Boilerplate Clauses, International Commercial Contracts and the Applicable Law

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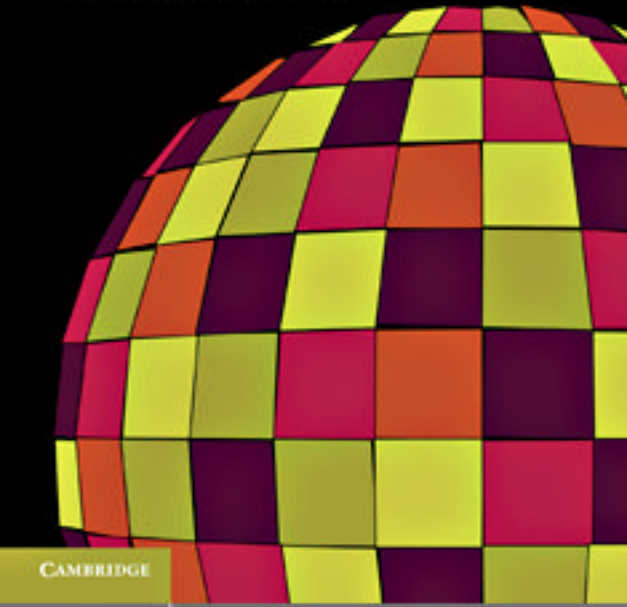

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The factual issues concerned conformity to the specifications of both the sub-contractor's and the main contractor's work. Legal issues between the sub-contractor and the main contractor included:

- which of two different sets of specifications the parties had agreed to;
- acceptance of the work;
- the availability of remedies for delay and for defects;
- the scope and validity of a clause which limited any damages payable by the sub-contractor to 25 per cent of the contract price; and
- the validity of a 'penalty clause' whereby, in case of delay, the sub-contractor was to pay 5 per cent of the contract price.

The case was eventually settled. This is often a very sensible solution. In that case, though, legal uncertainty played a dominant role amongst the incentives. This legal uncertainty was aggravated by a divergence between the law on which a contract is modelled and the law which applied to this contract.

On the facts of this case, German law requires that 'warnings' be issued in order to trigger a claim for damages for delay under §286 of the BGB,[30] and a similar step must be taken by the client in order to switch from a performance-based claim for repair of defects in works contracts to a claim for damages. Additionally, while there is strict liability for performance if this is possible, some remedies require the defaulting party to be responsible for non-performance. It is possible to agree otherwise, i.e., that no warning is necessary and that liability is strict, but English-style contracts do not normally include clauses on warnings being unnecessary and will frequently not say anything on whether fault or responsibility is required to trigger remedies. Thus, this opened up a number of additional legal questions which would not have arisen for either a common law-style contract under English law or a German-style contract under German law.

3.5 Control of standard terms and exclusion clauses

It may well be a coincidence that none of the cases discussed above turned on the control of standard terms. German law subjects standard contract terms, even for business-to-business transactions, to a general unfairness test,[31] which goes beyond what is provided for English law in the Unfair Contract Terms Act 1977. This might result in a situation

[30] See above, note 9.
[31] §§305–310 of the BGB. See in particular:

where parts of an English-style contract will not be upheld by German courts on the ground that those clauses are not on all fours with the requirement of good faith.[32] For example, a clause which seeks to exclude liability without making an exception for gross negligence is likely to be void.[33] Exceptions have in the past been allowed if such an exclusion is supported by business usage, as in the shipbuilding industry.[34] In other situations, however, standard terms may not even generally exclude the user's liability for simple negligence, as, for example, in one case which concerned a contract for storage, probably because the fate of the goods is almost completely in the hands of the party who provides storage.[35] Similarly, standard clauses which seek to cap liability to a certain amount will also be held void if they fail to make an exception for gross negligence.[36]

English law does not normally distinguish between simple and gross negligence, so that contract terms based on English law are unlikely to make the necessary exceptions. Standard contract term control could thus eliminate various clauses from common law-based contracts and replace them with German background law.[37]

4 Conclusions

The approach taken by the Reichsgericht in 1897, namely to see English-style clauses in contracts governed by German law as a matter

§307 BGB Review of subject-matter

(1) Provisions in standard business terms are invalid if, contrary to the requirement of good faith, they place the contractual partner of the user at an unreasonable disadvantage. An unreasonable disadvantage may also result from the fact that the provision is not clear and comprehensible.

(2) In case of doubt, an unreasonable disadvantage is assumed if a provision
   1. cannot be reconciled with essential basic principles of the statutory rule from which it deviates, or
   2. restricts essential rights or duties resulting from the nature of the contract in such a manner that there is a risk that the purpose of the contract will not be achieved.

[32] See Cordero-Moss, 'International Contracts between Common Law and Civil Law'.

[33] See, e.g., BGH 19.09.2007, BGHZ 174, 1 (sale of used cars).

[34] BGH 3.3.1988, NJW 1988, 1785; U/B/H §309 No. 7 at 43.

[35] BGH 19.2.1998, NJW-RR 1998, 1426.

[36] OLG Düsseldorf 29.11.1990, VersR 1991, 240 (parcel delivery).

[37] See J.R. Maxeiner, 'Standard-Terms Contracting in the Global Electronic Age: European Alternatives', *Yale Journal of International Law*, 28, 1 (2003), 141–156, on likely surprises which the German legislation can cause to common law-oriented contract lawyers.

of contractual interpretation, will usually make sense.[38] If parties use English-style clauses, they will often have done so with English law in mind. It will therefore be usually right to translate these clauses into a German-law meaning by using English law as a tool of understanding. But this approach may be less obvious when all connecting points (such as the domicile, place of business or nationality of the parties and the place of performance) are German and can become problematic if parties did not have English law in mind, such as when they simply plagiarised English-style contracts without realising what they were buying into. This may explain those German judgments which appear more reluctant to opt for the 'English interpretation of German contracts' approach, including both the 1883 judgment of the Reichsgericht and the 1991 judgment of the Bundesgerichtshof which have been discussed above.[39] Using the will of such parties as an entrance gate for English legal thinking can be just as artificial as the numerous terms which English courts have implied into the contracts of entirely unsuspecting parties.[40]

Penalty clauses demonstrate another limit of the prevailing approach which imports notions of English law in order to explain what parties had in mind. It is difficult to argue that clauses which are valid under the applicable law should be void because they would be under the law from which parties have copied the clause. German courts have occasionally flirted with the idea of striking down penalty clauses on this ground. If they ever were to hold such clauses void, they would go beyond interpretation in substantive law and would have created a new conflicts rule to the effect that English law applies to English-style penalty clauses in a contract which otherwise is governed by German law. Splitting the applicable law to a contract will, however, generally cause more problems than it solves.

