Basic Principles of Contract Law

Chapter 6. The Principle of Unconscionability

A. Introduction

One of the most important developments in modern contract law is the emergence of the principle that an unconscionable contract or term is unenforceable.\(^1\) Traces of that principle can be found in some older cases\(^2\) and equity courts have long reviewed contracts for fairness when equitable relief was sought,\(^3\) but unconscionability was not a recognized principle under classical contract law.

On the contrary, that school of thought embraced the bargain principle, under which bargains are enforceable according to their terms without regard to fairness. Exceptions were made for bargains involving fraud, duress, incapacity, and certain kinds of mistakes. However, those exceptions were narrowly bounded, and rested in part on the ground that a contract requires consent, and a contract that involves one of these exceptions lack true consent.

Beginning in the 1960s, the position of contract law changed radically, following Uniform Commercial Code Section 2-302, which provides that "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." Section 2-302 was

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1. For convenience, I will use the term *contract* to include contract terms.
2. See, e.g., Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948); Mersereau v. Simon, 225 A.D. 997, 8 N.Y.S.2d 534 (1938); 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); McClure v. Raben, 133 Ind. 507, 33 N.E. 275 (1893).
limited to contracts for the sale of goods, but the principle it embodies has been embraced in other uniform acts,\(^4\) in the Restatement Second of Contracts,\(^5\) in the Restatement Second of Property,\(^6\) and in the case law.\(^7\) The precise meaning and reach of the unconscionability principle, however, have still not been fully established.

Early on, an effort was made to reconcile the unconscionability principle with the bargain principle. A major step in this direction was a distinction, initially drawn by Arthur Leff and later adopted by many courts and commentators, between procedural and substantive unconscionability.\(^8\) Essentially, Leff defined *procedural unconscionability* as fault or unfairness in the bargaining *process*, and *substantive unconscionability* as fault or unfairness in the bargaining *outcome* -- that is, unfairness of a contract as such, without regard to whether the bargaining process was fair.

Procedural unconscionability is easy to reconcile with the bargain principle. That principle rests in significant part on the predicate that private actors are the best judges of their own utility. This predicate, however, only justifies the application of the bargain principle where the bargaining process is fair and both parties act voluntarily and are fully informed. Where the bargaining process is unconscionable -- unfair -- a major predicate of the bargain principle is not satisfied, and that principle therefore cannot properly be applied to enforce the contract.

In contrast, it may seem difficult to reconcile the bargain principle with a regime based on pure substantive unconscionability -- unfairness of terms unaccompanied by unfairness of process -- because under such a regime a contract could be found unconscionable even if the bargaining process was fair. Accordingly, the effect, if not the purpose, of the distinction between


\(^5\) *Restatement (Second) of Contracts* § 208 (1979).

\(^6\) *Restatement (Second) of Property* § 5.6 (1977).


procedural and substantive unconscionability was to suggest that pure substantive unconscionability should not suffice to render a contract unconscionable.

The distinction between procedural and substantive unconscionability is useful, but takes us only so far and in some ways clouds the relevant issues. Often the distinction will be artificial, because unfairness in the bargaining process will be significant only if the resulting bargain is unfair. Conversely, under some circumstances extracting an unfair contract will be unfair in itself. Finally, the distinction does not address the critical question, how should it be determined whether a contract is procedurally or substantively unconscionable?9

The answer, which is not provided by the procedural/substantive distinction, is that two elements should figure in the determination of unconscionability.

The first element is the nature of the market on which the

9. Cf. 1 ONTARIO LAW REFORM COMM'N REPORT ON SALE OF GOODS 157 (1979):

[T]he distinction between substantive and procedural is, in our view, too rigid. We do not, therefore, recommend its adoption. What is “procedural” and what is “substantive” will frequently result in a sterile debate. These are not terms of art. Let us suppose an exculpatory clause is clearly flagged so that the buyer cannot avoid noticing its presence; should this preclude a court from finding the clause unconscionable if the product is the only one of its kind or if other manufacturers use an identical provision? What is important, it seems to us, is that the tribunal should be able to investigate all the circumstances of a transaction without being restricted in the scope of its inquiry. We are fortified in our conclusion by the fact that none of the criteria of unconscionability listed in recent Canadian, American and U.K. legislation are restricted to examples of what might be considered to be procedural unconscionability.
contract was made. Contracts made on perfectly or reasonably competitive markets will rarely if ever be unconscionable. However, when contracts are made off-market, or on markets that are not reasonably competitive, the stage is set for unconscionability.

The second and most important element is whether the contract involved moral fault on the part of the promisee. Regardless of the nature of the market on which a contract is made, the contract will not be unconscionable without the element of moral fault.

