Good Faith and the Enforceability of Standardized Terms

Robert Dugan
GOOD FAITH AND THE ENFORCEABILITY OF STANDARDIZED TERMS

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The concepts of good faith and unconscionability increasingly play a key role in the resolution of disputes over the enforceability vel non of standardized terms, a problem which dominates contemporary contract litigation.1 Although both these general constraints enjoy explicit recognition in statute and case law,2 neither

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litigation nor protracted academic discussion has reduced either concept to a generally accepted set of working rules.\(^3\) The lack of consensus as to the meaning of these terms may impair the regulatory efficacy of contract law.\(^4\) An equally important and, for the most part, wholly unexplored corollary issue concerns the relationship of good faith and unconscionability to each other and to the other enforceability challenges\(^5\) based upon incorporation, con-


5. See discussion in Schroeder v. Fageol Motors, Inc., 86 Wash. 2d 256, 544 P.2d 20 (1975). In one notable development, courts are making increasing use of the good faith obligation to preserve a clause from attack under UCC § 2-302. See Jamestown Farmers Elevator, Inc. v. General Mills, Inc., 413 F Supp. 764 (D.N.D. 1976) (extension clause in grain contract held not unconscionable because enforcement of clause is subject to good faith
construction, and specific constraints. In this article, the author proposes and defends a working definition of good faith as applied to the enforcement of standardized terms. In a sequel essay, he will propose counterpart rules for unconscionability and explore the interrelationship between the two general constraints.

**RECAPITULATION OF THE PROBLEM**

This paper builds upon six propositions formulated and defended by the author in two earlier articles. First, standardized forms constitute a recognizable commercial phenomenon characterized by a collection of written contract terms (1) formulated in advance for use in an undetermined number of similar transactions and (2) presented to the nondrafter as a condition of doing business. These two characteristics describe, respectively, the “abstract generality” and “unilateralness” of standardized forms. The definition encompasses precontract forms (purchase orders and acknowledgements), integration forms (sales contracts and security agreements), as well as extrinsic collections (general terms and mandates), rev’d in part, 552 F.2d 1285 (8th Cir. 1977); W.L. May Co. v. Philco-Ford Corp., 273 Or. 701, 543 P.2d 283 (1975) (clause giving franchisor option of repurchasing inventory upon termination held not unconscionable since franchisor must exercise rights in good faith).


8. “Extrinsic” collections of standardized terms refer to those terms which the drafter does not reproduce in toto in the contract documents but seeks to incorporate by cross-reference. For cases involving the use of such terms, see, e.g., Beathard v. Chicago Football
conditions) and postcontractual forms (warranty manuals and invoices). Unlike many of the discussions in the traditional literature and case law dealing with adhesion contracts and unconscionability, this definition makes no reference to relative bargaining power, the merchant-consumer distinction, overreaching, or the individual vulnerabilities of the nondrafter.  

Second, the use of standardized forms threatens two distinct abuses, each associated with one of the definitive characteristics. The one abuse, "surprise," occurs when the content of the standardized term diverges from the expectations of the nondrafter. This abuse follows as an inevitable consequence of the abstract generality of standardized terms. Standardized terms cannot achieve a uniform regulation of an indefinitely large number of future transactions without disregarding the unique interests of the particular nondrafter in the individual transaction. The concerted efforts of the education system and advertising industry notwithstanding, many nondrafters, whether consumers or merchants, approach transactions with distinct expectations. The other abuse, denominated "imbalance," refers to standardized terms which, by reference to some yet undefined standard, are too harsh to warrant enforcement. Given the drafter's complete control over the content of the standardized form, his profit motive, unless constrained by competition (unlikely in our highly regulated econ-
GOOD FAITH AND STANDARDIZED TERMS

omy) or by legislative restraints, invariably will generate excessively one-sided terms.

Third, the peculiarities of standardized form contracting undercut the jurisprudential basis for many rules of traditional contract law. Those rules presuppose a contracting environment characterized by negotiative interplay of conflicting interests. Whether such an environment ever existed as a matter of fact or merely represents an ideological construct for justifying the rules favoring a certain economic class is not at issue here. Within such an environment, many diverse features of traditional contract law—including the matching-ribbon theory of contract formation, the stricture against indefiniteness, the parol evidence rule, the Hadley v. Baxendale measure of damages, and the absence of specific and general constraints on the substance of contract terms—are justifiable in that they reflect and further the interests of both parties to a transaction. When, as in standardized contracting, unilateralness replaces negotiation and abstract generality precludes bilateral realization of interests, these traditional doctrines no longer serve that end. For instance, if each party proceeds from his own set of terms, the ribbon-matching rule enables the parties to recognize the instant at which they become contractually bound as well as the terms of the contract itself. If, in contrast, all the terms originate with one party, such a rule is no longer necessary. In an environment of negotiation, the possibility of mutual influence upon contract terms minimizes the need for substantive constraints upon imbalance. When, however, one party drafts the terms, the institution of contract quickly becomes an instrument of class oppression in the absence of substantive constraints. Likewise, the essential incomprehensibility of standardized terms, which are neither read nor intended to be read by the nondrafter, absolutely contradicts the integration assumption that underlies the parol evidence rule. As applied in the standardized contracting environment, traditional contract law as reflected in the Restatement of Contracts enhances rather than mitigates the potential for abuse inherent in standardized forms.

Fourth, in the last two decades, contract law has undergone numerous changes in response to the abuses and peculiarities associ-
ated with the use of standardized forms. The steady displacement of contract law by the law of torts has occurred, in large part, as a means to avoid the operation of traditional contract doctrine in transactions consummated on the basis of standardized forms. The Uniform Commercial Code (UCC) keys its rules of contract formation and construction to factors other than mutual assent, in recognition of the absence or reduced role of that phenomenon in standardized contracting. Section 237(3) of the Restatement (Second) of Contracts virtually abolishes the parol evidence rule as applied to standardized forms. The specific substantive constraints found in recent remedial legislation—such as the federal Truth-In-Lending and Magnuson-Moss Acts as well as state consumer-protection and franchising statutes—combat harsh terms that almost invariably are imposed through standardized forms. Other legislation—such as UCC section 2-207(2), UCC section 2-316(2), and the extensive state and federal “disclosure” statutes—obviously aim at the abuse of surprise. The gaps left by


14. See U.C.C. §§ 1-201(3), 1-205, 2-208 (role of trade usage, course of performance, and course of dealing); id. § 2-204(3) (contract formation based on conduct); id. § 2-207(2)(b) (incorporation based upon materiality of term); id. § 2-207(3) (contract recognition in face of differences in parties' writings).

15. This provision, which is less of a restatement than a repudiation of common law, see Dugan, An Introduction, supra note 6, at 1321 n.50, gradually is gaining acceptance by the courts. See C & J Fertilizer, Inc. v. Allied Mutual Ins. Co., 227 N.W.2d 169 (Iowa 1975).

16. As examples of specific federal substantive constraints, see 15 U.S.C. § 1666i (1976) (credit card holder's defenses against issuing bank); id. § 1667b (limitation of liability upon termination of consumer lease); id. § 2308a (ineffectiveness of warranty disclaimer); id. § 2802 (Supp. II 1978) (limitations upon right to terminate motor fuel distributorship). On a state level, the Uniform Consumer Credit Code and its counterparts prevent the enforceability of a wide range of clauses found in security agreements. See U.C.C.C. §§ 3.301-309. The Uniform Commercial Code specifically regulates certain clauses. See, e.g., U.C.C. §§ 2-205, 2-209(2), 2-316(2), 2-719(3), 2-725(4).

