ARTICLES

CONTRACT AS COMMODITY: A NONFICTION APPROACH

John J. A. Burke[*]

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The concept of adhesion contracts introduces the serpent of uncertainty into the Eden of contract enforcement.[1]

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[*] Associate Counsel, New Jersey Law Revision Commission.

[1] Klos v. Lot Polish Airlines, 133 F.3d 164, 168 (2d Cir. 1997).

I. Introduction

You are surfing the Net and decide to buy a software program. You pay for the program by entering your credit card number in the seller's form. You download the program to your computer. After launching the program, a dialogue box labeled "License Agreement" occupies the center of your screen. The first few lines of the license agreement are visible. Below are two buttons, one marked "I accept" and the other "I don't accept." The dialogue box has a scroll bar allowing you to view the entire document. Without scrolling down or reading the license agreement, you click the "I accept" button.

Later, you take your clothes to the dry-cleaner. The clerk hands you a receipt and you leave the store. The receipt has your name, the price of the service, and a number written on its front side. The reverse side contains a list of written terms.

That afternoon, your plane tickets, which you have purchased by telephone, arrive in the mail. You check the dates and times of departure and arrival printed on the tickets. Attached to the tickets are several pages of written terms. Later, you fly to Phoenix and, wheeling your luggage-laden cart, arrive in the terminal. You find the Rent-A-Car counter. After waiting in line, the clerk places a car rental agreement several pages thick on the counter, tells you where to sign and gives you the keys to the car.

These transactions are ordinary, routine, and recurrent. The transactions are entered into to buy a product, which is broadly defined to include goods, services, and intellectual property. The focus of each transaction is the product being purchased. Other considerations, such as price, quality, specifications and seller's reputation, are secondary. However, while the focus of the transaction in each case is the product, the merchant used a standard form contract purportedly to affect the transaction's legal consequence.

Courts generally enforce standard form contract terms under the theory of constructive consent.[2] Under that theory, courts find

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[2] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981) [hereinafter RESTATEMENT] (stating in part that "where a party to an agreement signs or otherwise manifests assent to a writing and85 has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing").

that one has agreed to standard terms contained in writings accompanying the purchase of a product, even if the terms were not read, because the person either had notice of the terms or an opportunity to read them.[3] Under this view, the standard form contract governs the parties' rights and obligations in the same way a bargained-for contract would cover the transaction had the parties negotiated and agreed to one. The analytical framework applied to standard form contracts revolves around the traditional idea of contract as agreement resulting from an offer and acceptance.[4] The concepts of offer, acceptance and agreement, however, are foreign to the use of standard form contracts in ordinary transactions.

In reality, people do not intend or contemplate making a contract in these transactions. The law is at odds with the commercial reality it governs. In ordinary transactions, the merchant and customer do not formulate a mutually acceptable agreement. A standard form contract does not fit the ordinary concept of contract; rather, it is tantamount to a commodity. The contract is embedded in the product and constitutes part of its identity. The properties of the contract can no more be changed than the properties of the product itself, because the contract's properties, like the product's, are preset prior to being offered on the market. The purchaser either chooses or refuses to buy the product with the contract included.

In 1996, the New Jersey Law Revision Commission ("Commission") reviewed the problem of enforcement of terms found in standard form contracts.[5] The Commission found that the

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[3] *See, e.g.*, Caspi v. Microsoft Network, 732 A.2d 528, 532 (N.J. Super. 1999); Rudbart v. North Jersey Dist. Water Supply Comm'n, 605 A.2d 681, 687 (N.J. 1992) (holding that a bondholder is bound to the terms of a standard form contract contained in the bond instrument even though the bondholder did not read the contract).

[4] *See* RESTATEMENT, *supra* note 2, § 17. "The formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration." *Id.* Section three of the Restatement defines agreement as "manifestation of mutual assent on the part of two or more persons." *Id.* § 3. "A bargain is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances." *Id.*

[5] The New Jersey Law Revision Commission, created by statute in 1985, is charged with revising the statutory law of the State of New Jersey. *See* N.J. STAT. ANN. § 1:12A-1. The Commission submits its Report and Recommendations to the Legislature. These reports are available on the Internet at <www.lawrev.state.nj.us> or by request sent to: NJLRC, 153 Halsey Street, 7th Floor, Newark, New Jersey, 07101, USA.

law governing the formation of standard form contracts did not reflect the reality of the market place.[6] In addition, the Commission found that the judicial tests for invalidating offensive terms in standard form contracts produced disparate results and, therefore, failed to provide a reliable rule of law.[7] The Commission conducted an empirical study of standard form contracts to identify potentially abusive terms and to determine how parties entered into contracts in the market place. The Commission also conducted a national study of judicial and legislative regulation of standard form contracts to identify regulations related to standard form contracts. Based on its empirical and legal analyses,[8] the Commission produced the Standard Form Contract Act.[9]

II. Anatomy of Standard Form Contracts

A standard form contract is a pre-established record of legal terms regularly used by a business entity or firm in transactions with customers.[10] The record specifies the legal terms governing the relationship between the firm and another party.[11] The firm requires the other party to accept the record without amendment, and without expecting the party to know or understand its terms.[12]

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6 *See generally* New Jersey Law Revision Commission, *Final Report relating to Standard Form Contracts* (visited Mar. 27, 2000) <www.lawrev.state.nj.us/contract.htm> [hereinafter *Commission Report*].

7 *See generally id.*

8 *See id.* at 3.

9 *See* Standard Form Contract Act, A. 3161, 208th Legislature (N.J. 1999). On January 11, 2000, Assemblyman Gary W. Stuhltrager re-introduced the Standard Form Contract Act as A. 978. The bill has been referred to the Assembly Judiciary Committee where it is awaiting action.

10 *See* Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 594 (1990) (defining consumer contract forms as "offered on a 'take-it-or-leave-it' basis, with the purchaser presenting the consumer with a preprinted form detailing the obligations of both parties."). Most definitions related to standard form contracts are phrased in terms of adhesion contracts. *See, e.g.*, Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1177 (1983) (defining seven basic characteristics of contract of adhesion).

11 *See id.*

12 *See* RESTATEMENT, *supra* note 2, § 211 cmt. b ("A party who makes regular use

There are various types of standard form contracts, and they appear in both the paper and electronic media. Some standard form contracts, such as tickets, invoices, and receipts, do not resemble the written contract paradigm. The number of terms contained in standard form contracts ranges from one term, such as that found on a film store receipt, to twenty or more terms, such as those found in bank deposit account contracts.[13]

The widespread use of standard form contracts reflects underlying economic realities.[14] Efficiency requires firms engaged in the mass production and distribution of products to develop identical legal contracts regulating their rights and obligations.[15] A remote producer selling its goods or services to anonymous parties in the market place cannot negotiate individualized legal terms for discrete transactions without disrupting its flow of goods, increasing its exposure to risk and raising the cost of production.[16]

Standard form contracts are an old method of doing business.[17] In the 1880's, Western Union Telegraph Company used standard form agreements containing non-negotiable terms to limit their liability for damages and to standardize terms for products and services offered to the public.[18] Similarly, insurance, telephone, and

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of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms.").

13 For a listing of standard form contracts which demonstrate the range of terms to be found in standardized agreements, see *infra* note 29.

14 *See* W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 531 (1971).

15 *See* RESTATEMENT, *supra* note 2, § 211 cmt. a. ("Standardization of agreements serves many of the same functions as standardization of goods and services; both are essential to a system of mass production and distribution.").

16 Standard form contracts are a practical response to the economic system of mass production and distribution of goods and services. *See* LAWRENCE A. CUNNINGHAM & ARTHUR J. JACOBSON, 3 CORBIN ON CONTRACTS § 559A(B) (rev. ed. Supp. 1999).

17 *See* Andrew Burgess, *Consumer Adhesion Contracts and Unfair Terms: A Critique of Current Theory and A Suggestion*, 15 ANGLO-AM. L. REV. 255 (1986). Burgess notes that in England, standard form contracts run back to the end of the eighteenth century, when large railway companies used standardized terms to disclaim liability for goods damaged during carriage. *See id.* at 259-60.

18 *See, e.g.*, Primrose v. Western Union Telegraph Co., 154 U.S. 1 (1893). In 1888, the reverse side of Western Union's standardized message form contained non-negotiable terms limiting Western Union's liability for failed message transmissions to the price of the transmission or, in case of non-delivery, to fifty times that price. *See id.* at 13. Senders could purchase insurance at an additional cost to assure the correctness of the message to any particular point on the line. *See id.* at 13-14. The Supreme Court held that Primrose accepted the terms of the contract by writing his message and

railroad companies adopted standardized contracts to set uniform terms with customers.[19] Today, the use of uniform and inflexible contract terms is the unquestioned and universal manner of doing business. Standard form contracts are a logical result of large-scale enterprise and complex economies.[20]

A standard form contract is similar to, though not identical to, a contract of adhesion.[21] The Supreme Court of New Jersey, using a broadly accepted definition, has stated, "the essential nature of a contract of adhesion is that it is presented on a take-it-or-leave-it basis, commonly in standardized printed form, without opportunity for the 'adhering' party to negotiate except for a few particulars."[22] When a contract is deemed one of adhesion, courts review the parties' relative bargaining power, the degree of economic compulsion motivating the "adhering party," and the public interest affected by the contract to determine whether to enforce the terms of the contract.[23]

Courts generally treat the adhesion contract as if it were a rare deviation from the common bargained-for contract.[24] The reality, however, is that in an advanced economy the standard form contract accounts for more than 99% of all contracts used in commercial and consumer transactions for the transfer of goods, services and software.[25] It would be difficult for any person to go through one day without encountering a standard form contract. These contracts

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signing the blank form. *See id.* at 25. There is no substantive difference between the 1888 Western Union contract and the average standard form contract today.

19 *See* Frederich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631 (1943). Kessler observes that "[t]he insurance business probably deserves credit. . .for having first realized the full importance of the so-called 'juridical risk.'" *Id.* at 631

20 *See* Burgess, *supra* note 17, at 260.

21 *See* Burgess, *supra* note 17, at 256 (observing that "[t]he contract of adhesion was first isolated as a transaction type by the French jurist Raymond Saleilles, who, in 1901, identified what he called 'contrats d'adhesion'"). According to Saleilles, the adhesion contract consisted of "pre-formulated stipulations in which the will of one party dominates the transaction." *Id.* at 256.

22 *Rudbart*, 605 A.2d 681, 685 (N.J. 1992).

23 *See id.* at 687.

