STOLEN GOODS, A CRUISE DISASTER AND A RIGHT OF WAY GONE WRONG: THREE UNCONSCIONABLE CONTRACTS CASES FROM A LAW AND ECONOMICS PERSPECTIVE

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1. INTRODUCTION

In Hunter Engineering Co. v. Syncrude Canada Ltd.,¹ the Supreme Court of Canada rejected the doctrine of fundamental breach in favour of a more openly discretion-based approach to the policing of exclusion clauses. The case lays the foundations for a generalized unconscionability doctrine that lower courts have since picked up on and applied.² A noteworthy recent example is Solway v. Davis Moving & Storage Inc.,³ where the Ontario Court of Appeal used the unconscionability doctrine to strike down a limitation of liability clause in a contract for the removal and storage of goods.⁴

Some provinces have enacted unconscionability laws, but only for consumer transactions.⁵ The contract in Hunter Engineering was

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3. Ibid. See the text at footnote 29 and following.

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a commercial one and the unconscionability doctrine the case appears to establish is not limited to consumers. Courts in other common law countries have not followed suit. In *National Westminster Bank plc v. Morgan*, the House of Lords refused to endorse a general unconscionability doctrine, saying that further restrictions on freedom of contract were a matter for the legislature. In *Commercial Bank of Australia Ltd. v. Amadio*, the High Court of Australia revitalized the equitable doctrine of unconscientious dealing in its application to commercial contracts, but the court has stopped short of restating the law in terms of unconscionability and unequal bargaining power at large. Nor is it likely to take this step, at least in the short term, because the prevailing judicial culture is to respect the traditional boundaries between common law and equity. A generalized unconscionability doctrine synthesizes common law and equitable principles and it would raise "fusion fallacy" objections. The court has recently said that the phrase "unconscionable conduct" tends to mislead because it encourages the false notion that "there is a distinct cause of action, akin to an equitable tort, wherever a plaintiff points to conduct which merits the epithet 'unconscionable'". On the other hand, in both the United Kingdom and Australia there have been statutory developments — not limited to consumer dealings — which at least partially compensate for the courts' unwillingness to create a generalized unconscionability doctrine of their own.

"Perhaps unsurprisingly this has been taken up with reverential wonder in Canada by the courts . . . But it is sad stuff . . . The new "general principle" is stated to follow from a consideration . . . of "duress of goods", payments exacted *colori officii*, fraud, misrepresentation, unconscionable transactions, undue pressure, undue influence and salvage agreements. But what is the value in mixing together a number of elements found as to some in each but as to all in none of these categories and in pretending that the result is a general principle which replaces all that went before?"
The inspiration for most of these initiatives has been the unconscionability provision in § 2.302 of the United States Uniform Commercial Code. Section 2.302 only applies to sales contracts, but in most states the courts have expanded it by analogy to cover other kinds of contracts as well. The arguments in favour of a generalized unconscionability doctrine are well known. The following is as good a summary as any.

While often paying lip-service to the sanctity of contract doctrine, the courts have felt the need to respond to changing needs and expectations in the community and have developed a number of devices to subvert the doctrine of sanctity of contract in order to do justice in individual cases. These devices include the extension of the existing principles of duress, undue influence and illegality, and principles of construction, such as the implication of additional terms, the doctrines of fundamental breach, reading down of exclusion clauses, the collateral warranty device, and the doctrine of frustration and equitable estoppel.

The main criticism of the devices referred to in the last paragraph are [sic] not that they failed to achieve justice in the individual cases to which they were applied, but that

(a) they do not make a frontal attack on the root cause of the problem, and by using technical devices the courts invite the contract draftsman to try again;
(b) they tend to present a multitude of individual decisions which fail to accumulate experience or authority in marking out the minimal requirements of fairness;
(c) since they often turn upon construction of terms which are necessarily misconstrued to avoid injustice, difficulties are created for the construction of similar terms in subsequent wholly legitimate contracts.