17. See, e.g., 15 U.S.C. § 77(e) (1976) (disclosure of financial information in connection with sale of securities); id. § 2302 (disclosure of warranty information); id. §§ 1637-1639 (disclosure of credit terms); id. § 1667a (disclosure of lease terms); 16 C.F.R. §§ 436.1-3 (1980) (disclosure of financial information in connection with sale of franchise). State law counterparts appear in the Uniform Consumer Credit Code and its equivalents, blue sky
the specific constraints are filled by the general mandates of good faith and conscionability; the latter originated in an attempt to deal with abusive standardized terms.\textsuperscript{18} These changes evidence a legislative judgment that standardized transactions warrant special regulation to protect the nondrafter against surprise and imbalance.

Fifth, as applied to the use of standardized terms, the general constraints of good faith and unconscionability should serve to regulate the abuses of surprise and imbalance respectively. Although this allocation of regulatory function contradicts the generally accepted bifurcation of unconscionability into substantive and procedural unconscionability,\textsuperscript{19} it is firmly supported by the text, internal structure, official comments, and legislative history of the UCC and Restatement (Second) of Contracts.\textsuperscript{20} Even though such an allocation says nothing about the substantive content of either concept, it does establish that existing contract law contains a sufficient number of instruments for complete regulation of the general abuses inherent in the use of standardized forms. Moreover, the association of constraints and abuses is a necessary first step in defining the good faith and unconscionability concepts and thereby alleviating the uncertainty which they, particularly the unconscionability concept, have imported into contemporary contract law.

Sixth and last, the standardized form itself, as regulated by contract law, provides the most appropriate vehicle for the resolution of disputes arising from transactions subject to standardized terms.\textsuperscript{21} Tort law and special remedial legislation operate with rules of general applicability which, unlike those contained in stan-

\textsuperscript{18} The earlier drafts of UCC § 2-302 limited its application to “form clauses.” For discussion, see Leff, supra note 9, at 490.


\textsuperscript{20} See Dugan, Unconscionability, supra note 6, at 730-35.

\textsuperscript{21} See id. at 743-45.
standardized forms, are not easily revised, not necessarily responsive to the interests of either party to a transaction, and not keyed to the peculiarities of the subject matter of a transaction. Rules drafted by one party to a transaction, rather than by a third party such as a court or legislature, provide a degree of regulatory flexibility perhaps necessary for the smooth functioning of an exchange economy. Because standardized terms are not amenable to comprehension or consent, whether the standardized terms are intrinsic or extrinsic to the transaction is irrelevant.22

The law of contract now contains sufficient instruments to protect the nondrafter against the surprise and imbalance abuses. The other, more subtle consequences resulting from the widespread use of standardized forms—for example, suppression of nondrafter individuality and social alienation—are evils that neither the law of contract nor any admixture of tort law and remedial legislation can cure or even mitigate. They represent structural consequences of an economy and citizenry dedicated to mass consumption and political apathy.

**Preliminary Issues and the Proposed Test for Good Faith**

Any inquiry into the scope and meaning of good faith must begin with the general mandate in UCC section 1-203 and the definitions in sections 1-201(19) and 2-103(1), which read respectively as follows:

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

“Good faith” means honesty in fact in the conduct or transaction concerned.

In this Article unless the context otherwise requires (b) “Good faith” in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

These provisions provide no information as to the meaning of good faith in a specific case except that the concept requires consideration of both objective and subjective elements. The honesty in fact

22. For a discussion of the parity properly afforded extrinsic and intrinsic standardized terms, see id. at 740-45.
definition combines an abstract subjective element (honesty) with an equally abstract objective element (in fact). The reasonable commercial standards definition also mixes abstract factual referents (observance, standards, and dealing) with vague evaluative criteria (reasonable and fair).

The general mandate and definitions raise two significant threshold issues concerning the application of good faith to the enforcement of standardized terms. First, does UCC section 1-203 by its reference to “performance or enforcement” preclude application of the good faith constraint to the other stages (formation and termination) of a contract?23 Second, does the good faith constraint, once accepted as an enforceability criterion, operate in that mode through the honesty in fact definition and/or reasonable commercial standards definition?24

Given the essential vacuity of the definitions, resolution of the threshold issues and the eventual articulation of standards for good faith require the identification and use of other authoritative bases. For instance, commentators most frequently draw upon the case law in the areas outside the UCC.25 Another less acknowledged, but more direct source of information is contained in the many specific references to good faith in the UCC text and comments.26 To the extent that these Code references anticipate concrete situations, protect identifiable interests, and further specific

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24. This issue has been litigated in transactions subject to both Articles 2 and 9. See, e.g., Sherrock v. Commercial Credit Corp., 290 A.2d 648 (Del. 1972) (whether UCC §§ 1-201(19) or 2-103(1)(b) defines good faith as applied to the “buyer in ordinary course” element of UCC § 9-307(1)).


policies, they form a basis for developing the good faith concept.\textsuperscript{27}

For example, the other Code references to good faith shed considerable light on the first threshold issue, that is, whether the good faith mandate of UCC section 1-203 applies to the formation as well as the enforcement of standardized contracts. Although the nonpurchase references to good faith in the UCC anticipate a wide range of transactional settings, they display one common characteristic: they deal with situations in which one party unilaterally determines the jural position of the other.\textsuperscript{28} In every case the good faith concept operates as a constraint upon that determination. Because by definition the use of standardized terms represents an act of unilateral jural determination, by analogy it should be viewed as an activity subject to the good faith constraint. Specific authority for applying the good faith constraint to the use of standardized terms appears in UCC section 2-311(1). This provision anticipates a situation very similar, if not identical, to standardized form contracting: the parties “agree” to little more than to do business with one another and then “leave” the drafter free to specify the particulars of performance.\textsuperscript{29} By imposing the good faith constraint upon such specification, section 2-311(1) either expands the scope of the good faith mandate beyond “performance or enforcement” to include one type of contract formation or subjects that type of contract formation to a “duty within this Act” for purposes of applying UCC section 1-203.

\textsuperscript{27} For an analysis which relies heavily upon these references to delimit the regulatory function of good faith and unconscionability, see Dugan, \textit{Unconscionability, supra} note 6, at 730-40.

\textsuperscript{28} For instance, Code §§ 2-305(2), 2-306(1), and 2-311(1) involve situations in which one party determines one or more terms of the contract; §§ 1-208, 2-603(3), 2-706(1), and 2-712(1) allow one party to determine the measure of another's liability; §§ 2-324(b) and 2-402 involve vulnerabilities resulting from the particular factual setting.

\textsuperscript{29} The text of this provision and the official comments do not allude in any detail to the commercial setting anticipated by this provision. The official comment does little more than describe the subsection as a corollary to UCC § 2-204(3) and emphasize the leeway inherent in the reference to “leave.” Neither courts nor commentators have noticed the provision's apparent applicability to the use of standardized terms. For typical application of § 2-311(1), see Westinghouse Elec. Corp. v. CX Processing Laboratories, Inc., 523 F.2d 668 (9th Cir. 1975) (applied to specification of date and amount of lot shipments); Neal-Coooper Gram Co. v. Texas Gulf Sulphur Co., 508 F.2d 283 (7th Cir. 1974). For discussion of UCC § 2-311(1), see Dugan, \textit{Unconscionability, supra} note 6, at 738-42. Cf. 1 J. ESSEH, SCHUL-DRECHT, Allgemeiner Teil. 105-06 (5th ed. 1975) (discussing § 315 of the West German Civil Code (BGB)).
As a matter of regulatory policy and historical precedent, the good faith duty properly applies to both the formation and performance stages of standardized contracts. The pre-Code law of contracts and sales abhorred unilateral jural determination. It neither recognized a general duty of good faith nor contained statutory counterparts to UCC sections 1-208, 2-402(1), and 2-706(1). Such provisions extend the law of sales to include recognition of the antecedents of rights and duties, namely unilaterally exercisable powers. The increased flexibility entailed by this extension called for an equally flexible constraint. The appearance of the good faith constraint in this role comports with its traditional service in the law governing agents and fiduciaries, who, like the user of standardized forms, possess power to determine unilaterally the jural position of another. Imposition of the good faith duty at the formation stage of a standardized contract also responds to the fact that events at this stage often generate expectations, the frustration of which results in surprise, the main abuse regulated by the duty.