**Markets.** In this book the term *competitive market* will be used to mean a market that is either perfectly or reasonably competitive. A *perfectly competitive market* involves four characteristics: a homogeneous commodity, a marketplace on which perfect cost-free information is readily available, 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 terms on which the commodity is sold.\(^\text{10}\) A *reasonably competitive market* is a market whose characteristics approximate those of a perfectly competitive market. There are relatively few perfectly competitive markets, but many reasonably competitive markets.

Now assume a perfectly competitive market, and let the parties to a bargain be S, a plaintiff-seller, and B, a defendant-buyer. Given the conditions of a perfect market, the contract price will be the market price. This price will rarely if ever be unconscionable, because for a variety of reasons a perfectly competitive market is generally regarded as a fair mechanism to set prices. (1) By normal measures of value, the contract price will be equal to the benefit S has agreed to confer upon B. (2) S would not voluntarily have agreed to transfer 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. (3) Since cost-free information is readily available on such markets, the parties to the transaction will almost always be fully informed. (4) The contract price will normally equal the seller’s marginal cost, plus a normal profit. (If

\[\text{10. [Citation.]} \text{ For ease of exposition, I will use the term price to include all the terms offered by a seller.}\]
the price on such a market exceeds marginal cost plus a normal
profit, then the prospect of above-normal profits will provide an
incentive to increase supply, leading to a new and lower equilibrium
price that yields only normal profits.)

The price in a perfectly competitive market will also
normally be efficient. First, given that pricing decisions on such a
market 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. Second, if perfect competition prevails, at any price
less than the market price demand for the commodity would exceed
the supply. 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.

These effects will be scaled down where a market is only
reasonably competitive. For example, because commodities sold on
a reasonably competitive market normally will not be homogeneous,
and information is not cost-free, exploitation is a possibility. In
general, however, transactions on reasonably competitive markets
are unlikely to be unconscionable, for much the same reasons that
transactions on a perfectly competitive market will rarely if ever be
unconscionable.

In this connection, however, it is important to distinguish
between commodities and the markets on which they are traded. In
the case of commodities that are sold on competitive markets,
contracts are normally made on physical or virtual markets in which
the public can readily participate. However, a commodity that is
normally sold on a public market may occasionally also be sold
privately, that is, away from any public market that is readily
available to both parties. Where that occurs, the contract should be
treated as having been made off-market, even though the commodity may also be traded on a reasonably competitive market. Although making a contract on a market that is not reasonably competitive is not itself unconscionable, unconscionability is most likely to be found where a transaction occurs either off-market or on a public market that is not reasonably competitive.

Moral Fault. In short, contracts made on perfectly competitive markets will rarely if ever be unconscionable, and contracts made on reasonably competitive markets will not often be unconscionable. However, the converse is not true: a contract that is made off-market or on a market that is not reasonably competitive is not unconscionable for that reason alone. Instead, such a contract will be unconscionable only if the contract involves moral fault on the part of the promisee. For contract-law purposes, moral fault should normally mean social morality, that is, moral standards that are rooted in aspirations for the community as a whole and, on the basis of an appropriate methodology, can fairly be said to have substantial support in the community, can be derived from norms that have such support, or appear as if they would have such support.

The importance of moral fault in this connection is made explicit in many civil-code and civil-code-based rules that operate like the unconscionability principle. For example, Section 138(2) of the German Civil Code provides:

. . . [A] legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgment or considerable weakness of will of another, causes himself or a third party, in exchange for an act of performance, to be promised or granted pecuniary advantages which are clearly disproportionate to the performance.\(^\text{11}\)

\(^{11}\) (Emphasis added.) See also, e.g., Article 21(1) of the Swiss Code of Obligations:

Where a contract establishes an obvious disparity between the respective considerations given by the parties, and where the conclusion of the contract was induced by one of the parties exploiting the distress, inexperience, or improvidence of the other,
Similarly, Article 4.109 of the European Principles of Contract Law provides:

(1) A party may avoid a contract if, at the time of the conclusion of the contract:

(a) it was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skills, and

(b) the other party knew or ought to have known of this and, given the circumstances and purpose of the contract, took advantage of the first party’s situation in a way which was grossly unfair or took an excessive benefit.\textsuperscript{12}

Although the essential role of moral fault is not as explicit under American law as it is under some civil-code and civil-code-based rules, it is implicit in the concept of unconscionability, because what kind of conduct is not conscionable must depend on what kind of conduct involves moral fault. This is not to say that a contract that involves any moral fault at all is necessarily unconscionable. Moral fault comes in different degrees, and the term \textit{unconscionable} suggests a significant degree of moral fault.

\textsuperscript{12} then the party prejudiced thereby may, within one year, declare rescission of the contract, and demand restitution for the consideration already given. (Emphasis added.)

