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Chapter 8

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CHAPTER 8

Contract Enforceability:
Protecting a Party
Against Overreaching

Chapter 8 deals with the second group of contract enforcement problems-ad hoc protection of an individual on a transaction by transaction basis. Four situations are discussed: adhesion contracts and unconscionability; fraud and misrepresentation; duress and undue influence; and a mistake in a basic assumption of fact.

The Road Map for Contract Enforceability: Protecting a Party Against Overreaching is Exhibit 8-1 (256).

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Adhesion Contracts

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Adhesion Contracts

ADHESION CONTRACTS AND UNCONSCIONABILITY (265)

The introductory material defines adhesion contracts-contracts in which one party imposes his or her terms on the other party. An attempt to negotiate by the offeree will be unsuccessful. The terms of the contract are presented on a take it or leave it basis. Although adhesion contracts are one sided, not all adhesion contracts are unenforceable.

This section focuses on one form of adhesion contract, the unconscionable contracts under UCC § 2-302. Note that the discussion of unconscionability is limited to the sale of goods. Although court findings of unconscionability are few and far between, common law unconscionability is even more difficult to find.

The time for determining unconscionability is at the time of contract formation and not at some later time. This principle applies for most other enforcement problems as well.

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Unconscionability under Common Law (257)

Unconscionability is generally recognized as an absence of meaningful choice coupled with unreasonably favorable terms. This means that one party has a substantial power over the other and takes advantage of this power. If this substantial power is not exercised in the form of unreasonably favorable terms, the terms of the contract are not unconscionable. Meaningful choice has two components: bargaining power and knowledge of the terms. A gross inequality of bargaining power can constitute absence of meaningful choice regardless of whether the other party had knowledge of the terms.

An inequality of bargaining power coupled with a lack of knowledge of the terms can constitute absence of meaningful choice regardless of whether the inequality of bargaining power was less than gross. This basic test for unconscionability was articulated in *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

Although Article 2 of the UCC had been enacted in the District of Columbia at the time the case was heard by the various courts, Article 2 was inapplicable to the Williams case since the Williams transactions occurred prior to the effective date of the UCC in the District. Therefore, Williams was a pre-Code case. This pre-Code definition of unconscionability developed in Williams, however, has been accepted by courts as a definition of unconscionability under the Code. In Williams, the District of Columbia Circuit Court of Appeals reversed and remanded for the trial court to apply the facts to the definition.

Although the reader could guess the outcome in the trial court, the Williams case technically cannot be used as an application of unconscionability. The *Williams v. Walker-Thomas* Test for Unconscionability is Exhibit 8-2 (258).

Unconscionability as a Shield (258)
As with the enforceability doctrine of minority (infancy), unconscionability may be used as either a shield or a sword. *Garrett v. Hooters-Toledo* (258) illustrates unconscionability as a shield since Garrett is trying to fend off Hooters's motion.

Garrett, an employee at Hooters, signed a mandatory arbitration agreement. After becoming pregnant, Garrett was dismissed and brought a gender discrimination action against Hooters in the United States District Court for the Northern District of Ohio.

Hooters moved to compel arbitration and to stay the litigation. Garrett defended claiming the arbitration agreement was unconscionable. Hooters motion to compel arbitration was denied.

Garrett v. Hooters-Toledo uses the "absence of meaningful choice coupled with unreasonably favorable terms" definition of unconscionability. Garrett presents a nice discussion (including application since this is a trial court opinion) of the

difference between substantive unconscionability and procedural unconscionability. Both need to be present for a finding of unconscionability.

Substantive unconscionability relates to the contract terms and whether they are commercially reasonable. Although the court rejected Garrett's claim that arbitration would be cost prohibitive (but would have given her leave to provide a detailed showing of the costs associated with arbitrating her claim and her personal financial record, reflecting her inability to pay the split arbitration costs), the court found substantive unconscionability in that the agreement was skewed to be unreasonably favorable toward Hooters (e.g., the 10-day time limit for bringing a claim, mandatory mediation prior to arbitration, prohibition of counsel, location of mediation, process for selection of mediator).

The court also found procedural unconscionability by considering the "factors bearing on the relative bargaining positions of the contracting parties, including their age, education, intelligence, business acumen and experience, relative bargaining power, who drafted the contract, whether the terms were explained to the weaker party, and whether alterations in the printed terms were possible."