Dickson C.J.C. in Hunter Engineering said that the doctrine allows the courts “to focus expressly on the real grounds for refusing to give force to a contractual term”. In a similar vein John Peden, who was the architect of the New South Wales Contracts Review Act 1980, claimed that the new statute would make the law “sharp in focus,

15. Supra, footnote 1, at p. 342.
conceptually sound and explicit in its policy underpinnings, preserving judicial rigour and avoiding ‘ad hocery’ in decision-making.”

Unfortunately, the unconscionability doctrine, as stated, does not live up to any of these claims. The problem is that the key terms, “unconscionability” and “inequality of bargaining power,” are indeterminate, while the various competing values that might conceivably inform the doctrine are left unresolved. As Leff recognized years ago, the upshot is that the courts can make the doctrine mean anything they want: the unconscionability doctrine does not solve the problems it sets out to address; all it does is subsume them. Consider the following hypothetical example. A holds a garage sale. Among the items for sale she includes a painting which she prices at $20. B, an art dealer, attends the sale and immediately recognizes the painting as a long lost Lawren Harris. B buys the painting from A for $20 without disclosing what he knows. The real value of the painting is $250,000. Would a court set the contract aside? One argument might be to say that the contract is unconscionable because, given B’s superior information, there was a material inequality of bargaining power between the parties at the time of the agreement or, perhaps, because B used unfair tactics in failing to disclose the painting’s real value. An argument along these lines would be consistent with the idea that contracting parties should share their information with one another. This is a distributive concern. An opposing argument would be to say that there is nothing wrong with a party trading on the basis of superior information. On the contrary, if B were required to disclose, he would end up having to share the gains from his discovery with A. A disclosure requirement, routinely imposed, would act as a disincentive to search and discovery. This is an economic concern. How should the court choose — in favour of a sharing rule, or in favour of exclusivity? The unconscionability doctrine is no help. It can be relied on in support of either outcome.

This article favours the economic approach. Part II below outlines the economic case for an unconscionability doctrine. Parts III to V discuss three sample cases, from Canada, Australia and New

Zealand respectively: Solway v. Davis Moving & Storage Inc.,19 Dillon v. Baltic Shipping Co.20 and Nichols v. Jessup.21 In each case, the court overlooked or downplayed key economic considerations. The aims of the article are to show: (1) how an economic approach can be used to give the unconscionability doctrine some structure, and (2) that if a court ignores economic considerations, its decision may have unanticipated side effects, potentially making matters worse rather than better on the policy front.

II. THE ECONOMIC CASE FOR POLICING UNCONSCIONABLE CONTRACTS

The economic case for policing unconscionable contracts starts with the idea that contracts create wealth. In the normal case, a contract can be assumed to make both parties better off, because otherwise at least one of them would not have agreed to deal. For example, if B sells A a painting for $15,000 it can be inferred that A values the painting more highly than the money and B values the money more highly than the painting. The transaction satisfies each party's individual preferences. This is a private benefit. The transaction simultaneously improves the allocation of resources (the movement of resources to more highly valued uses), and this is a social benefit.

These outcomes depend on both A and B freely choosing to enter into the contract with full understanding of what they are doing. Without free choice and full understanding A, for example, might end up not being better off after all. This is a private loss. It may also represent a social loss in the form of a misallocation of resources. Society as a whole may be better off if the painting belongs to someone who is in a better position than A to extract value from it. Trebilcock and Elliott use the expression “contract failure” to describe the absence of free choice and full understanding.22 They identify two main categories of case: (1) contract failure resulting from cognitive incapacity,23 and (2) contract failure