In respect to the threshold choice between honesty in fact and reasonable commercial standards as the proper vehicle for implementing good faith as a constraint upon the use of standardized terms, the former standard has several advantages. First, it promises uniform application. Whereas the reasonable commercial standards definition applies only to some transactions under Article 2, the honesty in fact standard applies to all Code transactions. There is no apparent reason why standardized sales terms should be subjected to a different good faith rule than standard-

30. An agreement which permitted one party to determine unilaterally a significant term was commonly viewed as unenforceable for want of definiteness or mutuality. See 1A A. Corbin, Contracts §§ 152, 157-58 (1963). See, e.g., Schlegel Mfg. Co. v. Cooper's Glue Factory, 231 N.Y. 459, 132 N.E. 148 (1921) (traditional hostility to requirements contracts).


32. U.C.C. § 2-103(1)(b). Whether this definition applies throughout Article 2 or only to those sales provisions which specifically refer to good faith is an open issue. See Summers, supra note 23, at 212.
ized terms in security agreements, negotiable instruments, or warehouse receipts. In fact, use of the reasonable commercial standards definition would subject the drafting party to two potentially conflicting versions of the good faith duty in the many transactions which involve both standardized terms under Article 2 and terms under other articles of the Code.\(^3\)

The honesty in fact definition also seems inherently better suited as a vehicle to consider the issues relevant to the surprise abuse associated with the good faith constraint. As defined for purposes of this study, surprise entails a divergence between contract terms and the expectations of the nondrafter. These expectations vary from one case to the next and generally depend upon the particular communications and parties' perceptions thereof. The reasonable commercial standards definition anticipates subsumption of various fact patterns under general norms (reasonable commercial standards) and leaves little leeway for investigation into individual expectations of the parties. In contrast, the honesty in fact definition permits, by reference to "honesty," examination of the subjective expectations of the parties and, by reference to "in fact," consideration of the facts involved in the particular case.\(^3\)

Resolution of the threshold issues clears the way for formulation of a specific standard for good/bad faith. Relying primarily upon the specific references to good faith in the UCC text and official comments, the author proposes a four-prong test for good faith as it applies to the use and enforcement of standardized terms. (1) Did the nondrafting party entertain a specific interest or expectation in respect to the subject matter regulated by the challenged standardized term? (2) Was the interest legally cognizable? (3) Did the drafter have notice of the expectation or interest? (4) Did the drafter unduly disregard the interest or expectation? A finding of bad faith requires an affirmative answer to all four questions.

On its face, the proposed test differs in several important respects from the orthodox learning about good faith. Most signifi-

\(^3\) Such transactions include conditional sales contracts and consignments. See U.C.C. §§ 1-201(37), 2-102, 2-326, 2-401(1), 9-102(2), 9-113, 9-114.

\(^3\) For use of UCC § 1-201(19) as a vehicle for evaluating the specific facts and expectations, see Williamson v. Wanlass, 545 P.2d 1145 (Utah 1976) (good faith under UCC § 1-208). Cf. Holmes, supra note 25, at 442-49 (using a similar definition to analyze factors respecting disclosure in insurance contracts).
cantly, the test reduces the abstract notion of honesty in fact to four specific questions, three of fact and one of law (point 2). The emphasis upon the nondrafter's expectations (points 1 and 2) also conflicts with prevailing construction of UCC section 1-201(19), which makes bad faith solely a function of the dominant party's state of mind. In the following pages, the author first defends each component of the test in terms of Code authority and commercial policy and then applies the test to a number of concrete hypotheticals taken from recent litigation. In a sequel essay, the author proposes a similarly specific test for the unconscionability constraint as applied to standardized terms.

**Issue 1. Did the Nondrafter Entertain an Expectation or Interest Respecting the Content of the Challenged Standardized Term(s)?**

The role accorded nondrafter expectations distinguishes the proposed test from the orthodox doctrines which view honesty in fact as some vaguely defined state of mental innocence on the part of the party subjected to the good faith constraint. The state of mind approach to good faith had its origin in the law governing purchase transactions, where it served as a constructive notice device. Both courts and legislators have recognized that the subjec-

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35. Compare Summers, supra note 23, at 200-07 (rejecting the possibility of specific criteria for good faith), with Holmes, supra note 25, at 402, 460-52 (identifying a "core of meaning consisting of a spectrum of related, objective qualities").

36. "[T]he question [under UCC § 1-201(19)] is a narrow one focused only on the subjective intent with which the purchaser acted." Oscar Gruss & Son v. First State Bank, 582 F.2d 424, 432 (7th Cir. 1978) (discussing relationship of notice and good faith requirements for good faith purchaser status). "The good faith 'test requires honesty of intent rather than absence of circumstances which would put an ordinarily prudent holder on inquiry."


37. See UNIFORM NEGOTIABLE INSTRUMENTS ACT § 56 (withdrawn 1951). What Constitutes Notice of Defect. To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

Id. The objective definition of notice in UCC § 1-201(25) now performs this notice function and leaves considerable doubt as to the role properly served by the good faith concept. See
tive standard cannot be applied sensibly to the wholly different nonpurchase context.\(^{38}\)

Although neither the definitions nor the general mandate in UCC section 1-203 support inclusion of an expectation element in a test for good faith, this component finds ample authority in the specific nonpurchase references to good faith throughout the Code.\(^{39}\) Of the many nonpurchase references to good faith, UCC sections 2-306(1) and 2-311(1) anticipate situations most similar to standardized form contracting in which one party is entitled by agreement to fix unilaterally the other party's obligations. The specification entitlement in section 2-306 pertains to only a single term; that contemplated by section 2-311(1) compares favorably, in potential breadth, to the specification entailed by standardized contracts. In light of this fundamental similarity, conclusions and inferences concerning the meaning of good faith under these sections deserve great weight in deriving working rules for application of the good faith constraint to the use of standardized forms.

Even a casual reading of UCC sections 2-306(1) and 2-311(1) reveals that the good faith element serves to protect the interests of the subordinate party to the unilateral jural determination contemplated by the provisions. According to the official comments, the constraints of section 2-306(1) promote foreseeability,\(^{40}\) and those in section 2-311(1) insure that there is "no surprise and the range of permissible variation is limited by what is commercially reasonable."\(^ {41}\) Both foreseeability and surprise are functions of the expectations of the subordinate party to the transaction. Although the non-good faith constraints found in these sections unquestionably advance the foreseeability objective, they are not sufficient safeguards.\(^{42}\) Accordingly, the good faith constraint as used in sec-

Oscar Gruss & Son v. First State Bank, 582 F.2d 424 (7th Cir. 1978); J. White & R. Summers, supra note 9, at 562-63.