Unconscionability as a Sword (266)
Unconscionability becomes a sword when a contracting party brings an action to reform an unconscionable term in the contract. *Vockner v. Erickson* (266) illustrates unconscionability as a sword.

In *Vockner*, Erickson sold Vockner, a real estate agent, a 12-unit apartment house and took a 30-year mortgage with monthly payments being less than the accumulating interest on the note that was secured by the mortgage. Subsequently, Erickson became dissatisfied with the agreement and filed a complaint seeking specific performance and in the alternative damages contending that the agreement was unconscionable.

The superior court found the agreement unconscionable and reformed the contract.

On appeal, the Alaska Supreme Court affirmed the trial court on both the finding of unconscionability and the reforming the contract. Since Vockner deals with the sale of real estate and not a sale of goods, Article 2 of the UCC is inapplicable. Restatement (Second) of Contracts § 208, however, parallels UCC § 2-302(1).

Although Vockner does not explicitly reference the "absence of meaningful choice coupled with unreasonably favorable terms" text, the case could be analyzed using that test and the court's opinion could be divided between substantive and procedural unconscionability.

Vockner is also useful as a demonstration of the court's use of reformation as a remedy after a finding of unconscionability.

Unconscionability under Article 2 of the UCC (UCC § 2-302) (271)
The text quotes UCC § 2-302. Note that neither the UCC nor the Restatement defines unconscionability. The code cases use "the absence of meaningful choice coupled with unreasonably favorable terms" definition as found in Williams v. Walker-Thomas. This leads to a division between substantive unconscionability (unreasonably favorable terms) and procedural unconscionability (absence of meaningful choice).

Unconscionability as a Shield
Note the lead-in to UCC § 2-302(1)-"If the court as a matter of law finds."

Unconscionability is a question of law for the judge and not a question of fact for the jury. Therefore, the hearing on unconscionability is before the judge.

UCC § 2-302(2) mandates a hearing when the issue of unconscionability is raised.

Unconscionability can be raised by a party or by the court. Many early section 2-302 cases were reversed when the trial court refused to have a hearing on the unconscionability issue.

Note the remedies for unconscionability provided in § 2-302(1):

1. the court "may refused to enforce the contract";
2. the court "may enforce the remainder of the contract without the unconscionable clause"; and
3. the court "may so limit the application of any unconscionable clause as to avoid any unconscionable result."

PARALEGAL EXERCISE 8.1 (272) is based on *Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264 (Supreme Ct. 1969), although the facts are modified so the Oakleys are defendants in the breach of contract action, rather than plaintiffs in an action to reform.

In Paralegal Exercise 8.1, the price is the term in question. Whether a term is unreasonably favorable requires a balance between the needs of the buyer and the seller. As to the seller, some investigation into the needs of the industry might be appropriate.

For example, a 300% mark-up might be appropriate in a highly fashionable and variable industry (e.g., women's hats) while the same mark-up would be inappropriate in another industry (e.g., men's shoes).
To determine whether the Oakleys suffered from an absence of meaningful choice, two factors must be evaluated: relative bargaining power and knowledge of the terms.

As welfare recipients, did the Oakleys have little bargaining power? Who would sell to them and on what terms? Did this lack of bargaining power amount to a gross inequality of bargaining power? If so, knowledge of the terms becomes irrelevant. If the lack of bargaining power is less than a gross inequality, knowledge of the terms becomes critical. A party may lack knowledge of a term if it is hidden in fine print, minimized by deceptive sales practices, or unknown to the party who has not been given a reasonable opportunity to become acquainted with the term. Are more facts needed to make this determination? We have our students develop a list of facts they would look for if they were planning an investigation.

Care should be taken with the unconscionability doctrine. A search for cases with a holding of unconscionability will not reveal an overwhelming number of cases. Courts appear to be reluctant to find unconscionability, except in the most extreme circumstances.

Unconscionability as a Sword (272)
The previous subsection presented unconscionability as a defense to a breach of contract action. This subsection investigates whether unconscionability could support an action for breach of contract, an action for reformation, or an action for restitution.