19. Supra, footnote 2.
23. Ibid., at pp. 56-59.
resulting from choices that do not reflect underlying preferences.\textsuperscript{24} There is cognitive incapacity when A lacks the capacity to form a stable or coherent preference structure.\textsuperscript{25} Examples include immaturity and mental incompetence.\textsuperscript{26} These are long-term, if not permanent, conditions. Causes of short-term cognitive incapacity include impulsiveness or lack of reflection, fatigue, excessive agitation and intoxication.\textsuperscript{27} Even without cognitive incapacity, there may be a contract failure if the contract does not reflect A's underlying preferences. Potential causes include (1) coercion and (2) information failure. Coercion may take various forms, including the threat of physical violence, economic pressure (for example, a threat to withdraw financial support or exploitation of a situational monopoly B has over A) and abuse of a relationship of dependency between A and B (undue influence).\textsuperscript{28} Information failure may be the result of B's active misrepresentation or simply A's lack of information. Information failure may relate to the legal nature and effect of the transaction, the availability of lower cost alternatives than the contract in question, the riskiness of the contract, and so on.\textsuperscript{29}

To see how a contract failure may reduce wealth, consider the following example. A sells B a painting for $15,000. The real value of the painting is $150,000. A is poorly educated and unintelligent. She has led a sheltered existence and is totally unskilled in business matters. If A had known the real value of the painting she would not have been prepared to sell it for less than $150,000. B does know the real value of the painting, but he would have been prepared to pay no more than $50,000. The contract results in a gain to B of $35,000 ($50,000 - $15,000) but a loss to A of $135,000 ($150,000 - $15,000). The net result is a loss of $100,000 ($135,000 - $35,000). This is the social cost of the contract failure.

Taking account of the potential social costs, it is tempting to think that courts should intervene in all cases of contract failure. However, that would be a mistake. Routine intervention may have the benefit of correcting past contract failures but it also carries the cost of perversely affecting parties' behaviour in future cases. It may result in A's taking too little care in her own interests at the

\textsuperscript{24} Ibid., at pp. 59-64.
\textsuperscript{25} Ibid., at p. 56.
\textsuperscript{26} Ibid., at p. 57.
\textsuperscript{27} Ibid., at pp. 57-58.
\textsuperscript{28} Ibid., at pp. 59-62.
\textsuperscript{29} Ibid., at pp. 62-63.
time of contracting because she can be confident that if there is a contract failure the court will correct it for her later. Given the costs of litigation, a policy that focuses on preventing contract failures from happening in the first place will nearly always be preferable to a policy that focuses on picking up the pieces afterwards.\footnote{30} One way to prevent the contract failure would be for A to take precautions. Another way would be for B to take precautions. From an economic perspective, the choice depends on which party is the lower cost avoider. In some cases, A will be the lowest cost avoider, despite her disadvantage. In other cases, the lowest cost avoider will be B (the hypothetical example discussed above is a possible case in point). In any event, the economic approach is to say that the courts should apply rules to give whoever happens to be the lower cost avoider the incentive to act. In cases where A is the lower cost avoider, the court should allow the contract to stand, despite the contract failure. Conversely, in cases where B is the lowest cost avoider, the court should set aside the contract or the offending term, as the case may be.

\section*{III. SOLWAY V. DAVIS MOVING & STORAGE INC.}

In \textit{Solway},\footnote{31} the plaintiffs (customers) entered into a contract with the defendant (carrier) to have their household goods removed from the house, stored briefly and moved to their new house. The contract included a clause limiting the carrier’s liability for loss of the goods to 60 cents per pound for a total of $7,089.60. The carrier stored the goods in a trailer. The trailer and its contents were stolen. The customers sued the carrier, claiming damages for loss of the goods. The carrier admitted liability, but only up to the limit the contract imposed.

The trial judge, relying on \textit{Hunter Engineering}, held that the limitation of liability clause was unconscionable and she declined to enforce it. On appeal the majority (Labrosse J.A., Gillese JJ.A. concurring) agreed. The reasoning went as follows. (1) The customers’ goods were valuable in both monetary and sentimental terms. (2) The carrier gave the customers an assurance that their goods would be secure. (3) The customers entered into the contract on the strength of this assurance. (4) The trailer was parked on the street,

\footnote{30} This ceases to be true only at the point where the cost of additional precautions begins to exceed the savings from any further reductions in the risk of contract failure.

