sup>94</sup> 246 Cal. App. 2d 123, 54 Cal. Rptr. 533 (1966).

apartment. The officials advised Odorizzi that if he did not resign immediately he would be dismissed and his arrest would be publicized, jeopardizing his chances of securing employment elsewhere, but that if he resigned at once the incident would not be publicized. Odorizzi then resigned, and the criminal charges were later dismissed. The court held that on these facts Odorizzi was entitled to reinstatement. Undue influence, the court said, involves two aspects — undue susceptibility and undue pressure:

Undue influence in its second aspect involves an application of excessive strength by a dominant subject against a servient object. Judicial consideration of this second element in undue influence has been relatively rare, for there are few cases denying persons who persuade but do not misrepresent the benefit of their bargain. Yet logically, the same legal consequences should apply to the results of excessive strength as to the results of undue weakness. Whether from weakness on one side, or strength on the other, or a combination of the two, undue influence occurs whenever there results "that kind of influence or supremacy of one mind over another by which that other is prevented from acting according to his own wish or judgment, and whereby the will of the person is overborne and he is induced to do or forbear to do an act which he would not do, or would do, if left to act freely."<sup>95</sup>

Support for a doctrine of unfair persuasion can also be found in rules that permit a buyer who has made a contract in his own home to rescind during a specified "cooling-off" period, typically three days. Such rules have been adopted by a number of state legislatures,<sup>96</sup> by the Commissioners on Uniform State Laws in the Uniform Consumer Credit Code,<sup>97</sup> by the Federal Trade Commission,<sup>98</sup> and by Congress with regard to home improvement contracts.<sup>99</sup> The diverse agencies

---

<sup>95</sup> *Id.* at 132, 54 Cal. Rptr. at 540-41 (quoting *Webb v. Saunders*, 79 Cal. App. 2d 863, 871, 181 P.2d 43, 47 (1947)); *accord* *Keithley v. Civil Serv. Bd.*, 11 Cal. App. 3d 443, 89 Cal. Rptr. 809 (1970); *see also* *Methodist Mission Home v. B.*, 451 S.W.2d 539 (Tex. Civ. App. 1970) (unwed mother surrendered child for adoption under pressure from officials of home for unwed mothers in which she was residing). In *Newman & Snell's State Bank v. Hunter*, 243 Mich. 331, 220 N.W. 665 (1928), which served as a loose model for *Troubled Widow*, the court refused to enforce the contract on the ground that there was no consideration.

<sup>96</sup> *See* *Hogan, Cooling-Off Legislation*, 26 BUS. LAW. 875, 878 (1971); *Sher, The "Cooling-Off" Period in Door-to-Door Sales*, 15 U.C.L.A. L. REV. 717 (1968).

<sup>97</sup> UNIF. CONSUMER CREDIT CODE § 3.502 (1974).

<sup>98</sup> 16 C.F.R. § 429.1 (1981).

<sup>99</sup> Consumer Credit Protection Act § 125, 15 U.S.C. § 1635 (1976) (amended, effective Apr. 1, 1982, by Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 612(a)(1), (3)-(6), 94 Stat. 132, 175-76 (to be codified at 15 U.S.C. § 1635(a)-(g))). A major rationale of these rules is that a

adopting these rules gave recognition to the problem of a transitory state of acquiescence produced by unfair means, and fixed a reasonable boundary line for determining the time within which such a state may be expected to lapse. The principle underlying these rules supports a comparable rule applicable to transactions outside the home.<sup>100</sup>

Two objections might be made to the doctrine of unfair persuasion, as here defined. First, it might be argued that the doctrine would permit review of any contract induced by advertising, since advertising often relies on an appeal to non-deliberative elements. This argument need not detain us. Unfair persuasion exists only where the promisee creates and exploits a state of acquiescence that he knows or should know is only transitory. In the case of advertising, time must normally elapse between persuasion and purchase. Accordingly, advertisers would normally have no reason to believe that their advertising would be effective unless it produced a more-than-transitory effect.

A second possible objection is that under the doctrine of unfair persuasion the courts could review any consumer transaction entered into as an immediate result of sales talk. This objection has weight, but it must be put in perspective. In the overwhelming bulk of transactions involving sales talk, there is no use of bargaining methods that seriously impair the free and competent exercise of judgment. Application of the doctrine could also be cut down by limiting its scope to cases in which the consumer makes known his change of heart fairly soon after the bargain, both by analogy to the cooling-off rules and because late objection implies that the seller's persuasion had more than a transitory effect.

---

consumer in his own home is subject to much more intense personal influence by the salesman than a consumer in the store: partly because it is often very difficult, in this marketplace, to break off the transaction; partly because the conventions of hospitality work against the consumer; and partly because door-to-door salesmen often specialize in high-pressure selling techniques. See UNIF. CONSUMER CREDIT CODE § 3.502 comments 1-2 (1974).

<sup>100</sup> The *Restatement (Second)* provides that:

Undue influence is unfair persuasion of a party who is under the domination of the person exercising the persuasion or who by virtue of the relation between them is justified in assuming that that person will not act in a manner inconsistent with his welfare.

RESTATEMENT (SECOND) OF CONTRACTS § 177(1) (1979). Section 177 is derived from *Restatement [First]* § 497, see *supra* note 93, and that provision, taken with its comments, admittedly seemed to contemplate a preexisting relationship. The language of § 177, however, might be interpreted to state two disjunctive tests — one hinging on an existing relationship, the other on domination. Under this interpretation, it would not be a very large step from § 177 to the doctrine of unfair persuasion, because often the intent and effect of unfair persuasion is to put the promisor at least temporarily “under the domination of the person exercising the persuasion.”

Assume, however, that in some cases it will be difficult to distinguish between normal sales talk and unfair persuasion, so that the doctrine of unfair persuasion would enable some consumers to back out of a transaction in which the persuasion was not actually unfair. Even under this assumption, the problem is not particularly worrisome. Observation suggests that reputable merchants commonly permit consumers to return unused merchandise for refund or credit. Accordingly, erroneous application of the doctrine of unfair persuasion in the consumer context would do no more than produce a result that is often obtainable from reputable merchants even without judicial intervention.

#### *D. Price-Ignorance*

One condition of a perfectly competitive market is a homogeneous marketplace in which cost-free information concerning price is readily available. When this condition is not satisfied and marketplaces are differentiated, the price of a homogeneous commodity in a given marketplace may be strikingly higher than the price at which the commodity is normally sold. For example, the *New York Times* recently reported as follows on a group of Manhattan stores, most of them clustered on Fifth Avenue, which apparently specialize in one-shot sales, often to tourists:

[S]uch shops . . . [offer] \$40 radios for \$80, \$30 calculators for \$95 and ivory and jade collectibles, so-called, at similarly inflated prices, according to cases cited by the New York City Department of Consumer Affairs.

. . . .  
 . . . [A] lawyer representing some of the leading stores . . . acknowledged that marked prices in his clients' stores might be high . . . but he said that a knowledgeable [sic] shopper could easily negotiate a better deal. "My clients will not allow customers to walk out unless they insist on paying less than cost," he maintained, suggesting that a store that paid \$50 for a radio and marked it to sell for \$100 would be willing to sell it to a shrewd customer for \$51. . . .