39. See note 26 supra.


41. U.C.C. § 2-311, Comment 1.

42. The reasonable commercial limits constraint in UCC § 2-311(1) will not protect expec-
tions 2-306(1) and 2-311(1) must protect some other aspect of the subordinate party’s expectations.

Most other references to good faith in the UCC text also require one party to act with due regard for the other party's interests and expectations. Particularly illustrative are those provisions (UCC sections 1-208, 1-205, 2-508, 2-603, 2-614, 2-615) which the official comments to UCC section 1-203 designate as “applications” or “implementations” of the good faith mandate.\textsuperscript{43} Except for section 1-205, all of these provisions contemplate a situation in which one party has the other party “at his mercy.” The specific measures prescribed by these provisions require the dominant party to act with due regard for the other party’s interests and expectations. For example, under sections 2-508 and 2-614, the aggrieved party (dominant by virtue of the powers associated with the other party’s breach) must permit the breaching party the opportunity to cure. Under UCC section 2-603, the aggrieved party must follow the instructions of the breaching party as to the disposition of rightfully rejected goods. Under section 2-615, the excused supplier must notify his purchasers of delay or nondelivery and allocate existing supplies first to the regular customer. The main objective of these applications and implementations of good faith is the protection of certain expectations.\textsuperscript{44}

The official comments abound with specific examples of good faith and bad faith conduct, almost all of which involve a dominant party acting with or without regard for the interest of the subordinate party. Consider the following illustrations. If the contract entitles one of the parties to fix the price, the use of a posted or market price satisfies the good faith requirement.\textsuperscript{45} In a supply or output contract, good faith requires that the quantity specification approximate a “reasonably foreseeable figure.”\textsuperscript{46} In connection

\textsuperscript{43} U.C.C. § 1-203, Comment.
\textsuperscript{44} See U.C.C. § 1-205(2) (reference to “expectation”); \textit{id.} § 2-508(2) (reference to seller’s “reasonable grounds to believe”); \textit{id.}, Comment 2 (reference to “suprise”); \textit{id.} § 1-208, Comment (reference to “whim and caprice”); \textit{id.} § 2-615(a) (reference to “basic assumption”) & Comment 1 (reference to foreseeability).
\textsuperscript{45} U.C.C. § 2-305, Comment 3.
\textsuperscript{46} U.C.C. § 2-306, Comment 2.
with the enforcement of the unilateral termination clause, the terminating party must give reasonable advance notice so that the other party can make substitute arrangements.\footnote{47} Good faith precludes an interpretation of contract warranty language that would amount to exchange of a real price for a pseudo obligation.\footnote{48} A seller's good faith obligation includes full disclosure of material, but hidden, defects that are known to him.\footnote{49} Good faith requires that a rejecting buyer follow the seller's instruction regarding resale, storage, and reshipment.\footnote{50} Additionally, good faith prevents a party from arbitrarily rejecting assurances.\footnote{51} In an installment sale, a buyer must make any reasonable outlay of time or money necessary to cure an overshipment and to cooperate with the seller in curing a material nonconformity.\footnote{52} These examples represent a cross section of more than two dozen illustrations of good faith contained in the official comments.\footnote{53} In nearly every instance, the good faith obligation serves consistently and primarily to protect the expectations of the subordinate party.

The standard for good faith in the nonpurchase references differs fundamentally from the interpretation of honesty in fact, which requires nothing more than some otherwise unspecified state of mind on the part of one party. As used in these references, good faith focuses not on that party's state of mind, but rather upon the interests and expectations of the subordinate party. Not supris-

\footnotetext{47}{U.C.C. § 2-309, Comment 8.}
\footnotetext{48}{U.C.C. § 2-313, Comment 4.}
\footnotetext{49}{U.C.C. § 2-314, Comment 3.}
\footnotetext{50}{U.C.C. § 2-603, Comment 1.}
\footnotetext{51}{U.C.C. § 2-609, Comment 4.}
\footnotetext{52}{U.C.C. § 2-612, Comment 5.}
\footnotetext{53}{For other illustrations of good faith serving to protect the subordinate party's interest, see U.C.C. § 2-306, Comment 2 (normal and sudden expansion or contraction in requirements contracts); \textit{id.} § 2-306, Comment 5 (best efforts in exclusive dealing contracts); \textit{id.} § 2-309, Comment 5 (notice in open time contracts); \textit{id.} § 2-311, Comment 3 (cooperation in fixing particulars of performances); \textit{id.} § 2-312, Comment 3 (indemnification); \textit{id.} § 2-313, Comment 6 (fair drawing of samples); \textit{id.} § 2-314, Comment 10 (conformity to label descriptions); \textit{id.} § 2-324, Comment 1 (noninterference); \textit{id.} § 2-326, Comment 2 (presumption in favor of general creditors); \textit{id.} § 2-504, Comment 5 (cooperation in pursuing claim against carrier); \textit{id.} § 2-206, Comment 1 (impairment through partial acceptance); \textit{id.} §§ 2-605, Comment 2, 2-607, Comment 5 (notice of defect and loss); \textit{id.} § 2-608, Comment 5 (content of revocation notice); \textit{id.} § 2-609, Comment 6 (use of insecurity clauses); \textit{id.} § 2-612, Comment 7 (extension of time for negotiation); \textit{id.} § 2-615, Comment 7 (readjustment to meet new conditions); \textit{id.} § 2-615, Comment 11 (allocation favoring existing customers).}
ingly, few of these references make any allusion whatsoever to the dominant party’s state of mind. Prevention of surprise requires that the regulatory instrument focus upon the operative component of that phenomenon, namely the expectations of the subordinate party. Because these expectations bear no necessary relationship to the dominant party’s state of mind, any test that focuses solely upon that party’s state of mind will not necessarily promote foreseeability or prevent surprise. If surprise is the relevant abuse, one element in any good faith standard must involve the expectations and interests of the subordinate party.

**Issue 2: Is the Expectation Legally Cognizable?**

Nondrafter expectations cannot be used as an element of a good faith test without some associated standard for limiting the set of protected expectations. Otherwise, the good faith mandate would place the drafter at the mercy of the nondrafter’s wildest fantasies and, like the doctrine of unconscionability, would tend to engulf the entire law of contracts. Elsewhere in the law, expectations do not appear as elements of remedial norms unless accompanied by cognizability criteria. For instance, section 237 of the Restatement (Second) of Contracts, one of the few rules to employ expectation as a specific element, requires that the expectation be reasonable and apparent to the other party. Neither the general mandate of good faith nor the definitions of that term in the UCC indicate which expectations warrant protection. Considerable guidance, however, is found in the specific good faith references in the text and official comments which so strongly support inclusion of non-

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54. A few of the 84 comment references to good faith associate that constraint with the dominant party’s state of mind. See U.C.C. § 1-208, Comment; id. § 2-323, Comment 2; id. § 2-324, Comment 4; id. § 2-615, Comment 10.

55. See emphasis on the subordinate party’s expectations in Restatement (Second) of Contracts § 231, Comment a at 92 (Tent. Draft No. 5, 1970), and Holmes, supra note 25, at 433, 442-46, 452.

56. See note 4 supra; Dugan, An Introduction, supra note 6, at 1329-30.

57. Other rules of law which aim, albeit not explicitly, at protecting expectations also carefully delimit the protected expectations. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 90 (Tent. Draft No. 2, 1965) (imposing restrictions both in respect to the source (promise) and manifestation (reliance) of the expectation). UCC § 2-313(1) restricts protection both in respect to source (representation of fact) and function (basis of the bargain) of the expectation.
drafter expectation in the good faith test.