\footnote{31} \textit{Supra}, footnote 2.
outside the carrier’s lot, at the time of the theft. (5) The carrier’s failure to keep the trailer inside the lot was a breach of its assurance to the customers that the goods would be secure and therefore it would be unconscionable to enforce the limitation of liability clause. Carthy J.A. dissented, pointing out that the limitation of liability clause in the contract was mandated by statute and holding that the majority’s ruling was contrary to the statutory policy.

The statute imposes absolute liability on the carrier up to the limit determined by the limitation of liability clause. Carthy J.A. explained the policy underlying the absolute liability rule:

the cargo owner’s separation from his cargo involves relinquishment of any opportunity to protect it; the carrier’s exclusive possession gives the carrier exclusive access to all evidentiary considerations in the event of a loss; the ability of the owner to prove a case of action based on fault would be completely illusory; and imposing liability without fault on the carrier would encourage his diligence and care in the safeguard of the cargo.\(^{33}\)

He explained the history and policy of the limitation of liability as follows:

Eventually it was found that commercial realities required a limit to that liability. The carrier has no means of knowing the value of the goods and, even if it did, the cost of insurance for the most valuable of goods in a cargo would impose prohibitive charges on the consignor of lesser valued goods. Thus statutes or regulations emerged maintaining the concept of absolute liability but limiting that liability to a declared value or, more often, to a value measured by weight. In this fashion the consignor can either insure the goods or bear the risk of their loss or damage, knowing the value of such goods. The carrier also bears some risk, which will act as an incentive to act prudently, while knowing that the extent of liability is tied to the weight of the goods being transported.\(^{34}\)

In *Solway* the carrier assured the customers that the goods would be secure. The majority relied on this assurance as a justification for not enforcing the limitation of liability clause. Carthy J.A. disagreed, pointing out that a promise to keep the goods secure is implicit in every contract of carriage and so the assurance was superfluous. To use the assurance as a basis for intervention would open the way for the court to intervene in every case. As the preceding passage from

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\(^{32}\) *Truck Transportation Act*, R.S.O. 1990, c. T.22 and Regulation 1088 made thereunder. There is similar legislation in all provinces.


\(^{34}\) *Solway*, *ibid.*, at para. 45.
Carthy J.A.'s judgment indicates, the aim of the statute is to reduce uncertainty about the carrier's potential liability for loss or damage by limiting liability to an amount the carrier can calculate at the outset of the transaction. The majority decision undermines this objective because now a carrier has no way of knowing ex ante whether a court will uphold the clause.

Of course, it is open to argument that the statutory policy is misguided. Some might say that in the interests of better consumer protection there should be no limitation of liability at all. Others might say that in the interests of party autonomy, the legislation should give way to private ordering. However, these are choices for the legislature, not the courts. At trial in Solway the carrier argued that the unconscionability doctrine cannot be used to contradict a statutorily implied term. The court failed to address the argument.\textsuperscript{35} So did the majority of the Court of Appeal. There might have been a case for a finding of unconscionability if the carrier had been guilty of fraud or unfair surprise. However, there was no evidence of any such conduct. In particular, this was not a case about customers being caught unawares by an onerous term buried in the fine print of a standard form contract. The customers knew about the limitation of liability clause and they knew what it meant in terms of the distribution of risk between themselves and the carrier. They responded appropriately by taking out additional cover. The problem was that they did not take out enough. From an economic perspective, the function of the unconscionability doctrine is to remedy contract failure, not to relieve the plaintiff from what in hindsight is a bad deal. Solway is open to criticism on the ground that it misapplies the doctrine in this respect. Misapplication of the doctrine threatens the security of transactions and increases the costs of doing business.

\textbf{IV. DILLON V. BALTIC SHIPPING CO.}

In Dillon v. Baltic Shipping Co.\textsuperscript{36} the plaintiff, a 53-year-old widow, took a holiday cruise around New Zealand on the defendant's ship. Ten days into the 14-day voyage, the ship sank off the New Zealand Sound. The plaintiff suffered physical injury and nervous shock and she lost all her belongings. She claimed compensation from the defendant. The defendant offered her $4,786 in settlement. In the face of advice from her solicitor, the plaintiff

\textsuperscript{35}. Solway, ibid., at para. 93.
\textsuperscript{36}. Supra, footnote 20.
accepted the offer and executed a deed of release in the defendant’s favour. She later brought an action against the defendant for damages, arguing that she was entitled to be relieved from the release on the ground that it was “unjust” within the meaning of the New South Wales Contracts Review Act 1980. There was a printed set of terms and conditions attached to the plaintiff’s ticket, including a limitation of liability clause.

