THE UTILITARIAN-ECONOMIC MODEL OF CONTRACTUAL OBLIGATION: UNCONSCIONABILITY AT THE FRONTIER

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[In this article the author argues that the utilitarian-economic model of contractual obligation is relevant to explaining and understanding modern contract law. In particular, the Australian doctrine of unconscionability can be accommodated within the utilitarian-economic model, reflecting an increasing awareness of the problematic nature of some of the assumptions underlying the utilitarian-economic model (in particular, the assumption of rationality), and representing an attempt to establish limits to the binding force of contracts while maintaining a degree of security of contract which is essential to the welfare-maximising objective of the practice of contracts.]

INTRODUCTION

Utilitarian theories of contractual obligation explain the history of contract law. However the utilitarian ideal of contract as a welfare-maximising transaction between rational parties has come under attack from English scholars such as Patrick Atiyah who claim that contract law and practice no longer mirror the utilitarian model.[1] Australian contract scholars have also written of an Australian law of contract based on principles quite different from the English law from which it developed (and also from current English law).[2] They point to the development of equitable and statutory concepts of unconscionability — generally described in terms of a prohibition on 'advantage-taking' — which have become a significant feature of Australian contract law.[3] These trends create a

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1 Patrick Atiyah, *The Rise and Fall of Freedom of Contract* (1979); Patrick Atiyah, *Promises, Morals, and Law* (1981).

2 Sir Anthony Mason, 'Australian Contract Law' (1988) 1 *Journal of Contract Law* 1; Manfred Ellinghaus, 'An Australian Contract Law?' (1989) 2 *Journal of Contract Law* 13; Nicholas Seddon, 'Australian Contract Law: Maelstrom or Measured Mutation?' (1994) 7 *Journal of Contract Law* 93. See generally John Carter and David Harland, *Contract Law in Australia* (2nd ed, 1991), 10-15; Joseph Starke, Nicholas Seddon and Manfred Ellinghaus, *Cheshire and Fifoot's Law of Contract* (6th Australian ed, 1991) 22-45.

3 In particular, *Blomley v Ryan* (1956) 99 CLR 362; *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 ('*Amadio*') and *Louth v Diprose* (1992) 175 CLR 621 (although a gift rather than a contract case), and for relevant statutory provisions: Contracts Review Act 1980 (NSW) and Trade Practices Act 1974 (Cth) ss 51AA and 51AB (previously s 52A). Note that, apart from the contractual unconscionability doctrine, unconscionability principles have been applied in other contexts such as estoppel (*Waltons Stores (Interstate) v Maher* (1988) 164 CLR 387; *Commonwealth v Verwayen* (1990) 170 CLR 394) and breach of confidence (*Franklin v Giddins* [1978] Qd R 72; *Moorgate Tobacco Co Ltd v Philip Morris Ltd [No 2]* (1984) 156 CLR 414), although the policies which lie behind the principles in these contexts are arguably different.

new impetus to examine the classical utilitarian theories and consider to what extent they have continuing relevance to modern Australian contract law.

The first part of this article examines the classical utilitarian theories and compares them with modern economic theories of contract law which represent a contemporary articulation of the classical utilitarian theories, although to some degree influenced also by broader liberal and libertarian perspectives. The second part examines criticisms which have been made of the utilitarian-economic model, in particular its assumption of rationality, by Atiyah and by Australian scholars who argue in favour of broadly framed unconscionability doctrines. It is argued that the treatment of irrationality suggested by the Canadian law and economics scholar, Michael Trebilcock can be drawn on to develop a set of principles consistent with the Australian doctrine of unconscionability. It is further argued that a focus on the promisee as a potential advantage-taker under the Australian doctrine is appropriate in utilitarian and economic terms: identifying that party as the one with the greater ability to avoid or take steps to overcome the negative effects of promisor irrationality. The focus suggests a reformulation of the utilitarian-economic model of contractual obligation in terms of a more explicitly cooperative model of welfare maximisation.

CLASSICAL UTILITARIAN AND MODERN ECONOMIC THEORIES COMPARED

Classical Utilitarian Theories

The basis of the classical utilitarian model of contract law was that freedom of contract tends to maximise individual and therefore collective welfare. Sidgwick, in *The Methods of Ethics*, said that 'generally speaking, each is best qualified to provide for his own interests, since even when he does not know best what they are and how to attain them, he is at any rate most keenly concerned for them'.[4] Similarly, John Stuart Mill argued that individuals can only benefit from the ability to 'pursue our own good in our own way' and that the freedom to unite in the pursuit of mutual welfare follows from that.[5] Paley also referred to the value of promises as a means to maximising welfare.[6] But Hume, writing in the 18th century before utilitarianism had emerged as a unified school of thought and at a time when modern contract law was just developing, explained most clearly the utilitarian basis for the binding nature of contractual promises:

> [E]xperience has taught us, that human affairs would be conducted much more for mutual advantage, were there certain *symbols* or *signs* instituted, by which we might give each other security of our conduct in any particular incident. After these signs are instituted, whoever uses them is immediately bound by his

[4] Henry Sidgwick, *The Methods of Ethics* (7th ed, 1907) 444.

[5] John Stuart Mill, *On Liberty* (1st published 1859, 1962 ed) 138.

[6] William Paley, *The Principles of Moral and Political Philosophy* (1978) 106.

> interest to execute his engagements, and must never expect to be trusted any more, if he refuse to perform what he promised.[7]

Hume's statement signalled the developing trend of the time away from purely familial, community and profession-based arrangements, and towards more widespread contracting between 'strangers'.[8] As Hume recognised, it was only when the binding force of a contractual promise was socially accepted and legally enforced that a full market economy could begin to develop.[9]

A common fallacy in criticisms of the utilitarian theories is the identification of them in terms of a belief that welfare would *always* be maximised by freedom of contract; a belief which in its absolute form is manifestly incorrect.[10] At a deeper philosophical level, Atiyah has questioned whether utilitarianism provides any basis for insisting that a contractual promise should be binding when it is not in the promisor's interests to perform.[11] These criticisms call for a response since they misunderstand the nature of the reasoning being employed in the classical utilitarian analysis. The mistake stems from a failure to distinguish between the benefit to be gained from a particular act or combination of acts which may be justified in utilitarian terms (to which a rule may refer by way of summary), and the benefit to be gained from a rule or rules which establish a new practice and make possible acts which could not exist without the rule.[12] An example is the practice of contracts where the benefit lies in the ability to use promises to tie down the future and coordinate plans in advance (which would not be possible without the practice).[13] In this case, the rules of the practice are crucial to its existence, and it is essential that they are treated as more or less

7 David Hume, *A Treatise on Human Nature* (1888) 522.

8 Hume, above n 7, 519-20:

> Men being naturally selfish, or endowed only with a confined generosity, they are not easily induced to perform any action for the interests of strangers, except with a view to some reciprocal advantage, which they had no hope of obtaining but by such a performance, Now as it frequently happens, that these mutual performances cannot be finished at the same instant, it is necessary that one party be contented to remain in uncertainty, and depend upon the gratitude of the other for a return of kindness. But so much corruption is there among men, that, generally speaking, this becomes but a slender security .... Here then, is the mutual commerce of good offices in a manner lost among mankind, and every one reduced to his own skill and industry for his well-being and subsistence.

9 See also Atiyah, *Rise and Fall*, above n 1, 398.

10 See, eg, Starke, Seddon and Ellinghaus, above n 2, 22 (referring to K Shatwell, 'The Doctrine of Consideration in the Modern Law' (1955) 1 *Sydney Law Review* 289): 'The assumptions that contracting parties were "gifted with mature reason and governed by enlightened self-interest" needed re-examination' — although adding that even the classical utilitarians could not argue this without reservation.

11 Atiyah, *Promises, Morals, and Law*, above n 1, 69. See also, although less explicitly, Starke, Seddon and Ellinghaus, above n 2, 22 and Carter and Harland, above n 2, 11 — arguing that exceptions need to be made to the binding force of the promise-keeping principle behind contract law on utilitarian grounds of the 'hardship' that would otherwise be caused.