24 *See, e.g.*, Lauvetz v. Alaska Sales & Service, 828 P.2d 162 (Alaska 1991). In *Lauvetz* the Court concluded that a damage waiver exclusion in an automobile lease was unenforceable, in part because the National agent did not explain the exclusion term to the lessees before they signed the lease. *See id.* at 165-66.

25 *See* Slawson, *supra* note 14, at 529.

are neither good nor bad, and neither just nor unjust, for they are necessary and generally mutually beneficial.

Nevertheless, the judiciary holds standard form contracts in low regard. Ever since Frederich Kessler's 1943 seminal article, *Contracts of Adhesion - Some Thoughts About Freedom of Contract*, the charge of exploitation has tarnished the reputation of standard form contracts.[26] Borrowing from Professor Kessler's jargon, standard form contracts enable "powerful and commercial overlords. . .to impose a new feudal order of their own making upon a vast host of vassals."[27] The case law in the area of standard form contracts juxtaposes images of dominant corporations against disadvantaged submissive individuals.[28] According to this view, the delegation of law-making powers to private parties, the cornerstone of the freedom of contract model, has had an unexpected and undesirable consequence upon the institution of contract.

In 1999, the Commission collected fifty typical standard form contracts likely to be encountered by the general public including: (1) consumer goods; (2) general services; (3) banks, brokerage, and financial services; (4) computer software; and (5) motor vehicles.[29]

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26 *See generally* Kessler, *supra* note 19.

27 Kessler, *supra* note 19, at 640.

28 In 1997, over fifty years after Professor Kessler's article, the Second Circuit stated that "[t]ypical contracts of adhesion are standard-form contracts offered by large, powerful corporations to unrepresented, uneducated, and needy individuals on a take-it-or-leave-it basis, with no opportunity to change the contract's terms." Klos v. Lot Polish Airlines, 133 F.3d 164, 168 (2nd Cir. 1997).

29 Sample contracts were obtained from various merchants, financial institutions, catalogue and on-line businesses. The following contracts are on file with the Commission: (1) Bauhaus USA Inc. Furniture Warranty registration card (1996); (2) Braun Limited Warranty 0-855-144/V-90; (3) CMC, NJ, purchase agreement; (4) Casio Limited Warranty Card; (5) Edison Park Fast Receipt Rev. (04/27/93); (6) General Electric Air Conditioner Warranty Pub. No. 49-7327 (4/95); (7) Kenmore Camera Warranty (11/14/97); (8) Madison Plumbing Supply Company, NJ, Purchase Order with Terms and Conditions (12/30/97); (9) Nokia Limited Warranty 9358105; (10) Photos Splash receipt; (11) Radio Shack Limited Warranty (9/94); (12) Toymax 90 Day Limited Warranty; (13) Turtle Beach Systems Warranty; (14) Stella Dry Cleaners Receipt, NJ; (15) Open-Vue Cleaners Receipt, NJ; (16) Glassman Cleaners Receipt, NJ; (17) AT&T System 25 Purchase Agreement (05/87); (18) AT&T Wireless Services Agreement; (19) Bell Atlantic Premises Work Invoice (11/24/95); (20) Computer Renaissance Test to Buy Form, NJ (5/9/97); (21) Fairmount Cemetery, NJ, Agreement; (22) Federal Express Airbill (Rev. 12/92); (23) Gibson Greetings Inc. Ohio, Nonconfidential Disclosure Agreement (4/28/98); (24) NJ Bell Yellow Pages Agreement (5/17/90); (25) American Express Notice of Amendments OPT-CTB-0 (8/91); (26) First Chicago Standby Letter of Credit; (27) First Union Deposit

Counter-intuitively, most standard form contracts are not comprehensive agreements, but terms printed on a card or slip of paper found in the product's packaging.[30] In the Commission's study, twelve standard form contracts contained more than ten terms,[31] thirty-nine contained less than ten terms, and a few contracts contained only a single term.[32] Comprehensive standard form contracts were limited to the computer, banking and automobile industries, which are institutions likely to retain counsel to draft their contracts.

Most short contracts were printed on a written receipt and addressed two issues: scope of warranty and limitation of liability. For example, film processors limited their liability to the cost of film and processing if the exposed roll of film is damaged during the development process. Terms of this sort are reasonable restrictions imposed on the transaction.[33] Holding a film store liable for the cost of one's overseas vacation because they damaged the film while trying to develop it would raise the price of film, produce frivolous

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Agreement and Disclosures for Non-Personal Accounts; (28) First USA Titanium Mastercard (10/9/98); (29) The Home Depot Commercial Revolving Charge Agreement (4/97); (30) Hudson City Savings Bank Notice of New Mortgage Term 092R/96-30M; (31) National Westminster Bank NJ Letter of Credit; (32) PaineWebber Combined ACAT/RMA Application BMKT 3267(Rev. 8/94); (33) Anawave Software, Inc. End User Software License; (34) Terms and Conditions for Use of Counsel Connect (9/20/96); (35) Creative End-User Software License Agreement (4/10/99); (36) Hewlett Packard Software License Terms (8/97); (37) PointCast Network License Agreement (10/31/97); (38) End-User License Agreement for Microsoft Software Windows 95 (4/10/95); (39) Microsoft End-User License Agreement and Limited Warranty (2/14/96); (40) Microsoft License Agreement (1/30/95); (41) Netscape Navigator End User License Agreement; (42) Chase Automotive Finance Lease Agreement; (43) Ford Credit New Jersey Motor Vehicle Lease Agreement (11/96); (44) GMAC Lease Agreement (10/96); (45) Madison Honda Courtesy Car Agreement, NJ, 2330A (5/89); (46) Madison Honda Lease Agreement, NJ, (2/97); (47) Mazda New Jersey Motor Vehicle Lease Agreement (5/95); (48) Nissan Retail Buyer Order; (49) Nissan Motor Acceptance Corporation Closed End Motor Vehicle Lease Agreement (7/96) and (50) Macys Charge Account Agreement (11/97).

30 *See, e.g.*, Toymax 90 Day Limited Warranty; Braun Limited Warranty; *see also supra* note 29.

31 *See, e.g.*, AT&T System 25 Purchase Agreement; Netscape Navigator End User License Agreement; Mazda New Jersey Motor Vehicle Lease Agreement (5/95); Nissan Motor Acceptance Corporation Closed End Motor Vehicle Lease Agreement (7/96); GMAC Lease Agreement (10/96); Madison Honda Lease Agreement (2/97); *see also supra* note 29.

32 *See, e.g.*, Toymax 90 Day Limited Warranty; *see also supra* note 29.

33 *See Commission Report, supra* note 6, at 15-17.

litigation, and implement an insurance system without legislative approval.[34]

With a few exceptions, terms in standard form contracts addressing a broad array of legal issues were also reasonable. An exception was a courtesy car contract providing that the lessee agrees "to release Lessor from any claim that Lessee might have against Lessor for any alleged defects in the vehicle, or in any manner growing out of the Lessee's use of the vehicle."[35] The lessor, by contract, therefore is not liable for its wrongs, a term unenforceable in tort law.[36]

Of the seventeen standard form contracts relating to goods in the sample, none contained especially onerous terms.[37] For example, the Casio scientific calculator provided a warranty limited to one year, which covered only repair or replacement of the product and excluded incidental and consequential damages.[38] The warranty imposed the cost of freight on the buyer, the only term arguably one-sided, but unlikely to be deemed unconscionable. The remaining sixteen contracts contained similar limited warranty terms. The only unusual term was one contract's requirement that the buyer provide the original proof of purchase and the UPC code label from the box to qualify for the warranty.[39]

The Commission found that certain types of terms appear with regularity and have the potential for abuse: (1) warranty; (2) damages; (3) attorneys' fees; (4) refund and repair; (5) indemnification; (6) risk of loss; and (7) waiver of rights.[40] But the hue and cry over enforcement of "adhesive" contract terms is out of proportion compared to the actual problems posed.[41] It is not helpful to evaluate standard form contract terms by focusing on whether one party had "overweening" bargaining power.[42] In the case of standard form contracts, the existence of one party with

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34 *See Commission Report, supra* note 6, at 15-17.

35 Madison Honda Lease Agreement (2/97); *see also supra* note 29.

36 *See, e.g.*, Marr Enterprises v. Lewis Refrigerator Co., 556 F.2d 951, 956 (9th Cir. 1977) (holding that tort liability for negligence cannot be contractually waived).

37 *See* Commission Report, *supra* note 6, at 14.

38 *See* Casio Limited Warrranty Card; *see also supra* note 29.

39 *See* Toymax 90 Day Limited Warranty; *see also supra* note 29.

40 *See Commission Report, supra* note 6, at 14.

41 *See Commission Report, supra* note 6, at 12.

42 *See Commission Report, supra* note 6, at 12.

overweening bargaining power with respect to that transaction is the norm.[43]

III. The Legal Dilemma

A. Enforcing Standard Form Contracts

Standard form contract terms are enforced by assuming that the party has adopted the writing.[44] This presumed, or fictional consent, is consistent with the objective character of contract law that avoids probing the "mind" of the contracting party and stresses objective criteria such as the buyer's signature or other manifestations of assent.[45] By pretending that buyers have consented to terms, courts enforce promises as if they were freely and knowingly made.[46] The problem is that the legal fiction is not the exceptional case. The signature scrawled on the car rental contract at the airport, or the click of the mouse button on the computer screen is not real consent.[47] The law thus solves the legal problem of enforceability by denying the problem in the first place.

Equally devoid of merit is the second approach of enforcing contracts only when they can be deemed the products of negotiation and consent.[48] The virtue of this approach is its fidelity to the

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43 *See Commission Report, supra* note 6, at 12.

44 *See, e.g.*, Lewis v. Great Western Ry., 5 H.& N. 867, 157 Eng. Rep. 1427 (Ex.1860) (holding that the document regulating rights between the railroad and the plaintiff was binding upon the plaintiff who had signed but not read it). American courts have consistently applied this rule to signed contracts. *See, e.g.*, Upton v. Tribilcock, 91 U.S. 45, 50 (1875).

45 *See* Hotchkiss v. Nat'l City Bank of New York, 200 F. 287, 293 (S.D.N.Y. 1911). In *Hotchkiss,* Judge Learned Hand stated that "[a] contract has. . .nothing to do with the personal or individual intent of the parties. A contract is an obligation attached by mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent." *Id.*; *see also* CORBIN ON CONTRACTS § 9 (1952) (examining the importance intent plays in the formation of a contract).

46 *See Commission Report, supra* note 6, at 2.

47 Consent is approval of what is proposed by another person. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 482 (1986). It follows that one cannot approve of something one neither knows nor understands.