We have seen that some problems may arise if English-style contracts are subjected to the stricter control exercised by German statutes and courts. A case in point is the control of standard terms under §§305–310 BGB, which has frequently been used to invalidate contract clauses even in commercial contracts. Exclusion clauses which are not specifically adapted to these provisions run the danger of being invalid. More interventionist German judges might also interpret contracts against their wording on the ground of good faith where English judges would

[38] RG 22.5.1897, RGZ 39, 65; BGH 2.12.1991, NJW-RR 1992, 423.
[39] RG 16.6.1883, RGZ 11, 100.
[40] As, for instance, in the famous case of *Taylor* v. *Caldwell* (1863) 3 B&S 826.

have let the literal meaning prevail. It should be added, though, that the present author has not found any evidence of exaggerated interventionism when German judges have applied German law to common law-based contracts.

We have furthermore noticed that common law-style contracts to which German law applies may be unnecessarily demanding on judges, arbiters and counsels, who may find it difficult to place English-style contracts within a German law context. First, they may simply overlook the foreign element in a contract and for this reason struggle with problems of interpretation. Secondly, even where the foreign element is noticed, they may find it difficult to cope with this particular exercise in conflicts and comparative law.

We have noticed that a loss of legal context occurs whenever a common law-style contract is governed by German law or vice versa. In consequence, some remedies might not be available. This will frequently counteract the main potential advantage of using English-style clauses in contracts governed by German law, namely that such clauses are internationally more recognisable and that they may in particular correspond to contract terms under which one of the parties is bound under a contract with a third party. In the vast majority of cases, however, this is likely to create a mere illusion of certainty and uniformity. If, for instance, a main contractor copies terms from its contract with a client to which English law applies and transplants these clauses to its contract with a sub-contractor to which German law applies, this seeming uniformity is illusionary indeed. This will not exclude the typical risk which a middleman tries to eliminate by using identical contract terms – namely being liable towards the client for a failure of a sub-contractor without being able to resort to the sub-contractor. The sub-contractor may indeed not be liable towards the main contractor, because, for example, responsibility for this failure is required in order for the sub-contractor to be liable under German law, whereas the main contractor may be strictly liable to the client under the English law contract.

The main disadvantage of using common law-style contracts within German law is the legal uncertainty which this creates. Some legal systems cope better with uncertainty than with results which are perceived as unfair, and the German legal system is certainly a case in point. However, the same cannot be said about English contract law, which seems to be preoccupied with legal certainty almost more than with anything else. If certainty is a priority, using common law models in a German legal environment is perhaps not a recipe for disaster, but definitely not a wise choice.

5

Comparing exculpatory clauses under Anglo-American law: testing total legal convergence

EDWARD T. CANUEL

Commercial transactions are increasingly global in scope, spanning jurisdictions and indeed legal families and traditions. Within the comparative law framework, globalisation elevates the prominence and relevance of legal convergence through legal transplants, as attempts have been made under private law regimes to achieve certain minimal levels of contractual standardisation.[1] Legal convergence theory, a currently popular yet controversial comparative law concept, holds that different legal systems may apply different technicalities, but in the end arrive at similar results. In essence, significant distinctions between legal systems are frequently only on the surface.[2]

Testing the validity of total convergence theory, this chapter examines specific, commercially important contractual provisions known in the Anglo-American legal family as 'exculpatory clauses'. Section 1 of this

[1] Note that calls in European private law for systemic legal integration and harmonisation, and the possibility of a single European civil law, have dominated substantial legal scholarship. F. Nicola, 'Book Review: The Enforceability of Promises in European Contract Law (ed. by James Gordley)', *Harvard International Law Journal*, 44 (2003), 597, 605; A. Hartkamp and M. Hesselink (eds.), *Towards a European Civil Code* (Kluwer Law International, 1998); M. Hesselink, *The New European Private Law: Essays on the Future of Private Law* (Kluwer Law International, 2002); P. Legrand, 'Against a European Civil Code', *Modern Law Review*, 60 (1997), 44.

[2] See U. Mattei, L. Antoniolli and A. Rossato, 'Abstract: Comparative Law and Economics' (1999), 505, 508, available at http://encyclo.findlaw.com/0560book.pdf (last accessed 28 May 2010) (convergence refers to 'the phenomenon of similar solutions reached by different legal systems from different points of departure'). For a critical view of total legal convergence, see G. Cordero-Moss, *Anglo-American Contract Models and Norwegian or other Civilian Governing Law*, Publications Series of the Institute of Private Law No. 169 (University of Oslo, 2007).

chapter explores the weight and necessity of the comparative legal method. It also further sets the groundwork for this by introducing legal convergence within the context of exculpatory clauses. Section 2 reviews how exculpatory clauses are treated in the US legal context, analyses the legal theory of unconscionability and examines the divergent treatment such clauses receive in different US jurisdictions. While convergence scholarship often involves the comparison of legal concepts between different legal families, this section explores the use of exculpatory clauses within a single legal family, the common law legal tradition. Accordingly, Section 3 utilises a comparative approach, reviewing the use of exculpatory clauses in the context of an important commercial industry, tow and towage, under Anglo-American law. The chapter concludes by surmising that total convergence is problematic.

1 Introducing the comparative legal method: the first step in evaluating total legal convergence

Chinese philosopher Lao Tzu's foresight holds true to comparative law when he wrote that 'a journey of a thousand miles begins with a single step'.[3] Comparisons can be made in a variety of different ways or steps. A method of untangling the convergence-theory web involves the comparative legal *method*, a valuable tool with impact both for scholars and practitioners. Comparative law allows us to venture beyond a simple, mechanical application of given rules.[4] Rather, the comparative approach teaches the analysis of legal problems on a more flexible level, a process where legal concepts can be compared, evaluated and reflected upon.[5]

In such a sense, comparative law scholars may discern legal patterns transcending individual legal systems, discover a certain system's unique attributes, find new alternatives to previously accepted, traditional legal rules or reveal unintended domestic similarities.[6] Comparative study also

[3] Lao Tzu, 'Tao Te Ching', in Emily Morrison Beck (ed.), *Bartlett's Familiar Quotations* (Little, Brown and Company, 1980), p. 65.