12. (Emphasis added.) \textit{See also} Article 3.10(1) of the Unidroit Principles of International Commercial Contracts:
A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage.
Regard is to be had, among other factors, to
(a) the fact that the other party has taken \textit{unfair advantage} of the first party’s dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack or bargaining skill; and
(b) the nature and purpose of the contract.
(Emphasis added.)
It will often or usually be unnecessary to apply the elements of unconscionability on a case-by-case basis. Instead, the law should aim to develop specific unconscionability norms to govern specific classes of cases. The next four sections of this Chapter will be devoted to developing several such norms. The purpose of this enterprise is not to develop every specific unconscionability norm. On the contrary, unconscionability is a fundamental principle that continues to unfold as social norms evolve. However, one purpose of this Chapter is to explicate the methodology by which specific unconscionability norms should be developed. Three general propositions underlie the methodology. First, the development and application of specific unconscionability norms is closely related to the manner in, and the extent to which, the market where the contract was made deviates from a competitive market. Second, because the bargain principle rests on arguments of fairness and efficiency, a specific unconscionability norm is especially appropriate when fairness does not support the application of the bargain principle to a class of transactions and efficiency will not be impaired -- or indeed will be enhanced -- by reviewing those transactions for fairness. Third, specific unconscionability norms can often be developed by using the general unconscionability principle as a charter that enables the court to either create wholly new rules and enlarge the traditional boundaries of existing rules, such as those dealing with duress, incapacity, and undue influence.

B. 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 with B on any terms he can get - a condition that will be referred to in this book as *distress*. This condition evokes various images - for example, A is stranded in the desert, and B adventitiously discovers her, or A needs a lifesaving operation that only B can perform. At first glance these images may seem similar. In fact, however, they present different problems, and together they illustrate most of the major issues raised by the problem of distress. Accordingly, those issues will be analyzed through an exploration of hypotheticals built upon these images.
The Desperate Traveler. A, a symphony musician, has been driving through the desert on a recreational trip, when she suddenly hits a rock jutting out from the sand. A's vehicle is disabled and her ankle is fractured. She has no radio and little water, and will die if she is not soon rescued. The next day, B, 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. A explains the situation and asks B to take her back to Tucson, which is sixty miles away. B replies that he will help only if A promises to pay him two-thirds of her wealth or $100,000, whichever is more. A agrees, but after they return to Tucson she refuses to keep her promise, and B sues to enforce it.

Under classical contract law, A's promise would be enforceable to its full extent: she has made a bargain, and none of the traditional contract defenses apply. The defense of duress might seem apposite, but traditionally that defense requires not only that the promisor was in distress, but that she was put in distress by the promisee's legally wrongful act or threat. B did not put A in

13. See, e.g. ___ v. ___ 118 N.H. 232, 385 A.2d 835 (19xx) ("... [T]he coercive circumstances must have been the result of the acts of the opposite party. A contract signed because a party is bargaining under adverse conditions or in pressing want of pecuniary means is not unenforceable on account of duress if the other party is not responsible for those circumstances and did not create the necessities."

RESTATEMENT SECOND § 175, 176. Section 176(2) 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." The comment to this Section does not provide much guidance on when a threat constitutes a use of power for illegitimate ends. According to Illustration 16, the phrase would apply to a threat by a municipal water main company to refuse water to a developer except at a price greatly in excess of that charged to those similarly situated. 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
distress, and B’s threat to not help A unless she agrees to pay the compensation he demands is not legally wrongful, because the common law imposes no duty on strangers to rescue persons in distress, even when life is at stake. ¹⁴ (This rule is morally indefensible, but at least for now it is the rule.)

However, although the lack of legal wrongfulness of the threat may forestall the defense of duress, the contract in *The Desperate Traveler* is unconscionable.

To begin with, the transaction between A and B did not occur on a competitive market. Quite the contrary: the transaction occurred off-market, and B was a monopolist because A did not have any readily available alternative source of rescue. Of course B is only a bilateral monopolist, because if B is to derive an economic gain from A's distress, he needs A's assent. However, that a monopoly is bilateral does not imply that the strengths of the two parties are equal. The parties' relative strengths are determined by the relative costs if a bargain is not made and their relative benefits if it is. In *The Desperate Traveler*, A's costs for not making a bargain is the loss of his life, while B's cost is only a forgone financial windfall. Next, B’s conduct violated accepted moral standards. Our society posits, as part of its moral order, some degree of concern for others. In *The Desperate Traveler*, B has acted wrongly in treating A as simply an economic object.