The breach of contract cause of action requires all steps of the paradigm to be satisfied: the contract must be formed; the contract must be enforceable; and the contract must have been breached. Although generally unconscionability as a sword does not relate to a breach of contract cause of action, unconscionability may play a role in a breach of contract cause of action if the duty of the alleged breaching party is subject to a condition and the condition is removed by a finding of unconscionability. For example, an apartment tenant, if raped in her apartment, may assert the landlord's exculpatory clause dealing with security is unenforceable due to unconscionability and
thereby sue the landlord for breach of contract. See *Lloyd v. Service Corp. of Alabama,*
Inc., 453 So. 2d 735 (Ala. 1984).

The action for reformation requires the contract formation step of the paradigm. In the enforcement step, the court reforms the contract by deleting the unconscionable clause or by rewriting the unconscionable clause so it is no longer unconscionable.

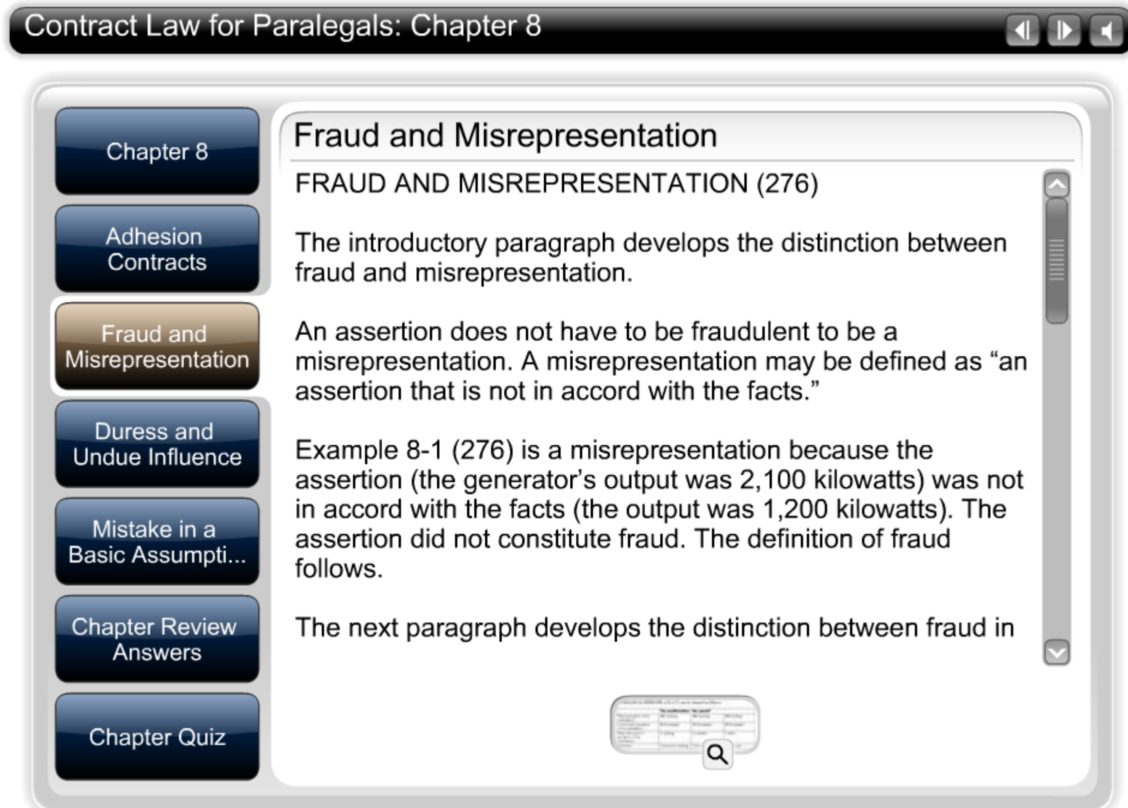
Jones v. Star Credit Corp. (273) illustrates reformation. In *Jones v. Star Credit Corp*. the buyer brought an action to reform the contract and the court complied. The same analysis for unconscionability used in the Williams case can be used in the Jones case.

In *Jones* the unfavorable term is the price term. At the time of contract formation did the Joneses suffer from an absence of meaningful choice? Did they lack bargaining power? Was this lack gross? Did they have knowledge of the price term and, if not, why? In Jones the court reformed the price term in the contract so the Joneses could keep the freezer without having to pay more than they already had paid.