[4] R. Sacco, 'Legal Formants: A Dynamic Approach to Comparative Law', *American Journal of Commercial Law*, 39 (1991), 1–34, 343–402; R. Sacco, 'One Hundred Years of Comparative Law', *Tulane Law Review*, 75 (2001), 1159–1176; see also C. A. Rogers, 'Review Essay: Gulliver's Troubled Travels, or the Conundrum of Comparative Law', *George Washington Law Review*, 67 (1998), 149–190, 157.

[5] K. Schadbach, 'The Benefits of Comparative Law: A Continental European View', *Boston University International Law Journal*, 16 (1998), 331–422, 415.

[6] D. A. Farber, 'Book Review: The Hermeneutic Tourist: Statutory Interpretation in Comparative Perspective', *Cornell Law Review*, 81 (1996), 513–529, 515.

reveals how different laws handling the same problem actually function in practice. Through this approach, a comparison necessarily assumes two or more sectors, laws or periods of time, which are analysed with the purpose of discovering differences and similarities.

While a detailed comparison of the common and civil law systems is beyond the scope of this chapter, any comparative law piece must distinguish essential systemic characteristics from these widely held legal traditions. Under the civil law tradition, courts interpret and apply written laws, which include codes, statutes and decrees.[7] The civil law system presents the law-giving role to the legislator, who crafts a code that controls the judiciary's acts, while the civilian judges must identify the proper existing rule and apply it to the facts of the subject case.[8] Alternatively, the common law family is composed of organic law, with judges reliant upon *stare decisis*.[9] The importance civil law courts place on *stare decisis* is less well settled: the value given to precedents in the civil law context is a source of dissention among legal scholars.[10]

[7] See P. G. Stein, 'Relationships among Roman Law, Common Law and Modern Civil Law: Roman Law, Common Law and Civil Law', *Tulane Law Review*, 66 (1992), 1591–1603, 1595–1596; J. L. Freisen, 'When Common Law Courts Interpret Civil Codes', *Wisconsin International Law Journal*, 15 (1996), 1, 7; J. Dainow, 'The Civil Law and the Common Law: Some Points of Comparison' *American Journal of Comparative Law*, 15 (1967), 419–435, 424.

[8] See R. B. Cappalli, 'Open Forum: At the Point of Decision: The Common Law's Advantage over the Civil Law', *Temple International and Comparative Law Journal*, 12 (1998), 87, 96–97. See, generally, Shumei Lu, 'Gap Filling and Freedom of Contract' (2000) (Athens: Master's Thesis, University of Georgia), available at http://digitalcommons.law.uga.edu (last accessed 20 June 2008).

[9] See Cappalli, 'Open Forum', 92; M. Sellers, 'The Doctrine of Precedent in the United States of America', *American Journal of Comparative Law*, 54 (2006), 67–88, 86; see also *Auto Equity Sales* v. *Superior Court of Santa Clara County*, 369 P.2d 937 (1962), 939–940 ('the doctrine of stare decisis requires all tribunals of inferior jurisdiction to follow the precedents of courts of superior jurisdiction, to accept the law as declared by superior courts, and not to attempt to overrule their decisions').

[10] See Freisen, 'When Common Law Courts Interpret Civil Codes', 8 (stating that existing judicial decisions are not formally binding legal sources). See also J. H. Merryman, *The Civil Law Tradition* (Little, Brown and Company, 1985), pp. 46, 60; R. David and J. E. C. Brierly, *Major Legal Systems in the World Today* (Stevens and Sons Publishing, 1985), pp. 136–137. But see W. Ewald, 'What's So Special about American Law?', *Oklahoma City University Law Review*, 26 (2001), 1083–1115, 1088 (civilian courts do not embrace the same necessity for precedents as in the common law system; civil law courts may in practice follow precedent to avoid the chance of a reversal, causing the subject court embarrassment and possibly adversely affecting the subject judge's promotional chances); C. Pejovic, 'Civil Law and Common Law: Two Different Paths Leading to the Same Goal', *Victoria University of Wellington Law Review*, 32 (2001), 817–842, 821, No. 8 at

Comparativists also note key distinguishing traits *within* the civil law family, as demonstrated by reviewing the Scandinavian legal traditions.[11] Compared to other civil law traditions, Scandinavian regimes lack a systematic codification of the law of obligations and significantly elevate equitable justice over individual autonomy.[12]

1.1 *Legal convergence theory: discussion points*

Modern comparative law research focuses on finding underlying similarities across legal families. A clear trend is to highlight the fact that perceived divergent outcomes based on systemic differences may be overemphasised. Looking deeper, disparate legal systems may apply different technicalities, but in the end lead to similar results. This is convergence theory.

Convergence theory may be evaluated through the lens of a certain form of exemption provision,[13] an exculpatory clause. Given the great importance of legal convergence in both scholarship and practice,[14] this chapter will additionally address the related topic of legal technicalities, showing that they may have a deeper significance than expected. This chapter will not focus on comparisons across legal families, but across states belonging to *one* family: the Anglo-American family. Ultimately, total convergence within a single legal family cannot be presumed, which

www.upf.pf/IMG/doc/16Pejovic.doc (last accessed 28 May 2010). See also M. A. Glendon *et al.*, *Comparative Legal Traditions* (West Publishing, 1994), p. 208.

[11] For a basic overview of the various Scandinavian legal systems, see M. Bogdan, *Comparative Law* (Kluwer Law International, 1994); K. Zweigert and H. Kötz, *Introduction to Comparative Law* (Oxford University Press, 1998). See also Pejovic, 'Civil Law and Common Law', 818 ('the term "civil law" has two meanings: in its narrow meaning it designates the law related to the areas covered by the civil codes, while the broader meaning of civil law relates to the legal systems based on codes as contrasted to the common law system').

[12] G. Cordero-Moss, 'International Contracts between Common Law and Civil Law: Is Non-state Law to be Preferred? The Difficulty of Interpreting Legal Standards such as Good Faith', *Global Jurist (Advances)*, 7 (2007), 1, 14. Unlike other countries inspired by Germanic law, Norway founded its contract interpretation on the Act on Formation of Contracts of 1918 and has not codified its obligations law. See *ibid.*, 13, referring to J. Hov, 'Avtaleslutning og ugyldighet', in *Kontratsrett I* (Papinian, 2002), pp. 60, 167–168.