48 *See, e.g.*, Broemmer v. Abortion Serv. of Phoenix, Ltd., 840 P.2d 1013 (Ariz. 1992) (finding that an arbitration clause was unenforceable because it was not negotiated prior to patient's signature and term not brought explicitly to patient's

concept of contract as a promise, which remains a widely held convention.[49] This approach often relies on technical niceties to prove adequate notice of terms. The font size of the print or the location of disputed terms in the contract becomes critical to finding that the party knew, or should have known, of the term.[50] If literally followed, this view would throw into doubt most terms found in standard form contracts. No matter how big the type, buyers do not really read and accept the terms.[51]

Conversely, when a court does not want to enforce a particular term in a standard form contract, it relies upon a variety of devices.[52] The primary test, though expressed in many formulations, is whether the term "shocks the conscience" of the court, or in other words, is unconscionable.[53] Courts have characterized the basic test in terms of reasonable expectations, unfair surprise, and public policy.[54] The common fault of these tests is their lack of objective criteria.[55] Each test boils down to the subjective preferences of

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attention).

49 *See* RESTATEMENT, *supra* note 2, § 3 ("A bargain is an agreement to exchange promises.").

50 *See, e.g.*, Cate v. Dover Corp., 790 S.W.2d 559, 562 (Tex. 1990) (holding that a disclaimer of the warranty of merchantability in text undistinguished in typeface, size, or color is unenforceable unless the buyer has actual knowledge of the of term).

51 *See* Barry Meier, *In Fine Print, Customers Lose Ability to Sue*, N.Y. TIMES, Mar. 10, 1997, at A1 (noting that Americans are often consenting to arbitration without even knowing it due to fine print and practical impediments to careful reading of lengthy disclosed terms).

52 *See* G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CALIF. L. REV. 433, 439 (1993) ("Under the current public policy doctrine, judges may draw not only on constitutions, statutes, and case precedent, but also on their own views of what public interest or morality requires to overrule market choices by refusing to enforce certain types of agreements.").

53 *See, e.g.*, Bosinger v. Phillips Plastics Corp., 57 F. Supp. 2d 986 (S.D. Cal. 1999); Greene v. Gibraltar Mortgage Investment Corp., 488 F. Supp. 177 (D.D.C. 1980); Kinney v. United Healthcare Services, Inc., 70 Cal. App. 4th 1322 (Cal. Ct. App. 1999).

54 *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins., 682 P.2d 388, 396 (Ariz. 1984) (illustrating the convergence of the unconscionability doctrine and the test set out in Restatement (Second) of Contracts § 211); Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843, 857 (1967) (holding that a real estate broker contract requiring payment of a commission upon presentation of a qualified and ready buyer was contrary to public policy because it was unconscionable and contrary to seller's expectations that payment was due only upon closing).

55 *See* Comment, *Unconscionable Contract Provisions: A History of Unenforceability from Roman Law to the UCC*, 42 TUL. L. REV. 193, 196 (1967) (stating that "[o]ne of the most significant problems in applying a concept of

judges applying the test.[56] Consequently, the enforceability of a particular term depends on whether the court likes or dislikes the term.[57]

B. Constructive Consent to Constructive Signature

Courts historically have enforced contracts in which one party has not read the contract by relying on the simplifying assumption that, if the party signs the contract or otherwise indicates consent, it will be presumed that the party agreed to the contract terms.[58] The signature rule is justified for practical reasons. Articulating this proposition, Justice Oliver Wendell Holmes once stated, "[t]he law has nothing to do with the actual state of the parties' minds. In contract, as elsewhere, it must go by externals, and judge parties by their conduct."[59] Similarly, Professor Corbin remarked, "[i]n these cases he may be bound by promises that he did not consciously know he was making but by which he leads the other party reasonably to believe that he intends to be bound."[60] Cases enforce signed contracts even when evidence shows that the signer never read the contract.[61]

'unconscionability' is simply definitional"). The lack of definition has allowed courts to use a variety of devices, such as lack of consideration, lack of mutual assent, and contract language ambiguities, to invalidate contract terms on the ground that they are unconscionable. *See id.*

56 *See* Shell, *supra* note 52, at 439-43.

57 *See* Shell, *supra* note 52, at 439-43.

58 *See, e.g.*, Gaskin v. Stumm Handel Gmbh., 390 F. Supp. 361, 366 (S.D.N.Y. 1975). One federal judge has made the following observation:

He who signs or accepts a written contract, in the absence of fraud or other wrongful act on the part of another contracting party, is conclusively presumed to know its contents and to assent to them, and there can be no evidence for the jury as to his understanding of its terms.

Id.

59 OLIVER WENDELL HOLMES, THE COMMON LAW 309 (1991).

60 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS, § 607 (West 1952).

61 *See, e.g.*, Fivey v. Pennsylvania Railroad Co., 52 A. 472 (N.J. 1902). In *Fivey*, the railroad's company physician told plaintiff, during a mandatory physical examination, to sign the membership application, as "it was all a matter of form." *Id.* at 473. The plaintiff signed the application without reading or understanding its contents. *See id.* The membership agreement provided that acceptance of payment from the relief fund operated as a release of all claims for damages against the company. *See id.* Relying on "the well-settled principle that affixing a signature to a contract creates a conclusive presumption. . .that the signer read, understood and

The legal fiction of consent based primarily on signature has yielded to the reality that most standard form contracts today are not signed.[62] Courts now look to other manifestations of assent to infer that the party consented to written standardized terms. In 1991, the United States Supreme Court in *Carnival Cruise Lines v. Shute* established that acceptance of a passenger ticket was equivalent to acceptance of its terms. [63] The Court there enforced a forum selection clause found included among three pages of terms attached to a boarding ticket for a cruise ship vacation.[64] The face of the ticket contained in large print: "SUBJECT TO CONDITIONS OF CONTRACT ON LAST PAGES IMPORTANT! PLEASE READ CONTRACT – ON LAST PAGES 1,2,3."[65] Ignoring the fact that the ticket was already purchased, the Court concluded that this language gave the Shutes the "option of rejecting the contract with impunity."[66] Stating that "[c]ommon sense dictates that a ticket of this kind will be a form contract the terms of which are not subject to negotiation, and that an individual purchasing the ticket will not have bargaining parity with the cruise line," the Court found that Mrs. Shute knew she had taken the ticket subject to non-negotiable terms. [67] In addition, the Court, without producing any empirical data, reached the economic conclusion that forum selection clauses result in reduced cruise fares.[68]

Cases decided after *Carnival Cruise* support this proposition. In the 1996 case, *ProCD v. Zeidenberg*,[69] for example, ProCD produced a CD-ROM, entitled SelectPhone, containing the database of information from telephone directories and a proprietary search engine.[70] The compact disc was sold in retail software packages

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assented to its terms," New Jersey's highest court affirmed the trial court's dismissal of Fivey's claim for damages. *Id.*

62 *See* Katie Hafner, *It May Be Boilerplate, but Read Before You Click*, N.Y. TIMES, Apr. 16, 1998, at G3 (remarking that the digital equivalent of boarding a plane is that mouse click on the "I Agree" button, which the vendor construes as a customer's acceptance of the contract terms).

63 Carnival Cruise Lines v. Shute, 499 U.S. 585, 596-97 (1991).

64 *See id.* at 587.

65 *Id.*

66 *Id.* at 595

67 *Id.* at 593.

68 *See Carnival Cruise*, 499 U.S. at 594.

69 ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).

70 *See id.* at 1449.

covered in plastic, and each package stated that the software was subject to an enclosed license.[71] ProCD offered a consumer version of its product at a substantially lower price than the commercial version.[72]

Zeidenberg purchased a consumer copy of SelectPhone.[73] Contrary to the license, he resold the information contained in the SelectPhone database to the public at a price less than that ProCD charged its commercial customers.[74] ProCD filed suit to obtain an injunction prohibiting any distribution of the product in violation of the license agreement.[75] The district court held that the license terms were invalid because they did not appear on the outside of the package.[76] Zeidenberg, the district court reasoned, could not have agreed to such hidden terms at the time of his purchase.[77] Rather, the court determined that only terms disclosed prior to purchase formed part of the contract.[78]

Judge Easterbrook, writing for the Seventh Circuit, reversed.[79] The court reasoned that by paying for the product and by not rescinding the transaction as he had a right to do under the license, he was bound by the contract and the license terms, notwithstanding the fact that their delivery occurred after payment.[80] Numerous transactions involve the exchange of money prior to delivery of terms such as airline tickets and insurance contracts.[81] As a practical matter, upholding the district court judgment would have sent contract practice back to the nineteenth century.

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71 *See id.*

72 *See id.*

73 *See id.* at 1450.

74 *See ProCD*, 86 F.3d at 1450.

75 *See id.*

76 *See id.*

77 *See id.*

78 *See id.*

79 *See ProCD*, 86 F.3d at 1450.

80 *See id.* at 1452.

81 *See* Robert W. Gomulkiewicz, *The License is the Product: Comments on the Promise of Article 2B for Software and Information Licensing*, 13 BERKELEY TECH. L.J. 891, 898 (1998) (stating that "[s]tandard form contracts are not only ubiquitous in modern commerce; they are also regarded as an efficient method of distribution under the Restatement (Second) of Contracts and universally upheld under Article 2 of the Uniform Commercial Code").

It does not follow, however, that purchasers act at their peril. The Seventh Circuit held that the contract is not formed and not binding upon the buyer until the buyer has had a chance to read the post-payment terms and fails to exercise his right to reject the product.[82] This delayed formation rule allowed the Court to treat "pay-now terms-later" agreements as ordinary contracts whose effectiveness can be determined by resorting to the standard rules of offer, acceptance and consent.[83] Just as use was equivalent to consent in *Carnival Cruise*, failure to reject was equivalent to consent in *ProCD*.[84]

In theory, constructive consent is sound; in practice, with regard to standard form contracts, it is bankrupt. Pretending that a party's signature, or its equivalent, means consent ignores what everyone already knows. There is not one iota of consent to be found in most standard form contracts or license agreements whether a signature appears on the bottom of a written contract or the "I agree" button was depressed on a digital contract. Courts know that parties sign or manifest assent to standard form contracts that they have not read, understood or negotiated.[85] Courts apply the simplifying assumption of constructive consent to enforce standard form contracts and thereby create a legal regime that contradicts the commercial reality it governs.[86]

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82 *See ProCD*, 86 F.3d at 1453.