12 The distinction between these two forms of rule utilitarianism is identified by John Rawls, 'Two Concepts of Rules' (1955) 64 *Philosophical Review* 3, drawing on classical utilitarian theories of promising and contract.

13 Ibid 16. (Rawls adopts a rather different justification in *A Theory of Justice* (1972) 344-8, based on a perception of what would be agreed to in the original position (behind the veil of ignorance). Nevertheless, Rawls still appears to accept that the reason why those in the original position would choose to have a practice of promises is because they believe on utilitarian grounds that the practice will be a useful one).

definitive by those who participate.[14] The principle of security of contract reflects the practice conception. It indicates that, although exceptions may be made to the binding force of a contract, a general exception that it is better for a promisor not to perform would too significantly undermine the practice of contracts.[15]

Hume's theory of contractual obligation is consistent with the practice conception. This is evidenced by his justification in terms of affairs being 'conducted much more for mutual advantage', his reference to the adoption of 'symbols or signs' establishing the practice, and his emphasis on the importance of maintaining 'security of conduct' once those signs or symbols are used.[16] The practice conception is equally apparent in the writings of Sidgwick and Paley who also referred to the value of contracts in facilitating the coordination of plans, and the importance of maintaining security of contract.[17] Finally, the practice conception is indicated by Mill's argument that a contractual promise 'for money or money's worth' creates a binding obligation,[18] and that security of contract is 'the most vital of all interests'.[19] Mill concluded that

> [w]hen a person, either by express promise or by conduct, has encouraged another to rely upon his continuing to act in a certain way — to build expectations and calculations, and to stake any part of his plan of life on that supposition — a new series of moral obligations arises on his part towards that person, which may possibly be overruled, but cannot be ignored.[20]

The classical utilitarian argument for the binding effect of contracts was therefore based on the social benefit of having a practice of contracts. Inherent in the argument was the recognition that a promise could not be broken simply because the promisor judges that as better on the whole when the time comes for performance.[21] As Hume said, without contract law to maintain the practice, '[h]ere then, is the mutual commerce of good offices in a manner lost among mankind and every one reduced to his own skill and industry for his well-being and subsistence'.[22]

14 Ibid 24.

15 Ibid 17-18, 31.

16 See above n 7 and accompanying text. In particular, Rawls refers to Hume's theory of contractual obligation in support of his argument regarding the practice conception of rules.

17 See Sidgwick, above n 4, 443: 'The importance to mankind of being able to rely on each other's actions is so great, that in ordinary cases of absolutely definite engagements there is scarcely any advantage that can counterbalance the harm done by violating them'; and Paley, above n 6, whose full statement is: 'But there could be no confidence in promises, if men were not obliged to perform them: the obligation therefore to perform promises is essential, to the same end, and in the same degree'.

18 Mill, *On Liberty*, above n 5, 236: 'there are perhaps no contracts or engagements, except those that relate to money or money's worth, of which one can venture to say there ought to be no liberty whatever of retraction'.

19 John Stuart Mill, *Utilitarianism* (1st published 1861, 1962 ed) 310.

20 Mill, *On Liberty*, above n 5, 139.

21 Rawls, above n 15.

22 See Hume, above n 7, 520.

Modern Economic Theories

In contrast to the classical utilitarians, modern law and economics scholars, particularly those of the Chicago school, tend to use both efficiency *and* more general liberal or libertarian grounds to justify contract law. So Epstein states that:

> This general regime of freedom of contract can be defended from two points of view. One defence is utilitarian ... [that] its enforcement will tend to maximise the welfare of the parties to it, and therefore the good of society as a whole. The alternative defence is on libertarian grounds. One of the first functions of the law is to guarantee to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties ... [and] two individuals ... should have the same right with respect to their mutual affairs against the rest of the world.[23]

Trebilcock, although not of the Chicago school, also indicates a mixed approach to the justifications for contract law. In *The Limits of Freedom of Contract* he refers both to economic arguments in support of contract and broader liberal and libertarian justifications:

> As articulated by earlier scholars such as Mill, and contemporary scholars such as Hayek, Friedman, Nozick and Fried, individual autonomy is seen as a paramount social value and a central precondition to individual freedom.[24]

Trebilcock does not distinguish between the liberalism of Mill, and that of, for instance, Fried who values liberty as an assertion of individual freedom and power.[25] Yet Mill's liberalism was part of his broader utilitarian philosophy, based on the idea of liberty serving utilitarian ends, albeit in the largest sense 'grounded on the permanent interests of man as a progressive being'.[26] As in the case of Hume and the other classical utilitarians, Mill justified contractual obligation on the basis of the tendency of contracts to maximise welfare, rather than on the broader basis of treating liberty as a value in its own right.[27]

Both Epstein and Trebilcock accept that utilitarian justifications for contract law correspond to economic arguments used in modern law and economic analysis.[28] Yet the utilitarian-economic arguments are not fully developed in

[23] Richard Epstein, 'Unconscionability: A Critical Reappraisal' (1975) 18 *Journal of Law and Economics* 293-4.

[24] Michael Trebilcock, *The Limits of Freedom of Contract* (1993) 8.

[25] As Fried states '[e]verything must be available to us, for who can deny the human will the title to expand even into the remotest corner of the universe?': Charles Fried, *Contract as a Promise: A Theory of Contractual Obligation* (1981) 8.

[26] See Mill, *On Liberty*, above n 5, and his general comment at 136: 'I regard utility as the ultimate appeal on all ethical questions'.

[27] For an explicit distinction drawn between the liberal argument and the utilitarian argument for freedom of contract see Sidgwick, above n 5, 445: 'in so far as Common Sense has adopted the Individualistic ideal in politics, it has always been as subordinate to and limited by the Utilitarian first principle.' Mill, of course, believed that liberty and welfare were necessarily inextricably entwined.

[28] By contrast, Posner rejects the suggestion that law and economics can be equated with utilitarianism partly because utilitarianism in his view fails to acknowledge liberal values: Richard Posner, 'Utilitarianism, Economics and Legal Theory' (1979) 8 *Journal of Legal Studies* 103.

their writings. Similarly, in their introduction to *The Economics of Contract Law*, Kronman and Posner explain why

> [t]he fundamental economic principle with which we begin is that if voluntary exchanges are permitted — if, in other words, a market is allowed to operate — resources will gravitate towards their most valuable uses.[29]

The authors also comment on the role of contract law in ensuring that promises are performed and in removing 'the strategic opportunities that parties might try to exploit in the absence of legal sanction',[30] an argument echoed by Trebilcock in *The Limits of Freedom of Contract*.[31] However, it is left to others to provide a more elaborated analysis of the economic function of contract law in establishing and maintaining the practice of contracts.

In their article 'Enforcing Promises', Goetz and Scott come close to providing this analysis, identifying the possibility of 'beneficial reliance' (defined in broad terms to encompass any reliance on a contractual promise which would benefit the promisee in the event the promise is performed) as the value of the practice of contracts, a value which would be lost without a sanction for breach of contract in cases where a promisor would prefer not to perform:[32]

> What happens if the promisee knows that the probability of the promisor's performance is less than certain? In this case, the beneficial results of ... an adaptive action is balanced against the risk of loss. Whatever the reasons for the riskiness attached to the performance prospects of any promise, the promisee can protect himself against any prospective losses from detrimental reliance by limiting his behaviour adjustments. In practice, the attempt to do this is frequently manifested in intermediate courses of action taken by promisees who ... do not react as fully as if performance were certain. The price for this self-protection against the risk of detrimental reliance is, therefore, the value of the prospective beneficial reliance that would accrue from full adaptation to the advance knowledge of a promissory performance.[33]

But even more significant, although less emphasised by Goetz and Scott, is Hume's earlier argument that, to the extent that there is uncertainty as to performance of contractual promises, promisees may be reluctant to enter into contracts at all.[34] On this analysis, entering into a contract is itself a form of beneficial reliance on the other party's promise. It is the expectation that the promise will be performed which provides the reason for the contract being

29 Anthony Kronman and Richard Posner (eds), *The Economics of Contract Law* (1979) 1.

30 Ibid 3.

31 Trebilcock, above n 24, 16:

> Whereas in traditional societies conventions may develop that mitigate the problem, in contemporary societies the law of contracts — by providing remedies in the event of breach of contractual promises — provides an essential check on opportunism in non-simultaneous exchanges by ensuring that the first mover, in terms of performance, does not run the risk of defection, rather than cooperation by the second mover.