. . . .  
 In one shop, . . . [a salesman] offered a Sanyo RP-1900 AM radio for \$80 (list price \$39.95) and an RP-6700 AM-FM model for \$100 (\$59.95) . . . .<sup>101</sup>

---

<sup>101</sup> *On Fifth Avenue, Shoppers' Jungle*, N.Y. Times, July 9, 1980, at C1, col. 5, C9, col. 1. For further data, see the companion article, *'Good Price' Proves To Be No Bargain*, N.Y. Times, July 9, 1980, at C9, col. 1. These articles report that New York City adopted consumer regulations that require merchants not only to mark all goods with the current selling price, but also to disclose the manufacturer's list price if it is lower than the selling price.

Similarly, a number of cases have concerned door-to-door sales at a price more than twice as high as that charged for comparable commodities in conventional retail marketplaces. For example, in *Toker v. Westerman*,<sup>102</sup> People's Foods sold a stripped-down refrigerator-freezer for \$899.98 plus a credit charge, when the evidence showed that the normal retail price of this model was \$350-400 and that the most expensive model of comparable size, equipped with extra features, retailed for only \$500. In *Kugler v. Romain*,<sup>103</sup> Romain was engaged in selling door-to-door a set of books bearing a cash price of \$249.50, when the usual retail price for comparable books was approximately \$108-110.<sup>104</sup>

In analyzing whether the seller has acted wrongfully in such cases, we must first determine what accounts for the disparity between the contract price and the normal retail price. Let us begin with the Fifth Avenue stores described in the *Times* article. These sellers appear to offer little or no advantage over nearby stores that sell the same commodities at list price. Since no consumer would knowingly pay twice that price in the absence of such advantage, it seems clear that the price disparity in this case is based on the ignorance of some consumers concerning normal retail prices and on their assumption that further search is unnecessary because a merchant-seller's price for a homogeneous commodity is almost certainly representative of the prevailing price.

Accordingly, one method for dealing with such transactions would be to adopt a rule that a merchant who offers homogeneous commodities at fixed prices impliedly represents that the offered price is not strikingly disproportionate to its prevailing price at other readily accessible marketplaces — giving

---

<sup>102</sup> 113 N.J. Super. 452, 274 A.2d 78 (Union County D. Ct. 1970).

<sup>103</sup> 58 N.J. 522, 279 A.2d 640 (1971).

<sup>104</sup> Similarly, in *State v. ITM, Inc.*, 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966), ITM was engaged in an extensive door-to-door business in which it sold appliances at prices two to three times the normal retail price — for example, a Model 200 broiler at a cash price of \$499, while its normal retail price was \$199; a Model 300 broiler at a cash price of \$699, while its normal retail price was \$299; a central vacuum cleaner for \$749, while its normal retail price was \$350-400; and color television sets at an average price of \$999, while their average normal retail price was \$600-650. In *Jones v. Star Credit Corp.*, 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969), the seller sold a food freezer for \$900 plus a credit charge while the retail price of a comparable unit was \$300. See J. WHITE & R. SUMMERS, *HANDBOOK OF THE UNIFORM COMMERCIAL CODE* § 4-5 (2d ed. 1980). A study of door-to-door sales of cooking utensils which compared three lines sold at retail with three sold door-to-door found that the door-to-door prices were two to three times as high. Although the door-to-door lines were of higher quality than the retail lines, it is unlikely that much of the price differential was accounted for by differences in manufacturing costs. T. Fish, *The Direct Sale of Cooking Utensils*, 46-47 (1957) (M.A. thesis available in University of California, Berkeley, Graduate School of Business Library).

due weight to the merchant's tangible and intangible advantages over other merchants, its reputation, and the normal range of pricing variations.<sup>105</sup> On every aspect of a sale transaction except price, the old doctrine of caveat emptor has given way to the doctrines that a seller will be held to his express representations and that the very act of sale gives rise to implied warranties. The theory of caveat emptor was that the obligation to ensure quality was on the buyer; to put it differently, that it was the buyer's task to search for defects in the product. The buyer therefore absorbed the loss if he did not search or searched inadequately. The theory of implied warranty, on the other hand, is that holding out a product for sale creates certain expectations in a buyer — for example, that the goods are fit for the ordinary purposes for which such goods are used<sup>106</sup> — and that these expectations should be protected unless the seller has explicitly negated them.

Caveat emptor might be viewed as justified in its day if we assume that when this doctrine prevailed, buyers had little or no confidence in sellers and therefore had no expectation of quality beyond such expectations as arose from their own search. In a modern economy, however, buyers place confidence in merchant-sellers regarding a great variety of product attributes, and most merchants work hard to engender and maintain that confidence. So too with price. At one time, perhaps, buyers viewed every sale transaction as an occasion for haggling and had no expectations concerning price beyond those engendered by their own search. Today, however, haggling is the exception, not the rule, and it seems clear that in most consumer marketplaces the quotation of a price, like other statements made by a seller, is understood to convey information. This information, in turn, raises certain expectations and implicitly gives rise to certain representations.<sup>107</sup> In particular, it would conform to modern understanding to adopt a rule that a merchant who offers a homogeneous commodity at a fixed price impliedly represents that the price is not strikingly disproportionate to that at which the commodity

<sup>105</sup> See Thayer, *supra* note 17 at 337.

<sup>106</sup> U.C.C. § 2-314(1), (2)(c) (1977).

<sup>107</sup> For example, in an English experiment:

[I]nvestigators . . . handed to the subject for inspection . . . a good quality plain Wilton carpet, and . . . were instructed to explain that it was of pure wool, available in a wide range of shades and in all sizes. The actual price (not communicated to the investigators) was 72s. per square yard. . . . Whereas prices in the 40s. to 50s. range elicited about 60 per cent of 'buy' responses, only about half of this percentage was still interested in the 20s. to 30s. range.

Gabor & Granger, *Price as an Indicator of Quality: Report on an Enquiry*, 33 *ECONOMICA* 43, 51 (1966). The obvious conclusion was that "considerable proportions of the subjects trusted price rather more than the evidence of their senses." *Id.*



is normally sold in readily accessible marketplaces, giving due weight to the merchant's relevant advantages, reputation, and normal price variations.

Under such a rule, however, whether the seller knew or had reason to know that the price quotation was strikingly disproportionate would be irrelevant. The rule would therefore not be based on a concept of fault, and accordingly would go beyond the concept of unconscionability. For now, it is not necessary to go that far. Instead, it suffices to adopt the fault-based doctrine that it is unconscionable for a merchant to exploit a consumer's price-ignorance by offering a homogeneous commodity at a price he knows or has reason to know is strikingly disproportionate in the stated manner. Application of the bargain principle to such cases is unsupported by either of that principle's two major props. Fairness does not support application of the principle, since the promisee has violated conventional morality by making a kind of misrepresentation and by exploiting the promisor's ignorance of a body of cheaply acquired and readily available knowledge (as opposed to knowledge that is generated by the promisee's own skill and diligence). Efficiency considerations are at worst neutral: since the commodity is by hypothesis selling at a much lower price in comparable marketplaces, it hardly seems likely that the higher price is required to move the commodity to its highest-valued uses or to allocate properly the factors necessary for its production. Indeed, it is arguable that by reducing wasteful search, a prohibition on exploitation of price-ignorance would lead to greater efficiency than would enforcing the bargain to its full extent. A consumer who knows that the law prohibits a merchant from charging a price for a homogeneous commodity that the merchant knows or should know strikingly exceeds the prevailing price in comparable marketplaces can make a more or less informed decision on whether the likelihood of finding a moderately lower price justifies the cost of searching for such a price. In contrast, a consumer who knows that the law does not prohibit such behavior may feel constrained to search several marketplaces for every purchase, lest he be exploited in the first marketplace.