83 *See id.*

84 *See id.* The decision in *ProCD* has set the norm. In 1997, the Court in *Hill v. Gateway 2000* held that Hill's failure to return the Gateway computer within the 30-day period specified in the written terms contained in the shipment box constituted acceptance of the contract terms. *See* Hill v. Gateway 2000, 105 F.3d 1147, 1150 (7th Cir. 1996). In 1999, the Court of Appeals of Washington enforced a license agreement on the ground that Mortenson, a commercial party, installed and used the software, although prior to delivery Mortenson had discussed only the terms of price and quantity with the seller. *See* Mortenson v. Timberline, 970 P.2d 803 (Wash. Ct. App. 1999); *see also* Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (App. Div. 1998) (enforcing an arbitration clause contained in Gateway's license agreement).

85 *See Commission Report*, *supra* note 6, at 2.

86 *See Commission Report*, *supra* note 6, at 2.

IV. Judicial Scrutiny of Unenforceable Terms

Judges often invalidate standardized terms they do not like.[87] The traditional method of voiding abusive contract terms relied upon principles such as breach of good faith, estoppel, waiver, unconscionability and rules favoring the non-drafting party.[88] Most, if not all, abusive contract terms may be avoided by relying on the traditional repertoire of judicial tools. Finding these principles overly constrictive, however, courts have developed additional concepts specifically addressed to terms found in standard form contracts.[89] These new concepts are particularly insidious since they allow the courts to ignore the written language of the contract and substitute their own judgment.[90]

A. The Reasonable Expectations Test

The reasonable expectations test has its roots in insurance contract law. Professor Robert Keeton formulated a set of principles to explain the results of disparate insurance law decisions voiding exclusionary clauses in insurance policies.[91] In the insurance context, the "reasonable expectations" test is concerned with that coverage which a layperson would reasonably have expected to obtain, given a layperson's interpretation of the policy's terms.[92]

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87 *See, e.g.*, Kubis & Perszyk Assoc., Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996) (invalidating a choice-of-forum clause in a commercial contract by noting, with reference to Motor Vehicle Franchise Act, "we entertain little doubt that the Legislature would prefer to extend that prohibition to other franchisees rather than to permit forum-selection clauses to thwart the vindication of franchisee's rights under the Act").

88 *See* Allen v. Prudential Property & Cas. Ins., 839 P.2d 798, 805 (Utah 1992) (maintaining that rules such as estoppel, waiver, unconscionability, breach of the implied duty of good faith, fair dealing, and the rule that ambiguous language is to be resolved against the drafter, are sufficient to protect against contractual overreaching).

89 *See Commission Report*, *supra* note 6, at 2.

90 *See Commission Report*, *supra* note 6, at 2.

91 *See generally* Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions (Part 1)*, 83 HARV. L. REV. 961 (1970); Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions (Part 2)*, 83 HARV. L. REV. 1281 (1970).

92 *See, e.g.*, Kievit v. Loyal Protective Life Ins., 170 A.2d 22, 26 (N.J. 1961) (declaring that "[w]hen members of the public purchase policies of insurance they are

Courts have adopted different versions of the reasonable expectations test. The Supreme Court of Utah has stated, "[t]oday, after more than twenty years of attention to the doctrine in various forms by different courts, there is still great uncertainty as to the theoretical underpinnings of the doctrine, its scope and the details of its application."[93] Despite these shortcomings, the reasonable expectations test has leached into the domain of contracts generally. Generally, the test seeks to preserve those expectations a consumer would have after reading the standard form contract.

Neither courts nor parties are likely to know the consequences of applying the test to any particular set of facts. First, whose expectations are measured? A court may look to either: (1) the litigant's; (2) the hypothetical consumer's; or (3) the hypothetical reasonable person's. Second, what is the source of the reasonable expectation? Possible sources include: (1) an ambiguous term in the contract; (2) the subjective preference of the insured; or (3) objectively independent expectations? Members of courts often bitterly dispute the meaning and effect of the test.[94] The test is a muddled and protean judicial doctrine lacking a uniform and accepted definition within the common law.

Consider the 1976 case of *Wheeler v. St. Joseph Hospital*.[95] Prior to his admission to St. Joseph's Hospital for an angiogram and catheterization test, David Wheeler signed an admission form containing an agreement to arbitrate claims with the hospital.[96] The Wheelers subsequently sued the hospital for damages arising from the injuries sustained during his medical treatment.[97] The hospital

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entitled to the broad measure of protection necessary to fulfill their reasonable expectations"). The Third Circuit Court of Appeals in *Murray v. United of Omaha Life Ins.*, concluded that New Jersey state courts would not enforce an interpretation of the insurance contract that would defeat the insured's reasonable expectations, thus attesting to the continuing vitality of *Kievit*. *See Murray*, 145 F.3d 143 (3d Cir. 1998); *see also* Davis v. M.L.G. Corp., 712 P.2d 985, 989 (Colo. 1986) (holding that, with regard to collision damage waiver, "courts are desirous of upholding a lessee's reasonable understanding of the scope of the rental agreement's collision damage waiver provision"); Darner Motor Sales, Inc. v. Universal Underwriters Ins., 682 P.2d 388, 395 (Ariz. 1984) (finding that, in standardized agreement, insured is not bound to unknown terms which are beyond the range of reasonable expectation).

93 *Allen*, 839 P.2d at 802.

94 *See, e.g.*, Wheeler v. St. Joseph Hosp., 133 Cal. Rptr. 775 (Cal. Ct. App. 1976).

95 *See id.*

96 *See id.* at 778.

97 *See id.*

sought to enforce the arbitration agreement in the admission form.[98] The *Wheeler* court produced a majority opinion and a dissenting opinion.[99] The majority opinion noted that "a party cannot be compelled to arbitrate a dispute he has not agreed to submit," and ruled that Mr. Wheeler's signature did not constitute his consent to be bound by the written and clear terms of the contract.[100] The court held that "[a]bsent notification and at least some explanation, the patient cannot be said to have exercised a 'real choice' in selecting arbitration over litigation."[101]

The *Wheeler* majority also found that the admission document was a contract of adhesion, stating, "[e]nforceability depends upon whether the terms of which the adherent was unaware are beyond the reasonable expectations of an ordinary person or are oppressive or unconscionable."[102] This characterization allowed the Court to conclude that something as vague as the parties' "reasonable expectations" constituted the contract instead of the words contained in the contract itself.[103] Without substantiation, the court concluded that a patient "would hardly expect his signature to an admission form to be taken as an agreement to give the hospital as well as any doctor the option to compel arbitration of a malpractice claim."[104]

Taken to its logical conclusion, the rule in *Wheeler* would require face-to-face encounters between sellers and buyers where the seller's representative would have to explain the contents and legal effects of standard terms to the buyer. This result was fully rejected by the United States Supreme Court in *Carnival Cruise* and the Seventh Circuit in *Hill v. Gateway 2000, Inc.*[105]

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98 *See id.*

99 *See Wheeler*, 133 Cal. Rptr. at 794.

100 *Id.* at 782.

101 *Id.* at 786.

102 *Id.* at 783. The court reasoned that "[i]n dealing with standardized contracts, courts have to determine what the weaker contracting party could legitimately expect by way of services according to the enterpriser's 'calling' and to what extent the stronger party disappointed reasonable expectations based on the typical life situation." *Id.*

103 *See id.* at 785.

104 *Wheeler*, 133 Cal. Rptr. at 786.

105 *See generally* Hill v. Gateway 2000, 105 F.3d 1147 (7th Cir. 1996).

The dissent in *Wheeler* reached the opposite conclusion based on the identical set of legal rules.[106] The dissent observed that essentially all written commercial transactions, other than those designed by attorneys representing clients with equal bargaining power, are, to some degree, contracts of adhesion.[107] Merging the reasonable expectations test with the unconscionability test, the dissent stated that the strict rules governing adhesion contracts come into play only when the contract contains terms giving the party with superior bargaining power an unconscionable advantage.[108] The dissent did not find that the hospital admission document took any unconscionable advantage over Mr. Wheeler. Rather, the dissent noted that the arbitration clause was spelled out in plain English, in normal size type, and appeared right above his signature.[109]

The contrast between the majority and minority opinions demonstrates the undisciplined and arbitrary character of the reasonable expectations test.[110] The *Wheeler* majority opinion and dissent represent nothing more than the personal preferences of the judges who wrote the opinions. In each instance, the progression from the court's initial premise to its final conclusion did not constitute a logical chain of reasoning, but a broad-based policy analysis based upon absolutely no empirical data. The *Wheeler* majority found that no reasonable person would expect to find an arbitration clause in a hospital agreement.[111] The dissent found that no reasonable person would prefer litigation to arbitration.[112]

The reasonable expectations test essentially posits that the source of contract terms is outside the written contract and that the written contract itself does not represent the parties' agreement. This permits courts to substitute their own judgment for that of the authoring party and to legislate contract standards without the support of clear rules. Consequently, the doctrine does not produce predictable results.

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106 *See Wheeler*, 133 Cal. Rptr. at 797 (Gardner, J., dissenting).

107 *See id.*

108 *See id.* at 796-97 (Gardner, J., dissenting).

109 *See id.* at 797 (Gardner, J., dissenting).

110 *See, e.g., Allen*, 839 P.2d at 810 (applying the "reasonable expectations test"). and leading to contradictory majority and dissenting opinions).

111 *See Wheeler*, 133 Cal. Rptr. at 786.

112 *See id.* at 795 (Gardner, J., dissenting).

B. The Restatement Approach

The Restatement of Contracts also attempts to regulate standard form contracts.[113] With respect to standard form contracts, section 211 of the Restatement provides that "[w]here the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."[114] This test, often referred to as unfair surprise, turns the reasonable expectations test on its head.

Unlike the reasonable expectations tests, the Restatement test assumes that the taker of the contract has neither read nor understood most standardized terms.[115] The rule focuses on the state of mind of the party preparing the standard form contract.[116] This party must ask itself whether the other party to the contract would be surprised to learn that the standard form contract contained the term in dispute and would reject the contract. As indicated a comment in the Restatment, section 211 of the Restatement was on the case of *Kievit v. Loyal Protective Life Insurance Co.*, in which the court invalidated an exclusion clause contained in an endorsement to an accident insurance policy.[117] The *Kievit* decision, however, stands on flimsy reasoning. The court had ample medical evidence to find that the exclusion did not apply by finding that the disabled worker did not suffer from a pre-existing disease and that the injury resulted from an accident. Ignoring the clear terms of the endorsement, the court adopted the broad rule, "[w]hen members of the public purchase policies of insurance they are entitled to the broad measure of protection necessary to fulfill

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113 The Restatement (Second) of Contracts is a restatement of common law in the form of a Code. It carries weight by virtue of the fact that it was published by the American Law Institute.