[13] 'A contractual provision relieving a party from liability resulting from a negligent or wrongful act': Bryan A. Garner (ed.), *Black's Law Dictionary* (West Publishing, 1999).

[14] See L. Nottage, 'Comment on Civil Law and Common Law: Two Different Paths Leading to the Same Goal', *Victoria University of Wellington Law Review*, 32 (2001), 843–851, 848.

further suggests that it is even more difficult to assume total convergence across many families.[15] Investigating convergence theory, a review of exemption clauses in the US and its different jurisdictions, illustrates a lack of total convergence. Additionally, through comparing the US regime to that of its common law cousin, England, a lack of complete convergence is revealed.

Exemption clauses relieving liability from negligent acts, also known as exculpatory provisions, will be reviewed under a comparative framework. These important contract provisions are found in many standardised agreements used in daily commerce. To evaluate possible convergence within the American legal regime, one must understand how the exemption clauses are evaluated under US law. This involves reviewing the limitations of the clauses' use based upon unconscionability and public policy, also revealing tensions regarding the boundaries of American contractual freedom.[16]

Cases from different US state and federal jurisdictions will be compared. Understanding US law sets the stage for comparing the American and English legal regimes by analysing exemption clauses in a specific area of admiralty law – towage. The result will reveal that total convergence has not occurred in one legal family and will raise doubts as to whether such convergence could spread *across* legal families.

[15] See, generally, G. Cordero-Moss, 'Commercial Contracts between Consumer Protection and Trade Usages: Some Observations on the Importance of State Contract Law', in R. Schulze (ed.), *Common Frame of Reference and Existing EC Contract Law* (Sellier, 2008), p. 65. See also J. H. Merryman, 'On the Convergence (and Divergence) of the Civil Law and the Common Law', in *The Loneliness of the Comparative Lawyer and other Essays in Foreign and Comparative Law* (Kluwer Law International, 1999), pp. 17, 27.

[16] Under the common law, freedom of contract is often held to be prime. Parties are free to enter into mutually beneficial economic exchanges. Absent public policy exceptions, courts will not inquire into the bargain's wisdom. The words and terms used in the contracting parties' agreement will otherwise have control, as parties will live with the benefits and burdens of their bargain. See *Baltimore & Ohio Sw. Ry. Co.* v. *Voigt*, 176 U.S. 498, 505 (1900). Compare this to the principles of good faith, which are held to be central under the civil law. See Garner (ed.), *Black's Law Dictionary*, p. 693 (good faith is 'an intangible and abstract quality with no technical meaning or statutory definition, and it encompasses, among other things, an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage'); A. D. Mitchell, 'Good Faith in WTO Dispute Settlement', *Melbourne Journal of International Law*, 7 (2006), 339–373 (in a civil law context, good faith is 'a principle of fair and open dealing'). For an interesting discussion of good faith and freedom of contract in the comparative law context, see Cordero-Moss, 'International Contracts between Common Law and Civil Law', 12.

Legal technicalities will also be examined, reviewing the breadth of their significance. Contracts may be shaped for the purpose of meeting specific requirements of one legal system, as evidenced in the admiralty context. Legal systems may have different technicalities, rules or requirements: writing a valid contract in one system means complying with these technicalities. Another system may demand different technicalities in order to have a contract validated in its jurisdiction. Contracts will thus be written differently to obtain the same result in different systems. If these contracts migrate into each different legal system, any potential convergence could be annulled.

2 Exculpatory clauses: background, interaction with contractual theories and duties

The starting point for analysis begins with the exculpatory clause itself, related to the exemption clause. An exemption clause is a 'contractual provision providing that a party will not be liable for damages for which that party would otherwise have ordinarily been liable'.[17] American courts often specify exemption clauses excluding negligence as exculpatory clauses. Such a clause is defined as a 'contractual provision relieving a party from liability resulting from a negligent or wrongful act'. In fact, Corbin labels the term 'exemption clauses' as 'the British terminology for exculpatory clauses'.[18] Clauses exempting liability from negligence are found in many standard business contracts, often involving essential commercial activities. Such contracts serve important purposes, attempting to streamline efficiencies in business transactions that are crucial to the daily conduct of business.[19] Simplifying standard transactions, non-negotiated boilerplate contracts may reduce transaction costs, saving drafters time and expense.[20]

[17] K. Bruett, 'Can Wisconsin Businesses Safely Rely upon Exculpatory Contracts to Limit their Liability?', *Marquette Law Review*, 81 (1998), 1081, referring to Garner (ed.), *Black's Law Dictionary*, p. 566 (the term 'exculpatory clause' is defined as '[a] contract clause which releases one of the parties from liability for his or her wrongful acts').

[18] A. L. Corbin, *Corbin on Contracts*, 15 vols., Joseph Perillo (ed.), (Matthew Bender and Company, 2002), vol. vii, Section 29.7, p. 401.

[19] See, generally, *Arrowhead School Dist. No. 75, Park County* v. *Klyap*, 79 P.3d 250 (2003).

[20] See E. A. Farnsworth, *Farnsworth on Contracts*, 3 vols. (Aspen Publishers, 1998), vol. ii, Section 4.26, p. 533; James P. Nehf, 'Writing Contracts in the Client's Interest', *South Carolina Law Review*, 51 (1999), 153.

To understand the possibility of convergence within the American legal system's disparate legal jurisdictions, in light of exculpatory clauses, the method employed by courts must be discussed. US courts evaluate the clauses, particularly within the context of boilerplate contracts, by considering issues and factors such as unconscionability, adequate disclosure, relative bargaining power and public policy.[21]

2.1 The role of unconscionability

Unconscionability is an amorphous term.[22] It has been defined in *Williams* v. *Walker-Thomas Furniture, Co*. as an 'absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party'.[23] The concept is also embedded in the Uniform Commercial Code ('UCC' or 'Code') at §2–302.[24] Unconscionability moved outside the UCC and migrated into the general law of contracts.[25] This contractual theory is primarily applied to consumer transactions, with courts stating that businesses are expected to guard against their own commercial dealings to a larger extent than consumers.[26] In the commercial context, courts tend to limit the doctrine's use to contracts involving small businesses that appear to be differentiated by implication from larger corporations by courts.[27]

[21] Farnsworth, *Farnsworth on Contracts*, vol. ii, Section 5.2, pp. 12, 14.