Thus far, no assumption has been made concerning the seller's profits. Is the argument affected if the seller's profits are not above normal? To explore this issue, let us return to door-to-door sales at prices very much higher than those charged for comparable goods at conventional retail outlets, which I shall refer to hereinafter as high-price door-to-door selling. Assume, for purposes of argument, that high-price door-to-door sellers do not earn above-normal profits. In that

case, they are recovering their costs but not much more, and their high prices must therefore reflect high costs. This in turn raises two issues. First, can prices be deemed unconscionable if the seller is only covering its costs, including a fair return? Second, if a high-cost seller is making only normal profits, can it not be inferred that the costs are translated into consumer benefits? The two issues are intimately connected, since if the seller's costs are completely translated into consumer benefits, its price can hardly be deemed unconscionable.

To address these issues, consider two possible models of high-price door-to-door selling. Under one model, prices are high because these sellers offer nonprice benefits that consumers value to the extent of the difference between the contract price and the normal retail price. In particular, these sellers may bring to a buyer's attention information the buyer did not previously have — for example, that a certain type of product exists.<sup>108</sup> Under this model the sellers' high prices are justified, since the consumer is paying for both a commodity and a special service. Indeed, it might be argued that any lower price would be economically inefficient. If sellers were forced to charge a lower price, some or all would have to withdraw from the business.<sup>109</sup> To the extent such sellers are engaged in the provision of information, their withdrawal would result in the provision of less information. Potential buyers who would have valued the commodity at an amount as high as or higher than the price actually charged would therefore be deprived of the utility derived from making the purchase.<sup>110</sup>

The second model is much less flattering. Under this model, high-price door-to-door firms are not selling information, but searching out and exploiting price-ignorant buyers.<sup>111</sup> Each completed sale has a very high cost because each salesperson must spend considerable time and effort searching for

---

<sup>108</sup> See Comment, *supra* note 90, at 1176. Another type of information provided may concern the attributes of the product; salespersons in conventional retail outlets are uninterested in providing time-consuming demonstrations. See, e.g., M. JONES, *THE MARKETING PROCESS — AN INTRODUCTION* 167 (1965); T. Fish, *supra* note 104, at 17.

<sup>109</sup> That is, if the prices of a high-price, door-to-door seller just cover its costs (including a fair profit), it could not remain in business if it had to charge lower prices.

<sup>110</sup> See Comment, *supra* note 90, at 1176.

<sup>111</sup> The activity of shoppers in conventional retail marketplaces will usually (although not always) keep prices in such marketplaces competitive. See Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979). Sellers therefore have an incentive to try to seek out buyers who do not frequent normal retail marketplaces, and going door-to-door is one way to do this.

uninformed buyers. The cost of that time and effort is subsidized by completed sales.

It seems likely that the second model describes high-price door-to-door selling better than the first. It is hard to believe that a consumer operating from behind the veil would value the benefits of high-price door-to-door selling to the extent the first model presupposes. (That is, if consumers were given a choice between: (1) no visits by high-price door-to-door sellers, at the cost of occasionally missing out on information concerning new commodities; or (2) periodic visits, at the cost of unknowingly paying twice or more the normal retail price of a commodity on occasion, it is hard to believe that many would choose the second alternative.<sup>112</sup>) If this is true, refusing to enforce contracts with high-price door-to-door sellers to their full extent would not necessarily reduce the satisfaction of buyers as a class, even if some sellers were forced out of business. Call a high-price door-to-door seller who is forced out of the market by a rule against exploitation of price ignorance *S<sub>1</sub>*. By hypothesis, products comparable to the commodity sold by *S<sub>1</sub>* are available in other marketplaces, and the buyer would purchase in those marketplaces if he had the relevant information. It seems likely that many of the persons who would buy the commodity from *S<sub>1</sub>* would sooner or later visit one of these marketplaces and discover the commodity and its normal retail price. In effect, *S<sub>1</sub>* is engaged in intercepting such persons before they have undertaken a price search themselves. For those buyers, at least, the withdrawal of *S<sub>1</sub>* from the door-to-door market would result in *increased* utility whenever the difference between the price charged by *S<sub>1</sub>* and the normal retail price exceeded the utility lost by not having the use of the commodity between the date on which the buyer would have purchased it from *S<sub>1</sub>* and the date on which the buyer actually purchased it. To this differential must be added the amount of wasteful search, by those buyers who would like to deal with door-to-door sellers, that can be forgone under a doctrine prohibiting exploitation of price-ignorance by such sellers.<sup>113</sup>

---

<sup>112</sup> See T. Fish, *supra* note 104, at 69 ("It appears . . . [that the] absence of comparative merchandise at the point of sale is one of the most important advantages to the direct-selling cooking utensil companies.").

<sup>113</sup> Another possible service that may be provided by high-price, door-to-door sellers is to aid people who do not like to shop in conventional retail outlets. See S. TERKEL, *WORKING* 132-39 (1974); *Knock, Knock*, *FORBES*, Aug. 1, 1971, at 26. It seems unlikely that even such people would knowingly pay more than twice the normal retail price. If, however, they would, prohibiting exploitation of price-ignorance would not prevent selling to them at those prices, because they would buy even if the

In short, if, as seems likely, the second model describes high-price door-to-door sales better than the first, the fact that such sellers earn only normal returns becomes irrelevant. In terms of fairness, conduct may be exploitive even if it does not produce above-normal returns. In terms of efficiency, profits are normal only because the seller incurs the socially wasteful cost of searching out and intercepting the price-ignorant. Even if the seller's prices do provide only a fair return on investment, the investment is not one that the law should promote by enforcing a recovery that reimburses those unproductive costs.

A doctrine prohibiting the exploitation of price-ignorance is sufficiently justified by the principle of unconscionability. In addition, it is but a modest extension of section 5.108(4)(c) of the Uniform Consumer Credit Code, which provides that in determining whether a consumer credit sale is unconscionable, consideration shall be given to "gross disparity between the price of the property or services sold . . . and the value of the property or services measured by the price at which similar property or services are readily obtainable in credit transactions by like consumers."<sup>114</sup> The doctrine also finds support in the results of cases involving door-to-door selling. For example, in *Toker v. Westerman*,<sup>115</sup> the buyer had purchased a freezer for \$899.98 plus a credit charge. The retail price of comparable units was \$350-400. Buyer made payments of \$655.85 and then stopped, and seller's assignee sued for the remaining balance. The court held that the seller and his assignee had already received a reasonable sum, and gave judgment to the buyer. Similarly, in *Jones v. Star Credit Corp.*,<sup>116</sup> the buyer had purchased a food-freezer for \$900 plus a credit charge of over \$400. The retail price of a comparable unit was \$300. Buyer paid \$619.88 and then brought suit to reform the contract. The court ordered that the contract be reformed by changing the price to the amount the buyer had paid.

Finally, the doctrine is supported by — and helps rationalize — the language of door-to-door cases in which the courts stressed that the contract price far exceeded the retail price in conventional marketplaces, and concluded that "exorbitant price . . . makes this contract unconscionable and therefore

---

seller disclosed the price differential, and disclosure would negate the element of exploitation.

<sup>114</sup> UNIF. CONSUMER CREDIT CODE § 5.108(4)(c) (1974).

<sup>115</sup> 113 N.J. Super. 452, 274 A.2d 78 (Union County D. Ct. 1970).