32 Charles Goetz and Robert Scott, 'Enforcing Promises: An Examination of the Basis of Contract' (1980) 89 *Yale Law Journal* 1261.

33 Ibid 1270.

34 Goetz and Scott refer to the prospect of no reliance on highly uncertain promises only indirectly, adding that they may nevertheless be relied on to some extent if the anticipated benefit is sufficient to off-set the risk of non-performance: ibid n 27.

undertaken, regardless of whether further actions 'in reliance' on the promise are likely to be adopted prior to performance.[35]

As Goetz and Scott point out, any reduction in the beneficial reliance that there can be on a contractual promise (it may be added, including beneficial reliance in the broadest sense of entering into the contract), is to the disadvantage not only of promisees but also of promisors who may genuinely intend to perform their promises but have no effective way of reassuring those they deal with. Promisors may seek to offer personal assurances such as 'the offer of guarantees, verbal persuasions and the development of a reliable reputation' but these tend to create additional costs in the contracting process and may still be inadequate.[36] The need for a sanction for non-performance of a contractual promise is, therefore, twofold:

1 to provide security of contract for promisees in a cost-effective way and ensure that, even if it is more efficient for a promisor to break the contract, the promisee is fully compensated for loss of the value of the promise;[37] and

2 to place any risk of non-performance on promisors who must take this into account in determining whether the contract is worth undertaking and performing.[38] The risk may be able to be passed on to a promisee in exchange for a lower price or other benefits, but as a negotiated term of the contract based on the assessment that the promisee in the particular case is the 'least-cost bearer of any risk'.[39]

The economic argument developed above builds on classical utilitarian theories in explaining the value of having a practice of contracts in economic terms, and the need for the legal sanction measured in terms of expectation damages. But it is not necessary to the economic approach, any more than to the classical utilitarian approach, that contracts benefit all parties in all cases. The practice

35 By contrast, the statement of Goetz and Scott, above n 33 and accompanying text suggests that beneficial reliance encompasses only actions taken *after* receiving the promise.

36 Ibid 1273-5.

37 Ibid 1281-6, although query the precise reasoning. Goetz and Scott propose an optimal damages formula for non-reciprocal promises of $(1-p)D=(1-p)R-pB$ where:

- D is optimal damages
- p is the probability of performance (and $(1-p)$ is the probability of non-performance)
- R is the value of detrimental reliance in the event of non- performance
- B is the value of beneficial reliance in the event of performance

This conveniently reduces to D=R=E (the expectation under the contract) in the case of contractual promises on the basis that, at least in the case of contracts with market substitutes, B will be zero because there is no 'extra' benefit to be gained from that contract over other contracts in the market: ibid 1284. Whereas R, the lost opportunity to contract elsewhere in the market, is equivalent to E. However, the statement assumes that there would be market substitutes if contract damages were not available, whereas the practice theory of contracts implies the opposite. The broader approach to beneficial reliance indicated in the text accompanying nn 34-5 does not make the assumption. Rather, the reasoning there suggests that B (the anticipated benefit under the contract if performed = E) equates to R (the benefit lost if the contract is not performed) and since p would be close to 0 if damages were not available, this leads to the result that D=R(=E).

38 Goetz and Scott suggest that generally a promisor will be in a better position to avoid the risk of non-performance than a promisee, and so this is an appropriate starting point: Goetz and Scott, above n 32, 1280.

39 Ibid 1285 (adopting what is essentially a Coasean analysis). See also Kronman and Posner, above n 29, 4-5.

conception of contracts is based rather on a more general view of the value of contracts as providing a mechanism for planning for the future as well as, in situations of uncertainty, the allocation of foreseeable risks.

THE UTILITARIAN-ECONOMIC MODEL AND THE RATIONALITY ASSUMPTION

The Assumption of Rationality

An underlying assumption of both utilitarianism and the law and economic analysis is that individual promisors can effectively determine whether their contracts are welfare-maximising in the sense of

1 identifying their preferences, which are transitive with the course of time; and

2 identifying the contract as a means to furthering their preferences and acting on that judgment.[40]

At a more fundamental level the assumption of rationality also means that

3 subjective preferences reflect an objective standard of optimal welfare for the decision-maker;[41] and

4 preferences will remain relatively constant over time so that identifying the contract as a means to further preferences in the present will continue to reflect an objective standard of optimal welfare for the future.

Critics of the utilitarian-economic model of contract law may reject the assumption of rationality to varying degrees: either implicitly in arguments that judgments about unconscionability should play an all-pervasive role in contract law,[42] or more explicitly as in the case of Atiyah's statement:

> No doubt [the rationality assumption] is a reasonable working assumption — indeed, the only possible assumption in a society which is to have any respect for freedom and dignity; but it is surely to fly in the face of all human experience to treat it as a universal truth. Even reasonably intelligent people like law or economics professors must often find it very difficult to know whether major personal decisions are likely to be in their long-run interests (for example to take a new job, buy a new house); but university professors have IQs somewhat above average. For every professor, there must be someone in the population with an IQ below average. When these people come to make important deci-

[40] For articulations of the rationality assumption as the basis of law and economic analysis, see Robert Cooter and Thomas Ulen, *Law and Economics* (1988) 234; Cento Veljanovski, *The New Law and Economics: A Research Review* (1982) 26-8.

[41] This is indicated by Veljanovski, above n 40, 27:

> The modern economic theory of utility ... does not attempt to explain why individuals prefer particular things or to imply that the choices made are 'good' in any other sense than as subjectively assessed by the individuals concerned. *That is, it is assumed the individual is the best judge of his own welfare.* (Emphasis added.)

See also Sidgwick, above n 4; Mill, *On Liberty*, above n 5.

[42] See the works cited above n 2, particularly Ellinghaus, 'An Australian Contract Law?' representing the strongest statement of this position as far as Australian commentators are concerned.

> sions, the chances that they will act in their own long-term interests are often quite low.[43]

The difficulty for the critics is that it is not possible to disprove the assumption that people are generally capable of deciding in their own interests.[44] Nor, on the other hand, can the assumption be proved: its validity as an assumption can only be based on reason and argument.

One argument in favour of the assumption is, as Atiyah indicates, the broader liberal one that respect for human dignity requires some acknowledgment of freedom of contract. But there are also relevant utilitarian-economic arguments, including that:

- in many cases people seem to remain happy with their preferences and do not wish to change them (as evidenced by the number of contracts which are entered into and performed without complaint);[45]
- a person is more *likely to be* a better judge of his or her own welfare than an outsider simply because, as Sidgwick and Mill suggested, an outsider can never fully appreciate another person's feelings and desires;[46]
- incentives should be provided for rational choices to be made and irrational choices to be avoided wherever possible — or, as Kronman and Posner argue, a benefit of making contractual obligations binding is to discourage 'careless behaviour in the contracting process';[47]
- through the exercise of choice, even choices involving irrationality, the rational faculty may become better developed and this possibility cannot be ignored or discounted. As Mill put it, '[t]he mental and moral, like the muscular powers, are improved only by being used;[48]
- permitting broad arguments about irrationality may, as Epstein argues, raise 'both opportunity and incentive for many to take advantage of the rights conferred on them by law to manipulate the system to their own advantage';[49] and,
- more generally, any value for an irrational promisor in being given the freedom to change his or her mind and renege on a promise must be weighed

[43] Patrick Atiyah, 'Executory Contracts, Expectation Damages, and the Economic Analysis of Contract', *Essays on Contract* (1990) 150, 155.