[22] Farnsworth laments that 'Nowhere under the Code's many definitions is there one of *unconscionability*. That the term is incapable of precise definition is a source of both strength and weakness' (emphasis in original): Farnsworth, *Farnsworth on Contracts*, vol. i, Section 4.28, p. 555. See also Corbin, *Corbin on Contracts*, vol. vii, Section 29.3, p. 377 ('Unconscionability is one of the most amorphous terms in the law of contracts').

[23] *Williams* v. *Walker-Thomas Furniture, Co*., 350 F.2d 445, 449 (D.C. Cir. 1965) (unconscionability is the 'absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party'); *A&M Produce Co.* v. *FMC Corp*., 135 Cal. App. 3d 473 (1982) (unconscionability is defined as 'a flexible doctrine designed to allow courts to directly consider numerous factors which may adulterate the contractual process').

See also, Farnsworth, *Farnsworth on Contracts*, vol. i, Section 4.28, p. 555; *NEC Technologies, Inc.* v. *Nelson*, 478 S.E.2d, 771–772 (1996).

[24] The Code, which effectively merged equity doctrine into law, is a uniform act promulgated to harmonise the law of the sale of goods and other transactions. For a detailed treatment of §2–302 of the UCC (Unconscionable Contract or Clause), see Corbin, *Corbin on Contracts*, vol. vii, Section 29.3, pp. 383–387. See also §2–719(3) of the UCC.

[25] Corbin, *Corbin on Contracts*, vol. vii, Section 29.3, pp. 382–383.

[26] *Ibid.* See also Farnsworth, *Farnsworth on Contracts*, vol. i, Section 4.28, pp. 562–563.

[27] See, e.g., *De Valk Lincoln Mercury* v. *Ford Motor Co*., 811 F.2d 326 (Seventh Cir. 1987); *Stirlen* v. *supercuts, Inc*., 60 Cal. Rptr. 2d 138 (Ct. App. 1997).

A further divide was raised in *NEC Technologies, Inc.* v. *Nelson*, where the court analysed unconscionability in terms of both procedure and substance.[28] Procedural unconscionability focuses on the contract-making process, with courts looking to factors including the parties' business acumen, experience, bargaining power, the contract language's comprehensibility and the 'oppressiveness' of the terms.[29] Concerning substantive unconscionability, courts focus on issues such as the contractual terms' commercial reasonableness, the purpose and effect of the terms, parties' risk allocation and other public policy concerns.

The impact of unconscionability in practice is controversial, as Corbin writes:

> Most claims of unconscionability fail. The mere fact that there is a lack of equivalence between the performances of the parties does not even get close to the establishment of unconscionability. A harsh result alone is an insufficient ground for a finding of unconscionability. Superior bargaining power is not in itself a ground for striking down a resultant contract as unconscionable.[30]

Further, as Farnsworth discusses:

> On the whole, judges have been cautious in applying the doctrine of unconscionability, recognising that the parties often must make their contract quickly, that their bargaining power will rarely be equal, and that courts are ill-equipped to deal with problems of unequal distribution of wealth in society.[31]

2.2 Assent, duty to read

Courts will also seek to ensure parties assented to exculpatory clauses. The common law 'duty to read' has been one measure to recognise assent. Under that duty, a party who executes an instrument manifests assent to it and later cannot complain that it neither read nor understood the agreement.[32] The same rule applies even without a signature if the acceptance of a document purporting to be a contract implies assent to its

[28] *NEC Technologies, Inc.* v. *Nelson*, 478 S.E. 2d, 771–772 (1996).
[29] *Ibid.* See also Farnsworth, vol. i, Section 4.28, p. 557 ('fashionable' to brand 'an absence of meaningful choice' as procedural unconscionability); Corbin, *Corbin on Contracts*, vol. vii, Section 29.4, pp. 387–389 (holding that elements of both procedural and substantive unconscionability are frequently present).
[30] Corbin, *Corbin on Contracts*, vol. vii, Section 29.7, pp. 392–393.
[31] Farnsworth, *Farnsworth on Contracts*, vol. i, Section 4.28, p. 559.
[32] A. L. Corbin, *Corbin on Contracts*, vol. vii, Section 29.8, pp. 402–403.

terms (such as bills of lading or insurance policies).[33] There are many qualifications to this duty indicating that there was actually no assent to the contractual terms, including: (i) the document was illegible; (ii) the terms were not sufficiently called to the attention of a party; and (iii) misrepresentation of the document's contents.[34] Nevertheless, there is also case law *subverting* the established duty-to-read proposition when dealing with form contracts on three grounds: (i) no true assent existed to a particular term; (ii) public policy dictates that a particular term be removed, even if there was assent, because it contravenes public policy; or (iii) the term is unconscionable.[35] Courts may now incorporate all three elements in such 'modified' duty-to-read analysis.[36]

At first blush, unconscionability suggests that common and civil law can converge. In this specific context, common law courts may apply the law in a way resembling that usually found in the civil law context. That context is grounded on good-faith principles and approaches, meaning a flexible application of principles and general clauses of fair and open dealing.[37] Nevertheless, the diversity of decisions within the US reveals that outcomes may not be the same, again doubting consistent convergence in practice.

One such example is *Weaver* v. *American Oil Co*., 276 NE2d 144 (1971), an Indiana Supreme Court case, which involved a lease from an oil company to a gas station operator. The station owner signed the lease without reading it. The lease provided that he would indemnify the oil company, acting as lessor, for damages caused by the lessor's negligence: the clause rather broadly excluded liability.[38] The court did

[33] See *ibid*., p. 403. [34] See *ibid*, pp. 404–415.

[35] *Weaver* v. *American Oil Co*., 276 NE2d 144 (1971).

[36] See, generally, Corbin, *Corbin on Contracts*, vol. vii, Section 29.10, pp. 415–424.

[37] See L. A. DiMatteo, 'An International Contract Law Formula: The Informality of International Business Transactions Plus the Internationalisation of Contract Law Equals Unexpected Contractual Liability', *Syracuse Journal of International Law and Commerce*, 23 (1997), 67–111, 85–86, referring to Dennis Campbell (ed.), *Legal Aspects of Doing Business in Western Europe* (Kluwer, 1983), pp. 295, 218 ('Civil law states tend to use a more expansive approach to the good faith obligation applying it to both contract formation and performance. Common law states prefer a more narrow good faith duty applicable only to contract performance'). See also Cordero-Moss, 'Commercial Contracts between Consumer Protection and Trade Usages', 65, 68; Cordero-Moss, 'International Contracts between Common Law and Civil Law', 12.