<sup>116</sup> 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969).

unenforceable";<sup>117</sup> that it is "unconscionable . . . [to sell] goods for approximately 2½ times their reasonable retail value";<sup>118</sup> or that "the value disparity itself leads inevitably to the felt conclusion that knowing advantage was taken of the plaintiffs."<sup>119</sup>

### III. EXECUTORY BARGAINS

Part I showed that in the case of a half-completed-bargain promise, there are normally very strong reasons for applying the bargain principle, which requires the defendant to pay the agreed-upon price for a bargained-for performance that has been rendered and received. Part II considered limits that should be placed upon that principle when the plaintiff acted unconscionably. These limits might be thought of as substantive, in the sense that they relate to the quality of the bargain. In this Part it will be assumed that the plaintiff did not act unconscionably, but that the defendant broke or repudiated a bargain promise while the bargain was wholly executory, that is, when neither party had begun performance.

At least at first glance, the case for enforcement of such promises to their full extent through the award of expectation damages seems weaker than when the bargain has been half-completed. True, deliberativeness is as likely as in the half-completed bargain, and the concern for evidentiary security is at least partially met by the Statute of Frauds and the relative difficulty of fabricating a bargain promise.<sup>120</sup> Unlike the half-completed transaction, however, performance has been neither rendered nor received. Accordingly, both the interests of the plaintiff and the injustice of nonenforcement may seem relatively slight.<sup>121</sup> On closer inspection, however, it can be seen

---

<sup>117</sup> *Toker v. Perl*, 103 N.J. Super. 500, 503, 247 A.2d 701, 703 (Law Div. 1968), *aff'd per curiam on other grounds*, 108 N.J. Super. 129, 260 A.2d 244 (App. Div. 1970).

<sup>118</sup> *Toker v. Westerman*, 113 N.J. Super. 452, 454, 274 A.2d 78, 80 (Union County D. Ct. 1970).

<sup>119</sup> *Jones v. Star Credit Corp.*, 59 Misc. 2d 189, 192, 298 N.Y.S.2d 264, 267 (Sup. Ct. 1969); *see also State v. ITM, Inc.*, 52 Misc. 2d 39, 53, 275 N.Y.S.2d 303, 321 (Sup. Ct. 1966) ("These excessively high prices constituted 'unconscionable contractual provisions.'"), *discussed supra* at note 104.

<sup>120</sup> For example, it would be suspicious if there were no record of the bargain at all, if the parties had no reason for coming together in a contract, or if an undocumented bargain was made at a highly disadvantageous price.

<sup>121</sup> Thus, Professor Atiyah argues that the grounds for imposing liability for any "promise-based" obligations are weak, and comes close to arguing that wholly executory contracts ought not to be enforceable. P. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 1-7, 754-64 (1979). The argument is based on a division of enforceable promises into three categories: "benefit-based," in which a price has been

that three strong justifications, based on fairness and efficiency, normally support the application of the bargain principle even to executory contracts.

---

paid for the promise (largely equivalent to what I have called half-completed bargains); "reliance-based," in which a party has acted in reliance on a promise; and "wholly executory," in which the promise has been neither paid for nor relied upon. Although Professor Atiyah's theses are based principally on English law, it is profitable to examine them in light of American contract principles.

(i) In the benefit-based case, Atiyah argues, liability does not rest on promise, but on benefit conferred. The only function of the promise is evidentiary. "If, for example, a price has been agreed this will obviously provide evidence (often conclusive evidence) of what is a fair price and the court will be spared the necessity of fixing the price itself." *Id.* at 753. As a description of American contract law, this argument would certainly be wrong. If it were right, then whenever *A* sued *B* for breach of a half-completed bargain, seeking to measure damages by the agreed-upon price, *B* would be permitted to introduce counterevidence of fair value. The jury would then be instructed to measure *A*'s recovery by the fair value of *A*'s performance on the basis of all the evidence, including the promise. But that is not what happens. Nor should it, *see supra* pp. 745-46, in the absence of unconscionability, and in the case of unconscionability the promise is not even evidence of fair value. (The problem is not dispelled by suggesting that the promise may often be "conclusive" evidence, because that approach is functionally equivalent to saying that liability is based on the promise.)

(ii) In the reliance-based case, Atiyah makes a comparable argument: liability does not rest on the promise, but on reliance. To support this argument, Atiyah points out that conduct alone may give rise to an action based on reliance. "For instance, a person who buys a new house, in reliance on the proper performance by the local authority of its duties of ensuring compliance with the Building Regulations, may have a remedy against the authority for malperformance even though they give no promise." *Id.* at 2. This argument, however, rests on a non sequitur. That the law sometimes grants recovery for reliance on conduct alone in no way demonstrates that liability for a relied-upon promise is not promise-based. When liability rests on reliance, the reliance must be based on a legitimate expectation. If the expectation is based on conduct, it is conduct-based. If it is based on promise, it is promise-based. As a matter of American law, the argument would also be wrong. An examination of promissory estoppel cases will show that, in most such cases, without a promise there would be no liability. Furthermore, in the case Atiyah describes, liability does not seem to rest on reliance at all; would the plaintiff be out of court if he were new in town and did not know the regulations?

(iii) As to executory contracts, Atiyah argues in part that, "[i]f benefit-based and reliance-based liabilities are taken as the paradigm cases of obligation, whether legal or moral, it may be suggested that promise-based liabilities are neither paradigmatic nor of central importance." *Id.* at 4. This argument is also a non sequitur. The fact that a transaction is not "paradigmatic" or "of central importance" provides no guidance concerning how the law should treat the transaction when it does occur. A further argument is that, based on a change in social values, especially in England, as an empirical matter executory contracts are coming to be regarded as unenforceable unless relied upon. *Id.* at 5-6. This argument has force when applied to questions of damage measures in particular transaction-types, *see infra* pp. 792-98. However, for the reasons given below, *see infra* pp. 787-92, it lacks force (at least in the United States) when applied to executory contracts as a class.

It is of course true that the law does not enforce promises as such. If it did, there would be no doctrine of consideration. The law does, however, enforce classes of promises that ought to be enforced for functional reasons. Bargain promises are one such class.

First, fairness normally requires that a promisee should at least be compensated for the cost he incurred in reasonably relying on a bargain promise. As will be shown below, in many transaction-types enforcement of an executory contract to its full extent is desirable on the ground that expectation damages are approximately equal to cost, but much easier to measure.<sup>122</sup> I shall call this justification the surrogate-cost theory.

Second, a contract for forward delivery typically is made with the purpose of enabling the parties to plan their future conduct reliably. Efficiency normally requires that such planning should be facilitated. The award of expectation damages conduces to that end by making breach unprofitable in the normal case.<sup>123</sup> I shall call this justification the planning theory.

Third, when a contract is made for forward delivery at a fixed price, it is frequently a purpose of the contract to allocate the risk of price changes. Efficiency normally requires effectuating this allocation, and that is just what is done by expectation damages. Risk allocation also implicates considerations of fairness. As Sharp observed:

[T]his is not only an industrial and credit economy, but also a risk taking, profit making, more or less gambling economy. This may mean not only that harmful reliance, in fluctuating markets, is best remedied by expectation damages, but also that the profits dependent on good guesses about the future are generally to be assured to the person who is willing to gamble on his judgment.<sup>124</sup>

To put this differently, when parties gamble on market movements and the market does in fact move, the contract is in a sense half-completed rather than executory, and the breaching promisor is like a gambler who welshes on his bet. I shall call this justification the risk theory.<sup>125</sup>

The balance of Part III will consider the extent to which these theories support the application of the bargain principle

---

<sup>122</sup> See Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 60 (1936).