The trial judge allowed the plaintiff’s claim in relation to the deed of release. He awarded the plaintiff $56,182 damages made up as follows: (1) damages for personal injury ($35,000); (2) restitution of fare ($1,417); (3) loss of belongings ($4,265); (4) compensation for disappointment and distress ($5,000); and (5) interest ($10,000). On the authority of the “ticket cases”, the trial judge held that the limitation of liability clause did not apply. The defendant had not taken reasonable steps to bring the terms and conditions to the plaintiff’s notice before the contract was made. The Court of Appeal by a majority (Gleeson C.J. and Kirby P., Mahony J.A. dissenting) upheld the trial judge. The case went on further appeal to the High Court of Australia on two questions: (1) whether the award of restitution of the fare was properly made, and (2) whether the award of compensation for disappointment and distress was properly made. The High Court said no to the first question on the ground that full compensation and full restitution cannot be given for the same breach of contract. It said yes to the second question, citing Jarvis v. Swans Tours Ltd, and other English cases. The interesting part of the case for present purposes is the Court of Appeal’s ruling, upholding the trial judge, that the deed of release was unjust within the meaning of the Contracts Review Act 1980. The statute defines “unjust” tautologically to mean “unconscionable, harsh or oppressive”. It also directs the court, in deciding whether a contract is unjust, to have regard to the public interest and all the circumstances of the case, including whether or not there was any material inequality of bargaining power between the parties. Leff coined the expressions “procedural unconscionability” and “substantive unconscionability” to describe the applications of § 2-302 of the United States Uniform

40. The defendant appealed this ruling along with the Court of Appeal’s other rulings, but the High Court rescinded leave to appeal the issue during the hearing of the appeal.
A court may find that a contract between A and B is unconscionable because of sharp dealing on B's part which affected the quality of A's consent. This is procedural unconscionability. Alternatively, a court may conclude that a contract is unconscionable because, in its view, it unduly disadvantages A or advantages B. This is substantive unconscionability. Procedural unconscionability is unfairness in the bargaining process and substantive unconscionability is perceived unfairness in the bargaining outcome. In *West v AGC (Advances) Ltd.*, the court introduced this terminology into the Contracts Review Act 1980 jurisprudence. McHugh J.A. suggested that while most cases under the Act will turn on both procedural and substantive unconscionability, in an appropriate case proof of substantive unconscionability alone may be enough.

*Baltic Shipping* is an example of a case decided on substantive unconscionability grounds alone. The trial judge gave two main reasons for saying that the release was an unjust contract: (1) the plaintiff was in an emotional state at the time she signed the release, and (2) there was a substantial difference between the amount the plaintiff received under the release and her entitlements at law. There was no evidence that the defendant knew about the plaintiff's emotional state at the time of the release. In other words, there was no sharp dealing on the defendant's part and no procedural unconscionability. In the Court of Appeal, Kirby P. said that it would be a mistake to read a procedural unconscionability requirement into the statute. A contract may be unjust even though the defendant has acted quite honourably and lawfully. In other words, proof of substantive unconscionability alone will do: "this is not such a shocking notion".