[38] 'Lessor, its agents and employees shall not be liable for any loss, damage, injuries, or other casualty of whatsoever kind or by whomsoever caused to the person or property of anyone (including Lessee) on or off the premises, arising out of or resulting from Lessee's use, possession or operation thereof, or from defects in the premises whether apparent or

not find true assent, and held public policy violations and contractual unconscionability.

Finding an unequal power relationship between the oil company and the gas station owner, the court raised its view of an evolving freedom of contract. First, the court cited Justice Frankfurter's dissent in the landmark Supreme Court case, *U.S.* v. *Bethlehem Steel*, 315 U.S. 289, 312 (1942):

> Fraud and physical duress are not the only grounds upon which courts refuse to enforce contracts. The law is not so primitive that it sanctions every injustice except brute force and downright fraud. More specifically, the courts generally refuse to lend themselves to the enforcement of a 'bargain' in which one party has unjustly taken advantage of the economic necessities of the other.
>
> The traditional contract is the result of free bargaining of parties who are brought together by the play of the market, and who meet each other on a footing of approximate economic equality. In such a society there is no danger that freedom of contract will be a threat to the social order as a whole. But in present-day commercial life the standardized mass contract has appeared. It is used primarily by enterprises with strong bargaining power and position. The weaker party, in need of the good or services, is frequently not in a position to shop around for better terms, either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses.[39]

Reflecting upon Justice Franfurter's dissent, the *American Oil* court held that:

> When a party can show that the contract, which is sought to be enforced, was in fact an unconscionable one, due to a prodigious amount of bargaining power on behalf of the stronger party, which is used to the stronger party's advantage and is unknown to the lesser party, causing a great hardship and risk on the lesser party, the contract provision, or the contract as a whole, if the provision is not separable, should not be enforceable on the grounds that the provision is contrary to public policy.

hidden, or from the installation existence, use, maintenance, condition, repair, alteration, removal or replacement of any equipment thereon, whether due in whole or in part to negligent acts or omissions of Lessor, its agents or employees; and Lessee for himself, his heirs, executors, administrators, successors and assigns, hereby agrees to indemnify and hold Lessor, its agents and employees, harmless from and against all claims, demands, liabilities, suits or actions (including all reasonable expenses and attorneys' fees incurred by or imposed on the Lessor in connection therewith) for such loss, damage, injury or other casualty. Lessee also agrees to pay all reasonable expenses and attorneys' fees incurred by Lessor in the event that Lessee shall default under the provisions of this paragraph.' *Weaver* v. *American Oil Co.*, 276 NE2d, 144, 145 (1971).

[39] *Ibid.*, 146.

> The party seeking to enforce such a contract has the burden of showing that the provisions were explained to the other party and came to his knowledge and there was in fact a real and voluntary meeting of the minds and not merely an objective meeting.[40]

The court thus found the contract to be unconscionable. The objective assent which stems from a duty to read cannot bind a contracting party to clauses which are unfair, unless the provisions are brought to the obligated party's attention and explained. The rationale is that an informed, voluntary consent must be required as such provisions impose a greater risk to a weaker party in the midst of a power relationship with a much stronger contracting partner.[41]

Other jurisdictions take a markedly different approach, particularly in the commercial context. Take, for instance, the recent US Federal District Court of Minnesota case, *Hormel Foods Corporation* v. *Chr. Hansen, Inc.*, 2001 WL 1636490 (D.Minn.) (no page numbers available online). In that case, Hormel, the international food producer, alleged that Hansen sold it dry mustard spice which, unfortunately, also contained pieces of rubber. Hansen, in turn, contracted with the firm Montana Specialty Mills to produce the mustard. Hormel was not pleased with such a distasteful, unsavoury situation: customers do not appreciate rubber-enhanced Dijon. A lawsuit followed and parties with any possible link to this troublesome spice were included in that action. After Hormel sued Hansen, Hansen joined Montana to the suit, who in turn sued the manufacturers of a rubber conveyor belt identified as the contamination source.

Investigating the underlying agreement and its implications on third-party suppliers, the court held that an exculpatory clause would be enforced where there is 'no vast disparity in the bargaining power between the parties and the intention to do so is expressed in clear and unequivocal language'.[42] The exculpatory clause was extremely broad and did not specifically refer to acts of negligence. It held that:

> Hansen shall indemnify and hold Montana harmless from 'any liability of whatsoever nature or kind' derived from Hansen's use of the spice blend.[43]

[40] *Ibid.*, 147–148.
[41] See *Kansas City Power & Light Company* v. *United Telephone Company of Kansas, Inc.* 458 F.2d 177 (1972).
[42] *Hormel Foods Corporation* v. *Chr. Hansen, Inc.*, 2001 WL 1636490 (D.Minn.) (no page numbers available online).
[43] *Ibid.*

Even with such broad wording not specifically indicating negligence, the court upheld the clause, focusing on the fact that the contracting parties should have known what they were bargaining into.

Similarly, the *Pinnacle Computer* v. *Ameritech Publishing, Inc*., 642 N.E.2d 1011 (1995) court in the US Federal District Court of Appeals in Indiana distinguished itself from its *American Oil* brethren. In that case, a yellow pages advertiser brought suit against a publisher for breach of contract when the advertiser's display ad was mistakenly omitted from the correct section of the yellow pages.[44] The appellate court found that the contracting parties mutually assented to an enforceable exculpatory provision.

The *Pinnacle* court distinguished the case before it from *American Oil*, while the court's decision closely analysed the *American Oil* facts. There, the gas station businessman was a man with only one-and-a-half year's worth of high school education and was told to sign, without any explanation, the oil company's standard lease drawn up by the company's attorneys.[45] The exculpatory clause was in fine print and contained no title heading. The *Pinnacle* facts were different. In *Pinnacle*, the plaintiff, a business owner, had a higher level of education. He was a president of a company engaged in a fairly technical career: the sale, repair and installation of computer-related equipment.[46] Although he alleged that the clause was not explained to him prior to signing the contract, the court found that he had the ability, unlike the *American Oil* gas station owner, to read and understand the clause's significance. Further, the clause was printed in a manner designed to emphasise its most crucial provisions. As the court said: 'Nothing in the designated matters in this case demonstrates that Ameritech's contract was one that no sensible person not under delusion, duress or in distress would make, and that no honest and fair person would accept.'[47]

Thus, there is a tension among jurisdictions regarding enforceability of contracts in a commercial setting: the referenced cases cut across jurisdictions and revealed different outcomes within one nation's legal system.[48] In general, a contracting party may exempt another party