[44] This was the author's experience while working on a project on unfair contracts while a legal research officer at the New Zealand Law Commission. The Commission's conclusion regarding the 'evidence' of unfairness gathered from community law centres and citizens' advice bureaux was that, although there were a large number of complaints (50 from one community law centre alone), 'the cases were of complaints only. It does not follow that all or most of them were justified': Law Commission, *Unfair Contracts: A Discussion Paper*, Paper No 11 (1990) 22-3.

[45] Ibid. The discussion paper revealed that the figures for complaints received demonstrate that, compared to the number of contracts entered into in New Zealand (estimated by the Law Commission at many thousands daily), the proportion which a party might later judge to be irrational constitutes only a tiny fraction.

[46] See Sidgwick, above n 4 and accompanying text; Mill, *On Liberty*, above n 5, 197: 'Human beings are not like sheep; and even sheep are not undistinguishably alike'.

[47] Kronman and Posner, above n 29, 4.

[48] Mill, *On Liberty*, above n 5, 187-8.

[49] Epstein, above n 23, 305.

against the value of security of contract for promisees and promisors generally.[50]

The first and second arguments could not seriously be contested by critics such as Atiyah. They are primarily concerned with promisors who later determine that a contract is not in their interests; the outsider's judgment only entering the equation at that point. The third and fourth arguments could also have only limited significance for irrationality, being primarily focussed on the case of a careless contractor who, at least with some greater effort, is capable of deciding in his or her best interests. Their relevance is minimal in the case of someone who in the circumstances of the particular contract is simply not capable of deciding in his or her best interests. In that case, only the fifth and sixth economic-utilitarian arguments are of real weight against Atiyah's argument that it cannot be assumed that people will always be capable of identifying and furthering their interests through their contracts. Nor do the arguments provide a complete answer; rather, they must be balanced in the light of the need to protect the interests of irrational promisors who are incapable of controlling their irrationality at the time of contracting.

The above reasoning indicates that even within the utilitarian-economic model of contracts it is feasible to admit exceptions to the binding force of contracts on individual welfare-maximising grounds, provided these are not over-inclusive (permitting abuse by those who do not need the protection), and provided they do not undermine security of contract so significantly as to cause more harm than good.[51] Balanced against any reduction of security of contract for promisees is the benefit of ensuring that irrational contracts which are contrary to the interests of promisors are not enforced against them.

An acknowledgment among the classical utilitarians of the need to make at least some exceptions to the practice of contracts, was Mill's broad statement that a contract should be binding only 'provided it is made knowingly and voluntarily'.[52] But it has been for law and economics scholars, with the benefit of 100 years of experience of the problems of contracts, to provide a more detailed consideration of the scope of possible exceptions to the economic model

[50] Trebilcock identifies this argument in his article 'An Economic Approach to the Doctrine of Unconscionability' in Barry Reiter and John Swan (eds), *Studies in Contract Law* (1980) 379, 391:

> Thus, it is clear that existing rules [of incapacity, restraint of trade, physical duress and undue influence] bearing directly on transactional unfairness are underinclusive. The question then becomes can they be made more inclusive at an acceptable cost? That uncertainty comes at a price is, however, beyond debate: a higher rate of return will be demanded by firms operating in the industry, which will in turn be reflected in higher prices for buyers in such markets.

It may be added that if firms ultimately determine that nothing can compensate for the additional risks involved, they may alternatively refuse to contract in the particular market. See above n 34 and accompanying text.

[51] See also Rawls, 'Two Concepts of Rules', above n 15 and accompanying text.

[52] Mill, *Utilitarianism*, above n 19, 300. See also Mill, *On Liberty*, above n 5, 138. Sidgwick, above n 4, 305-11 and Paley, above n 6, 110-21 provide more specific statements of the scope of possible exceptions to the utilitarian model based on fraud, duress, undue influence and mistake. See, however, Hume, above n 7, 525, suggesting that the grounds for non-enforcement should be limited to cases of 'public interest and convenience' (giving the example of the promise of payment in response to threats made by a robber).

based on identifiable cases of the failure of the rationality assumption involving promisors who cannot control their irrationality and so avoid its effects.

Law and Economics Analysis and the Rationality Assumption

That many modern law and economics scholars accept only a very limited role for exceptions to be made to the enforcement of contractual promises is attributable to their failure to distinguish their economic analysis from their broader liberal or libertarian perspectives which emphasise individual responsibility over any form of communitarian involvement.[53] Epstein and Posner, representing the Chicago school, demonstrate this in their arguments against an unconscionability doctrine. To use Posner's words,

> economic analysis reveals no grounds other than fraud, incapacity, and duress (the last narrowly defined) for allowing a party to repudiate the bargain that he has made in entering into the contract.[54]

Fraud and duress are more concerned with problems in the contracting environment affecting a promisor's ability to act freely in entering into the contract, than with the assumption of rationality whose concern is with the promisor's *internal* decision-making processes.[55] Although Epstein does acknowledge a role for a doctrine of undue influence — accommodating some problems of irrationality — this is only in the particular case of a party who 'brings to bear psychological pressure of considerable force and duration against the will of another individual who, while of full legal capacity, may be irresolute, feeble or weak'.[56] The broader rejection of the need for unconscionability doctrines to deal with problems of irrationality going beyond incapacity and Epstein's narrow category of undue influence gives little credence to the failure of the rationality assumption. In part, this is justified on the economic basis that such broader doctrines 'do more harm than good' because of their uncertain scope and the potential for abuse by those who do not need protection.[57] But the argument also suggests that, for Posner and Epstein, rationality is to some extent a normative principle to be imposed on promisors regardless of whether they can meet its standards.[58]

By contrast, in 'The Bargain Principle and its Limits' Eisenberg suggests that a wide-ranging doctrine of unconscionability, as in the case of section 2-302 of the

[53] See also Fried, above n 25, 8: 'this [liberal] ideal makes what we achieve our own and our failures our responsibility too — however much or little we may choose to share our good fortune and however we may hope for help when we fail'.

[54] Richard Posner, *Economic Analysis of Law* (4th ed, 1992) 116. See also Epstein, above n 23, 302-3, although adding that an unconscionability doctrine would have the advantage of making proof of these causes of action easier.

[55] In the first case the promisor may be rational but must operate within the constrained circumstances of inadequate information provided or pressure applied. For the distinction elaborated, see Cooter and Ulen, above n 40, 235-6.

[56] Epstein, above n 23, 303.

[57] Epstein, in particular, uses these arguments as a basis to criticise the application of unconscionability principles.

[58] For a more general critique of Posner's economic analysis on the grounds that its assumptions impose normative standards, see Robin West, 'Submission, Choice and Ethics: A Rejoinder to Judge Posner' (1986) 99 *Harvard Law Review* 1449-56.

Uniform Commercial Code (regarding sale of goods), can be justified in economic terms because unconscionable contracts manifestly fail to meet the welfare-maximising basis of contract law as far as the promisor is concerned.[59] More significantly, Eisenberg also argues that security of contract need not be undermined because the main application of s 2-302 has been in the following categories of cases, all of which involve sufficient seller knowledge for the categories to be predictable in their operation:

- a buyer's temporary state of necessity or desperation exploited by the seller;
- a buyer's transactional incapacity (inability through 'lack of aptitude or experience or judgmental ability' to understand very complex terms of a contract or its implications) exploited by the seller;
- unfair persuasion by a seller (corresponding in part to Epstein's narrower undue influence category); and
- a buyer's ignorance of alternative prices available in the market exploited by the seller.[60]

The first and fourth categories might be better viewed as, respectively, categories of economic duress and seller non-disclosure which, as in the case of Posner's and Epstein's categories of duress and fraud, have more to do with the contracting environment than with the promisor's irrationality in the sense of his or her internal ability to decide in his or her best interests.[61] But the second and third categories are more directly concerned with irrationality and provide a useful basis for exploring the corresponding applications of Anglo-Australian unconscionability doctrines as well.