Efficiency considerations point in the same direction. Where (1) rescue is adventitious, (2) there are no other bidders to provide the rescue services at the time of the rescue, and (3) prior to the accident there was no market on which the victim could have purchased a contingent contract to rescue, full enforcement of victim's promises 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. Instead, full enforcement of promises like A’s would probably be inefficient. If it were known that victims 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

¹⁴ See *id.*, *infra.*

municipal sewerage authorities to charge equal rates to similarly situated customers.)

Principles Chapter 6 - The Principle of Unconscionability Format.doc
necessary, or might spend an aggregate amount on precautions that exceeds the cost of adventitious rescue.\textsuperscript{15}

Moreover, while prior to the emergence of unconscionability the common law might have enforced B's promise to its full extent, other mature legal systems have long allowed the courts to review bargains made under distress for fairness. For example, German Civil Code Section 138(2) provides that a transaction is void "when a person [exploits] the distressed situation . . . of another to obtain the grant or promise of pecuniary advantages . . . which are obviously disproportionate to the performance given in return."\textsuperscript{16} French law is in accord.\textsuperscript{17} At home, it is well established in admiralty law that a contract for salvage - that is, a contract to rescue a ship that is in distress, or its cargo - is reviewable for fairness. For example, in \textit{Post v. Jones},\textsuperscript{18} the whaling ship \textit{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 \textit{Richmond} had more whale oil than the ships could take. At the instance of the captain of one of these ships, the \textit{Richmond}'s captain held an auction of his ship's oil. One of the three captains bid $1/barrel for as much as he needed, the two others bid $.75/barrel, and each of the three captains took enough oil at the bid price to complete his cargo. The three ships then returned to port with the \textit{Richmond}'s oil and its crew. In an action by the owners of the \textit{Richmond}, the sale of the oil at the bid prices was set aside as unfair:

> The contrivance of an auction sale, under such circumstances, where the master of the \textit{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.

\textsuperscript{16} BGB § 138(2)
\textsuperscript{17} See, e.g., 2 M. Planiol, \textit{supra} note 17, No. 1076.
\textsuperscript{18} 60 U.S. (19 How.) 150 (1857).


. . . 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 . . . 19

This leaves open how to measure the promisee's recovery in such cases. One possibility is to compensate the promisee for his financial costs. That remedy, however, would often fail to adequately recognize 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, B's financial cost is close to zero. Assuming that B is under no legal duty to rescue A, he would have no economic incentive to perform the rescue if his recovery was limited to his financial cost. The need for an economic incentive in such cases should not be overemphasized; most individuals in B's position would be likely to rescue A whether they had an economic incentive to do so or not. Nevertheless, an economic incentive would be helpful at the margin.

Admiralty law again suggests a solution. Although admiralty will not enforce unfair salvage-rescue contracts, it does provide ample compensation for rescuers. Recovery in salvage cases is viewed as both a reward and an inducement.20 Accordingly, in measuring recovery admiralty courts take into account the degree of danger to the rescued property, the value of the rescued property, the risk incurred by the salvor in effecting the rescue, the salvor's promptness, skill, and energy, the value of the property the salvor

19. Id. at 159-60. See also, e.g., Magnolia Petroleum Co. v. National Oil Transport Co., 281 F. 336, 340 S.D. Tex. (1922). ("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.") 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 SAVAGE 309-13 (K. McGuffie 4th ed. 1958).

employed, the degree of danger to that property, and the salvor's time and labor.21 In more general terms, the recovery in distress cases involving an adventitious rescuer should compensate the promisee for all costs, tangible and intangible, and 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 central. 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.22

To put this differently, the obligation to assist a victim in peril, like A in The Desperate Traveler, normally attaches only when the costs of rendering assistance are relatively low. However, the victim can make those costs low by agreeing to compensate a potential rescuer for the costs. Correspondingly, a potential rescuer who asks a victim to cover his costs, including his opportunity costs, together with a reasonable premium as an added incentive, has not acted in a way that is morally improper.

Accordingly, a contract by a victim to pay the costs of rescue, together with a reasonable premium, is not unconscionable. This illustrates the limitations of the distinction between procedural and substantive unconscionability. In a case like The Desperate Traveler, the mere fact of making a contract to rescue is not

21. 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. Underlying 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) (accord).

22. 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.
unconscionable, because B would not be acting unconscionably if he demands fair compensation. Nor has there been any procedural unconscionability, unless asking for too much money is procedurally unconscionable. Accordingly, such a contract is unconscionable if and only if the promisee extracts an unfair price, because only in that case does the promisee engage in immoral exploitation of the promisor’s distress.23

The Desperate Patient. P, a business executive, is dying of a fatal organ disease and requires a transplant which until recently could not be accomplished. However, S, a surgeon, has now developed a new surgical technique for doing such a transplant. Development of the new technique entailed $100,000 in out-of-pocket costs and forgone opportunities. At the moment, no one but S can perform the operation, and by the time others can learn the surgical technique involved, P will have died. P asks S to operate on her. S (who has the capacity to perform many more of these operations than he is currently performing) replies that he will do so only if P promises to pay $1 million, his standard fee for the operation. P agrees. After S performs the operation, however, P refuses to keep her promise, and S sues.

