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Hesselink, M.W.

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UNCONSCIONABILITY, UNFAIR EXPLOITATION AND THE NATURE
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PRINCIPLES OF CONTRACT LAW'

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Martijn W. Hesselink

m.w.hesselink@uva.nl

Centre for the Study of European Contract Law
Universiteit van Amsterdam
P.O. Box 1030
1000 BA Amsterdam
The Netherlands

Unconscionability, unfair exploitation and the nature of contract theory

Comments on Melvin Eisenberg's 'Foundational Principles of Contract Law'*

Martijn W. Hesselink (University of Amsterdam)

Melvin Eisenberg's new book *Foundational Principles of Contract Law* is an astonishing scholarly achievement, a *magnum opus* in the true sense, with regard to both the breadth and the depth of the argument.¹ It is written in Eisenberg's usual lucid and cogent style, full of powerful examples and, therefore, also highly pedagogical. It is not easy to find passages in the book to disagree with, especially in the chapter that the organisers assigned to me for comment, ie Chapter 4 on the unconscionability principle. Each of the categories of unconscionability that Eisenberg distinguishes and discusses, are, in my view, types of situations where there is good reason for the law to refuse enforcing an otherwise valid contract. If one tries hard enough, of course, one can always reach some disagreement. There are three points, in particular, on which I would like to comment. In brief, I will argue that Eisenberg's theory rightly subjects economic efficiency to human dignity, but pays too much attention to community, and not enough to democracy. My three comments have in common that they all raise questions concerning the nature of contract theory as presented by Eisenberg.

Inevitably, my observations will prove to be influenced by my background as a European legal scholar from a civil law system. In particular, in my comments I will draw on the recent experiences in the Netherlands and in the EU with drawing up comprehensive sets of contract law rules, in a new civil code and an optional contract law code respectively. Both the Dutch *Burgerlijk Wetboek* (civil code) of 1992 and the European Commission's proposal for a Common European Sales Law of 2011 contain provisions that are roughly functionally equivalent to the American doctrine of unconscionability as presented by Eisenberg, ie Art. 3:44 Para 4 BW on abuse of circumstances (*misbruik van omstandigheden*) and Art. 51 CESL on unfair exploitation, respectively. How much exactly any differences between the paths followed by American and European contract law matter for the academic enterprise of developing more general private law theories will be a question that I will come back to in my comments.

Market prices and human dignity

In the chapter on unconscionability, Eisenberg consistently distinguishes between transactions on a reasonably competitive market and off-market transactions. He reserves the applicability of the unconscionability principle for off-market transactions, assuming that the enforcement of transactions at market price corresponds to interests of both parties, and further assuming that, under those circumstances, in principle, the parties themselves are the best judges of their own interests (the bargaining principle).

* Paper prepared for the 'Foundational Principles of Contract Law Roundtable', organised on 11 and 12 January 2013, at the UC Berkeley School of Law.

¹ Melvin A. Eisenberg, *Foundational Principles of Contract Law* (manuscript: 1 November 2012).

However, he defines the category of non-market transactions - and consequentially the scope of application of the unconscionability principle - quite broadly. In particular, it includes cases where there is a functioning market but where one party manages to exploit the other party's price ignorance for charging an above-market price.

Eisenberg even goes one step further and also includes under the definition of off-market transactions and, therefore, within the scope of application of the unconscionability principle, what he calls 'substantive unfairness', ie unqualified *laesio enormis*. Under this principle it is morally unacceptable, and therefore legally unenforceable, to charge an excessively high price or stipulate an excessively low price. Eisenberg convincingly argues that there is good moral reason for such a principle. Through it, the state would not make exploitative transactions illegal, as is often suggested by its opponents; it would simply refuse to enforce them. Eisenberg:² 'If the doctrine of substantive unconscionability is paternalistic at all, it is a very diluted form of paternalism. Under that doctrine the government forbids nothing and commands nothing. It simply says to the promisee, "If you can accomplish your ends without our assistance, fine. But don't ask us to help you recover a pound of flesh."'