In *The Limits of Freedom of Contract*, Trebilcock draws on Eisenberg's categories of transactional incapacity and unfair persuasion[62] and suggests that Anglo-Canadian doctrines of undue influence and unconscionability support these categories in their practical operation.[63] Trebilcock also suggests that these categories may be reduced to the single category of *information processing disability* involving a case where

[59] Melvin Eisenberg, 'The Bargain Principle and its Limits' (1982) 95 *Harvard Law Review* 741, 743-8. That argument, however, is insufficient in itself to answer the utilitarian-economic arguments in favour of security of contract.

[60] Ibid 754-85.

[61] A similar comment may be made regarding Trebilcock's justified use of unconscionability doctrines in cases of situational (one-off cases of) monopoly and material non-disclosure. See Trebilcock, 'An Economic Approach to the Doctrine of Unconscionability', above n 50. Again these cases have little to do with problems of irrationality and are perhaps better dealt with under extended doctrines of duress and misrepresentation. Trebilcock possibly suggests this in the way he deals with such cases in his later book *The Limits of Freedom of Contract*, above n 24: see especially chh 4 (Coercion) and 5 (Asymmetric Information Imperfections).

[62] Trebilcock, *The Limits of Freedom of Contract*, above n 24, 117-18, 152.

[63] Ibid 118-19, referring, in particular, to *Lloyds Bank Ltd v Bundy* [1975] QB 326 (although a case decided before — and on broader terms than — the House of Lords decision in *National Westminster Bank plc v Morgan* [1985] AC 686 and more recently *Barclays Bank plc v O'Brien* [1994] 1 AC 180). In 'An Economic Approach to the Doctrine of Unconscionability', above n 50, 405, Trebilcock also argues that the information processing category substantially corresponds to the Canadian doctrine of unconscionability.

> the two parties, while sharing equal access to the relevant body of information about the contract subject matter have sharply differential capacities to evaluate the implications of information about the contract for his or her welfare.[64]

At the same time Trebilcock considers but rejects the use of any broader principle which would involve the second-guessing of a promisor's preferences.[65] The argument is essentially economic: the difficulty with judgments going to the quality of preferences is that, although they have may some merit in themselves, they would provide too broad and uncertain a scope to be consistent with any principle of security of contract.[66] Nevertheless, Trebilcock's concluding statement from Milton Friedman that paternalistic grounds for intervention in freedom of contract are 'the most troublesome for a liberal' and that state intervention is 'objectionable' *per se*,[67] indicates the residual influence of broader liberal or libertarian notions on even Trebilcock's thinking.

In utilitarian-economic terms, Trebilcock's distinction between the questioning of a promisor's identified preferences and the effectiveness of the contract as a means adopted to achieve given preferences makes sense. The second-guessing of preferences, except in extreme cases of incapacity, is inconsistent with security of contract which lies at the heart of the utilitarian-economic model. But that does not preclude the narrower questioning of a promisor's ability to determine the likely effectiveness of a contract in furthering his or her preferences. The question has particular relevance where a 'disability' can be identified in terms of the physical, mental or emotional characteristics of the promisor, and is manifested in the circumstances of the contract.[68] A focus on manifested dis-

64 Trebilcock, *The Limits of Freedom of Contract*, above n 24, 118-19. For a possibly broader definition of this category see Trebilcock, 'An Economic Approach to the Doctrine of Unconscionability', above n 50, 405, referring to the category as encompassing

> [a]n inability to reason about a proposed contractual offering in a reasonably mature adult fashion, as a result of some fairly precisely identifiable psychological disability, or an inability resulting from lack of experience to evaluate proposed contractual offerings against prevailing market benchmarks.

65 Trebilcock rejects arguments for paternalism on the basis of endogenous (conditioned) preferences, intuitive paternalism (based on a notion of sympathetic understanding of the decision-maker's true preferences) and what might be termed 'bad preferences' (direct attempts to second-guess individual preference based on society's values), although he acknowledges the need for limited categories of incapacity as a basis for second-guessing preferences: Trebilcock, *The Limits of Freedom of Contract*, above n 24, 158-63.

66 Ibid 163:

> [T]he case for paternalistic legal intervention on grounds of contingent, adaptive or bad preferences becomes much more problematic, and the burden of justifying intervention correspondingly much stronger, simply because clearly definable individual preferences are being repudiated in the absence of readily identifiable forms of ... information failure.

67 Ibid.

68 Trebilcock (drawing on Joel Feinberg, *Harm to Self* (1986)) identifies a range of mental or behavioural 'states or circumstances' which may affect a promisor's ability to process information:

- impulsiveness
- fatigue
- excessive nervousness
- agitation or excitement
- powerful passion (eg rage, hatred, lust, depression, mania)
- intoxication (alcohol and other drugs)
- pain

ability as the basis for judging irrationality establishes the category's predicability. Further, the focus can usefully be supported by an explicit requirement that the disability be known to the promisee, or at least that the basis for knowledge is there (in economic terms, that the information is discoverable at low cost), which Trebilcock also treats as significant to his information processing disability category.[69] Nevertheless, Eisenberg's unfair persuasion category, and even Epstein's formulation of undue influence, suggest that Trebilcock's information processing disability category can be supplemented by a category of what may be termed information *utilisation* disability. This involves a promisor who, although understanding or being capable of understanding the implications of information for his or her welfare, is unable in the circumstances of the contract[70] to exercise sufficient independence of thought or will to make or act on that judgment, again provided that the disability is known to the promisee or the basis for knowledge is available.

The Australian Unconscionability Cases

The same conclusion can be drawn from a review of the leading Australian cases in which the unconscionability doctrine has been developed and applied in recent years.[71] The doctrine resurrected by the High Court in *Commercial Bank of Australia Ltd v Amadio* in 1983[72] essentially involved an information processing disability. The case involved parent guarantors who — because of their age, lack of English language skills and relevant business experience, and their emotional dependence on their son, the beneficiary under the guarantee —had entered into a guarantee which was more likely to favour the bank's interests than anyone else's, given the amount already lent to the son and the poor financial state of his business (which the bank had concealed by selectively dishonouring cheques to keep the company afloat). Mason J found that, with reference to the bank's position,

- neurotic compulsion/obsessiveness
- severe time constraint

Trebilcock, *The Limits of Freedom of Contract*, above n 24, 148. A focus on the promisor's physical, mental or emotional characteristics and the circumstances of the contract works towards the same end but identifies the states or circumstances in terms of the underlying explanation rather than the behavioural or mental condition which results.

69 Trebilcock indicates a requirement of at least constructive knowledge of the information processing disability category in his earlier (and elaborated discussion) of the category: ibid 118.

70 In this context, the relevant personal characteristics referred to above n 68 and accompanying text, should include the state of *emotional dependency*.

71 Above n 3.

72 *Amadio* (1983) 151 CLR 447. Note, however, that Mason J, in particular, might be taken to suggest that the doctrine is concerned even more broadly (and paternalistically) with *any* party who 'is unable to make a worthwhile judgment of what is in his best interests': ibid 461. Such lack of clarity as to the role of unconscionability doctrines in judicial statements has been a source of uncertainty concerning its operation — leading to the conclusion by Duggan that there is a great and unresolved ambivalence 'concerning the equitable doctrine of unconscientious dealings' — an ambivalence which is even more apparent in the cases concerning the statutory doctrines which identify a range of factors for assessing unconscionability without indicating any clear philosophical basis for their application: see Anthony Duggan, 'The Trade Practices Act 1974 (Cth), Section 52A and the Law of Unjust Contracts' (1991) 13 *Sydney Law Review* 138, 167.