<sup>123</sup> See Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 278-79 (1972).

<sup>124</sup> Sharp, *Promissory Liability* (pt. 1), 7 U. CHI. L. REV. 1, 21 (1939). This point is developed further in Simon & Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1436-37 (1979).

<sup>125</sup> The last two theories tend to merge at their margins, but they reflect two operations, risktaking and planning, that operate independently and should be analyzed that way.

to executory contracts, and the conditions under which it is appropriate to place limits on the full reach of that principle even in the absence of unconscionability. These issues will be discussed in the context of selected transaction-types involving four variables — whether the commodities concerned were goods or services; whether they were homogeneous or differentiated; whether the contract was breached by the buyer or the seller; and the nature of the parties. As in Part II, the cases considered are intended to be suggestive, not exhaustive.

A note on the terminology: For ease of exposition, the term “replacement price” will be used to mean the price payable under a substitute contract.<sup>126</sup> Replacement price may be established by extrapolation from prices in similar transactions (market price), by the price actually paid by the buyer in a substitute purchase (cover price), or by the price actually received by the seller in a substitute sale (resale price). The term “forgone price” will be used to mean the best price that was available from an alternative buyer or seller on the date of the contract (or, in appropriate cases, between the contract date and the breach date). It will be assumed in all cases that no performance occurs before the breach.

*A. Sale of Relatively Homogeneous Goods by a Dealer to a Business Concern, with Breach by Seller*

Take first a contract for the sale of relatively homogeneous goods in which the seller is a dealer, the buyer is a business concern, and the seller breaches, as in the following hypothetical:

*Paper Buyer I.* Seller is in the business of selling office supplies to large users. Buyer is a financial corporation. On May 1, Seller and Buyer enter into a contract for the sale of one hundred ten-ream cases of a standard grade of typing paper at a price of \$4,000, delivery on July 1, payment on August 1. On July 1, Seller repudiates.

The argument for applying the bargain principle in cases like *Paper Buyer I* is very strong. The buyer's expectation damages in such a case are normally measured by the differ-

<sup>126</sup> Ordinarily, replacement price should be figured on the basis of the price, on the date the innocent party learns of the breach, for delivery on the date set under the original contract. The law sometimes appears to deviate from this approach by requiring the replacement price to be measured on the date set for delivery. See U.C.C. § 2-708(1) (1977). These deviations, however, do not affect the basic argument in the text and will be disregarded.



ence between the replacement price and the contract price<sup>127</sup> — a type of measure that will hereinafter be called a replacement-price formula. But a recovery that measured the buyer's damages by cost (the reliance measure) would usually be just as great. This is because the market for relatively homogeneous goods normally has continuity and depth — that is, purchases and sales can normally be made at any time, in significant quantities, at a price very close to the price at which the last such transaction was closed. It can therefore normally be presumed that if the buyer had not made his contract with the breaching seller, he would have made a contract on the contract date with some other seller, who would have performed.<sup>128</sup> By contracting with the breaching seller, the buyer lost the opportunity to make that other contract. The buyer's cost, as measured by his forgone opportunity, equals the difference between the replacement price and the forgone price. Given the nature of the market, however, the forgone price will normally equal the contract price. Accordingly, application of the bargain principle can be justified in such cases under the surrogate-cost theory, on the ground that the buyer's expectation damages will normally equal his cost or reliance damages and are much easier to determine.<sup>129</sup>

The planning and risk theories point the same way. Business firms make forward purchase contracts at fixed prices to ensure supply and to shift the risk of price changes from the buyer to the seller. A replacement-price formula helps ensure supply by making breach unprofitable, and effectuates the intended shift of risk.

### *B. Sale of Highly Differentiated Goods by a Dealer, with Breach by Buyer*

Take now the sale of highly differentiated goods by a dealer, with breach by the buyer, as in the following hypothetical:

---

<sup>127</sup> See *id.* § 2-713. The buyer's damages may include other elements, such as incidental damages. However, since this Article is basically concerned with the enforceability of promises, I shall omit discussion of those nuances in the law of damages that do not affect the basic argument.

<sup>128</sup> The presumption that the other seller would have performed is based on two grounds: (1) The reason for breach is often unique to the original seller — for example, his costs may have become peculiarly high, or a supplier may have failed him. (2) Parties to a bargain will normally perform rather than breach, even in the absence of legal compulsion, because of the economic importance of reputation and their altruistic regard for the morality of promise keeping. See Eisenberg, *supra* note 4, at 2-3.

<sup>129</sup> See Fuller & Perdue, *supra* note 122, at 62-63.

*Ulysses*. On June 15, Seller, a rare-book dealer, enters into a contract with Buyer for the sale of a mint first edition of *Ulysses*, which Seller owns, at a price of \$5000, delivery on July 1. On July 1, Buyer refuses to accept delivery and repudiates the contract.

As in *Paper Buyer I* the seller's expectation damages in such a case are normally measured by a replacement-price formula.<sup>130</sup> The surrogate-cost theory is not quite as strong as in cases like *Paper Buyer I*. Assume that on July 1, the replacement price for a mint first edition of *Ulysses* (measured, say, by resale price) is \$4600. Expectation damages (\$400) may then exceed the seller's opportunity cost. That cost is measured by the difference between the replacement price and the forgone price at which the book could have been sold between June 15 and July 1. However, because markets for highly differentiated goods often lack both continuity and depth, the forgone price in cases like *Ulysses* will often be highly uncertain. It may be that the forgone price for a mint first edition of the book during the relevant period was \$5000, but perhaps it was not, and when the commodity is highly differentiated, it will often be unclear which is the case. Nevertheless, the seller can argue that but for the contract with the buyer he might have made efforts to sell the commodity during the period between contract date and date of breach, and might have been able to make a sale at a price equal to the contract price. The seller may be unable to prove that he would have made this effort or would have obtained that price. This inability, however, results from the very fact that the buyer's promise diverted the seller from probing the market after the contract date. The buyer should therefore bear the consequences of the resulting uncertainty.

Efficiency considerations point the same way, although again not with quite the same force as in *Paper Buyer I*. Parties in the positions of Buyer and Seller normally realize that the price of a commodity like *Ulysses* is uncertain and speculative. When the contract is made, it therefore normally reflects an intent to allocate the risk of misjudgment of market value, changes in market value, or both. Furthermore, firms like the dealer in *Ulysses* must be able to plan on a reliable basis. One element of such planning is the ability to arrange their affairs as if their contracts will be performed. This ability would be seriously diminished if damages for breach in cases like *Ulysses* were based on the difference between contract

---

<sup>130</sup> See U.C.C. §§ 2-706, -708 (1977).

price and forgone price, just because the latter is so difficult to establish.

*C. Sale of Relatively Homogeneous Goods by a Dealer to a Business Concern, with Breach by Buyer*

Next consider a contract for the sale of relatively homogeneous goods by a dealer to a business concern, as in *Paper Buyer I*, but with breach by the buyer rather than the seller:

*Paper Buyer II.* Same facts as *Paper Buyer I* (sale of one hundred ten-ream cases of a standard grade of typing paper for \$4,000, delivery on July 1), except that Buyer rather than Seller repudiates on July 1.