A different way of making the same moral point is that as free and equal citizens we owe respect to each other's dignity, and that it is not right for the state to lend its power for the enforcement of bargains that are so disproportionate that they become exploitative and therefore disrespectful of the other party's human dignity. This is true as a matter of justice, quite apart from any prevailing communitarian principles, or from the democratic majority of the day, as part of the political principles on which a just society is built.³

Eisenberg cites the Principles of European Contract Law as authority for his position. Unfortunately, however, not only Art. 4:109 PECL, but also Art. II. – 7:207 DCFR and indeed Art. 51 CESL on 'unfair exploitation', only accept *qualified* *laesio enormis*. In each of these provisions the exploitation of the subjective weaknesses of the promisor, on the one hand, and the objective disproportion between the promises, on the other, operate as cumulative requirements; mere gross disparity does not suffice. Indeed, Art 51 CESL is located in the chapter on defects of consent, together with mistake, fraud, and threats, suggesting that it deals with procedural unfairness, not substantive unfairness. This is in contrast with the Unidroit principles of international commercial contracts, also quoted by Eisenberg, where, in Art 3.10 (Gross disparity) the test is 'excessive advantage' while advantage-taking is not a requirement, merely a circumstance to which 'regard is to be had, among other factors'. In my view this is a mistake in the CESL that should be redressed. Eisenberg's *Foundational Principles* should inspire the European legislator to amend the Commission's proposal to this effect.

² *Ibidem*, Part III, p. 46.

³ Charles E. Larmore, *Patterns of moral complexity* (Cambridge: Cambridge University Press, 1987); John Rawls, *Political Liberalism*, expanded edition [first edition 1993] (New York: Columbia University Press 2005).

Unconscionability and unfair exploitation

When reading the chapter on 'unconscionability',⁴ I was struck by the fact that much, if not everything, that Eisenberg claims for unconscionability in American contract law could also be argued for with regard to European contract law. Indeed, it is difficult to find among Eisenberg's treatment of the principle of unconscionability anything that could not also be claimed with regard to Article 51 on 'unfair exploitation' of the European Commission's proposal for a Common European Sales Law (CESL).⁵ In particular, the types of situations that Eisenberg distinguishes for unconscionability, ie distress, price-gouging, transactional incapacity, unfair persuasion, unfair surprise, above-market prices and the exploitation of price-ignorance, and substantive unfairness, are (or should be) covered also by Art 51 CESL or a more specific provision. How can this remarkable similarity be explained? Do universal truths with regard to general principles of contract law exist after all? To the extent that this is true it challenges Romantic or communitarian or even nationalistic claims that private law principles have something important to do with national culture, and that the differences between people concerning principles depend primarily on national borders rather than a broad variety of other factors.

In his book, Eisenberg freely borrows from 'other mature legal systems', in the chapter on unconscionability especially from German law and the PECL. However, somewhat surprisingly, there is also a communitarian element in Eisenberg's argument. Within the context of unconscionability, Eisenberg attributes an important role to moral fault.⁶ Contracts that are made off-market are non unconscionable for that reason alone, he argues. Instead, such contracts are unconscionable only if the promisee was at moral fault. Eisenberg explains what he means by a moral fault: 'Moral fault, for contract law purposes, should normally mean social morality - moral standards that are rooted in aspirations for the community as a whole and that, on the basis of the appropriate methodology, can be derived from norms that have such support, or appear as if they would have such support.'⁷ Eisenberg does not really explain why communitarian standards should be decisive here. As the main authority for this claim he cites, again, the German Civil Code and the Principles of European Contract Law, ie norms that are rooted in aspirations of different communities. Apart from this contradiction, in my view, the argument for communitarian standards is also unconvincing. If good arguments from outside the community can inform the debate then why should these not be allowed to play an important role as well? Similarly, if a well

⁴ Eisenberg, *op cit* note 1, Part III: 'Unconscionability'.

⁵ Art. 51 reads as follows: 'A party may avoid a contract if, at the time of the conclusion of the contract: (a) that party was dependent on, or had a relationship of trust with, the other party, was in economic distress or had urgent needs, was improvident, ignorant, or inexperienced; and (b) the other party knew or could be expected to have known this and, in the light of the circumstances and purpose of the contract, exploited the first party's situation by taking an excessive benefit or unfair advantage.' The provision goes back to Art 4:109 PECL (Excessive Benefit or Unfair Advantage), which is cited by Eisenberg, and II. – 7:207 DCFR (Unfair exploitation). The main differences between the CESL-provision and its 'predecessors' in the PECL and the DCFR is that in the latter two the test was stricter, requiring that a *grossly* unfair advantage was taken, while in the former the 'category of 'lacking in bargaining skill' was deleted (unfortunately).

⁶ Eisenberg *op cit*, note 1, Chapter 4, Section C (p. 5).