The majority's reasoning in *Baltic Shipping* smacks of *ex post* rationalization. It may have been true that the plaintiff was in an emotional state when she signed the release. However, that is hardly surprising. Most people find litigation stressful and a plaintiff will often settle her claim for less than it is worth just so she can avoid having to go to court. In any event, even if there were special circumstances above and beyond the normal pressures of

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41. *Leff, supra*, footnote 17.
42. (1986), 5 N.S.W.L.R. 610.
44. *Supra*, footnote 20, at p. 20.
the pre-litigation process, the defendant did not know about them and so, from an economic perspective, the court was wrong to take them into account.\(^{46}\) It was also true that the settlement figure represented only a small fraction of the plaintiff’s entitlement. However, the court was able to know this only with the wisdom of hindsight. At the time of the release, the outcome of the plaintiff’s claim was uncertain. The parties had no way of knowing what a court might end up saying about whether: (1) the limitation of liability clause applied, (2) compensation and restitution claims could be made together, and (3) damages for disappointment and distress were recoverable under Australian law. This uncertainty has to be factored into the equation. From an \textit{ex ante} perspective, a plaintiff’s entitlement is the amount of her loss discounted by the probability of winning the case. The majority in the Court of Appeal overlooked the discount factor. Mahony J.A. (dissenting) did not. He concluded that “having regard to the uncertainties of the position of both parties”, the release was not unjust.\(^{47}\) The majority decision is unsettling, so to speak. Courts should not reopen settlement agreements too readily. Otherwise they will reduce the certainty of settlement outcomes and discourage parties from attempting settlement in the first place.\(^{48}\)

\section*{V. NICHOLS V. JESSUP}

In \textit{Nichols v. Jessup},\(^{49}\) the defendant agreed to grant the plaintiff a right of way to improve access to the plaintiff’s land. In return, the plaintiff offered the defendant a right of way over his land. The defendant later refused to complete the transfer and the plaintiff sued for specific performance. It was shown at the trial that the effect of the transfer would be to increase the value of the plaintiff’s property by $45,000 and reduce the value of the defendant’s property by $3,000. The trial judge refused specific performance on the ground that the bargain was unconscionable. He found that the defendant was ignorant about property matters, unintelligent and muddle-headed. She had received no independent advice before entering into the agreement. There was no evidence that the plaintiff knew about these disadvantages. The trial judge held that proof

\begin{itemize}
\item \textsuperscript{46} See the text at footnote 57 and following, \textit{infra}.
\item \textsuperscript{47} \textit{Baltic Shipping}, \textit{supra}, footnote 20, at p. 53.
\item \textsuperscript{48} A point Gleeson C.J. conceded: \textit{ibid.}, at p. 9.
\item \textsuperscript{49} \textit{Supra}, footnote 21.
\end{itemize}
of knowledge was not a requirement. It was enough that the bargain was one-sided and unfair.

The plaintiff appealed. *Hart v. O'Connor* 50 was decided before the appeal was heard. In *Hart* the Privy Council held that proof of knowledge is a requirement for unconscientious dealing. On the basis of *Hart*, the New Zealand Court of Appeal in *Nichols v. Jessup* reversed the trial judge. However, it went on to say that knowledge includes constructive notice, suggesting that the plaintiff ought to have realized the defendant’s disadvantage given the transaction’s imbalance. The case was remitted to the trial judge for further hearing on the knowledge issue. The trial judge again held that the transaction was unconscionable and denied the plaintiff specific performance. 51

*Nichols v. Jessup* suggests that proof of actual knowledge is not necessary for unconscientious dealing. It is enough if B has constructive notice of A’s disadvantage. *Commercial Bank of Australia Ltd. v. Amadio* 52 seems to suggest likewise. 53 *Hart* suggests that proof of actual knowledge is required. Constructive notice on B’s part is not enough. According to *Hart* the aim of the unconscientious dealing doctrine is to prevent victimization and B cannot victimize A unless he knows about A’s disadvantage. Waddams argues that proof of wrongdoing on B’s part is not a general requirement of relief for unconscionability. 54 In other words, B’s liability does not depend on knowledge or even negligence. *Baltic Shipping* supports this position. 55 In summary, as the law presently stands, there are three competing positions: (1) proof of actual knowledge is required, (2) proof of actual knowledge is not required and constructive notice is enough, and (3) knowledge is not a requirement at all.