Nearly all the expectations protected by the specific nonpurchase references and illustrations share one characteristic: they can be accommodated by the dominant party without any sacrifice of the benefit of his bargain. For instance, the seller's right to cure under UCC section 2-508, one of the "applications" of the good faith mandate, does not impose upon the rejecting buyer any additional expense or undue delay. It does not threaten the buyer's right to performance or limit his available remedies in the event of ultimate breach. Likewise, the buyer who complies with his duty to follow instructions under UCC section 2-603(1), another "application" of good faith, is assured of reimbursement. Nor does the pre-acceleration notice frequently imposed by the courts on authority of the good faith requirement in UCC section 1-208 deprive the creditor of the benefit of his bargain. The many illustrations of good faith throughout the official comments depict behavior that benefits the subordinate party at no additional expense to the dominant party.

As a policy matter, recognition of expectations that can be accommodated without any sacrifice by the other party is easy to justify. Protection of such expectations enhances the classical role of contract as a device that enables both contracting parties to enhance their individual welfare. Indeed, as a matter of social policy, it is difficult to argue against any change that benefits one party and does not harm the other.

Another common, although not invariably present, characteristic of the expectations protected by the specific references to good faith involves the source of those expectations. In particular, expectations created by the dominant party receive a high degree of

58. See U.C.C. § 1-203, Comment.
59. The right to cure under UCC § 2-508(1) obtains only during the contract "time for performance." Under UCC § 2-508(2), a "suprise" rejection extends the performance period for a "reasonable time."
60. U.C.C. § 2-603(2).
61. The notice requirement is imposed routinely if the creditor has led the debtor to assume the acceleration clause will not be strictly enforced. See Ford Motor Credit Co. v. Waters, 273 So. 2d 96 (Fla. Dist. Ct. App. 1973); Williamson v. Wanlass, 545 P.2d 1145 (Utah 1976).
62. See text accompanying notes 45-52 supra.
63. See W BAUMOL, ECONOMIC THEORY AND OPERATIONS ANALYSIS 266-69 (1961).
protection, whereas expectations based upon referents extrinsic to the immediate transaction receive less protection. For instance, the good faith constraint frequently appears in connection with a reference to other constraints such as “commercial reasonableness” or more concrete standards. This fact indicates a general tendency to deal with expectations based upon such external referents through means other than the good faith concept. Moreover, most illustrations of good/bad faith in the official comments focus upon the behavior of the dominant party. This emphasis comports with the subjective overtone of both the honesty in fact definition in UCC section 2-101(19) and the emphasis upon fair dealing in UCC section 2-103(1)(b).

The peculiarities of standardized contracting justify giving special consideration to expectations created by the drafting party. If the contract is negotiated, either party in theory can insure that any expectation created by the other party finds express recognition in the agreement. In contrast, the nondrafter to a standardized contract has no way either to determine whether the expectation-creating behavior finds express recognition in the contract or, if it does not, to effectuate the necessary modification. The drafting party can induce whatever expectations lead the particular nondrafter to sign the agreement and at the same time employ such standardized terms as will insure legal immunity for nonfulfillment of those expectations. Unless the standardized contract is to operate unfettered as a medium for chicanery and oppression, such practice must be viewed as an abuse of the power given the drafting class by judicial and legislative recognition of the contracting device. The abuse in question inheres not in the particular terms; indeed, merger and disclaimer clauses are, in the proper context, legitimate means to achieve risk allocation and certainty. Nor does the abuse derive from the standardized nature of the contract. Rather, the abuse lies in the use of standardized terms in association with certain types of expectation-generating conduct by the drafter. As such, the chief source of the abuse lies largely


65. See note 53 supra & text accompanying notes 45-52 supra.

outside the specific statutory regulation of such terms.\textsuperscript{67} A preventive legal constraint must focus on the peculiar imbalances in standardized contracting, the preliminary behavior of the drafter, and the expectations of the nondrafter. As discussed above, the good faith concept is particularly well suited, both in terms of pre-Code law and Code usage, to accommodate all three components.\textsuperscript{68}

The role of good faith as a general constraint suggests a third cognizability criteria, not manifest in the specific references or illustrations. In order that a general constraint not engulf the whole of contract law, the suggested good faith test must deny recognition to expectations based upon the law itself. For instance, a nondrafter should not be permitted to avoid the statutory recognition and regulation of warranty disclaimers as provided in UCC section 2-316 by invoking the good faith doctrine in connection with expectations based upon the statutory recognition of implied warranties.\textsuperscript{69}


\textsuperscript{68} The courts have begun to use the good faith standard to restrict the enforceability of certain standardized terms by reference to these components. See Arnott v. American Oil Co., 609 F.2d 873 (8th Cir. 1979) (good faith as restraint upon franchise termination); Adams v. J.I. Case Co., 185 Ill. App. 2d 388, 261 N.E.2d 1 (1970) (dilatory and negligent repair bars enforcement of exclusive remedy clause); Eckstein v. Cummins, 41 Ohio App. 2d 1, 321 N.E.2d 897 (1974) (bad faith prevents enforcement of merger clause); W.L. May Co. v. Philco-Ford Corp., 273 Or. 701, 543 P.2d 283 (1975) (clause giving franchisor option of repurchasing inventory upon termination held not unconscionable since franchisor must exercise rights in good faith); Schroeder v. Fageol Motors, Inc., 86 Wash. 2d 256, 544 P.2d 20 (1971) (lack of direct notice or constructive notice through course of dealing or usage of trade may bar enforcement of exculpatory clause). \textit{But see} Corensweet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir.) (good faith duty held not applicable to override express termination clauses in distributorship agreement), \textit{cert. denied}, 100 S. Ct. 288 (1979).

\textsuperscript{69} This is the counterpart to Professor Leff's point that once a warranty disclaimer satisfied the specific requirements of UCC § 2-316(2) it should not be subject to defeat under
This enumeration of cognizability characteristics is not exhaustive. No doubt, other commentators who analyze the specific references and illustrations in the UCC will isolate other salient characteristics of the interests protected by the good faith concept. The pressures of concrete disputes will lead the courts to identify still other characteristics that justify protection of nondrafter expectations. Moreover, at this point the author hesitates even to broach the matter of necessary or necessary and sufficient conditions for cognizability.

The absence of an exhaustive list of cognizability criteria and/or statement of necessary or necessary and sufficient conditions for cognizability does not represent a flaw in the analysis. The analysis aims at converting the abstract concept of good faith to a set of specific working rules. Specificity is achieved in three ways. First, the discussion focuses on a particular situation: the use of standardized forms. Second, it proposes a four-prong test which identifies issues that are considerably more concrete than the blanket issue, "what is honesty in fact?" Third, the test distinguishes between the factual and legal issues inherent in the good faith concept. Whereas the first, third, and fourth elements of the test pose questions of fact, the cognizability issue is one for the court. As a matter of policy that is evidenced by the treatment of unconscionability under UCC section 2-302, judicial control over the application and evolution of any general undefined legal constraint is desirable. Finally, any attempt to formulate necessary or necessary and sufficient conditions for cognizability would convert the good faith concept from a general to a specific constraint. This would contravene the drafters' intent as well as the generally recognized need for general constraints in any regulatory system. 70

**Issue 3: Did the Drafting Party Know of the Expectation?**

Exegetical, historical, and theoretical considerations favor the inclusion of a culpability element in the proposed test for bad faith. On the most obvious and intuitive level, the definitional

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references in UCC sections 1-201(19) and 2-103(1)(b) to "honesty" and "fair dealing" unambiguously indicate the significance of the drafting party's moral involvement. As a matter of tradition, pre-Code law extensively used the good faith concept as an implicit or explicit culpability standard. Finally, in our legal system, liability norms frequently include an element that focuses on the claimant's personal responsibility for the injury. Fault-based liability has been justified on moral, deterrence-related, and economic grounds. The differentiation between degrees of culpability also serves as a guideline for the severity of the liability incurred.