Although the variation from *Paper Buyer I* may seem minor, it has major implications. As shown above in Section A, when the seller breaches in a case like *Paper Buyer I*, expectation damages measured under a replacement-price formula are almost certain to equal damages based on cost. When the buyer breaches, however, expectation damages measured under this formula may well exceed damages based on cost. When goods are in relatively unlimited supply, as is typical of relatively homogeneous goods, entering into a contract with any given buyer normally does not cause a dealer to forgo an opportunity to make a comparable contract with another buyer. Accordingly, the dealer's opportunity cost is likely to be zero. So too may be its out-of-pocket cost. In contrast, its expectation damages under a replacement-price formula may be substantial if the market is falling.

Nevertheless, such damages may easily be justified. The very purpose of contracts like that in *Paper Buyer* is normally to allocate the risk of changes in market price. Application of the replacement-price formula can therefore be justified on the grounds that it both effectuates this purpose and facilitates the seller's planning. Damages under a replacement-price formula may also be justified under the surrogate-cost theory. The dealer's contracts of sale are likely to play a significant role in his management of his own inventory and his purchase commitments. Therefore, assuming replacement price declines after the contract date (if it does not, there is no problem), the dealer is likely to suffer a directly related loss, of approximately the same amount, in the value of his inventory or under his contracts of purchase. Of course, the two figures may not be precisely equal, and in some cases the dealer may not have any loss at all. Accordingly, the law could simply require the dealer to prove affirmatively both the existence and amount of

such a loss. Still, a replacement-price formula is justifiable, because it is quite likely the dealer will suffer a related loss of approximately the same amount, but quite difficult to match that loss with the contract of sale.

However, in a case like *Paper Buyer II* the dealer also has the right to measure his damages by the difference between the contract price and his actual or projected out-of-pocket cost.<sup>131</sup> I shall hereinafter refer to this type of measure as a net-proceeds formula. (I use the term "net proceeds" rather than the more conventional "lost profits," because the formula reimburses for lost contribution to overhead as well as for lost profits. For example, suppose that the one hundred cases of paper, to be sold for \$4000, cost Seller \$3,000, and that all his other costs are fixed. His recovery under a net-proceeds formula would be \$1000, even though a cost accountant would say that his profit is less because some portion of his fixed costs should be allocated to the sale.) This formula must certainly be available to a dealer as a measure of his expectation damages, if such damages are to put him in as good a position as if the contract had been performed. This is because: (1) if the contract had been performed, the dealer would have been ahead by an amount equal to the contract price minus his out-of-pocket cost,<sup>132</sup> and (2) the dealer usually cannot replace this loss by making another contract, since normally any contract he makes after the breach would have been made even if the breach had not occurred.<sup>133</sup>

---

<sup>131</sup> See *id.* § 2-708(2).

<sup>132</sup> See Childres & Burgess, *Seller's Remedies: The Primacy of UCC 2-708(2)*, 48 N.Y.U. L. REV. 833, 881-82 (1973) (arguing that a lost profits — i.e., net proceeds — formula is more appropriate than a replacement-price formula in such cases).

<sup>133</sup> See, e.g., *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 285 N.E.2d 311, 334 N.Y.S.2d 165 (1972).

Several commentators have argued that, as a matter of economic theory, a net-proceeds formula is not required in order to place the dealer in as good a position as he would have been in had the contract been performed. See, e.g., Goetz & Scott, *Measuring Seller's Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979). These arguments, however, are based on models that fail to correspond with business reality. For example, Goetz and Scott begin by arguing that, "[i]n a purely competitive market," any sale made by the seller after the buyer's breach "is a replacement for the breached contract," so that the seller will incur no "lost volume" (i.e., lost proceeds) as a result of the breach. *Id.* at 333. (The theory behind the argument is that if a seller can sell only a limited number of units, and is able to sell that number despite the breach, his proceeds are the same with or without the breach. The authors argue that this is the case in a perfectly competitive market, because in such a market a seller will sell only an optimal number of units — specifically, a number such that the seller's marginal cost of the last sale equals the price of the last unit sold. Since

Nevertheless, this application of the bargain principle may seem too extreme. It would normally not be justified by the surrogate-cost theory: a recovery measured under the net-proceeds formula must by hypothesis exceed out-of-pocket cost and must also exceed a recovery under the replacement-price formula, since otherwise the seller would invoke the latter measure. It may be that the seller would not have entered into the contract unless he was assured of a return equal to net proceeds; and at least if the buyer is or should be aware of that fact, it might be said that the parties had allocated not only the risk of movement in the market price, but also the risk involved in assuring such a return. That such an allocation is intended, however, is far from clear. And while application of a net-proceeds formula will admittedly facilitate planning, since the higher the damages the more likely that performance will take place, the added stimulus provided by this formula, in cases like *Paper Buyer II*, might well be deemed excessive. In a somewhat analogous case, a study of the contract practices of nineteen English engineering manufacturers found:

---

the seller will sell that number with or without a breach, the breach causes no lost proceeds.)

This argument assumes a completely unrealistic level of planning. Goetz and Scott themselves admit that "[t]he perfectly competitive model is too simple for the real world," partly because "a firm's marginal operating costs in many cases may be nearly constant over wide ranges in output." *Id.* at 335-36. Accordingly, they invoke a second model, in which the seller has some power over price. Here again they admit that "a seller operating under constant marginal cost conditions will sustain classic lost volume from a buyer's breach." *Id.* at 340-41. However, they argue, such sellers sell in two distinct markets, one involving fixed contracts for future commitments and the other involving spot sales; buyers may also sell (that is, resell) on the spot market; and if a contract buyer cancels, the risk that he will resell in the spot market is removed. They conclude, "[I]n a frictionless environment [that is, one in which the buyer will be able to resell the purchased goods in the spot market under the same conditions the seller faces, and there are no costs to the buyer associated with the resale] a breach of B units [by a 'contract' buyer] produces a corresponding shift of B units in the seller's demand curve . . . [and] will actually place the seller in a better position than had the buyer performed." *Id.* at 341-42 & n.45. In footnotes, however, the authors make qualifications that almost entirely vitiate the argument. They admit that, "[b]ecause the model is developed in a frictionless environment, it is not surprising that few real-world applications of this phenomenon can be observed. Some positive transaction costs are associated with any breach. It is difficult to estimate how many sellers, in fact, do better by breach plus damages than by performance." *Id.* at 342 n.47. They also admit that "[t]he buyer's ability to resell in the seller's market is a central part of the thesis" and that "the observation may initially seem counter-intuitive." *Id.* at 344 n.50. To defend the observation, they can only observe that "the argument has been made successfully in one lost-volume case," *id.* — a rather thin defense for the fundamental premise of an economic model. For additional qualifications, see *id.* at 344 n.51.

In practice if a buyer cancelled before any work had been done or money spent on materials that could not be resold or used for other work a few firms would attempt to insist on payment of a cancellation charge, but most would not. In many cases the loss caused by such a cancellation would be slight, unless there was a shortage of work, and where a charge was made it often represented lost overheads, design costs, etc. On the other hand if work on the buyer's order had commenced even if the goods were standardized and could be resold, or if materials would be wasted, some charge would be made by all sellers and the buyers seemed to accept that sellers should be compensated for such a loss. There was less unanimity on whether the charge would include an element of profit, but most said that it would. However, the charge was usually made according to the machine time expended, and while the charge for machine time usually has a built-in profit element, it can only be profit on the work done.<sup>134</sup>

All these issues are brought into sharper focus in the next two transaction-types.