Like A in The Desperate Traveler, P is in distress, the transaction is not conducted on a reasonably competitive market, and the promisee is a monopolist. However, there is a significant difference between the two cases. Unlike the geologist B, the surgeon S has achieved his bargaining power not through adventitious circumstances but through diligence and skill. The prospect of deriving exorbitant gains may have been precisely what led S to forgo other opportunities and instead work on developing

23. Lifshitz argues that the cost of rescue includes the opportunity to extract a high price from the victim. [Citation] However, because extracting such a price would be morally improper, the law cannot properly consider that opportunity as a cost for this purposes. To do so would be like saying that an extortionist who is paid $5,000 in exchange for his promise not to do $10,000 damage to the payor simply recovers his opportunity, costs, and not even that.
the new surgical technique. It can therefore be argued that promises made in cases like *The Desperate Patient* should be enforced to their full extent so as to encourage desirable investment.

To put this differently, S is not merely an adventitious rescuer. On the contrary, S has rescue capacity precisely because he has invested in developing that capacity. And unlike an adventitious rescuer, such as the geologist in *The Desperate Traveler*, S has incurred costs to put himself in a position to provide rescue. From a moral standpoint, therefore, *The Desperate Patient* is harder to resolve than *The Desperate Traveler*. Nevertheless, a provider who has a monopoly on a life-and-death drug or medical procedure acts in a morally improper way if he demands an excessive price. A price is excessive, in this context, if it exceeds an allocable share of the provider's out-of-pocket costs for development and production, the opportunity costs of having forgone other profitable activities, and a generous premium to incentivize similar investments taking into account the cost of unsuccessful ventures and the risk that a number of investments may not succeed.

Furthermore, 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 (including a reasonable profit margin). Accordingly, all consumers who are willing and able to pay the cost of production will be able to purchase the commodity. Monopolistic markets, 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. Therefore, a practice of judicial review for excessiveness of price in cases like *The Desperate Patient*, 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 to result in the best allocation of resources.

Once more this is precisely the line taken in admiralty. Admiralty courts review salvage contracts for fairness not only when a rescuer adventitiously happens on the scene, but also when salvage is made by a professional salvor whose rescue capacity results from a planned investment. However, adventitious and professional rescue are treated differently as regards recovery. To encourage the provision and maintenance of rescue resources, awards for rescue by
professional salvors are deliberately set at a higher level than awards to nonprofessionals. The recovery in cases like The Desperate Patient should parallel the recovery in professional rescue at sea.

C. Price-Gouging

Another form of unconscionability is price-gouging. Price-gouging occurs when a seller significantly raises prices to take advantage of a temporary disruption of a consumer market due to a disaster such as a power outage. For example, during the New York City blackout of July 1977, some sellers of candles, flashlights, transistor radios, and batteries charged many times the normal price. Price-gouging is similar to the exploitation of distress, but

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> [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.

See also 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. In Nicholas E. Vernicos Shipping Co. v. United States, 349 F.2d 465, 472 (2d Cir. 1965), 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.

differs in several respects. To begin with, in price-gouging cases the buyer’s needs are normally vital for temporary well-being, but not desperate -- involving, for example, a generator to supply electricity, or lanterns to supply light, until power is restored. Next, the disruption of the market is, by definition, temporary. If there is a long-lived change in price levels -- due, for example, to war-time conditions -- charging prices at the new level should not be regarded as price-gouging. Moreover, partly because less is at stake for the promisor, and the disruption is temporary, the amount involved in the price-gouging is usually small in absolute terms, although high in percentage terms in relation to the pre-disaster price. Finally, unlike distress cases, where the court normally must determine what a fair price would have been based on a variety of factors, in price-gouging cases there is an easily administered measure of damages: the difference between the contract price and either the pre-disaster market price or the market price in adjoining non-disaster areas.