Discussion of the fault component of a liability norm generally proceeds in terms of the traditional common law categories. These

71. The culpability function clearly appears in those pre-Code provisions that used good faith as a limitation upon the actual notice requirement. See, e.g., Uniform Negotiable Instruments Act § 56 (withdrawn 1951). It appears that those provisions characterized bad faith as something more than ordinary negligence. See Uniform Sales Act § 76 (2d ed. withdrawn 1951) ("A thing is done 'in good faith' when it is in fact done honestly, whether it be done negligently or not."). Cf. Gutekunst v. Continental Ins. Co., 486 F.2d 194 (2d Cir. 1973) (guilty knowledge or conduct necessary to destroy bona fide purchaser status under UCC §§ 8-301 to -304). Outside purchase transactions, good faith was used widely as a culpability standard in the law governing liability of fiduciaries. See note 31 supra.


74. When liability is imposed without regard to fault, compensation is generally limited. See Restatement (Second) of Torts § 402A (1965) (liability for product defect limited to recovery of property damage and personal injury); id. § 552C (1977) (liability for innocent misrepresentation limited to recovery of warranty differential); U.C.C. §§ 2-714, 2-715(2) (recovery of economic loss in connection with breach of warranty requires showing of knowledge on part of seller).
include willfulness, recklessness, gross negligence, negligence, and *culpa in concreto*, as well as actual and constructive notice. Pre-Code law and the almost universally accepted construction of UCC section 1-201(19) equate bad faith with conduct exceeding ordinary negligence. At the other extreme, at least in the context of purchase transactions, recklessness or intentional disregard of suspicious facts generally suffices for a finding of bad faith. The threshold level of fault properly associated with bad faith lies somewhere between these two extremes. This limits the inquiry, if conducted in terms of traditional degrees of fault, to gross negligence and *culpa in concreto*. The gross negligence concept, however, has fallen into general disrepute with courts, commentators, and legislators. *Culpa in concreto*—a party's omission to exhibit in the management of another's affairs the diligence which the party exhibits in the management of his own affairs—offers an initially attractive standard, especially in light of the drafter's "management" of the nondrafter's affairs. The traditional application of this standard—for example, to the liability of partners *inter se*—rests, however, on the premise that the individual diligence of the claimee party constitutes one of the initiating factors for formation of the relationship in question. In contrast, in the standardized contracting context, the nondrafting party has little or no way to ascertain the business diligence of the drafting party. Nor does the nondrafting party have any choice with whom he nor-


76. See notes 37 & 71 supra.


78. See 2 F. HARPER & F. JAMES, LAW OF TORTS 945 (1956). The most recent erosion of the gross negligence concept has occurred in the legislative and judicial challenges to guest-statutes. See 63 IOWA L. REV. 693 (1978).

79. See F WHARTON, A TREATISE ON THE LAW OF NEGLIGENCE § 54 (2d ed. 1877).

80. The transactions subject to this standard generally involved some element of management of another's affairs. See BGB § 690 (German Civil Code) (imposing *culpa in concreto* standard upon the gratuitous bailee); A. Bromberg, CRANE AND BROMBERG ON PARTNERSHIP 395 (1968) (standard of care for partner not as great as that imposed upon a paid agent, *viz.*, diligence of the ordinary prudent man); F WHARTON, supra note 79, §§ 515-516 (liability of trustees and partners).

81. See F WHARTON, supra note 79, § 55.
mally does business. Moreover, application of the *culpa in concreto* standard would afford the nondrafter no protection when he needs it the most, for example, as against the habitually unscrupulous businessman.

The unsettled state of the culpability doctrine and its relationship to the good faith concept preclude, at least for the present, the formulation of a generally acceptable *minimum* standard of culpability. An appealing alternative is to require a level of culpability which exceeds all the commonly aired minimum standards. The proposed requirement that the drafting party's behavior occur *with knowledge* of the specific interests or expectations satisfies this condition. An actual knowledge requirement goes beyond both the objective (reasonable man) standard implicit in UCC section 2-103(1)(b) and the recklessness and *culpa in concreto* standards applied in purchase transactions. It should satisfy even the most stringently subjective interpretation of "honesty in fact" under UCC section 1-201(19). Moreover, when combined with the legal cognizability requirement, it implies at least one generally accepted intuitive notion of dishonesty: a person is dishonest if, with knowledge of another's justified expectations of him, he nonetheless acts in disregard of those expectations. Proposed only as a sufficient level of fault, the actual notice standard leaves the courts free to determine what lesser forms of culpability (recklessness and *culpa in concreto*) also might support a finding of bad faith.

The actual notice standard counterbalances the emphasis on nondrafter expectations in the first two prongs of the proposed good faith test. Expectations constitute an extremely ephemeral phenomena; they are easy to allege and difficult to disprove. Accordingly, although much of tort and contract law aims at protecting expectations, the protective norms usually impose certain

82. In addition to the expectation-oriented norms, see note 57 *supra*, tort and contract law generally seek to protect basic expectations. For instance, this is true particularly of the contract rules governing formation, adjustment, and remedies. See U.C.C. § 1-106 (gars remedies to expectation interest); *id.* § 2-204 & Comment (intent controls formal rules); *id.* § 2-207, Comments 4 & 5 (prevention of surprise is paramount); *id.* § 2-609(1) & Comment 1 (mechanism to protect performance expectation). In the area of tort law, expectations vie with efficiency as the paramount goal. See generally Hubbard, *Efficiency, Expectation, and Justice: A Jurisprudential Analysis of the Concept of Unreasonably Dangerous Product Defect*, 28 S.C. L. Rev. 587 (1977); Hubbard, *Reasonable Human Expectations: A Normative Model for Imposing Strict Liability for Defective Products*, 29 Mercer L. Rev. 465
side conditions that guarantee a high degree of probability as to the existence of the expectations. For instance, satisfaction of requirements involving "reliance," "materiality," and "basis of the bargain" generally insure that the aggrieved party did indeed harbor a particular expectation.\(^3\) In the present context, however, these side conditions are not appropriate.

Protagonists for the nondrafter will oppose the actual notice requirement on grounds that, like the \textit{scienter} requirement in fraud, it subjects the nondrafter to an impossible burden of proof. Although indeed severe, the evidentiary burden is far from insurmountable. Since "actual notice" refers to a state of mind which defies proof as such, recourse must be had to circumstantial evidence.\(^4\) The law of evidence regarding proof of the \textit{scienter} requirement for fraud accepts as admissible, and virtually dispositive, many types of circumstantial evidence. For instance, highly probative of \textit{scienter} is the defendant's control over property represented as nondefective.\(^5\) In criminal law, evidentiary presumps- (1968).

\(^3\) See Restatement (Second) of Contracts § 90 (Tent. Draft No. 2, 1965), Restatement (Second) of Torts § 548 (1976) (reliance); U.C.C. § 2-207(2)(b); Restatement (Second) of Torts § 538 (1976) (materiality); U.C.C. § 2-313(1) (basis of bargain).