114 RESTATEMENT, *supra* note 2, § 211.

115 *See* RESTATEMENT, *supra* note 2, § 211. A comment to the Restatement provides that "a party who makes regular use of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms." *Id.* § 211 cmt. b.

116 *See* RESTATEMENT, *supra* note 2, § 211 cmt. f.

117 *See Kievit v. Loyal Protective Life Ins.*, 170 A.2d 22 (N.J. 1961) (finding that members of the public who purchase policies of insurance are "entitled to the broad measure of protection necessary to fulfill their reasonable expectations").

their reasonable expectations," even if these expectations contradict the clear language of the insurance contract.[118]

This sympathetic analysis disregarded the parameters of the insurance contract limiting coverage to disabilities proximately caused by accidents, not by pre-existing conditions. The exclusion did not nullify the insurance. The *Kievit* court refused to enforce a term that produced a result it did not like. The Restatement test not only adds little to the reasonable expectations test but also derives its legal authority from an opinion founded on judicial sympathy, rather than logic.

C. *Unconscionability*

Unconscionability is an ancient common law principle derived from Roman law.[119] It is part of the common law of contract and has been enacted in statutory form, most notably in the Uniform Commercial Code.[120] The doctrine of unconscionability, unlike the reasonable expectations and unfair surprise tests, applies to bargained-for contracts and to standard form contracts. The doctrine recognizes two types of unconscionable conduct: procedural unconscionability, which is unconscionable conduct in the contract-making process, and substantive unconscionability, which is an unusual or oppressive term contained in the contract.[121]

Neither the Uniform Commercial Code nor the common law define the term "unconscionable." However, an unconscionable contract historically has been characterized as one "which no man in his senses, not under delusion, would make, on the one hand, and which no fair and honest man would accept on the other."[122] More contemporary standards ask whether a term is oppressive, gives the stronger party to the contract an unfair advantage over the weaker party, or whether the adherent had a meaningful choice concerning

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118 *Id.* at 26.

119 *See* Comment, *Unconscionable Contract Provisions: A History of Unenforceability from Roman Law to the UCC*, 42 TUL. L. REV. 193 (1967).

120 *See, e.g.*, UNIFORM COMMERCIAL CODE § 2-108 (1958); UNIFORM COMMERCIAL CODE § 2A-108 (1987).

121 *See* Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (App. Div. 1998).

122 Hume v. United States, 132 U.S. 406, 410 (1889).

the term.[123]

Unconscionability, like reasonable expectations and unfair surprise, allows rationalization of a preferred result. In *Denlinger, Inc. v. Dendler*,[124] the court enforced a personal guarantee clause in a credit application against an incorporated entrepreneur. Dendler signed the credit application, which contained a personal guarantee clause on its reverse side, in the name of his corporation.[125] The corporation went bankrupt and the creditor sued Dendler individually to recover the corporation's debt.[126] Finding that the credit application was not a contract of adhesion and finding the term reasonable, the majority enforced the application as written, observing that the high school-educated Dendler was a sophisticated businessman, presumably because he was an experienced laborer.[127] Therefore, unlike a consumer, he had equal bargaining power with his construction materials supplier and was bound by his signature.

The dissent, by contrast, reasoned that Dendler intended to bind the corporation, rather than himself, and that the supplier accepted that risk.[128] The dissenting judge also contended that Dendler was functionally a consumer in terms of education, business acumen and experience, the credit application was a contract of adhesion, and the clause constituted an unfair surprise.[129] Thus, the same doctrine of unconscionability, devoid of standards, was capable of justifying opposite results.[130]

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123 Webster's Dictionary defines "unconscionable" as follows: (1) "not guided or controlled by conscience: unscrupulous;" (2) "excessive, exorbitant;" or (3) "lying outside the limits of what is reasonable or acceptable: shockingly unfair, harsh, or unjust: outrageous." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY UNABRIDGED 2486 (1986).

124 Denlinger, Inc. v. Dendler, 608 A.2d 1061 (Pa. Super. Ct. 1992).

125 *See id.* at 1064.

126 *See id.* at 1063.

127 *See id.* at 1066.

128 *See id.* at 1072-73 (Del Sole, J., dissenting).

129 *See Denlinger*, 608 A.2d at 1073 (Del Sole, J., dissenting).

130 *See id.* at 1070 (Del Sole, J., dissenting); *see also* Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370 (Mass. 1980) (holding that a clause in franchise agreement permitting termination without cause is unconscionable).

V. *Statutory Regulation*

Congress and state legislatures have enacted numerous statutes in response to discrete problems arising from the use of standardized forms.[131] These statutes, however, do not constitute a comprehensive scheme of regulation. Rather, most legislation is a random act of market intervention to correct a particular practice. For example, at the federal level, the Truth-in-Lending Act requires disclosure of specific information to the consumer regarding loans,[132] and the Magnuson-Moss Act governs written warranties with respect to distributions of consumer products.[133] At the state level, typical health club legislation gives consumers the right to cancel executed contracts, requires the disclosure of specific information and limits the duration of the contract.[134] Likewise, legislation covering door-to-door sales gives consumers the right to cancel executed contracts and requires disclosure of certain terms in the contract.[135]

While federal and state legislation protects consumers, the legislative approach is haphazard. The scattered statutes do not address the fundamental legal questions of standard form contracts: the problem of the formation and enforcement of standard terms. The result is a regulatory system composed of pieces difficult to weave together to form a coherent whole. In addition, market developments often obviate the statutory protections and render them of little benefit.

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131 *See Commission Report*, *supra* note 6, at 7-9.

132 *See* 15 U.S.C. § 1601 (1999).

133 *See* Magnuson-Moss Act 15 U.S.C. § 2301 (1999).

134 *See, e.g.*, N.J. STAT. ANN. §§ 56:8-39 trough 56:8-48 (West 1999); N.J. STAT. ANN. § 56:8-42(a)-(b) (addressing delivery of written contracts and disclosure of specific information); N.J. STAT. ANN. § 56:8-42(e) (discussing the right to cancel a contract); N.J. STAT. ANN. § 56:8-42(d) (stating that contract duration may not exceed three years).

135 *See, e.g.*, Door-to-Door Home Repair Sales Act of 1968, N.J. STAT. ANN. § 17:16C-95; N.J. STAT. ANN. § 17:16C-99(a) (specifying owner's right to rescind contract for purchase price greater than $25); N.J. STAT. ANN. § 17:16C-100 (specifying disclosure of required terms).

VI. The New Contract

Having revealed the problems of current legislative and judicial regulation of standard form contracts, and of treating standard form contracts as agreements, it is necessary to reconstruct the law of standard form contracts. First, a standard form contract is not a contract as that word is normally understood. Rather, a standard form contract is a series of terms embedded by a seller in products marketed for mass distribution and consumption.[136] When the buyer purchases the product, the buyer also purchases the terms, thereby recording the parties' legal rights and obligations resulting from the sale.[137] Embedded terms are neither an exchange of promises nor an agreement reflecting a meeting of the minds between the parties.[138]

The large number of over-the-counter transactions that take place in any single year involving standard form contracts has not impeded the development of the American economy.[139] Nor have standard form contracts substantially harmed most buyers.[140] Rather, these contracts raise problems on the margins where particular terms deviate from commercially reasonable and industry accepted standards. Often, where problems have arisen, the market has corrected the problem in response to negative publicity.[141] Publicity about insurance problems with leased cars caused sellers to offer buyers insurance against this risk for a reasonable price. The standardized terms litigated most frequently, arbitration, insurance

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136 *See Commission Report, supra* note 6, at 5.

137 *See Commission Report, supra* note 6, at 5.

138 *See Commission Report, supra* note 6, at 5.

139 *See* DEPARTMENT OF COMMERCE REPORT, THE EMERGING DIGITAL ECONOMY IT (1999). The report notes that from 1995 to 1998, the Information Technology (IT) industry contributed 35% to the nation's economic growth; brought down overall inflation by 0.7 percentage points by increasing efficiency and productivity; had a robust 10.47 average annual growth rate; and is predicted by 2006 to employ half of the U.S. work force. *See id.* Because the IT industry uses standard form contracts almost exclusively, and because it is the least regulated medium in which these contracts are used, the fact that buyers purchase with impunity is strong evidence that overall standard form contracts operate effectively and do not require knee-jerk regulatory responses.

140 *See Commission Report, supra* note 6, at 14.

141 John J. A. Burke and John M. Cannel, *Leases of Personal Property: A Project for Consumer Protection*, 28 HARV. J. ON. LEG. 115, 141 (1991).

exclusions and limitations on use, are often not inherently abusive clauses.[142]

Incorporation of the new embedded-terms contract requires displacing conventional rules and legal analysis of contract law. Embedded-terms contracts are not subject to the rules governing traditional contract formation related to offer, acceptance and agreement, because embedded-terms contracts are not offered, accepted and formed as a result of negotiation and bargain.[143] The contract instead springs into existence as the result of a sale.[144] A buyer cannot argue that he did not really buy the terms because he did not understand them just as a buyer can not argue that he did not buy a radio because he did not understand transistors. The buyer owns the new contract. The only relevant legal questions are which standardized terms should be enforced as recorded, and which legal norms should govern their enforcement.

Sellers have a legal obligation to put defect-free goods into the stream of commerce.[145] Since the contract is functionally equivalent to a good, it would be consistent with current law to apply a similar obligation on sellers to bring to market defect-free terms. Civil obligations imposed on makers of products reflect the social choice to protect buyers against intolerable risks and collateral, and likely unknown, effects of products. Legal regulation of standard form contracts should be patterned after legal regulation of product risk. The expert preparing the standardized contract for the seller is in the best position to produce defect-free terms, regulate the legal effects of the sale and clarify the legal relationship between seller and buyer.

New legislation regulating standard from contracts must address three issues: (1) how embedded terms are formed and become effective; (2) the level of risk the seller may shift to the buyer by embedding terms in products; and (3) the likely collateral effects of the terms.[146] First, formation should follow sale.[147] For example, the embedded terms become effective when there is delivery of a

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142 *See Commission Report*, *supra* note 6, at 14.

143 *See Commission Report*, *supra* note 6, at 1.

144 *See Commission Report*, *supra* note 6, at 9.

145 *See, e.g.*, Henningsen v. Bloomfield Motors, 161 A.2d 69 (N.J. 1960); Greenman v. Yuba Power Products, 377 P.2d 897 (Cal. 1962).

146 *See Commission Report*, *supra* note 6, at 2, 6-7, 15.