⁷ *Ibidem*, p. 5. See also Chapter 1, p. 20 where Eisenberg distinguishes 'social morality' from 'critical morality' and argues, mainly on grounds of practicality, that the former rather than the latter should guide contract law reasoning.

established social standard is morally wrong, from a critical perspective, then surely the standard of social morality should be overruled.⁸ Even as a description, the communitarian account of the relevant moral principles is unconvincing. What is specifically American about the moral questions raised by the Desperate Traveller, the Desperate Patient, the Artless Heir, the Troubled Widow hypothetical cases? They seem to aspire to - and are very successful in - expressing more universal notions of fairness. Indeed, contract law theory, which aims at contributing to the rational reconstruction of a given legal system (including proposals for reform), is of a more abstract, idealising and universalising nature (and can therefore be more transnational) than doctrinal legal scholarship, which is much more limited by the local legal sources.

Contract law and democracy

However, what is most likely to strike many European readers of Eisenberg's book, is its strong (albeit mostly implicit) focus on courts as the main institution responsible for shaping the foundational principles of contract law. Eisenberg discusses in some detail the techniques by which a court can *legitimately* reformulate the law, ie by creating new exceptions, reconstruing, transformation, overruling,⁹ but remains silent as to whether the legislator may also legitimately reform contract law or formulate new general principles, and if so, what this means for the academic project of private law theory.

This is striking because for many Europeans it is entirely natural that the foundations of contract law be laid down in a civil code adopted by parliament. Of course, the original civil codes in Europe were not the outcome of a democratic process. On the contrary, they were enacted by more or less enlightened kings and emperors. However, since the 20th Century all new civil codes and major reforms of contract law have taken place through a democratic process. The most recent examples in this regard include the German reform of the law of obligations of 2002, and the French projects for a reform of the law of contract. In my own country, the Netherlands, the new civil code was the outcome of a particularly intense democratic process stretching over four decades. The re-codification process started with a Q&A between Parliament and the main drafter of the code on foundational questions. The complete *travaux préparatoires*, which document in every detail what Christian-democrat, socialist, liberal and communist Members of Parliament, had to say on the various provisions of the proposed new code, were published in some twenty volumes. In sum, in most European countries private law reform is a legislative endeavour which naturally comes about, like any other piece of legislation, through the ordinary democratic procedure. Even in England important reforms of certain contract law doctrines have taken place through Acts of Parliament, for example the Contracts (Rights of Third Parties) Act 1999.

Probably the most striking example of democratic private law making in Europe, however, has been the development towards a common European private law. In the course of the last few decades, the European legislator has enacted legislation on a variety of contract law subjects including unfair terms, distance contracts, late payment, and sales contracts. In

⁸ See also what was said above on dignity.

⁹ *Ibidem*, Chapter 1, pp. 5-11

each of these instances, the European Parliament was co-legislator, as required under Arts 114 and 289 TFEU and its predecessors, together with the Council (ie the Member States). The most ambitious project in this regard is the proposal for a Common European Sales Law, an optional code of contract law that is currently under examination in Council and Parliament.¹⁰ In the broader debate among academics, stakeholders and in national parliaments and of course in deliberations by the European legislator, many of the arguments draw on foundational principles: Does the CESL unduly undermine party autonomy and legal certainty? Does it blindly pursue the objective of increasing economic growth at the expense of consumers' interests? Such foundational questions are central to the current political debate. The proposed CESL itself even contains a section called 'General Principles', which includes three principles, ie the principles of freedom of contract (Art. 1), good faith and fair dealing (Art. 2), and co-operation (Art. 3). In other words, the European Union is currently considering the adoption of fundamental principles of contract law through legislation.

From this perspective, Eisenberg's focus on the prudent judge as the natural contract law maker seems to call for an explanation. Does Eisenberg provide one? The first part of the book discusses the nature of contract theory.¹¹ Eisenberg rejects formalist theories. These are theories which claim that principles of contract law can be deduced logically from self-evident axioms. In contrast, Eisenberg argues that the determination of contract law principles is, at least in part, a matter of moral evaluation. Eisenberg also rejects monist theories. These are theories that base contract principles on one core moral idea or value (traditionally private autonomy and commutative justice, more recently economic efficiency). Instead, Eisenberg maintains that contract law is best explained and justified in terms of a plurality of values. We may label these formalist and monist theories together also as essentialist theories. Essentialist theories claim that all contract law properly understood can be deduced from one single value or principle or a limited set of those, and that everything that cannot be based on these ultimate principles either must be justified as another branch of the law ('regulation' or 'public law') or cannot be legitimised at all as law (and therefore should not exist). One practical implication that essentialist theories of private law share is that they claim that legal scholarship can be relatively value neutral and thus 'scientific'. Both in the United States and in Europe the belief in the 'scientific' study of law reached its climax more than a Century ago. Eisenberg emphatically rejects contemporary attempts at reviving such 'classical legal scholarship' because it is obviously based on an illusion. Legal academics have no privileged access to foundational principles of the law and their implications. At best, monist theories provide us with one view of the cathedral; we will not get to see the whole picture. As Eisenberg rightly puts it, 'monistic theories fail because they deny the complexity of life.'¹²

However, if the determination of the foundations of contract law is at least in part a matter of moral evaluation and if the *prima facie* relevant values are plural and point in different

¹⁰ Proposal for a regulation of the European Parliament and of the Council on a Common European Sales Law, COM(2011) 635 final.