In a number of states price-gouging is prohibited by statute. For example, the New York General Business Law provides as follows:

396-r Price Gouging

During any abnormal disruption of the market for consumer goods and services vital and necessary for the health, safety and welfare of consumers, no party within the chain of distribution of such consumer goods or services or both shall sell or offer to sell any such consumer goods or services or both for an amount which represents an unconscionably excessive price. For the purpose of this section, the phrase “abnormal disruption of the market” shall mean any change in the market, whether, convulsion of nature, failure or shortage of electric power or other source of energy, strike, civil disorder, war, military action, national or local emergency, or other

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26. Geoffrey C. Rapp, Terrorist Attacks, Hurricanes, and the Legal and Economic Aspects of Post-Disaster Price Regulation, 94 Ky. L. Rev. 535, 541-46 (2005) reports that about half the states have some type of anti-gouging statutes, nineteen of which are keyed to disasters. Many of the statutes differ significantly from the New York statute in detail but reflect the same underlying concepts.
cause of an abnormal disruption of the market which results in the declaration of a state of emergency by the governor. . .

(b) . . . [P]rima facie proof that a violation of this section has occurred shall include evidence that

(i) the amount charged represents a gross disparity between the price of the goods or services were the subject of the transaction of their value measured by the price at which such consumer goods or services were sold or offered for sale by the defendant in the usual course of business immediately prior to the onset of the abnormal disruption of the market or

(ii) the amount charged grossly exceeded the price at which the same or similar goods or services were readily obtainable by other consumers in the trade area. 27

Whether or not prohibited by statute, price-gouging satisfies the two elements of unconscionability. First, price-gouging does not occur on a competitive market. Rather, the normal market has ceased to function, and instead of a multitude of sellers, the relevant disaster normally isolates a specific geographic area from national or even regional factors of supply. Second, it is morally improper for a seller to significantly raise its prices, absent a corresponding rise in costs, to exploit important human needs resulting from a temporary disaster.

It might be argued that price-gouging should not be treated as unconscionable, because productive resources are efficiently allocated only if prices are set by the market. In price-gouging cases, however, the market is dysfunctional, and in any event pricing levels in an isolated market during a transitory period are unlikely to affect the general allocation of productive resources. It might also

be argued that if sellers are not permitted to charge what the market will bear, commodities will not be allocated to those persons who value them most highly. This argument, however, holds only if wealth is more or less evenly distributed. If it isn’t – and it isn’t – in disaster scenarios, commodities will be allocated not to those who need them most and value them most highly, but to those who have the most wealth.

D. Transactional Incapacity

Suppose that the subject-matter of a bargain is highly complex, rather than homogeneous. The significance of this variation is that even an individual with average intelligence may lack the aptitude, experience, or judgmental ability to make a well-informed judgment concerning the desirability of entering into a given complex transaction. Such an inability will be referred to in this book as transactional incapacity.

For example, take the following case:

Artless Heir. Niece is a twenty-two-year-old high-school graduate, employed in a stockroom. Niece's great-aunt, who owns a commercial building, died on June 1. In her will she bequeathed a life interest in the building to her fifty-year-old sister, Y. The remainder interest was bequeathed to Y's fifty-year-old husband, if he survived her, otherwise to Niece. Tenant is a major tenant in the building, and also holds a third mortgage on the building for $370,000 and a second mortgage on a movie theater for $330,000. The third mortgage pays 11% interest and the second mortgage pays 9%. Both mortgages have fifteen years to run. On July 1, Tenant, who has learned of the bequest to Niece, offers to make a deal under which Tenant will assign the two mortgages to her in exchange for her promise to transfer her contingent remainder. Tenant points out that under this agreement Niece 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, Niece will get no immediate income from the contingent remainder and may never see a dollar from it. Even if she survives Y's husband, 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, Niece's contingent remainder has a present fair value of $870,000-$950,000, and that Tenant's two mortgages have a total present value of not more than $350,000. Tenant knows that a person with Niece'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. Niece signs a contract, and Tenant assigns the mortgages to her. Later, the estate's lawyer learns of the deal and advises Niece to refuse to transfer her contingent interest in the building to Tenant, and to offer to reassign the mortgages to Tenant. Niece follows the lawyer's advice.

If the rules of classical contract law were strictly applied, Niece's promise probably would be enforceable to its full extent. She has made a bargain, and none of the traditional contract defenses seem to apply. The defense of incapacity might seem apposite, but traditionally that defense requires what might be called general incapacity, consisting of a general inability to understand the nature and consequences of one's acts. For example, Restatement Second Sections 12(2), 15(1) provide:

Section 12. Capacity to Contract . . .

(2) A natural person who manifests assent to a transaction has full legal capacity to incur contractual duties thereby unless he is

(a) under guardianship, or

(b) an infant, or
(c) mentally ill or defective, or

(d) intoxicated.

Section 15. Mental Illness or Defect

(1) A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect

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

Although the lack of general incapacity may forestall a capacity defense, contracts like that in Artless Heir, in which a promisee exploits the promisor's transactional incapacity are unconscionable.