> Mr Virgo was aware that the respondents were Italians, that they were of advanced years and that they did not have a good command of English. He knew that Vincenzo had procured their agreement to sign the mortgage guarantee. He had no reason to think that they had received advice and guidance from anyone but their son. In cross-examination he conceded that he believed that Vincenzo had acted in the 'role of adviser/explainer' in relation to the transaction and referred to him as acting 'in his capacity as a dominant member of the family'. Mr Virgo also knew that, in the light of the then financial condition of the company, it was vital to Vincenzo to secure his parents' signature to the mortgage guarantee so that the company could continue in business. It must have been obvious to Mr Virgo, as to anybody else having knowledge of the facts, that the transaction was improvident from the viewpoint of the respondents. In these circumstances it is inconceivable that the possibility did not occur to Mr Virgo that the respondents' entry into the transaction was due to their inability to make a judgment as to what was in their best interests, owing to their reliance on their son, whose interests would inevitably incline him to urge them to sign the instrument put forward by the bank.[73]

Similar reasoning has been applied in many later cases of unconscionability with analogous facts.[74] Indeed the main application of the Australian unconscionability doctrine has been to guarantee or joint loan contracts entered into by parents or spouses who, in their circumstances — of, in particular, limited education, lack of business experience and/or emotional dependence on their child or spouse — and in the circumstances of the contract, had little or no ability to comprehend the full extent of the risks they were undertaking.[75] Additionally, stemming from the earlier case of *Blomley v Ryan*[76] where the doctrine was applied to set aside a contract for sale and purchase of a farm on

[73] *Amadio* (1983) 151 CLR 447, 466-7 (Mason J) and 476 (Deane J, with whom Wilson J agreed).

[74] For instance, encompassing cases both under the equitable doctrine and cases decided under the Contracts Review Act 1980 (NSW): *National Australia Bank Ltd v Nobile* (1988) 100 ALR 227 (parents of non-English speaking background, with limited experience in business matters, and who placed great trust in the bank, guaranteeing for the benefit of their son's business); *S H Lock (Aust) Ltd v Kennedy* (1988) 12 NSWLR 482 (mother in law, with a prior relationship of trust with the moneylender, guaranteeing a son in law's business debts in the face of false assurances as to the extent of the risk undertaken); *Beneficial Finance Corporation Ltd v Karavas* (1991) 23 NSWLR 265 (parents, with limited education and business experience and under pressure from their sons, guaranteeing their purchase of an unprofitable and risky business in receivership). Contrast, however, *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 (wife with some business experience lending money to her husband's business in exchange for repayment of a mortgage over her house to a finance company); *Gough v Commonwealth Bank of Australia* [1994] ASC 58,831 (wife with some experience of securities entering into a joint loan in respect of her husband's business debts) and *Akins v National Australia Bank* (1994) 34 NSWLR 155 (wife with no apparent disability guaranteeing her husband's business debts). In these cases unconscionability was not found on the basis of *Amadio* (1983) 151 CLR 447 or the Contracts Review Act 1980 (NSW); in *Akins v National Australia Bank* the Court following, in part, the approach adopted to undue influence by the House of Lords in *Barclays Bank plc v O'Brien* [1994] 1 AC 180.

[75] As Sneddon has commented: '*Amadio*'s most obvious legacy has been a boom in unconscientious dealings claims made by sureties seeking relief from their contracts with lenders': Mark Sneddon, 'Unconscionability in Australian Law: Developments and Policy Issues' (1992) 14 *Loyola of Los Angeles International and Comparative Law Journal* 545, 551.

[76] *Blomley v Ryan* (1956) 99 CLR 362.

the basis of the vendor's age and intoxication,[77] there is a line of cases involving sale and purchase of land where the basis of the doctrine's application was an information processing disability in the vendor or purchaser.[78] Nevertheless, there are other Australian unconscionability cases which can be better explained in terms of information utilisation disability. A recent example is *Louth v Diprose*,[79] a case involving a gift of a house by a male solicitor to a longstanding female friend with whom he was infatuated, who, on learning that she would have to leave her sister's house, had threatened to commit suicide if she could not have a house of her own. The High Court held that, to use the words of Mason CJ, the unconscionability arose out of the pressure deliberately applied to a person who was 'so emotionally dependent on, and influenced by, the [party exercising the pressure] as to disregard entirely his own interests'.[80]

The Australian unconscionability cases also address the difficult question of the scope of evidence for assessing a promisor's disability. Trebilcock indicates in *The Limits of Freedom of Contract* that there may be good utilitarian or economic arguments for rejecting judgments as to substantive 'unfairness' for the purposes of second-guessing a promisor's preferences.[81] But in the narrower context of assessing whether the promisor suffers from an information processing or utilisation disability, the substance of the contract and its likely effect in terms of the promisor's preferences (to the extent these are apparent) may be highly relevant.[82] In *Amadio*, for instance, the parents' preferences of helping their son while retaining some possibility of keeping their land were not in question; but the facts that the guarantee covered significant outstanding debts and was in respect of a business which was almost sure to fail, were — as the statement of Mason J quoted above indicates — among the reasons for finding that their age, non-English speaking background, lack of relevant business experience and emotional dependence on their son had given rise to an information processing disability.[83] Similarly, in *Blomley v Ryan* the fact that the price for which the farm was being sold was significantly below the market value for

77 Ibid 405 (Fullagar J) referring to other cases of 'serious disadvantage' as arising out of 'poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary'.

78 For instance *Sharman v Kunert* (1985) 1 NSWLR 225 (sale of a farm by a depressed and paranoid vendor placing unusual faith in the purchasers); *Westwill Pty Ltd v Heath* (1989) 52 SASR 461 (sale of land by an elderly and physically decrepit man who was also affected mentally by the pain-killing drugs he was taking); *Lee v Cafred Pty Ltd & Ors* [1992] ATPR 40, 238 (purchase of farm land by a purchaser who was illiterate and inexperienced in farming matters).

79 *Louth v Diprose* (1992) 175 CLR 621.

80 Ibid 626. See also 637-8 (Deane J, with whom Brennan, Dawson, Gaudron and McHugh JJ agreed). The case has been criticised, in particular for the court's interpretation of the facts (giving undue weight to the man's testimony and treating the woman as having deliberately 'manufactured' the sense of crisis, even though she had a history of mental illness and had in the past attempted to commit suicide) than for the principles espoused: see Lisa Sarmas, 'Storytelling and the Law: A Case Study of *Louth v Diprose*' (1994) 19 *MULR* 701.

81 Above nn 65-6.

82 Trebilcock acknowledges this, referring to the objective standards offered by market comparisons — although adding that 'courts should be alert to the dangers of making such inferences too readily solely from perceived imbalances in the values exchanged': Trebilcock, 'An Economic Approach to the Doctrine of Unconscionability', above n 50, 406-7.

83 *Amadio* (1983) 151 CLR 447, 466 (Mason J). See also 477 (Deane J).

farm land in the area was relevant to indicate that his intoxication had impaired his ability to understand the likely impact of the contract in terms of his preferences (receiving a fair price for the farm for the purposes of his intended retirement).[84] More contentiously, in *Louth v Diprose* the High Court's assessment that the gift of the value of a house was for the recipient's benefit with no identifiable benefit for the donor in terms of his preferences (maintaining an ongoing and preferably closer relationship with the recipient, something which she did not want), in part led to the conclusion that his emotional dependence on the recipient meant that the donor must not have independently exercised judgment as to how his interests would be affected.[85] The cases illustrate that, rather than being a basis for second-guessing a promisor's preferences, evidence of substantive 'unfairness' may, in indicating the likely ineffectiveness of a contract as a means to the promisor's ends, provide relevant evidence of an information processing or utilisation disability.