The action for restitution requires the contract formation step of the paradigm. In the enforcement step, the contract is found unenforceable due to unconscionability.

The party who raised the unconscionability issue now requests the restitution cause of action for disgorgement of the benefit that he or she conferred on the defendant. In the Jones case, the court reformed the contract so the Joneses did not have to make any additional payments. The issue that was not raised is whether unconscionability could be used to get money back. Does the language of UCC § 2-302 and the Official Comments which made no mention of damages as an available remedy for an unconscionable contract preclude the restitution action?

Fraud and Misrepresentation



Tab Text

FRAUD AND MISREPRESENTATION (276)

The introductory paragraph develops the distinction between fraud and misrepresentation.

An assertion does not have to be fraudulent to be a misrepresentation. A misrepresentation may be defined as "an assertion that is not in accord with the facts."

Example 8-1 (276) is a misrepresentation because the assertion (the generator's output was 2,100 kilowatts) was not in accord with the facts (the output was 1,200 kilowatts). The assertion did not constitute fraud. The definition of fraud follows.

The next paragraph develops the distinction between fraud in the factum (fraud in the "essence") and fraud in the inducement. Fraud in the factum involves the very character of the proposed contract. Example 8-2 (277) is fraud in the essence.

Fraud in the inducement involves a misrepresentation as to quality. Example 8-3 (277) is fraud in the inducement. The elements for fraud in the inducement follow the example.

PARALEGAL EXERCISE 8.2 (278) requires an application of the elements for fraud from the previous paragraphs.

Sylvia made two statements of fact: (1) the mileage; and (2) the dashboard warning light. Both were false.

Sylvia intentionally changed the odometer and disconnected the warning light so she knew the statements were false. Her purpose in making the statements was to influence Brad to buy the car.
Brad believed Sylvia's statements concerning the odometer and the warning light and relied on her statements.

Brad would not have purchased the car if he had known the car had twice the mileage and the faulty warning light, so Sylvia's statements were sufficiently material to induce Brad to purchase the car. Brad may disaffirm the contract.

PARALEGAL EXERCISE 8.3 (278) requires an application of fraud from the previous paragraph. Paralegal Exercise 8.3 differs from Paralegal Exercise 8.2 in that in Paralegal Exercise 8.3 neither party knew that the statement was false when made.

The disease had gone undetected by either party prior to purchase. Therefore, with the second element of the analysis missing, fraud in the inducement is unavailable and the contract is enforceable. The third element requires the buyer to rely. Even if the disease had not been detected prior to sale, an experienced owner of a winery probably would not have relied on the seller's representations.

Duress and Undue Influence

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Duress and Undue Influence

DURESS AND UNDUE INFLUENCE (278)

Duress is defined as “the use of any wrongful act or threat as a means of influencing a party to contract.” The discussion on duress is divided into: (1) duress by actual physical force; and (2) duress by threat.

Example 8-4 (278) illustrates duress by actual physical force. George grabs Clint by the neck and forces him to sign the agreement.

Example 8-5 (279) illustrates duress by threat. This example uses economic duress.

After the elements for duress by threat are listed, PARALEGAL EXERCISE 8.4 (279) asks students to apply a set of facts to the elements for duress by threat.

1. Hawkins threatened Reese by refusing to deliver the concrete.

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After the elements for duress by threat are listed, PARALEGAL EXERCISE 8.4 (279) asks students to apply a set of facts to the elements for duress by threat.

1. Hawkins threatened Reese by refusing to deliver the concrete.
2. The threat was improper since it was a breach of a contractual duty to perform in good faith.

3. The threat was subjectively perceived by Reese to be sufficiently grave to induce his assent since he was a general contractor performing for the government and would be accountable for breach of contract to the government if the work was not done.
4. Because of the threat, Reese assented to: (1) modifying the price in the first contract; and (2) giving Hawkins another subcontract.

The threat did not induce the assent to the price increase or to the additional subcontract unless Reese had no reasonable alternative. Could Reese have purchased his concrete elsewhere? If purchasing elsewhere was a reasonable alternative, then Reese would be found not to have been induced by the threat.

PARALEGAL EXERCISE 8.5 (280) is another application of a set of facts to the elements for duress by threat.