First, transactions involving a complex subject-matter are not made on competitive markets, because the subject-matter is not homogenous and there is only one seller. Furthermore, efficiency considerations fail to support the application of the bargain principle to the exploitation of transactional incapacity. The concept that a promisor is the best judge of her own utility can have little application, because 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.

Second, if, as in Artless Heir, A knows or has reason to know that B lacks capacity to fully understand a complex transaction and its implications, and A exploits that incapacity by inducing B to enter into the transaction on terms that a party who had full transactional capacity probably would not have agreed to, then A has acted in a manner that violates conventional moral standards. This is true even though B has the capacity to understand ordinary transactions, and even if her lack of capacity to understand the transaction at hand stems from limitations in experience or training, rather than from emotional instability or below-average intelligence.

The high barrier set by the traditional test for incapacity may
have stemmed in part from the drastic consequences of the application of that test. General incapacity usually renders a contract voidable by the promisor. The consequences of transactional incapacity normally should be less severe, requiring only 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 other party's lack of capacity.\textsuperscript{28} Transactional incapacity, on the other hand, should not give rise to a defense unless the fully competent party knew or had reason to know of the incapacity and exploited it.

Some support for a doctrine of transactional incapacity can be found in existing legal materials. Abroad, this concept is embodied in Section 138(2) of the German Civil Code: "[A] legal transaction is void by which a person by exploiting the … lack of sound judgment … of another, causes himself …, in exchange for an act of performance, to be promised or granted pecuniary advantages which are clearly disproportionate to the performance."\textsuperscript{29} Some American cases have also adopted a rule very close to the doctrine of transactional incapacity. For example, in Morgan v. Reaser,\textsuperscript{30} the Reasers, who owned a ranch, entered into a complex transaction with Morgan involving the ranch, an apartment complex owned by Morgan, and other consideration. It quickly became apparent that Morgan's apartment complex was a losing proposition, and the Reasers made a claim for rescission. The court held for the Reasers, because while "Reaser was not without some experience in the purchase and sale of real estate nor . . . completely lacking in understanding," he "was without understanding of a transaction of this nature and magnitude."\textsuperscript{31} Indeed, even Restatement Second

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\item 87 S.D. 138, 204 N.W.2d 98 (1973) (per curiam).
\item 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. 11183 Eng. Rep. 323 (K.B. 1623), and Thornborow v. Whitacre, 2 Ld. Raym. 1164, 11XX 92 Eng. Rep. 270, 271 (K.B. 1705), turn on exploitation of the promisor's lack of sophistication. James v. Morgan was an action to enforce a
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Section 15, whose text seems to require general incapacity, includes a comment that looks toward transactional incapacity: "[A] person may be able to understand almost nothing, or only simple or routine transactions, or he may be incompetent only with respect to a particular type of transaction."\textsuperscript{32}

It might be argued against the doctrine of transactional incapacity that its introduction would lead to undue uncertainty in contracting. However, sophisticated parties who engage in complex transactions normally deal with other sophisticated parties. If they deal with unsophisticated parties, they know it. An actor, A, who engages in a complex transaction with an unsophisticated party, B, and wants to make sure that the transaction is not unconscionable because of B's transactional capacity, has two simple ways to achieve that result. First, A can explain the transaction and its implications in terms that B can understand. So, for example, in \textit{Weaver v. American Oil Co.},\textsuperscript{33} which involved a complex and legalistically phrased form-contract term that required the untutored operator of an Amoco gas station to indemnify 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."\textsuperscript{34} Alternatively, A can, and should, advise B to get competent advice.\textsuperscript{35} So, for example, in \textit{Morgan v. Reaser} the court said, "There is such a lack of competency on the promise "to pay for a horse a barley-corn a nail, doubling it every nail." 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." Chief Justice Hyde directed the jury to award the plaintiff only the value of the horse. \textit{Thornborow} was comparable to \textit{James}. These cases were discussed in \textit{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." \textit{Id.} at 413.

\textsuperscript{32}. \textit{RESTASTATEMENT SECOND} § 15, Comment b.
\textsuperscript{33}. 257 Ind. 458, 276 N.E.2d 144 (1971).
\textsuperscript{35}. \textit{Cf.} 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.").
part of the defendants as to have made it necessary that they should have had protection and advice . . . n36

E. Unfair Persuasion

In a perfectly competitive market, persuasion ordinarily plays little or no role: buyers and sellers either take or refuse the market price. As the characteristics of a market recede from perfect competition, however, persuasion may play an increasingly important role. This opens the possibility that a promisor who is normally capable of acting in a deliberative manner may be rendered temporarily unable to do so by the promisee's use of unfair persuasion, that is, the use of bargaining methods that deliberately impair the free and competent exercise of judgment, and produce a state of acquiescence that the promisee knows or should know is likely to be highly transitory.