147 *See Commission Report*, *supra* note 6, at 9.

product in exchange for payment of money.[148] Second, the best way to address the remaining two issues is to identify and create specific rules for existing terms that have resulted in litigation or serious objection. If a term violates a specific rule, then the term is not enforceable.[149] Because it is impossible to foresee all potentially problematic terms, the new law must contain a default rule general enough to function for any term, yet specific enough to provide criteria to control judicial discretion.[150] In addition, the law must allow disposition by summary judgment to reduce litigation costs.[151] The Commission has drafted a model statute based on these general principles to reformulate contract law to fit the new contract paradigm and to reflect commercial reality.[152]

VII. The Standard Form Contract Act

A. Overview

The Standard Form Contract Act ("Act") applies to all transactions in which a standard form contract is used regardless of the type of transaction, the parties' identity, and relevant bargaining power.[153] The Act, therefore, covers standard form contracts used in most over-the-counter transactions and excludes only truly negotiated contracts or terms based on consent.[154] Under the Act, a standard form contract is formed when a seller transfers a product to a buyer and includes the contract with the product.[155] Consequently, the contract is effective upon a sale.[156] The existence of the contract does not depend on the parties' objectively measured consent or manifestation of assent.[157] As a result, the terms of

148 *See Commission Report*, *supra* note 6, at 14.
149 *See Commission Report*, *supra* note 6, at 15-19.
150 *See Commission Report*, *supra* note 6, at 13-14.
151 *See Commission Report*, *supra* note 6, at 14.
152 *See Commission Report*, *supra* note 6, at 2.
153 *See* Standard Form Contract Act, *supra* note 9, at 6.
154 *See* Standard Form Contract Act, *supra* note 9, at 6.
155 *See* Standard Form Contract Act, *supra* note 9, at 4.
156 *See* Standard Form Contract Act, *supra* note 9, at 4.
157 *See* Standard Form Contract Act, *supra* note 9, at 6.

standard form contracts are enforceable as recorded unless specifically unenforceable under the Act.[158]

The Act's breadth derives from its unconventional use of terms. The term "sale" covers leases, licenses and other dispositions of products.[159] The term "product" refers to a good, service, license, right to personal, tangible, or intangible property, or an extension of credit, provided the product is offered on the open market.[160] The Act reinterprets established terms of art to analyze transactions according to the nature of the contract rather than the identity of the product or characterization of the transaction.[161]

Specific rules cover classes of terms that, based on the Commission's empirical study, are recurring terms and are potentially abusive.[162] These rules specify to what extent sellers may allocate risks to buyers and exclude warranties.[163] Where these rules do not govern terms, the Act contains a default rule that makes a term unenforceable if a reasonable buyer, having had prior knowledge of the term, would not have purchased the product.[164] In other words, the default rule applies when the term is a deal-breaker.[165] Alternative formulations of the default rule are covered later.

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158 *See* Standard Form Contract Act, *supra* note 9, at 7.

159 *See* Standard Form Contract Act, *supra* note 9, at 3.

160 *See* Standard Form Contract Act, *supra* note 9, at 3.

161 *See* Standard Form Contract Act, *supra* note 9, at 3; *cf.* UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT (Proposed Draft 2000), *available in* The National Conference of Commissioners on Uniform State Laws, *Drafts of Uniform and Model Acts* (visited Apr. 17, 2000) <http://www.law.upenn.edu/bll/ulc/ulc_frame.htm>. The Commission followed the developments of proposed Article 2B of the UCC, now UCITA, and is presently studying the promulgated uniform law. For an extensive analysis and discussion on the Commission's treatment of UCITA, see *Commissions Memoranda* (visited Mar. 27, 2000) <http://www.lawrev.state.nj.us/index/alpha-page5.htm> (discussing the benefits and drawbacks of adopting UCITA). Whereas UCITA covers "computer information transactions," and leaves to other law, mainly UCC Article 2, hard goods transactions, the Standard Form Contract Act would govern all standard form contracts. *See id.* In drafting the Standard Form Contract Act, the Commission determined that UCITA contains serious problems, and thus is not suitable for New Jersey. *See id.*

162 *See, e.g., Commission Report, supra* note 6, at 15-19.

163 *See* Standard Form Contract Act, *supra* note 9, at 5.

164 *See* Standard Form Contract Act, *supra* note 9, at 4, 7.

165 *See Commission Report, supra* note 6, at 14.

The Act's rules replace all judicial devices to evaluate the enforceability of standardized terms.[166] When determining the existence of a standard form contract or the enforceability of its terms, courts must base their decision on the Act's language.[167] This requirement may lessen disparity by requiring judicial resort to this single point of reference.

Importantly, the question of whether a particular contract term is enforceable under the Act is a question of law for courts to decide without juries.[168] Courts may dispose of most, if not all, cases under the Act by summary judgment, thereby providing the parties an efficient means of dispute resolution.[169] There is no perfect solution to determine whether a term in a standard form contract should be enforced against the party who did not write the contract. The types of terms that these contracts contain are unforeseeable, and thus necessitate reliance upon an imperfect default rule. The Act, by specifying individual rules for particular problems, intends to reduce, if not eliminate, the instances in which the default rule must be used.[170] A summary of the Act's most important provisions follows.

B. Scope

Section three of the Act defines its scope.[171] The Act governs all standard form contracts used in the open market, with only four exceptions.[172] First, the Act excludes any transaction where a *buyer* uses a standard form contract.[173] For example, employment contracts are excluded because the employer, the buyer rather than the seller, is the one using the standardized form. Second, the Act excludes sales of items beyond the broad definition of product, such as sales or leases of real property.[174] Third, the Act excludes any contract that, prior to its use, was subject to review and approval, or

166 *See* Standard Form Contract Act, *supra* note 9, at 7.
167 *See* Standard Form Contract Act, *supra* note 9, at 7.
168 *See* Standard Form Contract Act, *supra* note 9, at 4.
169 *See Commission Report*, *supra* note 6, at 14.
170 *See* Standard Form Contract Act, *supra* note 9, at 7.
171 *See* Standard Form Contract Act, *supra* note 9, at 3.
172 *See* Standard Form Contract Act, *supra* note 9, at 3.
173 *See* Standard Form Contract Act, *supra* note 9, at 3.
174 *See* Standard Form Contract Act, *supra* note 9, at 3.

disapproval of, a federal or state regulatory agency.[175] For example, state laws regulating insurance often require companies to file their policies with the department of insurance.[176] The Act does not apply to these contracts in deference to existing regulatory schemes.[177] Fourth, the Act does not apply to terms governed by other law setting forth special requirements of contract formation.[178] For example, state health club legislation requires contracts to include certain terms as a prerequisite of contract formation.[179]

C. *Formation*

Section five of the Act provides that a standard form contract is formed and becomes effective when a sale occurs and the contract is given to the buyer.[180] The formation requirements may be satisfied in either order, thereby allowing for "pay-now terms-later" transactions.[181] The Act does not define when a sale occurs; that question is left to existing law. In ordinary transactions, the event of the sale will be obvious. The transfer of the contract is made either by its physical delivery to the buyer or by making it accessible to the buyer.[182] A contract may be delivered by placing the contract in the package containing the product or by making it accessible on-line.[183] Delivery does not depend on the buyer's awareness or knowledge of

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175 *See* Standard Form Contract Act, *supra* note 9, at 3.

176 *See, e.g.*, MICH. COMP. LAWS § 500.2236(1) (1994). The Michigan statute provides in part:

A basic insurance policy form or annuity contract form shall not be issued or delivered to any person in this state. . .until a copy of the form is filed with the insurance bureau and approved by the commissioner as conforming with the requirements of this act and not inconsistent with the law.

Id.

177 *See* Standard Form Contract Act, *supra* note 9, at 3-4.

178 *See* Standard Form Contract Act, *supra* note 9, at 4.

179 *See, e.g.*, ARK. CODE ANN. § 4-94-109 (Michie 1997); COLO. REV. STAT. § 6-1-105 (1998); CONN. GEN. STAT. § 21(a)-218 (1999); GA. CODE ANN. § 10-1-393.2 (1999); HAW. REV. STAT. § 486n-6 (1999); MD. CODE ANN., [COM. LAW I] § 14-12B-05 (1998); MASS. GEN. LAWS ch. 93, § 79 (1999); NEV. REV. STAT. ANN. § 598.283 (1998); N.H. REV. STAT. ANN. § 358-I:2 (1999); N.Y. GEN. BUS. LAW §§ 622a, 624 (McKinney 1999); R.I. GEN. LAWS § 5-50-3 (1998); TENN. CODE ANN. § 47-18-305 (1999).

180 *See* Standard Form Contract Act, *supra* note 9, at 4.

181 *See* Standard Form Contract Act, *supra* note 9, at 4.

182 *See* Standard Form Contract Act, *supra* note 9, at 4.

183 *See Commission Report*, *supra* note 6, at 10.

the contract.[184]

The formation requirements reflect commercial practices in the market. Terms are not formed; they are bought. In cases where the contract is available only after purchase, section six of the Act provides the option of returning the product.[185] Although it is unlikely that a buyer will ever read and consider the standardized terms, the buyer who does has a right to return the product for a refund if he returns it unused and in its original packaging within the set reasonable time period running from the date the terms became effective.[186] If the package is opened to access the contract, the product is considered unused provided the buyer opens only that part of the package needed to read the contract.[187] This nuance addresses the problem of software where the terms are contained in the box. In addition, the Act protects against theft of property by forbidding the buyer to access the software, load it on his computer, and then return the product by claiming that a contract term is objectionable.[188]

D. Primary and Secondary Terms

Section seven of the Act divides terms found in standard form contracts into two categories: primary and secondary terms.[189] Primary terms are bargained-for or real-consent terms such as the product's price, description of the product, insurance if purchased separately, and credit terms if applicable.[190] Buyers either bargain for these terms or, even when they are adhesive, like the price, actually consent to be bound by them. The Act applies ordinary principles of contract law to determine whether primary terms are enforceable. In general, in the absence of fraud, duress or mutual mistake, the buyer is bound by the primary term.[191] On the other hand, secondary terms, all other terms of a standard form contract,

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184 *See Commission Report*, *supra* note 6, at 10.

185 *See* Standard Form Contract Act, *supra* note 9, at 4.

186 *See* Standard Form Contract Act, *supra* note 9, at 4.

187 *See* Standard Form Contract Act, *supra* note 9, at 4.

188 *See* Standard Form Contract Act, *supra* note 9, at 4.

189 *See* Standard Form Contract Act, *supra* note 9, at 4.

190 *See* Standard Form Contract Act, *supra* note 9, at 4.