1. Jill threatened Ben by refusing to deliver the goods.
2. The threat was improper since it was a breach of a contractual duty to perform in good faith.
3. In this situation, Ben was in urgent need of the goods which should mean that he subjectively perceived the threat as serious.
4. Since Ben had reasonable alternatives (goods were available elsewhere), the fourth element for duress is missing. The threat did not induce him to assent to the modification unless the availability of other goods could not satisfy his urgent need (and why the need was urgent).

Undue influence differs from duress in that it neither requires threats nor deception but does require a special relationship between the parties. Undue influence involves unfair persuasion by a party who is either in a position of dominance or in a position of trust and confidence. The elements for undue influence are listed.

PARALEGAL EXERCISE 8.6 (281) asks for an application of the undue influence elements to a set of facts.

PARALEGAL EXERCISE 8.7 (281) also asks for an application of the undue influence element to a set of facts. Does merely being inexperienced in business constitute susceptibility or must Tom demonstrate either a mental or physical weakness which would make him susceptible?

Mistake in a Basic Assumption of Fact

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Mistake in a Basic Assumption of Fact

MISTAKE IN A BASIC ASSUMPTION OF FACT (281)

In mistake in a basic assumption of fact, the contracting parties believed they were bargaining for something different from what they actually contracted for.

Example 8-6 (282) and Example 8-7 (283) are the famous *Sherwood v. Walker* (Rose 2d of Aberlone). The court held that because the parties were mistaken about the very nature of the thing for which they contracted, the contract was unenforceable.

Thus, the problem in Sherwood is treated as an identity or existence problem rather than a value. The court could just as easily have concluded that the case involved attributes or qualities which would have made the contract enforceable.

PARALEGAL EXERCISE 8.8 (283) gives students an opportunity to apply the Restatement's elements in the previous paragraph to a set of facts. Because Paralegal

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PARALEGAL EXERCISE 8.8 (283) gives students an opportunity to apply the Restatement's elements in the previous paragraph to a set of facts. Because Paralegal Exercise 8.8 is an existence of the subject matter case and not a value type of case, the contract should be unenforceable.

Example 8-8 (283) is a value type case which means the contract is enforceable.

PARALEGAL EXERCISE 8.9 (284) is the famous Wood v. Boynton, the stone/topaz case. Was this a question of “attributes, quality or value,” or “existence or identity?” The court held the former and denied rescission. The court could just as easily have concluded “identity” and granted rescission.

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TRUE/FALSE QUESTIONS

1. T
2. T
3. F
4. F
5. F
6. T
7. F
8. F
9. F
10. T
11. F
12. T
13. F
14. F
15. T
16. F
17. F

Tab Text

TRUE/FALSE QUESTIONS

1. T
2. T
3. F
4. F
5. F
6. T
7. F
8. F
9. F
10. T
11. F
12. T
13. F
14. F
15. T

16. F
17. F
18. T
19. T
20. F
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23. T
24. F
25. F
26. T
27. T
28. F
29. T
30. T
31. F
32. T
33. F
34. F
35. T
36. F
37. T
38. T
39. F
40. F

FILL-IN-THE-BLANK QUESTIONS

1. Contract of adhesion
2. Imposition of will
3. Unconscionability
4. The judge (or the court)
5. Section 2-302
6. Misrepresentation
7. Fraud
8. Fraud in the factum
9. Fraud in the inducement
10. Power to disaffirm
11. Duress
12. Economic duress
13. Undue influence
14. Mistake in a basic assumption of fact

MULTIPLE-CHOICE QUESTIONS

1. c
2. e

3. a, b, & c
4. a, b, c, d, & e
5. a & d
6. e
7. d

SHORT-ANSWER QUESTIONS

1. Absence of meaningful choice has two components:
(1) the imbalance in bargaining power; and
(2) a lack of knowledge of the terms.
A gross inequality of bargaining power will negate the need for a lack of knowledge of the
terms. If the inequality of bargaining power is less than gross, the lack of knowledge of the terms
may be demonstrated by the terms being hidden in a maze of fine print, being minimized by deceptive
sales practices, or by the lack of a reasonable opportunity to become acquainted with the
terms.
2. The four elements of duress by threat are:
(1) there must be a threat;
(2) the threat must be improper;
(3) the threat must be sufficiently grave to induce the victim to assent; and
(4) the threat must induce the victim to assent to the contract.

Chapter Quiz

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