\(^4\) By using the "good faith belief" doctrine, the main problem to solve is how a trier of fact can obtain knowledge of the minds of others, to whose states we have no direct, introspective access. This knowledge can only be obtained from perceptible manifestations in speech, conduct and behavior of a person, or reasonable inferences to be drawn therefrom. This requires a trier of the fact to glean from the testimony and evidence such manifestations in speech, conduct, and behavior of a person that it can know or infer what a person thought in a given situation and whether the person was honest in what the person did. It is foreseeable that an expert opinion may be necessary to assist the trier of the fact.


tions assist in the proof of the equally subjective intent element.\textsuperscript{86} In the context of standardized form contracts, the notice requirement relates to the expectations of the nondrafter. Accordingly, if the drafter’s express oral statements conflict with the subsequently utilized standardized terms, the statements should be accepted as circumstantial evidence that the drafting party had notice of the expectations based upon the representations.\textsuperscript{87} Likewise, if an expectation derives from a particular term of the standardized form, for example, exclusive remedies, the drafter’s own authorship of those terms should be admissible evidence to prove his knowledge of the expectations based thereon.

\textit{Issue 4: Did the Drafting Party Disregard the Nondrafter’s Expectations?}

Implementation of the good faith obligation will fulfill the stated objectives of preventing surprise and enhancing foreseeability only to the extent that it brings expectations in line with reality. In a standardized contracting environment, the convergence of expectation and reality lies within the control of the drafting party. He determines absolutely the relevant reality, the contract terms, and, to a lesser extent through sales talk and advertising, nondrafter expectations. Given this concentration of control, the drafting party alone can prevent that divergence between expectation and contract substance which constitutes surprise. Accordingly, the drafter’s response to nondrafter expectation must necessarily figure in any determination of good/bad faith.\textsuperscript{88}


\textsuperscript{87} In fraud actions, the “intent to induce” element is proved routinely by reference to the content of the maker’s representations, actions, and omissions. \textit{See Scaife Co. v. Rockwell-Standard Corp.}, 446 Pa. 280, ---, 285 A.2d 451, 455 (1971), \textit{cert. denied}, 407 U.S. 920 (1972); note 85 \textit{supra}.

\textsuperscript{88} The many illustrations of good/bad faith in the UCC official comments focus primarily upon the nature of the dominant party’s conduct. \textit{See} notes 45-53 \textit{supra} \& accompany-
The drafter has at his disposal two distinct means to minimize surprise. He can adjust the contract terms to fit the nondrafter's expectations, or he can adjust the nondrafter's expectations to fit the contract terms. The first alternative cannot be implemented on a prospective basis without sacrificing the institution of standardized forms. Standardized forms owe their commercial utility primarily to the very fact that they ignore the unique expectations of the individual nondrafter.89 The fine tuning of contract terms entailed by the first alternative and the abstract, general nature of standardized forms are mutually exclusive. This conflict in no way, however, precludes the use of term adjustment as a remedial device, a matter discussed at length in the next section.

Unwilling to sacrifice the generality of his standardized form, a drafting party can comply with the antisurprise objective of the good faith mandate only by manipulating the nondrafter's expectations. He must bring any apparent nondrafter expectations in line with his standardized terms. The nature of the necessary behavior will depend upon the facts of the case, particularly upon the source of expectations and the content of the divergent standardized term(s).

A number of examples suffice to show the possible range of qualifying behavior. Consider, for instance, the seller who makes extensive representations in oral negotiations or brochures and then employs a standardized form that gives the buyer considerably less and contains a tightly drafted integration clause. Undoubtedly, this combination of circumstances has caused an inordinate amount of surprise.90 To protect himself from liability for bad faith under the proposed test, the drafting party must apprise the nondrafter of the limited warranties and the prospect of total integration, thereby bringing the nondrafter's expectations into line with the contract terms. Depending upon the circumstances, oral notification or a separate signature requirement for the warranty disclaimer and merger clause might suffice as an adequate accommodating text.

89. Schwartz, supra note 11, at 1067-70.
Consider further the seller who through standardized terms limits the buyer to the exclusive remedy of repair and disclaims all liability for consequential damages. Suppose the seller nevertheless fails to repair and the buyer seeks to revoke his acceptance and obtain consequential damages. A prompt offer to refund the purchase price and thus provide the buyer with the monetary equivalent of the expected performance might enable the seller to avoid an eventual allegation of bad faith. Also illustrative is the creditor who, having permitted his debtor to become lax in meeting his monthly installment obligations, suddenly accelerates and repossesses the collateral. To avoid potential liability for bad faith conduct, the creditor, before taking any action, should notify the debtor that further delinquency will not be tolerated. Like the many illustrations of concrete good faith behavior, the accommodation must demonstrate respect for the interests of the subordinate party.

APPLICATION OF THE TEST AND REMEDIES FOR BAD FAITH

While the proposed test serves to identify bad faith conduct in a specific context, it says nothing, either directly or indirectly, about the existence or form of the relief available to the aggrieved party.


94. See note 61 supra. The relevance of good faith to this dispute is discussed in detail in the text accompanying notes 121-39 infra.
Although UCC section 1-203 mandates a general duty of good faith and many Code sections impose it in particular situations, the Code nowhere establishes a specific remedy for bad faith.\footnote{5} Nonetheless UCC section 1-106(2) clearly requires recognition of some remedy for breach of the good faith obligation. Legislatures and courts generally respond to bad faith by disallowing the drafting party the benefit of specific contract clauses or Code provisions.\footnote{5} This disallowance may expose the bad faith party to damage liability.\footnote{7} Apart from recent developments in insurance law and situations involving incidental monetary relief, the courts do not award monetary damages as a remedy for bad faith.\footnote{8}

It is the position of this author that the appropriate remedy for bad faith generally consists of whatever measure will accommodate the expectation of the nondrafter with the least disturbance of the drafting party's position.\footnote{9} Since the relief will vary from case to case, discussion of the proposed test as it applies to concrete disputes also presents a proper context for analysis of the remedies issue.

The following hypotheticals present disputes that have occasioned considerable litigation and academic commentary. Not sur-


\footnote{6} Bad faith under UCC §§ 2-311(1) or 2-308(2) precludes reliance upon a specified term. Bad faith under § 2-706(1) prevents recovery of the statutory measure of damages. Buyer's failure to comply with UCC § 2-508, an application of the good faith mandate, precludes an effective rejection or revocation of acceptance. See Eckstein v. Cummins, 41 Ohio App. 2d 1, 321 N.E.2d 897 (1974) (bad faith prevents reliance upon merger clause).

\footnote{7} Thus, the buyer's failure to act in good faith under UCC § 2-603 will expose him to liability for loss or injury to seller's property. Cf. U.C.C. §§ 9-507(1), 9-504(3) (secured party's liability for failure to comply with provisions regarding default). See also Ford Motor Credit Co. v. Waters, 273 So. 2d 96 (Fla. Dist. Ct. App. 1973) (creditor's bad faith under UCC § 1-208 exposes him to conversion liability for repossession following wrongful acceleration).

\footnote{8} See Larraburu Bros. v. Royal Indemn. Co., 604 F.2d 1208 (9th Cir. 1979) (insurance case). See also Summers, supra note 23, at 252-60 (discussing the need for additional remedies for bad faith and citing Hoffman v. Red Owl Stores, Inc., 26 Wis. 2d 683, 133 N.W.2d 267 (1965) as an instance of damage liability for bad faith conduct in contract formation).