¹¹ Eisenberg, *op cit* note 1, Part I: 'The Theory of Contracts'.

¹² *Ibidem*, Chapter 1, p. 18

(and sometimes opposing) directions, then should not a theory of foundational principles of contract law also include an account of who should ideally make these value judgments and, if necessary, make a choice between competing views? Should not the theory tell us who is to determine what counts as a good or a bad argument in relation to the foundations of contract law? In my view this question has to be answered if we wish to know when we are talking about (legitimate) foundational principles of contract law. As far as I can see, neither the first, methodological chapter nor any other part of the book provides an answer to the question who may count as legitimate contract law makers. Given that essential principles of contract law do not exist but are contingent, the question remains, therefore, in what sense Eisenberg's principles are foundational principles. Who is it that founds contract law on these principles?

One possible answer is that no one does because, if Eisenberg is right, contract law *is* based on these principles. However, that answer would bring us back to the essentialist, natural law views of contract law that Eisenberg rejects so emphatically (and convincingly).

Another explanation for Eisenberg's focus on judicial law making is, of course, that in the United States contract law *is* in fact primarily judge made. The theory then would remain merely descriptive of the way the law is currently made in the United States. That explanation would match well with Eisenberg's realism but is clearly at odds with Eisenberg's claim that his book is about the law as it should be. In particular, it leaves open the possibility that also in the US, like in Europe, the most fundamental choices concerning contract law should in fact be made through a democratic process. So, the question remains then why Eisenberg's theory, in its normative part, does not contain an account of who should ideally be the main law maker or makers in the field of contract law. In the chapter on unconscionability, Eisenberg writes: 'It will often or usually be unnecessary to apply the elements of unconscionability on a case-by-case basis. Instead, the law should aim to develop specific unconscionability norms to govern specific classes of cases.'¹³ And that is what Eisenberg then proceeds to do, with admirable clarity, in the remainder of the chapter which reads like an invitation to the legislator, a blueprint for text and comments, for a contract law reform. However, instead Eisenberg writes that 'specific unconscionability norms can often be developed by using the general unconscionability principle as a charter that enables the court to either create wholly new rules or enlarge traditional boundaries of existing rules'.¹⁴

A third possibility is that the book, although it has the general title of 'Foundational Principles of Contract Law' is in fact a book on 'Foundational Principles of *American* Contract Law' with no broader, universalistic normative aspirations. If that is true, then the theory is an interpretative or reconstructive theory, ie a theory not of contract law in general but of the contract law of given legal system here and now belonging to a given political unit today, in this case the modern contract law of the United States of America. However, it is then puzzling to read that Eisenberg explicitly rejects interpretative theories,

¹³ *Ibidem*, Chapter 4, p. 7

¹⁴ *Ibidem*, Chapter 4, p. 7.

such as eg the one formulated by Stephen Smith.¹⁵ Maybe this is because he rejects Dworkin's single right answer thesis that is often associated with interpretative and reconstructive legal theories.¹⁶ However, there is no necessary link between interpretation and normative monism. Indeed, a reconstructive approach, like the one developed by Habermas, in which one tries to make sense of the world we live in, and of the legal system that we actually have, here and now, is fully compatible with the possibility that there is more than one plausible answer to the questions that we are asking.¹⁷ Therefore, it seems plausible that Eisenberg's theory is in fact a (crypto-) interpretative or reconstructive theory of modern American contract law, ie a theory of the principles on which contemporary American contract law is founded.