[44] *Pinnacle Computer* v. *Ameritech Publishing, Inc*, 642 N.E.2d 1011, 1012 (1995).
[45] See *ibid*., 1017. [46] See *ibid.*
[47] *Pinnacle Computer* v. *Ameritech Publishing, Inc*, 642 N.E.2d, 1011, 1017 (1995).
[48] See *Continental Airlines* v. *GoodyearTire & Rubber Co*., 819 F.2d 1519, 1527 (9th Cir. 1987) (the court held that invoking the unconscionability doctrine in a matter involving 'two large, legally sophisticated companies' made 'little sense'); *K&C Westinghouse Elec. Corp*., 263 A.2d, p. 390 (PA. 1970).

from liability resulting from ordinary negligence. Note, however, that courts do not enforce agreements to exempt parties from liability 'if the liability results from that party's own gross negligence, recklessness or intentional misconduct'.[49] Nevertheless, the general enforceability rule does not apply to certain agreements, including when a party released from liability renders a public service and the agreement relates to that service.[50] In such instances, courts consider a variety of factors, including whether the activity is suitable for public regulation, whether there is a decisive unequal bargaining power and whether the clause is part of a standardised contract.[51] Although there are several cases involving exemption-from-negligence provisions based upon public policy, courts tend to tightly limit such provisions to very specific situations.[52]

While US courts may agree that an exculpatory provision cannot be enforced if the words do not clearly express an intention to exclude liability, they clearly disagree on exculpatory clause *construction*. Several cases express that a liability exemption is not interpreted from liability of harm negligently caused and require that the provision *expressly intended* to include the actor's negligence.[53] Other courts acknowledge that the intention to exclude liability for negligence may be made clear without specifically using the word 'negligence'.[54] Such an example was found in the *Hormel* case, where the liability based on negligence was not specifically exempted. Yet again, American law takes different perspectives when handling these clauses.

In a comparative sense, US jurisdictions do not share unanimity as to interpreting exculpatory clauses. A specific area of admiralty law, tug and towing, further demonstrates how Anglo-American family members have comparatively divergent views on exculpatory clauses.

[49] Corbin, *Corbin on Contracts*, vol. xv, Section 85.18, p. 455. [50] *Ibid*., pp. 455–456.
[51] *Brooks* v. *Timberline Tours, Inc*., 127 F.3d, p. 1273 (10th Cir. 1997).
[52] See, e.g., *Pittsburgh, C.C. & St. L. Ry.* v. *Kinney*, 115 N.E. 505 (Ohio 1916); *Tunkl* v. *Regents of University of California*, 383 P.2d , 442, 445–446 (Cal. 1963); *Harris* v. *National Evaluation Sys*., 719 F. supp. 1081 (N.D. Ga. 1989).
[53] See, e.g., *Eller* v. *NationsBank of Texas, N.A*., 975 S.W.2d 803 (Texas Ct. App. 1998); *Freddi-Gail, Inc.* v. *Royal Holding Corp*., 34 N.J. super. 142, 133 (1955); *J.A. Jones Constr. Co.* v. *City of Dover*, 372 A.2d, 540 (Del super. Ct. 1977).
[54] See, e.g., *Lexington Ins. Co.* v. *Tires Into Recycled Energy & supplies, Inc*., 522 S.E., 2d 798 (1999); *Basin Oil Co.* v. *Baash-Ross Tool Co*., 271 P.2d 122 (1954).

3 Testing convergence within the Anglo-American family: towage contracts and exculpatory clauses

In practice, exculpatory provisions are involved in contracts contending with significant commercial interests. Such is the case with towage,[55] which plays a strong, vibrant role in global transport, and holds an important place in the American economy. Towage-service contracts are often complex, reflecting the substantial hazards and enormous potential liabilities involved in providing towage services. The towage contract is the parties' agreement that the tug will 'skillfully and carefully move the towed object and deliver it in good condition to the agreed destination'.[56] In American towage law, a tower may, with limitations, contract to exculpate itself from liability for its own negligence.

3.1 *The development of US law:* Bisso *and beyond*

The current US law of towage and exculpatory clauses developed from the seminal US Supreme Court case, *Bisso* v. *Inland Waterways Corp.*, 349 U.S. 85 (1955), and its progeny.[57] That case involved a contract to tow an oil barge on the Mississippi River. Due to the tug's negligent towage, the barge collided with a bridge pier and sank.[58] Sued by the barge owners, the defendants invoked two clauses contained in the towage agreement.[59]

[55] A. L. Parks and E. V. Cattell, Jr. (eds.), *The Law of Tug, Tow and Pilotage* (Schiffer Publishing, 1994), p. 18 ('Towing is the employment of one vessel to expedite the voyage of another when nothing more is required than accelerating of its progress'). See also B. L. Feingerts and M. S. Stein, 'Exculpatory Provisions in Towage Contracts', *Tulane Law Review*, 49 (1975), 392; The American Waterways Operators at www.american-waterways.com/about_industry/index.html (last accessed 11 January 2010) (the towage industry adds $5 billion a year to the US economy).

[56] J. C. Sweeney, 'Collisions Involving Tugs and Tows', *Tulane Law Review*, 70 (1995), 581, 591–592.

[57] For a spirited discussion of *Bisso* involving preeminent admiralty scholars and practitioners, see 'Panel Discussion of Collision, Towage, Salvage, and Limitation of Liability (March 18, 1999)', *Tulane Maritime Law Journal*, 24 (1999), 405.

[58] *Bisso* v. *Inland Waterways Corp.*, 349 U.S., 85, 86 (1955).

[59] *Ibid.* The clauses held that:

> (4) The movement contemplated will be done at the sole risk of the 'craft to be towed' and its cargo, and neither the boats and/or any other equipment used in said service nor the owner, charterer or hirer thereof shall be liable for any loss or damage to the 'craft to be towed' or its cargo nor for any damage done by the 'craft to be towed,' however occurring.
>
> The masters and crews and employees of all boats and/or other equipment assisting the 'craft to be towed' shall, in the performance of said service, become

The court refused to enforce the clauses, with the majority citing public policy reasons. First, the court found the pressing need to discourage negligence, which could be achieved by making wrongdoers pay damages.[60] Secondly, it sought to protect those needing towed goods or towage services from being overreached by other actors (including possible monopolies) who were empowered to drive 'hard bargains'.[61] Thus, *Bisso* prohibits exculpatory language that relieves a tug from all liability for negligent towage.