Suppose, in such a case, the promisor changes her mind when the persuasion is removed, as in the following hypothetical:

Troubled Widow. Wanda owns a small clothing boutique. On January 5, Wanda’s husband, Xaviar dies in an automobile accident. At the time of his death, Xaviar owed $60,000 to Robert. The debt was represented by a promissory note, and secured by all of the stock in a corporation that Xaviar wholly owns. Wanda did not sign, and was not liable, on the note. Although originally prosperous, the corporation had run into major troubles, and the stock as of January 5 was worth only $10,000-$15,000. On January 9, Robert goes to Wanda’s house, bringing with him the note and the stock, and tells Wanda that Xaviar's memory will be permanently dishonored unless his debts are paid. Wanda says she does not want to talk about such things now, and asks Robert to come back at another time. Robert goes on talking about Wanda's moral obligations and pounding away at the repugnance of dying with a dishonored

36. Morgan, 87 S.D. at 150.
reputation. Wanda pleads with him to stop, but Robert relentlessly continues. After two hours Wanda agrees that in exchange for the note and stock she will pay Robert $60,000. The next day Wanda has second thoughts, and tells Robert she will not go through with the transaction.37

If classical-contract-law rules were strictly applied, Wanda's promise would be fully enforceable. She has made a bargain, and none of the traditional contract-law defenses appears to apply. The doctrine of undue influence, which might otherwise seem on point, traditionally contemplates a relationship of dominance and subservience, or a special relationship of trust, that preexisted the time when the contract was made. For example, Restatement Second Section 177(1) 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." As stated by one commentator, "Fraud may be ... practiced upon a perfect stranger. Undue influence can exist only where one party occupies a position of dominance over the other."38

However, why should it matter whether dominance existed before the transaction or only in connection with transaction? Indeed, if the persuasion was unfair, why should dominance matter at all? The Comment to Restatement Second Section 177 states, "The ultimate question in determining whether the promisee engaged in unfair persuasion is whether the result was produced by means that seriously impaired the free and competent exercise of judgement." That is exactly right. A promisee who extracts a promise by the use of a bargaining method that he knows or should know seriously impairs the free and competent exercise of the promisor's judgment, and thereby creates a state of acquiescence that is only transitory, is as much at fault as a promisee who exploits a promisor's transactional incapacity. Indeed, he is more at fault,

37. Troubled Widow is loosely based on Newman & Snell's State Bank v. Hunter, 243 Mich. 331, 220 N.W. 665 (1928). The court there refused to enforce the contract on the ground that there was no consideration.
38. Milton Green, Fraud, Undue Influence and Mental Incompetence, 43 COLUM. L. REV. 176, 180 (1943)
because he deliberately creates a special type of transactional incapacity.

Treating unfair persuasion as unconscionable is also supported by considerations of efficiency. The bargain principle rests in substantial part on the premise that a bargain context induces a deliberative state of mind in a promisor, who is the best judge of her own utility. This premise is inapplicable where the promisee has used techniques of persuasion that are 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 persuasion.

A concern with unfair persuasion underlies and explains cooling-off rules that have been adopted by a number of state legislatures, by the Uniform Consumer Credit Code, by the Federal Trade Commission, and by Congress. These rules permit buyers who have made certain types of contracts in their own home to rescind during a specified period. The rules both give recognition to the problem of inducing a transitory state of acquiescence by unfair means, which is not uncommon in the door-to-door, off-market context, and determine the time periods within which a transitory state of acquiescence induced by unfair persuasion may be expected to recede.

Some present law supports treating unfair persuasion as wrongful. A well-known example is Odorizzi v. Bloomfield School District. 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 apartment. The officials advised Odorizzi that if he did not resign

immediately he would be dismissed and his arrest would be publicized, thereby jeopardizing his chances of securing employment elsewhere, but that if he resigned at once the incident would not be publicized. Odorizzi resigned, and the criminal charges were 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."

It might be argued that treating unfair persuasion as unconscionable is that doing so would allow the courts to review any consumer transaction that is entered into as a result of ordinary sales talk. However, ordinary sales does not involve the bargaining methods that seriously impair the free and competent exercise of judgment. Moreover, reputable merchants commonly permit consumers to return unused merchandise for refund or credit, subject, sometimes, to a restocking fee. Accordingly, occasional

erroneous application of the doctrine of unfair persuasion in a consumer context would do no more than produce a result that is often or usually obtainable from reputable merchants even without judicial intervention. Finally, by analogy to the cooling-off rules, the scope of the doctrine could and should be limited by requiring the promisor to make known her change of mind soon after the bargain, because a late objection implies that the seller's persuasion had more than a transitory effect.