191 *See generally* Independent Petrochecmical Corp. v. Aetna Cas. & Sur., 842 F. Supp. 575 (D.D.C. 1994).

are treated differently.[192] They are subject to the specific secondary term provisions.

E. Regulated Secondary Terms

The Commission identified the following potentially abusive clauses most likely to appear in standard form contracts: (1) arbitration; (2) risk of loss; (2) disclaimers of warranties; (4) payment of seller's attorneys' fees; (5) unilateral change of contract terms; (6) choice of forum and choice of law; and (7) remedy limitations.[193] The Commission examined these clauses and developed special rules to regulate them and, in exceptional cases, to forbid them.

1. Arbitration

Arbitration clauses require parties to waive their right to a jury trial and to submit disputes to an arbitrator.[194] The arbitrator renders a binding decision after the parties have had an opportunity to present evidence and argument. In standard form contracts, arbitration clauses, or clauses waiving the party's right to a jury trial, are extremely common, and not surprisingly, have been litigated frequently. Strangely, the arbitration clause is the term least likely to be judicially invalidated.[195] Legislative and judicial policy favor

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192 *See* Standard Form Contract Act, *supra* note 9 at 4.

193 *See Commission Report*, *supra* note 6, at 15-19.

194 *See Commission Report*, *supra* note 6, at 15-19. A typical arbitration clause provides:

> ARBITRATION OF DISPUTES. If either you or we have any unresolvable dispute or claim concerning your account, upon demand of either of us it will be decided by binding arbitration under the expedited procedures of the Commercial Financial Disputes Arbitration Rules of the American Arbitration Association (AAA) and Title 9 of the United States Code. Arbitration hearings will be held in the city where the dispute occurred or where mutually agreed by us. A single arbitrator will be appointed by the AAA and will be a retired judge or attorney with experience or knowledge in banking transactions. The arbitrator will award the filing fees, costs and arbitrator fees to the prevailing party, and a judgment may be entered upon the award by any court of competent jurisdiction.

First Union Deposit Agreement and Disclosures for Non-Personal Accounts ¶ 44; *see also supra* note 29.

195 In the brokerage industry, the United States Supreme Court has ruled that

arbitration.[196]

The Commission found that, as a policy matter, arbitration clauses promote an efficient and valuable alternative to litigation.[197] However, the Commission did identify two areas of concern. First, the arbitrator must be a neutral party to ensure that the proceeding does not favor one party as opposed to the other.[198] Second, the cost of arbitration must not be unreasonably high so as to deter parties from demanding arbitration of disputes.[199]

The requirement of neutrality of the arbitrator is well-established in the law and required for fair play.[200] The fee limitation is justified on the ground that if the cost of arbitration were unreasonably high, the cost would in effect deprive the buyer of any remedy. A consumer who has a $2000 dispute with a computer manufacturer is unlikely to pursue arbitration if the arbitration fee alone is $4000. Under section nine, the sample term would be enforceable if it were established that the arbitrator was neutral and the fee reasonable.[201]

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arbitration clauses are enforceable under the Federal Arbitration Act (FAA) even when the term is contained in a "take it or leave it" standard form contract. *See generally* Perry v. Thomas, 482 U.S. 483 (1987). The Court has extended this holding to arbitration clauses found in standardized franchise agreements and construction contracts. *See* Doctor's Association v. Casarotto, 517 U.S. 681 (1996); Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989).

196 *See generally* Doctor's Association v. Hamilton, 150 F.3d 157, 162 (2d Cir. 1998). In *Hamilton*, the Supreme Court emphasized that, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Id.* at 162; *see also* Perry v. Thomas, 482 U.S. 483, 489 (1987).

197 *See Commission Report*, *supra* note 6, at 15.

198 *See id.* (citing Graham v. Scissor-Tail, Inc. 623 P.2d 165 (Cal. 1981)). In *Graham*, the court held that a provision that designates the contractual party to act in the capacity of an arbitrator is unenforceable on the grounds of unconscionability. *See Graham*, 623 P.2d at 171.

199 *See id.* (citing Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (App. Div. 1998)). In *Brower*, the court implied that arbitration clause in Gateway 2000 standard form contract might be unenforceable if process and costs of arbitration were egregiously oppressive. *See Brower*, 676 N.Y.S.2d at 570-72.

200 *See generally Perry*, 482 U.S. at 483.

201 *See* Standard Form Contract Act, *supra* note 9, at 5.

2. Risk of Loss

Risk of loss terms transfer to the adhering party all risk related to events unlikely to occur, but upon occurrence likely to impose an unexpected level of liability.[202] For the most part, the standard form contracts in the Commission's sample did not contain potentially abusive risk provisions.[203] The absence of offensive risk-shifting terms may imply that the market has corrected this problem, or that sellers have determined beforehand that courts would invalidate these terms.

In the Commission's sample, one standard form contract relating to a fixed-term car lease contained the following risk of loss term: "INDEMNITY. You will protect us from all losses, damages, injuries, claims, demands, and expenses arising out of the condition, maintenance, use, or operation of the vehicle. You agree to indemnify and hold harmless us and our assigns from all such losses, damages, injuries, claims, demands, and expenses."[204]

This term transfers all risk to the lessee for any claim arising out of the automobile lease regardless of who is at fault or the cause of the claim. The Commission found that allocation of risk terms such as this one are unfair and determined that they would be presumptively invalid as secondary terms under the Act.[205] However, the Commission also found that sellers, under certain circumstances, are entitled to shift risks to buyers.[206]

Nevertheless, the seller is prohibited from transferring any risk carrying a value greater than the value of the product's price.[207] For example, if a person rents a lawn tiller for $100 per day, the expected total price of the product is $100. The Commission determined that

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202 *See Commission Report, supra* note 6, at 15.

203 *See Commission Report, supra* note 6, at 14.

204 GMAC Lease Agreement par. 35 (671 DLP NJ 10-96), *supra* note 29.

205 *See Commission Report, supra* note 6, at 15-16.

206 *See* Standard Form Contract Act, *supra* note 9, at 5. Section 10 of the Act provides:

> A secondary term placing a risk of loss on the buyer is enforceable if: (a) the amount of potential loss does not exceed the sale price of the product, (b) the seller makes available to the buyer insurance at a commercially reasonable price and the buyer refuses to purchase the insurance, or (c) the loss is caused by the fault of the buyer.

Id.

207 *See* Standard Form Contract Act, *supra* note 9, at 5.

a lessee would not expect to incur a financial obligation disproportionate to this price.[208] The lessee would not expect to pay the replacement cost of the tiller if the machine were damaged by ordinary use.[209]

This rule has two exceptions.[210] First, if the seller offers the buyer insurance, at a reasonable price against the risk and the buyer rejects the insurance, then the term is enforceable.[211] This offer and rejection essentially makes the term a "primary" term and subject to enforcement under ordinary contract principles. Second, if the loss is due to the fault of the buyer, the term is enforceable; a rule that incorporates existing law.[212] Under section ten, the risk of loss term cited above would be unenforceable because the risk is not clearly identified, not covered by insurance, and potentially exceeds the product's price.

3. Warranties and Exclusions

A warranty is an affirmation of fact or promise relating to the nature of material and workmanship and performance level of a product.[213] The law does not require sellers, even of new products, to give warranties; however, if sellers of consumer products give written warranties, the Magnuson-Moss Act requires disclosure of key terms and forbids the disclaimer of implied warranties.[214] With respect to non-consumer products, Article 2 of the Uniform Commercial Code allows sellers to disclaim, by disclosure, the implied warranty of merchantability.[215] By contrast, the law of tort imposes a duty on manufacturers to produce defect-free products into the stream of commerce, and tort obligations cannot be disclaimed through contract.[216]

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208 *See Commission Report*, *supra* note 6, at 16.

209 *See Commission Report*, *supra* note 6, at 16.

210 *See Commission Report*, *supra* note 6, at 15.

211 *See* Standard Form Contract Act, *supra* note 9, at 5.

212 *See* Standard Form Contract Act, *supra* note 9, at 5.

213 *See* Magnuson-Moss Warranty Act, 15 U.S.C. § 2301(6)(a) (1975) (setting out the definition of warranty as used in the Standard Form Contract Act).

214 *See* 15 U.S.C. § 2308(a).

215 *See* UNIFORM COMMERCIAL CODE § 2-316(2) (2000).

216 *See* Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69, 79 (N.J. 1960).

The difference between the implied warranty of merchantability, which can be disclaimed, and the civil duty to make defect-free products, which is obligatory by operation of law, is one of remedy, not workmanship or product performance level.[217] The only practical effect of disclaiming the implied warranty of merchantability is to provide no remedy for economic loss to Article 2 buyers not covered by the Magnuson-Moss Warranty Act. This result follows from the Code's rationale that buyers know what they are getting into when they enter into contracts, however, this result conflicts with the market reality that buyers rarely, if ever, read standardized forms.

To avoid that anomaly, the Act prohibits sellers of new products from disclaiming the implied warranty of merchantability, thereby providing a remedy to all buyers sustaining economic loss based on the failure of the product to perform as expected in the trade or described in the documentation.[218] Because software products generally contain defects, and sometimes are experimental, the Act provides a standard that takes into account the peculiarities of software products.[219] For clarity, the Act prohibits sellers from disclaiming liability for personal injury and property damage caused by manufacturing defects in their products.[220]

The following term found in a standard form contract for the sale of furniture illustrates the problem of restricting the warranty of

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217 *See* Magnuson-Moss Warranty Act, 15 U.S.C. §2301.

218 *See Commission Report*, *supra* note 6, at 17-18. Breach of warranty was originally a tort, viewed as a form of misrepresentation. *See* Robert W. Gomulkiewicz, *The Uniform Commercial Code Proposed Article 2B Symposium: The Implied Warranty of Merchantability in Software Contracts: A Warranty No One Dares to Give and How to Change That*, 16 J. MARSHALL COMPUTER & INFO. L. 393, 394 (1997). The contractual implied warranty of merchantability differs from the tort duty to produce defect free goods, not with regard to product quality, but with regard to remedy. *See id.* Damages for personal injury, not economic loss, are recoverable under strict liability in tort; conversely, damages for economic loss, not personal injury, are recoverable under breach of warranty. *See id.* In *MacGlashing v. Dunlop Equipment* Co., the court adopted "the majority view which draws a clear distinction between tort recovery for physical injury and contract recovery for economic loss." 89 F.3d 932, 936 (1st Cir. 1996).