*D. Sale of Relatively Homogeneous Services or Goods by a Merchant to a Consumer, with Breach by Buyer*

Assume now a contract for the sale of relatively homogeneous services by a merchant to a consumer, as in the following hypothetical:

*Dance Lessons.* *E*, an electrical engineer, wants to learn to dance. *S* operates a dancing school. On May 1, *E* signs a contract with *S* to take Dancing 1, a group class, which begins on July 1. Dancing 1 meets two hours a week, runs twenty-six weeks, and costs \$500. *E* understands all the provisions of the contract and considered the matter in a deliberative frame of mind, but knows nothing about damage rules. On June 15, *E* changes his mind and repudiates.

*S* incurs little or no incremental out-of-pocket costs for group classes, since its instructors work on full-year contracts and it owns its own studios. *S*'s classes usually don't fill to capacity. The capacity of Dancing 1 is twenty students. On June 15, sixteen students had enrolled. No additional students enrolled thereafter.

When the buyer breaches a contract for the sale of services, the seller's expectation damages are normally measured under

---

<sup>134</sup> Beale & Dugdale, *Contracts Between Businessmen: Planning and the Use of Contractual Remedies*, 2 BRIT. J.L. & SOC'Y 45, 53 (1975) (footnote omitted).

a net-proceeds formula, that is, contract price minus the seller's out-of-pocket cost of performance.<sup>135</sup> On facts like those in *Dance Lessons*, however, performance by the seller does not entail any incremental out-of-pocket cost. Accordingly, the seller's expectation damages under a net-proceeds formula equal the entire contract price, despite the fact that the buyer has received no benefit.<sup>136</sup>

Such a recovery is not easy to justify under the surrogate-cost theory when the seller has incurred no cost in reliance on the buyer's promise. In considering whether it is justified by the risk theory, two related questions must be asked. The first question is, why would *E* make a contract on May 1, rather than wait until July 1? Consumers normally do not make contracts like that in *Dance Lessons* for the purpose of allocating the risk of price changes or speculating in the market for dancing lessons. Rather, the typical purposes of such advance contracting are to ensure supply (that is, to ensure a place in the class) and, perhaps, to make a self-commitment. The second question is, would the parties have agreed to a provision permitting the seller to measure damages under a net-proceeds formula if they had consciously adverted to the issue? Given the buyer's assumed motivation for contracting, the answer pretty clearly seems to be no. It is hard to imagine that a buyer like *E* would realize that damages would be measured this way by the courts. It is even harder to imagine that he would have agreed to a contractual provision measuring damages this way, simply to ensure a place in the class and make a self-commitment. (This conclusion is reinforced by the fact that if the seller can measure damages under a net-proceeds formula, the remedies for buyer and seller are highly disproportionate. If the buyer repudiates, the seller will recover the entire contract price. If the seller repudiates, however, the buyer will normally be limited to a replacement-price formula. Since the market value of dancing lessons is unlikely to change perceptibly over short periods of time, the recovery under this formula would normally be zero.) The seller, on its part, would be unlikely to insist on such a provision, just

<sup>135</sup> See, e.g., *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967); RESTATEMENT [FIRST] OF CONTRACTS § 346(2)(a) & comment h (1932) (construction services).

<sup>136</sup> *JJ & L Inv. Co. v. Minaga*, 487 P.2d 561 (Colo. App. 1971); *Leo Foundation, Inc. v. Kiernan*, 5 Conn. Cir. Ct. 11, 16, 240 A.2d 218, 221 (App. Div. 1967); *Fayman v. Trustees of Burlington College*, 103 N.J. Super. 476, 247 A.2d 688 (Ch. Div. 1968). But see *Educational Beneficial, Inc. v. Reynolds*, 67 Misc. 2d 739, 324 N.Y.S.2d 813 (Civ. Ct. 1971) (contract with commercial school charging \$600 non-refundable enrollment fee and \$7 per hour of instruction in uncompleted course held unconscionable).

because very few buyers would then be willing to contract with it.

The final question is whether a net-proceeds formula is required to enable a seller like *S* to plan effectively. This is an empirical issue on which firm evidence is lacking. However, random evidence suggests that firms selling services to consumers can plan effectively without being entitled to damages measured by a net-proceeds formula. For example, the problem raised by *Dance Lessons* is characteristic of any contract for tuition, and such contracts often involve relatively large amounts. Nevertheless, many and perhaps most schools provide for refunding tuition on a declining basis if the student drops out. Indeed, under FTC regulations, if a student in a proprietary vocational school cancels his enrollment contract, the "school shall not receive, demand, or retain more than a pro rata portion of the total contract price" plus a relatively small registration fee.<sup>137</sup> Large retail sellers seem more likely to plan for default under executory contracts through application of statistical forecasting techniques than through a program of litigation to recover damages under a net-proceeds formula. Even small firms seem unlikely to do much planning on that basis.

Most important, even assuming that planning does require a consumer in *E*'s position to suffer some loss, requiring such a consumer to pay damages equal to the entire contract price seems excessive to the task, particularly if it is assumed that the consumer would not have agreed to such damages at the time the contract was made. Rather, the seller's damages should be measured by what might be called a cancellation charge.<sup>138</sup> Such a recovery should be based on the amount necessary to reimburse the seller for incidental costs, to provide enough deterrent to facilitate planning, and to pay for the benefit of having had a place reserved. The measurement required need not be as difficult as it may seem, since the law could leave it to the seller to fix such an amount in the contract

---

<sup>137</sup> 16 C.F.R. §§ 438.0 to 2, .4 (1981). The retained registration fee may be \$25 or 10% of the contract price up to a limit of \$75, whichever is greater. *Id.* § 438.4(c). Similarly, airlines normally allow individuals who have booked reservations to return their tickets for refund even though they never canceled their reservations. See *Emergency Reservations Practices Investigation*, [1972-1978 Transfer Binder] Av. L. REP. (CCH) ¶ 22,206 (C.A.B. Apr. 13, 1976). For comparable practices in England, see P. ATIYAH, *supra* note 121, at 756-57.

<sup>138</sup> Cf. *Airlines Start Getting Tough on No-Shows*, Wall St. J., Dec. 9, 1981, at 33, col. 3 (\$20 fee for failing to cancel reservations at least 30 minutes in advance on New York Air's Boston-Baltimore-Orlando flights reduced no-shows on some Orlando flights to 5% from as high as 30%; United Airlines suggests \$10 administrative fee for refunding unused tickets).



by way of liquidated damages, or might treat a deposit by the buyer as a tacit cancellation charge even if the contract does not so provide. In this connection, the courts might draw by analogy on section 2-718(2)(b) of the Uniform Commercial Code, which provides, in effect, that when a seller justifiably withholds delivery of goods because of a buyer's breach, the buyer is entitled to restitution of any amount by which the buyer's payments exceeded twenty percent of the price or \$500, whichever is less.

Suppose in a case like *Dance Lessons*, the seller is operating at full capacity. If the seller reserves a place for the buyer, he may then turn away an alternative customer. If the defaulting buyer's place is not filled, the seller will have incurred an opportunity cost equal to the contract price. One way to handle this problem is to permit the seller to recover damages under a net-proceeds formula if he could shoulder the burden of proving these elements. However, if a buyer would probably not agree to this measure in advance, a net-proceeds formula might be inappropriate even in the full-capacity case, at least in the absence of a specific contractual provision to that effect. In any event, the likelihood that a given seller is both operating at full capacity and unable to replace the defaulting buyer may be too slim to justify a special rule for such cases.