Position (3) represents a significant policy shift from Positions (1) and (2). Relief of A’s misfortune replaces prevention of B’s wrongdoing as the basis for intervention. There are likely to be costs involved. Routine interventions to correct past contract failures

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53. Though the majority judgments are ambiguous: see text at footnote 57 and following, infra.
55. See the text at footnote 46, *supra*. 
may have a perverse effect on the incentive for parties to avoid contract failure in future cases.\textsuperscript{56} There are threshold precautions A might take to avoid contract failure. For example, A might seek out independent advice before entering into the contract or, if A's disadvantage is a long-term or permanent one, she might hand over her business affairs at large to a third party such as a lawyer or an accountant or she may give a trusted friend or relative her power of attorney. Of course, A may be so seriously disadvantaged that she fails to appreciate the need for taking precautions at all. However, if that is the case her disadvantage will most likely be obvious to B and it is not open to question that the unconscionability doctrine should apply if B has actual knowledge. If the unconscionability doctrine applied regardless of whether B knew about A’s disadvantage, parties like A in future cases would have less incentive to take whatever steps might be within their capacity to protect their own interests. Correspondingly, parties like B would be faced with the prospect of investing resources to discover whether the other party might suffer from a disadvantage likely to result in the transaction being set aside. The alternatives would be to make this expenditure or to take the risk of judicial intervention. Either way, transactions would become more costly.

If B has no knowledge of A’s disadvantage, A is the likely lower cost avoider. Leaving A to bear the loss gives parties like A the incentive to take precautions in future cases. However, the picture changes if B knows about A’s disadvantage, because then B is the likely lower cost avoider. Low cost precautions open to B include: (1) giving A relevant information about the relative costs and benefits of the transaction to them both; (2) making sure A has independent advice; or (3) not going ahead with the transaction at all. Giving A relief creates an incentive for parties like B in future cases to take these precautions. In summary, Position (1) above is superior to Position (3).

Is Position (1) superior to Position (2)? In Commercial Bank of Australia Ltd. v. Amadio,\textsuperscript{57} the Australian High Court held that proof of actual knowledge is not necessary. It is enough if B was aware of the possibility that A might be at a disadvantage, or of facts that would raise this possibility in the mind of a reasonable person. The leading judgments are ambiguous. They might mean no more than

\textsuperscript{56} See the text at footnote 30 and following, supra.

\textsuperscript{57} Supra, footnote 52.
that wilful blindness counts the same as actual knowledge. Alternatively, they might mean that B is under an obligation to make reasonable inquiries.\footnote{Duggan, supra, footnote 12, at para. 513.} Read the first way, the decision catches reckless behaviour on B’s part. Read the second way, the decision goes further and catches negligence. The equation of recklessness with knowledge makes sense from an economic perspective because it reduces the incentive for B to ignore the obvious. If A’s disadvantage is obvious, the costs to B of confirming it are likely to be trivial. On the other hand, the equation of negligence with knowledge is a questionable move. If A’s disadvantage is a non-obvious one, the costs to B of discovering it may be substantial. Since B faces these same costs if there is no proof of knowledge requirement at all, the courts might as well move to Position (3) and be done with it.

There is a related evidentiary issue. Does the law require direct proof of B’s knowledge or can a court infer B’s knowledge from other proven facts? In many cases, direct proof of what B knew will be hard to come by, and so if the courts were not prepared to draw inferences at all A would stand no chance of winning her case. On the other hand, there is a danger that the courts might go too far. For example, a court might rely on the apparent one-sidedness of the contract outcome as a basis for saying that B must have known about A’s disadvantage. A move like this is tantamount to saying that there is no proof of knowledge requirement at all. Again, the court might as well move to Position (3) and be done with it.

In summary, the challenge for the courts is to be neither too quick nor too slow to (1) find that A’s disadvantage is or ought to have been obvious to B, and (2) infer B’s knowledge about A’s disadvantage from other proven facts. Nichols v. Jessup is a questionable decision in this regard.