219 The standard is based upon the proposal made by Robert W. Gomulkiewicz. *See* Gomulkiewicz, *supra* note 81, at 401. The standard provides that a merchant warrants that the computer program is reasonably fit for the ordinary purpose for which it is distributed, but specifies that the warranty applies only to functionality not accuracy, marketability, quality, or characteristics of informational content. *See id.*

220 *See Commission Report*, *supra* note 6, at 17-18.

merchantability:

> This warranty extends only to the original purchaser and cannot be transferred. This warranty applies only if the product has been delivered, by our authorized dealer, to the residence of the purchaser, and only if the product is not moved from the original residence. . .To be eligible for this warranty to cover your product you must return the properly completed warranty registration card to X within thirty (30) days from the date you purchased the product.[221]

The right to exercise this warranty is conditional upon several pre-requisites, which if not satisfied destroy the warranty. The buyer must fill out the warranty card within the prescribed time period; however, the buyer may not have the warranty card within the thirty days of purchase since a purchase of furniture often precedes the delivery of the furniture. Also, the buyer is unable to move his residence, and the seller's authorized dealer must deliver the product. Taken together, these requirements impede a buyer's reliance on a perfectly good warranty.

With one exception, section eleven establishes that the seller cannot disclaim its two fundamental duties to place a product in commerce free of defects and to deliver a product matching the description of the sale.[222] The exception allows sellers to sell defective products provided the seller discloses the defects to the buyer or the defects would have been discovered upon inspection.[223] The exception is intended to cover used products and products sold "as is," including goods sold in clearance sales.

The implied warranty of merchantability cannot be disclaimed in any other circumstance.[224] Such disclaimers contradict the seller's representation that the products have value precisely because they can be used for their ordinary purposes. Although sellers may not disclaim the implied warranty of merchantability, they may limit

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221 Bauhaus USA Inc. Furniture Warranty Registration Card; *see also supra* note 29.

222 *See* Standard Form Contract Act, *supra* note 9, at 5.

223 *See* Standard Form Contract Act, *supra* note 9, at 5.

224 *See* Standard Form Contract Act, *supra* note 9, at 7.

liability for the warranty's breach.[225] The Commission found that the most common term found in standard form contracts was the exclusion for consequential damages.[226] For example, a standard form contract for advertisement in the telephone yellow pages limits damages for mistakes, such as mistyped telephone numbers, to the cost of the advertisement and excludes liability for consequential damages such as loss of business income. The Commission found that exclusions for consequential damages for economic loss were reasonable terms of the contracts studied.[227] The Commission's finding is consonant with judicial decisions.[228] The Act permits sellers to exclude consequential damages for a buyer's economic losses related to a product's defect.[229]

Finally, the Act permits sellers to regulate their liability to refund the purchase price of a defective or non-conforming product.[230] The seller may require an opportunity to repair or replace and the seller may set a reasonable time limit on the right of refund.[231] The latter limitation recognizes that products have a useful life.

4. Attorneys' Fees

The American rule is that each party bears its cost of litigation including attorneys' fees. Some standard form contracts alter the general rule and require the adhering party to pay the seller's attorneys' fees in any litigation related to the contract.[232] Terms shifting the cost of litigation to one party have the effect of restricting the exercise of a party's legal rights and of deterring the resolution of valid and good faith claims. The Commission considered prohibiting fee shifting terms, but rejected that approach. The Act

225 *See* Standard Form Contract Act, *supra* note 9, at 5.

226 *See Commission Report*, *supra* note 6, at 18.

227 *See Commission Report*, *supra* note 6, at 18.

228 *See, e.g.*, Seely v. White Motor Co., 403 P.2d 145 (Cal. 1965).

229 *See* Standard Form Contract Act, *supra* note 9, at 5.

230 *See* Standard Form Contract Act, *supra* note 9, at 5.

231 *See* Standard Form Contract Act, *supra* note 9, at 5.

232 *See Commission Report*, *supra* note 6, at 18-19. The following language is taken from a service agreement contract: "You agree to pay all costs including attorneys fees, collection costs, and court costs we incur in enforcing this Agreement through an appeal." *See* AT&T Wireless Services Service Agreement; *see also supra* note 29.

takes a balanced position with regard to terms altering the American rule allocating legal costs to each party.[233] If a standard form contract contains a fee-shifting term, then, under the Act, the English rule covering attorneys' fees applies to the transaction.[234] The losing party pays the cost of litigation including attorneys' fees to the prevailing party.[235]

5. Unilateral Change of Contract Terms

A unilateral change of contract terms occurs when one party, without the consent of the other party, changes the terms of the contract.[236] In certain industries, the ability to unilaterally change contract terms has become standard business practice. For example, the credit card industry frequently sends a written notice of change in contract terms along with the monthly statement. Contract provisions providing for unilateral change of terms normally provide that continued use of the product after notification of the amendment is considered acceptance of the new term.[237]

Section thirteen codifies and regulates this commercial practice.[238] If the contract constitutes a continuing commercial relationship and if each party has the right to terminate the contract

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233 *See* Standard Form Contract Act, *supra* note 9, at 5-6.

234 *See Commission Report*, *supra* note 6, at 19.

235 *See Commission Report*, *supra* note 6, at 19.

236 *See Commission Report*, *supra* note 6, at 19.

237 *See, e.g.*, DLJ*direct* Customer Agreement; *see also supra* note 29. One provision in DLJ*direct*'s Customer Agreement declares:

> Modification of Agreement. We may unilaterally change these terms and conditions at any time by conspicuously posting notice of such change in the Customer Agreement online, located in the new account section of DLJ*direct* for a period of five (5) consecutive business days or by providing written notice to you. Continued use of DLJ*direct* after such notice will constitute acknowledgment and acceptance of the revised terms and conditions.

Id.

238 *See* Standard Form Contract Act, *supra* note 9, at 6. Section 13 provides:

> A seller may change a term of a standard form contract after the term has become effective if: (1) the standard form contract may be terminated by either seller or buyer at any time without penalty; (2) the seller gives recorded notice of the change; (3) the seller instructs the buyer how to cancel the contract; and (4) the change of terms applies prospectively.

Id.

without penalty at any time, the term is enforceable provided the seller gives notice and the buyer has an opportunity to cancel the contract.[239] The contract amendment then applies prospectively.[240]

The option to change contract terms unilaterally is not available for contracts covering a fixed time period and setting definite rights and obligations between buyer and seller.[241] For example, in a three-year car lease contract, a seller is prohibited from making any unilateral change of contract terms. A secondary term of this sort would defeat the buyer's expectation regarding the stability of contract price and legal obligations set forth in the standard form contract.

Under section thirteen, the term in the DLJ*direct* customer agreement would be enforceable.[242] First, the contract constitutes a continuing commercial relationship.[243] Second, the notice is recorded because it is capable of being reproduced, for example, by printing the computer screen.[244] Third, the customer is told that he is entitled to reject the term by discontinuing his use of the account.[245]

6. Default Rule

The Act contains a default rule in section eight to determine the enforceability of secondary terms not explicitly covered by the Act's term-specific rules.[246] The default rule is a rule of last resort.[247] In other words, the default rule applies only when a disputed standardized term does not fall within one of the Act's specific provisions.[248]

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239 *See* Standard Form Contract Act, *supra* note 9, at 6.

240 *See* Standard Form Contract Act, *supra* note 9, at 6.

241 *See* Standard Form Contract Act, *supra* note 9, at 8.

242 *See* Standard Form Contract Act, *supra* note 9, at 9.

243 *See* Standard Form Contract Act, *supra* note 9, at 9.

244 *See* Standard Form Contract Act, *supra* note 9, at 9.

245 *See* Standard Form Contract Act, *supra* note 9, at 9.

246 *See* Standard Form Contract Act, *supra* note 9, at 4. Section eight provides that "[a] secondary term is enforceable unless, at the time of sale, the term would have caused a reasonable buyer to reject the sale." *Id.*

247 *See Commission Report, supra* note 6, at 13.

248 *See Commission Report, supra* note 6, at 13.

The reasonable buyer is not the actual party to the contract but a hypothetical reasonable person.[249] The question to be determined is whether a hypothetical reasonable person who, contrary to fact, knew of the term prior to making a purchase, would have walked away from the sale.[250] The critical distinction between the default rule and traditional tests, such as unconscionability, is that the default rule focuses on rejection of the entire deal, not rejection of the disputed term.[251] In other words, the term must be so detrimental to the sale that a hypothetical reasonable person would not enter into a contract containing that term.[252] The term must be a deal-breaker and must destroy the economic value of the contract to the buyer.[253]

An alternative default rule, ultimately rejected by the Commission, addressed the criticism that the default rule was "unconscionability" in another dress. That alternative provided that "[a] secondary term is unenforceable against a buyer if it destroys the economic value of the contract which value is determined at the time the contract becomes effective."[254] This approach shifted the focus from "reasonableness" to economic value, a less slippery concept having historical precedent in the UCC principle of contract impairment. The Commission rejected this alternative on the ground that the term "economic value" is ambiguous and fact sensitive, thereby impeding disposition by summary judgment.[255] While the term "economic value" lacks an established definition in the law, it is no more inherently ambiguous than "reasonable person" and it has the potential to result in less subjective judicial judgments.

If applied honestly, the default rule would result in the enforcement of many terms that probably would not be enforceable under current law. For example, under the unconscionability doctrine, a court might find that a contractual choice of law clause is unenforceable as unconscionable if the forum is distant from a consumer's state of residence. However, under the Act, a court

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249 *See Commission Report, supra* note 6, at 14.
250 *See Commission Report, supra* note 6, at 14.
251 *See Commission Report, supra* note 6, at 14.
252 *See Commission Report, supra* note 6, at 13.
253 *See Commission Report, supra* note 6, at 13.
254 *See Commission Report, supra* note 6, at 12.
255 *See Commission Report, supra* note 6, at 14.

would be unlikely to find that a consumer would have rejected the contract totally because the contract designated a sister state as the choice of forum.[256] The Act contemplates a more severe term to invalidate the contract, such as designating a foreign country as the forum.[257] That term would clearly have the capacity to make a consumer reject the contract.[258]

VIII. Conclusion

The Act is neither pro-consumer nor pro-business. It coordinates legal rules to the realities of marketplace transactions. The Act's most innovative term is contract formation based on specific behavior, not upon consent. The Act's specific rules and its scope provide greater predictability to the enforcement of standard form contracts. The default rule, while not perfect, gives courts better guidance than existing judicial devices to invalidate standardized terms. The Act permits businesses to establish regularized contract terms to reduce the cost of risk, while it protects buyers from overly burdensome standardized terms. It appropriately balances the need for public protection against the benefits of market innovation.

256 *See Commission Report, supra* note 6, at 14.
257 *See Commission Report, supra* note 6, at 14.
258 *See Commission Report, supra* note 6, at 14.