Optimally Accommodating Irrationality

An important issue remaining is the scope for developing positive techniques for addressing a promisor's information processing or utilisation disability. Trebilcock concludes *The Limits of Freedom of Contract* with the statement (reminiscent of Goetz and Scott's broader arguments in favour of security of contract):

> [W]e need to be much more alert to the possibility of adopting public policies that *broaden* (rather than restrict) access to market opportunities for members of the community who either historically as classes, or as individuals through more specific sources of misfortune or disadvantage, would otherwise be denied these opportunities. Correspondingly, we should waste less time and energy on policies designed to restrict the domain of the market by limiting even further the contract opportunity set of such individuals, meagre as this may sometimes be at present.[86]

In the context of an information processing or utilisation disability the situation is one of promisors who, by definition, have limited or no ability to control their irrationality. In order to maximise the possibility of their contracts being

[84] Other relevant factors were that the deposit was only £5 and the interest rate 4%. Cf the New Zealand case of *Hart v O'Connor* [1985] AC 1000 where the fact that farm land was sold by a man in his eighties at an undervalue of $20,000 and an interest rate of 11% (in a time of high market interest rates) was held insufficient to impute knowledge to the purchaser (although the Privy Council did not exclude the relevance of substantive unconscionability in assessing knowledge). The main difference between the cases was the fact that in *Blomley v Ryan* (1956) 99 CLR 362 the purchaser was aware of the vendor's personal history (including his tendency towards drunkenness, particularly during the shearing season), indicating that substantive unconscionability will rarely be the sole basis for imputing knowledge of a bargaining disability.

[85] *Louth v Diprose* (1992) 175 CLR 621, 626 (Mason CJ) and 636-8 (Deane J). The judges contrasted the man's 'infatuation' with the woman's indifference, and noted the significance of the money gifted ($58,000) in terms of his total savings which amounted to $91,000. The case, however, represents a dangerous precedent in suggesting a basis for second-guessing preferences under the guise of identifying 'true' preferences, since these were less apparent in *Louth v Diprose* than in either *Amadio* or *Blomley v Ryan*.

[86] Trebilcock, *The Limits of Freedom of Contract*, above n 24, 268.

secured (and to encourage them to enter into contracts), the only option is for promisees to take precautions to overcome or balance the effect of irrationality.[87] Again, Australian unconscionability cases can be drawn on to suggest possible options for promisee self-protection.

1 In *Commercial Bank of Australia Ltd v Amadio* the High Court emphasised the significance of the absence of independent advice to the parent-guarantors as a key factor in its assessment of unconscionability. Mason J said that

> the bank was guilty of unconscionable conduct by entering into the transaction without disclosing such facts as may have enabled the respondents to form a judgment for themselves and without ensuring that they obtained independent advice.[88]

A similar approach was adopted in later cases of guarantee and joint loan agreements involving analogous facts to *Amadio*,[89] suggesting that from the lenders' point of view the most certain method for overcoming an information processing disability, at least, is for a promisee to require that independent advice (in particular legal advice) be given and understood by the promisor before the contract is entered into.[90] Nevertheless, the question remains to be determined on a case by case basis as to what advice might count as sufficiently independent and comprehensive to overcome the information processing disability.[91] Sneddon has commented that '[a]dequate independ-

87 That is, the promisee in this case, must be — to use Goetz and Scott's terminology — 'the least-cost bearer of [the] risk' of the information processing disability: Goetz and Scott, 'Enforcing Promises', above n 32, 1285.

88 *Amadio* (1983) 151 CLR 447, 468. See also Deane J at 476-8, stating that the Amadios also had not received proper advice from their son, adding that such advice would have been impossible, given that 'Vincenzo had himself never seen the document at the time when any such suggested explanation must have taken place'.

89 In *Gough v Commonwealth Bank of Australia*, Kirby P (in dissent) said: 'The general law is moving towards a recognition of a duty on the part of those with responsibility in relation to others, to ensure that they obtain independent advice': *Gough v Commonwealth Bank of Australia* [1994] ASC 58,831, 58,843. That statement has not, however, been endorsed by the Australian courts (although in the United Kingdom a more rigid approach to the requirement of advice with respect to guarantee contracts was adopted by the House of Lords in *Barclays Bank plc v O'Brien* [1994] 1 AC 180, but distinguished with respect to joint loan agreements in *CIBC Mortgages plc v Pitt* [1994] 1 AC 200). Nevertheless, as a matter of practice, the requirement that independent legal advice be obtained by security providers has become a normal part of the Australian lending procedure: see Victorian Solicitors' Liability Committee, *Learning from Amadio* (1995).

90 See also Trebilcock, 'An Economic Approach to the Doctrine of Unconscionability', above n 50, 408:

> [I]t is axiomatic that if a person who would otherwise be entitled to relief under the criteria outlined above nevertheless has the advantage of independent legal or similar advice, the presence of an agent with presumably normal information processing capabilities fully answers any claim for relief by the applicant.

91 For instance, in *Beneficial Finance Corporation v Karavas* (1991) 23 NSWLR 265, advice given that the business venture was worthwhile (which was followed) was considered inadequate in the face of the business's risky character and the amount at stake. On the other hand, advice that the contract should *not* be entered into but which is ignored is almost invariably a basis for upholding the contract: see, eg, *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, where a wife ignored her son's advice not to enter into the loan/guarantee contract (although she was also held not to suffer from a significant disability). Contrast the New Zealand case of *Contractors Bonding Ltd v Snee* [1992] 2 NZLR 157, where a mother (suffering from a disability due to her age,

ent advice is truly independent informed advice which not only explains the transaction and its implications but also evaluates the risks involved and advises whether the surety should enter into the transaction'.[92] The costs of such advice might be quite significant when weighed against the benefit of the contract being enforced by the court if unconscionability is claimed.[93]

2 However, as Mason J's statement in *Amadio* indicates, the promisee's responsibility need not be set this high in all cases of information processing disability. In addition to the costs of advice which is sufficiently comprehensive to overcome the disability, there are additional costs in the advice being obtained from an independent source, involving transaction costs for the adviser in obtaining the information and formulating the advice and a level of risk for the adviser (who may open to a suit for negligence if the advice is unsubstantiated).[94] These costs may not always be warranted given the level and type of disability, the nature of the contract and the amount at stake. Unconscionability cases involving lower levels of information processing disability and relatively straightforward contracts have indicated that impartial

lack of business experience and mental incompetence) entered into a guarantee in respect of her son's business debts, against the advice of her solicitor; that advice was held to be inadequate to overcome the disability. The contract was, however, upheld due to lack of relevant knowledge on the part of the finance company.

92 Mark Sneddon, 'Unfair Conduct in Taking Guarantees and the Role of Independent Advice' (1990) 13 *University of New South Wales Law Journal* 302, 345.

93 The promisee's calculation of the costs and benefits can be formulated in terms derived from the Learned Hand formula for negligence (on the basis that the promisee will bear a share of the costs of precautions and of the contract not being enforced): $B<(P-P_1)L$ where:

- B is the direct burden of precautions for the promisee (in this case, the cost of independent advice which currently is mainly the cost of added delay, but may become a full cost added to the principal debt if one of the options being considered by the Law Council of Australia is adopted)
- P is the probability that the contract will be set aside if the precautions are not taken
- P_1 is the probability that the contract will not be entered into by the promisor after the advice
- L is the loss suffered by the promisee and also = E(=R=B): see above n 37.

On the basis that P approximates 1, the calculation reduces to $B<(1-P_1)L$ where $(1-P_1)$ is the probability that the contract will be entered into by the promisor after the advice (and enforced by the court if unconscionability is claimed). The promisee will only contract if the costs of independent advice are less than the expected benefit of the contract being entered into (and enforced).

94 The Victorian Solicitors' Liability Committee, above n 89, has published figures showing that since *Amadio* (1983) 151 CLR 447 and, in particular, since the lending practice of requiring solicitors' certificates as to independent legal advice was introduced, a significant proportion of claims against solicitors have concerned what is termed '*Amadio* claims' — representing 13% of claims against its members (in money terms) in 1993, and 21% in 1994, although statistics are not yet available as to the number of successful claims. The Committee's response has been to introduce standard forms for giving advice and to advise its members to follow a checklist of criteria for giving advice, including:

- confining solicitors' certificates to existing clients;
- using an independent interpreter where appropriate;
- if there is more than one security provider, advising them separately;
- advising any security provider independently of the borrower;
- not providing financial advice; and
- advising the client about the key elements of the documents and the worst case scenario.