**VI. CONCLUSION**

Unconscionability standing alone does not mean anything. Nor does inequality of bargaining power. Bargaining power is hardly ever equal. There will nearly always be some imbalance between contracting parties in terms of wealth, experience, information and the like. If lawmakers were to insist on absolute equality, there would be no more contracts. On the other hand, if the call is for less than absolute equality, tricky questions such as “how much?” and
"of what kind?" start to assert themselves. Statements of the unconscionability doctrine typically do not address these questions. This is not a recent revelation. Leff made the point forcefully nearly 40 years ago with his memorable put-down of UCC § 2-302. He called it the "emperor's new clause". Regrettably, courts and legislatures around the common law world have managed to miss the allusion and ignore the message.

One danger of an unstructured unconscionability doctrine is that courts will apply it without paying attention to the likely economic consequences. The three decisions discussed in Parts III to V above are all cases in point. This article argues in support of an economic approach to make the unconscionability doctrine meaningful. Some judges may be resistant to the idea. Sir Anthony Mason, a former Australian Chief Justice, has argued that law and economics scholarship is not much use to judges. He gives three main reasons. First, he says, economics has no contribution to make when the legal issues are non-economic ones. Secondly, contest and debate about economic issues would add to the length and cost of litigation. And thirdly, "if counsel present an argument based on economic analysis which suggests that judgment for the defendant would lead to wealth maximization for society, how does a court take account of this if previous authorities or considerations of justice or morality point in the other direction?"

The first argument assumes that legal issues are more often than not non-economic ones. This overlooks the close interconnectedness of law and economics. Economics is the science of rational choice. It is "the study of behaviour in the face of scarcity. If there were an abundance of every good thing, there would be no need for law, no need for a state". Choice is central to most legal disputes. The negligent tortfeasor chooses not to take precautions against harm. The contractor chooses to deal. The criminal chooses to commit the crime. Whenever there is a question of choice, economics has something to say that will be relevant to the understanding of existing laws and the shaping of new ones. The analysis of the three cases in Parts III to V above is a sufficient demonstration of this point.

59. Leff, supra, footnote 17.
61. Ibid., at p. 172.
62. Ibid., at p. 174.
63. Ibid., at p. 181.
64. Frank H. Easterbrook, "The Inevitability of Law and Economics" (1989), 1 Legal Ed. Rev. 1 at p. 3.
The second argument assumes that if the courts adopted an economic approach, they would need outside experts to help them. This concern overestimates the complexity of the economic issues most cases involve. Contrast the views of Sir Ivor Richardson, a former President of the New Zealand Court of Appeal: “I do not believe that judges are incapable of understanding the relatively simple economic concepts required for most law and economic analyses.” In *Solway*, for example, all the court had to do was apply the governing statute. Carthy J.A., dissenting, had no trouble articulating the economic policy behind the statute and the potential costs of adopting a different policy. There is no obvious reason why the majority could not have done likewise. In *Baltic Shipping*, all the court had to do was to keep in mind the potential costs of too readily overturning settlement agreements. As it happens, the court did not overlook this imperative. The fault lay in not giving it sufficient weight. In *Nichols v. Jessup* all the court had to do was follow *Hart*.

The third argument is a counsel of despair. Judges have no way of weighing economic values against non-economic ones and so it is better for them not to take account of economic values at all. Judges should decide cases “within the framework of traditional legal principles” by implication because that way they remain value neutral. The trouble is that the unconscionability doctrine has taken away from courts the “framework of traditional legal principles”. The whole point of the doctrine was to wean the courts off technical arguments and make them “focus expressly on the real grounds for refusing to give force to a contractual term”. In other words, the unconscionability doctrine does not allow the courts to remain value neutral or even to maintain the appearance of value neutrality. In their applications of the doctrine, courts may end up preferring non-economic values over economic ones. Perhaps this is what was going on in the three cases discussed earlier. In any event, the point is that giving precedence to non-economic values is likely to have its costs. So there is no getting away from economics whichever way a court might turn. Courts should be aware of the economic costs of their decisions whether they favour economic values or not. Otherwise, how can they be sure the outcome is value for money?

67. See the text at footnote 15, supra.
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