Justice Frankfurter wrote a blistering twenty-two-page dissent. Among other things, he argued that the clauses should be enforceable on policy grounds. He did not find any evidence of unequal bargaining power.[62] He found no basis that the tug industry was so concentrated in ownership that tug owners had the ability, as monopolists, to dictate terms.[63] He also attacked the majority decision, alarmed by the court's use of judicial interpretation and concerned that the majority undermined contractual freedom principles.[64]

The number of exceptions and limitations to the *Bisso* holding, and the clever ways around that holding, show how the common law evolves. For example, the Supreme Court again addressed negligent towage in *Boston Metals Co.* v. *The Winding Gulf*, 349 U.S. 122 (1955), a case decided the same day as *Bisso*. *Boston Metals* involved a collision between an obsolete destroyer towed to a scrapping yard and a third vessel. The destroyer sank and the third vessel was damaged. The contract between the tug company and the destroyer's owners provided that: (i) the tug master and crew became the servants of the tow; and (ii) the tow owner would indemnify the tug company against all damage.[65] The tug was guilty of negligent navigation. The Supreme Court held that *Bisso* controlled and ignored the contract language specifying that the master and crew of the tug company would become servants of the tow. Public policy could not be circumvented by stipulating that the tug's employees would be considered the agents of the tow in order to shield the tug from liability.[66]

Dixilyn Drilling Corp. v. *Crescent Towing & Salvage Co.*, 372 U.S. 697 (1963) involved a contract where a tow would indemnify the tower

> and be the servants of the 'craft to be towed' regardless of whether the 'craft to be towed' assists in the service in any way and irrespective of whether they be aboard the 'craft to be towed' or in command thereof. *Ibid.*, 120.

[60] *Ibid.*, 91. [61] *Ibid.* [62] *Bisso* v. *Inland Waterways Corp.*, 349 U.S., 85, 116 (1955).
[63] *Ibid.* [64] *Bisso* v. *Inland Waterways Corp.*, 349 U.S., 85, 100 (1955).
[65] Sweeney, 'Collisions Involving Tugs and Tows', 593–594.
[66] Parks and Cattell, Jr. (eds.), *The Law of Tug, Tow and Pilotage*, pp. 70–71.

against third-party claims based on the tower's negligence. Further, the tow would provide the tower with the benefit of the tow's insurance. In a brief opinion, the Supreme Court, citing *Bisso*, overturned the Fifth Circuit decision which had upheld the clause. The Supreme Court suggested in *dicta* that the clause violated public policy given that the provision released the tower from all liability for its negligence.[67]

The *Bisso* court and subsequent decisions made it clear that the Supreme Court would not permit exculpatory language relieving tugs from all liability stemming from negligent towage. Comparing US, English and Canadian admiralty law on this issue reveals contrasts and opposing views *within* the Anglo-American family.

3.2 *The common law family comparison: English law*

English law recognises the validity of exculpatory clauses in towage contracts. The central case is *The President Van Buren* (1924) 19 Ll. L. Rep. 185. In this case, the tug owner was the Port of London Authority, a statutory authority controlling docks and wharves. Any vessel using the Authority's docks was required to employ its tugs: the Authority effectively had a monopoly over tug services.[68] Included in the conditions for the use of the tugs was a clause that tug masters and crew were to be servants of the towed vessel, and were thus effectively subject to the vessel's orders and control.[69] The vessel would also indemnify the Authority for any damage to its property or for other loss caused by the towed vessel.

The relevant exemption provision was as follows:

> The masters and crew of the tugs and transport men shall cease to be under the control of the port authority during and for all purposes connected with the towage or transport and shall become subject in all things to the orders and control of the master or person in charge of the vessel or craft towed or transported and are the servants of the owner or owners thereof who hereby undertake to pay for any damage caused to any of the port authority's property or premises and to bear, satisfy and indemnify the port authority against liability for all claims for loss of life or injury to person or loss or damage by collision or otherwise to the vessel or to or by the vessel or craft towed or to or by any cargo or other thing on board the same or to or by any vessel cargo or property of any other

[67] *Ibid.*
[68] See also Feingerts and Stein, 'Exculpatory Provisions in Towage Contracts', 404.
[69] *The President Van Buren* (1924) 19 Ll. L. Rep. 185, 186–187.

> person or persons or to the tug or tugs supplied, whether such damage loss or injury arise or be occasioned by any accident or by any omission, breach of duty mismanagement, negligence or default of any of such masters, crew or men or any servant of the authority or any other person or from or by any defect or imperfection in the tug or tugs supplied.[70]

While a towage was in progress, a collision occurred between the tug and the steamship, resulting in damage to both vessels. In the Authority's suit against the steamship owners, the owners counterclaimed for their damages. They alleged that the exculpatory provision was void due to it being against public policy. The court disagreed. Reaching a very different decision from *Bisso*, the *Van Buren* court held that the clause was *not* against public policy and granted full damages against the steamship owners. In a decision heavily laden with economic and freedom of contract discussions, the court held that the terms of the towage agreement were not against public policy despite the Authority's monopoly.[71]

Just how far apart were the judicial positions in both *Bisso* and *Van Buren*? One must consider that the *Bisso* court majority invalidated the exculpatory provision, largely motivated by public policy. The *Bisso* court was very concerned that a monopolistic tendency would cause overreaching. In a sense, freedom of contract was subordinated to a perceived important public concern. Even Justice Frankfurter's stinging dissent did not suggest that the clause should be upheld if a monopolistic situation existed. Rather, he found no evidence before the court that the tug owner could exercise any degree of monopolistic compulsion.

The English judge deciding *The President Van Buren*, Mr Justice Hill, clearly indicated in his opinion the divergent Anglo-American views of these clauses in the towage context, stating:

> On the first point as to whether the agreement is valid and not void as against public policy, I think the answer on this matter is that which I have already expressed, namely, that the English law, in my view, very fortunately regards business men as capable of knowing their own business and of making contracts for themselves and is very unwilling to limit the power of capable people to make what bargains they like.
>
> I can conceive no principle of public policy which should lead the Courts to say: 'We ought to step in and say "This or that contract ought not to be made by competent people," when the people making it are competent people. It is said that the Port of London Authority is a

[70] *Ibid.*
[71] Feingerts and Stein, 'Exculpatory Provisions in Towage Contracts', 392, 404.