Let us now apply this approach to a sale of relatively homogeneous goods by a merchant to a consumer, as in the following hypothetical:

*Buick Buyer.* *T*, a high school teacher, wants to buy a new Buick. After shopping around, *T* decides to buy at Seller's dealership, since Seller's price matches the lowest price available from competing dealers and Seller has a good reputation for servicing. On October 1, *T* signs a contract to buy from Seller a new Buick, with specified accessories, for \$10,000, delivery on December 1. On November 1, before the factory has begun to fill Seller's order for *T*'s car, *T* repudiates the contract. Seller's factory cost for the Buick ordered by *T* is \$8,500, and Seller can buy as many new Buicks from the factory as it sells.

Much the same analysis can be made in this kind of case as in *Dance Lessons*. Application of the bargain principle would permit the seller to recover under a net-proceeds formula. This is not as draconian as the application of that formula in cases like *Dance Lessons*: the seller's projected out-of-pocket cost is significant, and the recovery would therefore

be well below contract price. Nevertheless, the result is not easy to justify on the surrogate-cost theory, since the seller will have incurred little or no cost at the time of the breach. It is also not easy to justify on the risk theory. Consumers normally do not make contracts like that in *Buick Buyer* for the purpose of allocating the risk of price changes or speculating in the market for new cars, and a contract provision for such damages would probably be neither requested nor agreed to (particularly since the buyer's damages for seller's nondelivery, based on a replacement-price formula, would normally be very small since the market price of consumer goods normally does not change materially over short periods). The result might be justified on the planning theory, but it is doubtful whether full enforcement of executory contracts under a net-proceeds formula is really required for effective planning by sellers of consumer goods. Casual investigation suggests that few such sellers — including few new-car dealerships — bring suit for breach of executory contracts.<sup>139</sup>

It is of course possible that more consumers would breach executory contracts if it were known that a seller could not recover his net proceeds on a buyer's breach. That seems unlikely, however, because most consumers probably don't know that the seller might be entitled to measure damages this way. Damages for breach by a consumer of an executory contract to purchase relatively homogeneous services or goods should normally be measured by a replacement-price or cancellation-charge formula, even though such a rule places another limit on the fullest reach of the bargain principle.

#### IV. CONCLUSION

The first great problem of contract law — usually subsumed under the heading of consideration — is what *kinds* of promises the law should enforce.<sup>140</sup> This problem, however, is tightly linked with another: the *extent* to which a certain kind of promise should be enforced. Indeed, on a deep level the two problems are virtually inseparable. The proposition that promises made as part of a bargain ought to be enforced is relatively straightforward; the real question is to what extent.

The traditional answer to this question is embodied in the paradigmatic bargain principle, namely, that damages for the

<sup>139</sup> This assertion is based on a conversation with counsel for a large regional association of automobile dealers. This is not to say that such litigation is unknown.

<sup>140</sup> See 1A A. CORBIN, CORBIN ON CONTRACTS § 210 (1963); Eisenberg, *supra* note 4, at 1.

unexcused breach of a bargain promise should invariably be measured by the value that the promised performance would have had to the plaintiff, regardless of the value for which the defendant's promise was exchanged.

This principle, which in the typical case is supported by considerations of both fairness and efficiency, finds its fullest justification in the exemplary case of a half-completed bargain made in a perfectly competitive market. Bargains made in other kinds of markets are not intrinsically suspect. Nevertheless, that a market is less than perfectly competitive does set the stage for transactions in which the bargain principle loses much or all of its force, because it is supported by neither fairness nor efficiency. For example, a market that involves a monopoly sets the stage for the exploitation of distress; a market in which transactions are complex and differentiated rather than simple and homogeneous sets the stage for the exploitation of transactional incapacity; a market in which actors do not simply take a price established by a general market and are susceptible to transient economic irrationality sets the stage for unfair persuasion; a market that involves imperfect price-information sets the stage for the exploitation of price-ignorance.

Until recently, courts have tended either to apply the bargain principle to cases raising such problems, despite the difficulties this application presents, or to deal with these difficulties in covert and unsystematic ways. Over the past thirty years, however, a new paradigmatic principle — unconscionability — has emerged. This principle explains and justifies the limits that should be placed upon the bargain principle on the basis of the quality of a bargain.

Looking backward, the new paradigm enables us to reconstruct prior theory and phenomena by providing a general explanation for a wide variety of contract concepts that heretofore seemed distinct. So, for example, duress may now be seen as simply a special case of the exploitation of distress; undue influence may now be seen as simply a special case of unfair persuasion; and the prohibition against exploiting palpable unilateral mistake may now be seen as a specific norm of unconscionability.<sup>141</sup> Similarly, the apparent anomaly of review for fairness in courts of equity and admiralty can be explained by the new paradigm, while guidelines can now be set for that review; and the doctrine of general incapacity

---

<sup>141</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 153 (1979) (when mistake of one party makes contract voidable).

might be reformulated to apply only when exploitation is present.

Looking forward, the paradigm must be articulated and extended through the development of more specific norms to guide the resolution of specific cases, provide affirmative relief to exploited parties, and channel the discretion of administrators and legislators.<sup>142</sup> In accomplishing this task, it now appears that the distinction between procedural and substantive unconscionability, which may have served a useful purpose at an earlier stage, does not provide much help once the relatively obvious norms of unconscionability, such as unfair surprise, have been articulated. For example, it is both difficult and unproductive to classify as exclusively either "substantive" or "procedural" the problems posed by the extraction of an unduly high price from a person who is in distress, lacks transactional capacity, or is price-ignorant. Development of more specific norms must instead proceed by the identification of classes of cases in which neither fairness nor efficiency supports the application of the bargain principle — an effort that can be guided in part by the reconstruction and extension of existing contract doctrines.

Even where unconscionability is not present, application of the bargain principle may raise problems if the bargain is wholly executory at the time of breach, since in such cases a performance has, by hypothesis, been neither rendered nor received. Even in executory cases the bargain principle can normally be justified, despite the lack of performance, under the surrogate-cost, risk, or planning theories. In some transaction-types, however — particularly those involving breach by consumers in a contract for the sale of relatively homogeneous commodities — application of the bargain principle to its fullest reach, through a recovery measured under a net-proceeds formula, is supported by neither the surrogate-cost nor the risk theories, and results in damages that seem excessive to planning needs. In such cases the bargain principle should be limited by permitting the seller to measure damages only under a replacement-price or cancellation-charge formula.

Placing limits on the bargain principle is not cost-free. A major advantage of that principle, at least in theory, is its conceptual simplicity and the ease with which it can be administered. To apply the principle, it need only be determined whether a bargain was made, and if so, what remedy is required to put the innocent party in the position he would have been in had the bargain been performed. Development of

---

<sup>142</sup> See Dawson, *Unconscionable Coercion*, *supra* note 17, at 1044.

specific unconscionability norms and limitations on the full reach of the bargain principle in certain types of executory contracts make doctrine more complex by singling out certain transaction-types for special treatment. Administration is also made more complex and problematical by requiring decisions on such issues as whether a given course of conduct was exploitive or whether a given price was unfairly high.

The simplicity of the bargain principle, however, is partly a mirage. Concepts of fairness were smuggled into contract law even when the principle seemed most secure, through doctrines such as the legal-duty rule and the principle of mutuality. Partly because these doctrines are allowed to achieve their ends only in a covert fashion, they operate in an extremely technical manner and are riddled with legalistic exceptions. Furthermore, an increase in the complexity of some areas of law may be desirable, if it accurately mirrors the increased complexity of social and economic life. Placing limits on the bargain principle involves costs of administration. Failure to place such limits, however, involves still greater costs to the system of justice.