The purpose is to ensure that a more uniform standard of care is adopted — and also that this should be reflected in the costs of the advice. I an grateful to Sharon Taylor, Risk Manager for the Solicitors Liability Committee, for providing relevant information.

advice by the promisee or other sources of information available to the promisor may be sufficient to overcome the information processing disability.[95] The courts have also indicated that independent advice may be of less relevance where the unconscionability involves an information utilisation disability, the problem being an inability to exercise independent judgment (which the advice may not overcome).[96]

3 In the case of unconscionable contracts for which independent advice is not warranted or justified, there also may be other steps which could assist a promisor in overcoming an information processing or utilisation disability: in particular, allowing extra time for the promisor to consider the contract and its significance for his or her preferences. In *Blomley v Ryan* the fact that the vendor was pressured to sign the contract during a period of extreme drunkenness was highly significant in a finding of unconscionability.[97] In *Louth v Diprose* the High Court's assessment of the 'manufactured' crisis situation was treated as influential, although not conclusive, in the finding of unconscionability.[98] On the other hand, as the same case also illustrates, if there are no steps which would overcome the effect of the disability, the promisee's only option may be not to enter into the contract — or else to bear the risk of it being declared unconscionable.[99]

4 As an alternative to taking precautionary measures, a promisee may be able to establish that, notwithstanding the promisor's disability, the promisor's preferences are well-served by the contract. Deane J in *Amadio* suggested that if a *prima facie* case of unconscionability is proved the onus of showing that the contract is 'fair, just and reasonable' lies with the promisee.[100] Al-

95 An example is *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610. The fact that the loan was advanced by a woman with some business experience to a company which was not in extreme financial difficulties at the time the loan was made may have influenced McHugh JA's conclusion that the contract would not have been unjust, even apart from the independent advice that was given, because information from other sources indicated that Mrs West 'had a full appreciation of the consequences of the contract' when she chose to enter into it: ibid 627. A similar response was given to the claim in *Akins v National Australia Bank* (1994) 43 NSWLR 155 that the bank officers' advice regarding the guarantee was inadequate, Clarke JA commenting that not only did the wife not appear to suffer from any serious disability, but she had been informed by the bank officer of the extent of her exposure as a guarantor: ibid 173.

96 In *Louth v Diprose* (1992) 175 CLR 621, Mason CJ referred to evidence that the brother-in-law of the woman who received the gift had expressed surprise at the intended gift and may have indicated that she was under no immediate threat of disposition from her rental accommodation. Nevertheless, Mason CJ did not regard this as sufficient to overcome the donor's ongoing disability, adding at 626 that 'even if the respondent had come to this conclusion, he may well have thought that the purchase of the house in the appellant's name was the only sure means of giving her security and peace of mind'.

97 Arguably, this could also have provided an answer for the defendant in the case of *Antonovic v Volker* (1986) 7 NSWLR 151, a case of information utilisation disability involving an 'emotionally volatile' woman who was pressured by a real estate agent into bidding for a house after auction. The contract was set aside under the Contracts Review Act 1980 (NSW).

98 See above n 81.

99 It may be noted that in *Louth v Diprose* (1992) 175 CLR 621 the gift was made several weeks after the conversation in which the woman threatened to commit suicide (and after the man had talked with her brother in law who expressed surprise at the gift) — factors emphasised, in particular, by Toohey J who dissented.

100 *Amadio* (1983) 151 CLR 447, 474 (Deane J), citing Kitto J in *Blomley v Ryan* (1956) 99 CLR 362, 428-9. With respect to the Contracts Review Act 1980 (NSW), McHugh JA in *West v AGC*

though in practice judgments as to substantive 'unfairness' have tended to support findings of unconscionability, the possibility of demonstrating substantive fairness (but in a broader sense than simply showing adequacy of consideration) may in some cases be feasible for a promisee.[101] Relevant information includes market standards such as comparable prices for analogous goods or services,[102] as well as the particular desires, needs and circumstances of the promisor to the extent these can be determined.[103]

The above analysis indicates that, rather than assuming that a contract should be set aside once a relevant disability can be identified, this provides a first stage in the assessment of unconscionability. Also, the steps that a promisee should take need not be identified in rigid terms since the appropriate (in the sense of most cost-effective) action may vary with the particular case. Treating the promisee as subject to the risk of a finding of unconscionability unless an appropriate step in the circumstances is taken to overcome or respond to the disability, may nevertheless be the most effective way of ensuring that the step is determined and taken by the party in the best position to take it.[104] The aim is to maximise access to market opportunities for individuals who through sources of disadvantage would otherwise be denied these opportunities, as Trebilcock suggests,[105] but at the cheapest cost to those concerned.

CONCLUSION

The criticisms of classical contract theories which emerged in the 1970s and 1980s remain important today. The point made effectively is that the classical utilitarian conception of contracts as providing the pillar of economic and social development has its limitations when it comes to those who are not, for various reasons, able to look after their interests. However, it is wrong to suggest that is

(Advances) Ltd (1986) 5 NSWLR 610, commented at 621: '[i]f a contract or one of its relevant provisions is neither unfair nor unreasonable so far as the applicant is concerned, it is difficult to see how the existence of inequality of bargaining power or lack of independent advice, for example, can render the contract or a provision of the contract unjust'.

101 See above nn 82-5 and accompanying text. Perhaps the reason the option of showing the contract is substantively fair has so rarely succeeded in Australia is because the courts have insisted that full account be taken of the promisor's needs, desires or circumstances. But in addition it may be noted that promisors are unlikely to seek to invoke unconscionability doctrines in the case of contracts which serve their preferences.

102 In *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, McHugh JA indicated at 628 that the fact that the loan/guarantee contract was 'an ordinary commercial contract', the provisions of which were 'reasonably necessary to protect the legitimate interests of' AGC were reasons for upholding the contract (although in themselves these reasons may not have been sufficient had there not also been evidence that the borrower had been properly informed as to the terms and significance of the contract).

103 As in *Antonovic v Volker* (1986) 7 NSWLR 151, where the fact that the woman did not want the house was judged more important than whether the price was a 'fair' one in market terms.

104 By analogy with the negligence standard (B<PL) in terms of not only identifying the cheapest cost avoider but also the cheapest cost avoidance action (B) on a case-by-case basis. Note, however, that the court in identifying the appropriate precaution is not applying a full negligence standard. In the event that the precaution is not efficient compared to the promisee's expected benefit, responsibility rests with the promisee: the court does not itself judge whether B<PL, leaving that to the promisee. See further above n 93.

105 See above n 86 and accompanying text.

the end of the utilitarian argument, or indeed of its contemporary version in law and economics. First, the utilitarian-economic model which is based on the value of having a practice of contracts does not require that contracts benefit all parties in all cases. That the practice is in overall terms welfare-maximising is sufficient justification for holding to a principle of security of contract. Secondly, even the classical utilitarians thought there could be some exceptions to the binding effect of a contractual promise; Mill, for instance, stating that the promise must be made 'knowingly and voluntarily'. The scope of possible exceptions has been taken further by some more modern law and economics scholars. Trebilcock, in particular, argues that the presence of an information processing disability in the promisor (an inability to understand the implications of the contract for his or her welfare, which is reasonably apparent to the promisee) should be a basis for the contract not to be binding on the promisor.

This article develops the Trebilcock approach to try to identify further categories of contractual irrationality which can be accommodated without undermining the principle of security of contract which is essential to the utilitarian-economic model. A particular category is information utilisation disability involving a promisor who, although not suffering from an information processing disability, is unable to exercise sufficient independence of thought or will to make or act on a judgment about the implications of the contract for his or her welfare. It is suggested that both categories are acknowledged in the application of the unconscionability doctrine in Australian courts. The Australian courts have also indicated that the next step beyond identifying categories of contractual irrationality in respect of which promisors may be protected, is to place the responsibility on promisees to develop cost-effective methods for overcoming or balancing the effects of the irrationality, thus signalling the way towards a new paradigm of contract law based on more genuinely co-operative arrangements for mutual welfare.