However, if Eisenberg's theory is neither merely descriptive nor interpretative of American contract law he cannot simply take for granted that contract law should be further developed, on a case by case basis, by a prudent common law judge, and that, as a consequence, a contract theorist should develop a theory from that perspective. If general principles can be distilled from the combination of the available legal sources and sound moral principles, then in the United States should these general principles not also be suggested to the legislator rather than to the judge, or at least also to the legislator? If not, the normative part of the theory would seem to require an explanation why contract law should not be judge made. This should be a theory which explains which value judgments and normative choices *in relation to private law principles* are best made, not by the branch of government that was democratically elected, but by appointed judges. Such theories do indeed exist, for example the theory which claims that the common law is superior to the civil law because it is economically more efficient, or, as another example, the theories which claim that contract law is essentially based on one core value (eg private autonomy or corrective justice) from which specific rules can logically be deduced. However, these theories are not available to Eisenberg since he rejects, as we saw, essentialist theories of contract law. Nor can it be argued that it is somehow incompatible with American legal culture that contract law be made by the legislator, as is testified by the central role, acknowledged by Eisenberg, that is played in American contract law by the Uniform Commercial Code. Indeed, Eisenberg points out that the position of contract law with regard to contractual fairness changed radically, following the promulgation of Uniform Commercial Code Section 2-302 on unconscionability.¹⁸ This sounds like bold legislative innovation rather than judicial prudence.

There is strong case for the view that at least the main choices in relation to private law - ie its foundational principles - should be determined in an inclusive democratic process. Private law is the law that determines the outcome of disputes between private parties. Judgments of courts in civil cases can be enforced, in the absence of voluntary compliance, with the aid of the public force, ultimately through the public sale of part of the defendant's assets. The enforcement of civil judgements, like any other use of state force (or the threat

¹⁵ *Ibidem*, Chapter 1, pp. 14-17. Cf. Stephen A. Smith, *Contract Theory* (Oxford: Oxford University Press, 2004)

¹⁶ Ronald Dworkin, *Justice for Hedgehogs* (Cambridge, Massachusetts: Belknap Press, 2011).

¹⁷ Jürgen Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (Cambridge: Polity Press, 1996).

¹⁸ Eisenberg, *op cit* note 1, chapter 4, 1.

of such use), requires legitimation. For the legitimacy of law - be it public law or private law - it is indispensable that the addressees of the norms can at the same time regard themselves also as their authors.¹⁹ This requirement does not imply per se that legitimate contract law can only come about through a democratic process. Nor does it exclude the involvement of other actors in the law making process, such as courts or academic experts. However, from the legitimacy perspective this would seem to require an additional argument, eg that contract law is best developed piece-meal, from one case to another, and therefore requires judicial contract law making, or that contract law is a highly sophisticated and specialised field which requires expert knowledge of a kind that members of the public and Members of Parliament tend to lack. Still, although it is not required that all law, including private law, is actually made by its addressees, what remains is that for any law to be legitimate it is required that those affected by it *could* regard the law as one that they would have made.

Eisenberg formulates a two-pronged principle that the content of contract law should be generated by, or rest upon. The first part states that contract law should in principle aim to effectuate the objectives of the parties. The second part reads as follows:²⁰ 'The rules that determine the conditions to, and the constraints on, effectuating the parties' objectives, and the way in which those objectives are to be ascertained, should consist of those rules that best take into account all applicable and meritorious moral, policy, and empirical propositions. When more than one such proposition is applicable, good judgment should be exercised to give each proposition appropriate weight, considering the issue at hand (...).'²¹ How better could such good judgment be exercised, one wonders, than through an inclusive democratic process? Take again the example the principle of unconscionability. Suppose that in a society there is an inclusive debate, triggered by the legislator and guided by experts, which is not dominated by any special interests, nor is any group excluded from the debate. Following an open exchange of a broad variety of reasonable ideas where people listen and respond to each other's arguments, the deliberation is concluded, after a reasonable time, by a vote in parliament. The outcome is that pure 'substantive unconscionability' is not a ground for invalidity of the contract. What would this mean for the foundational principles of contract law as understood by Eisenberg? I think that the fact of this democratic outcome should matter in the sense that from then on it would be difficult to see what theoretical argument - ie qua theory - Eisenberg could propose for reform, as it cannot be said of the outcome of a legitimate political process that it was wrong. (If Eisenberg thinks that the outcome is wrong he must criticise the process; any substantive claim as to the truth of the substantive unconscionability thesis would bring him back to essentialism.) Of course, this was a hypothetical example. Given that in the real world that we live in we have not yet had anything like an inclusive societal debate on the desirability of the invalidity of contracts that are objectively extremely imbalanced, nor on foundational principles of contract law in general, there still remains much democratic

¹⁹ Habermas, *op cit* note 17. See also Jürgen Habermas, *The inclusion of the other: studies in political theory* (Cambridge: Polity Press, 1998).

²⁰ Eisenberg, *op cit* note 1, Chapter 1, p. 21.

²¹ *Ibidem*.

space for contract theories providing good reasons for reform. Eisenberg's book constitutes a compelling example of such a theory.