\footnote{9} This reflects one of the key elements in the test for legal cognizability of the frustrated interest or expectation, \textit{viz.}, that it be one that could be accommodated by the dominant party without sacrificing the benefit of his bargain. See text accompanying notes 58-63 supra.
prisingly, discussion of these cases has treated the disputes as unrelated. On the surface, the consequences of "failure of essential purpose" under UCC section 2-719(2) bear little resemblance to application of the parol evidence rule in UCC section 2-202 or to enforcement of a "for any reason insecure" default clause under UCC section 1-208. The common issue in these hypotheticals is the enforcement of standardized terms which, although not inherently unfair, nevertheless frustrate the expectations of the nondrafter. So characterized, the cases invite application of the general statutory constraint of good faith to prevent surprise in the context of standardized form contracting.

Example 1. Good Faith and the Parol Evidence Rule

In precontract communications (advertising and sales talk), the seller touts the quality of his product in such a manner as to induce the buyer to deal with the seller. As a condition of doing business, the seller presents for buyer's execution a standardized form that limits warranties to certain technical specifications and purports to integrate the entire agreement. When the goods prove unacceptable, yet within the technical specifications, the buyer seeks relief.100

Insofar as the dispute involves liability based upon the precontractual representations, its resolution turns upon the requirements and interrelationship of UCC sections 2-313(1), 2-316(1), and 2-202. The seller asserts that the merger clause precludes introduction of precontract representations.101 The buyer argues correctly that, under UCC section 2-202, the integration clause represents only some evidence of integrative intent and does not preclude introduction of precontractual representations as evidence that the parties did not intend the standardized form to be

the final expression of their agreement. If the buyer succeeds on
the integration issue, he can introduce the same representations as
evidence of express warranty under UCC section 2-313(1).

The buyer's case usually fails not for want of a sound legal the-
ory but due to the fact that the nondrafter bears the burden of
proof in respect to both integration vel non under UCC section 2-
202 and "basis of the bargain" under UCC section 2-313(1).103
Both items focus primarily on matters of intent, a notoriously slip-
ppery factual issue generally resolved against the party bearing the
burden of proof. Inasmuch as standardized merger and disclaimer
clauses shift the burden of proof to the nondrafter, the drafter con-
trols, albeit indirectly, the critical issue of intent. The resolution of
the intent element on the basis of nonconsensual standardized
terms, which are not read, intended to be read, or comprehended
by the nondrafter, runs counter to commonly accepted evidentiary
principles.104 Although universally displeased with the result, con-

102. See O'Neil v. International Harvester Co., 40 Colo. App. 369, 575 P.2d 862 (1978);
Drier v. Perfection, Inc., 259 N.W.2d 496 (S.D. 1977). The debate over the integrative effect
of a merger clause appears to have been resolved in favor of Professor Corbin. "[I]t is a
myth to assume that the document can conclusively establish its own completeness." F
KESLER & G. GILMORE, CONTRACTS CASES AND MATERIALS 654 (1970). Compare 4 S. WILLIS-
TON, A TREATISE ON THE LAW OF CONTRACTS § 633 (3d ed. 1961), with 3 A. CORBIN, CON-
TRACTS § 578 (1960). See also Interform Co. v. Mitchell, 575 F.2d 1270 (9th Cir. 1978); Mas-
terson v. Sine, 68 Cal. 2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968); 52 WASH. L. REV. 923

103. Once admitted into evidence, the writing creates a presumption of integration. Re-
statement (Second) of Contracts § 235(3) (Tent. Draft No. 5, 1970). This presumption,
however, is not conclusive. Id. § 240(a), (b); U.C.C. § 2-202, Comment 1(a). See also note
102 supra. The nondrafter bears the burden of overcoming the presumption. Under UCC
§ 2-313(1), the buyer must carry the burden of proving (1) that seller made the requisite
affirmation of fact, see Axion Corp. v. G.D.C. Leasing Corp., 359 Mass. 474, 269 N.E.2d 664
(1971); (2) that it went to the basis of the bargain, Stang v. Hertz Corp., 83 N.M. 217, 490
P.2d 475 (Ct. App. 1971), rev'd on other grounds, 83 N.M. 730, 497 P.2d 732 (1972); and (3)
that the injury resulted from a condition covered by the warranty, Crocker v. Sears, Roe-
buck & Co., 346 So. 2d 921 (Miss. 1977).

104. Specifically, such resolution contradicts the notion that an evidentiary presumption
cannot survive "unless it can at least be said with substantial assurance that the presumed
fact is more likely than not to flow from the proved fact upon which it is made to depend." Leary v.
United States, 395 U.S. 6, 36 (1969) (footnote omitted). Allocation of burden of
proof rests ultimately upon considerations of "policy and fairness based experience in
different situations." 9 J. WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVI-
DENCE IN TRIALS AT COMMON LAW 275 (3d ed. 1940). For instance, "[o]rdinarily a litigant
does not have the burden of establishing facts peculiarly within the knowledge of the oppos-
ing party." Browzin v. Catholic Univ. of America, 527 F.2d 843, 849 (D.C. Cir. 1975).
sumer advocates have proposed no relief for nondrafters short of legislative curtailment of disclaimer and integration clauses.105

The good faith doctrine offers an alternative approach to the problem within the present statutory framework. The seller’s conduct constitutes bad faith under the proposed test: (1) The buyer harbors specific expectations respecting quality. (2) The expectations are legally cognizable in that they were created by the seller and comport with the statutory rights afforded the buyer under the implied warranty of merchantability in UCC section 2-314. (3) A finding that the seller had actual knowledge of the expectation can rest alone upon the fact that he created that expectation.106 (4) The use of the standardized integration clause without explanation or warning shows disregard for the expectations. Conceivable remedies for bad faith include avoidance of the merger clauses, avoidance of the entire contract and, after the manner of UCC section 2-207(3), relegation of the parties to their Code rights, reallocation of the burden of proof, and damages (nominal, compensatory, and punitive).

Award of damages must overcome both theoretical problems and historical animus. Except for some recent insurance cases, no authority exists for awarding damages for bad faith conduct.107 The traditional constraints of certainty and causation108 make difficult the computation of compensatory damages. Whereas nominal damages will not provide sufficient relief, an award of punitive damages faces the specific constraint in UCC section 1-106(1)109 that such

106. See notes 84-87 supra & accompanying text.
108. Restatement of Contracts §§ 330, 331 (1932). See also Summers, note 23 supra, at 253-55 (advocating recognition of special cases in which the aggrieved party should recover consequential damages for bad faith even though the injury was not otherwise compensable under traditional contract rules governing damage liability).
109. See also Restatement of Contracts § 342 (1932) (“Punitive damages are not recoverable for breach of contract.”). Cf. Restatement (Second) of Contracts § 369 (Tent. Draft No. 14, 1979) (“Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.”); Waters v. Trenckmann, 503 P.2d 1187 (Wyo. 1972) (award of punitive damages re-
GOOD FAITH AND STANDARDIZED TERMS

33

damages may be awarded only if authorized by the Code or by other rule of law.

Avoidance of the contract or objectionable terms, the most commonly utilized remedy for bad faith,\textsuperscript{110} requires reconciliation with the sanctity of contract axiom, which precludes avoidance unless specifically authorized by statute or common law. Except for grounds concerning fraud and public policy, the UCC exhaustively regulates—under specific constraints such as sections 2-316(2) and 2-209(2), as well as through more general constraints such as sections 2-302 and 1-102(2)—the conditions under which a court may declare a clause or contract unenforceable.\textsuperscript{111} Furthermore, because good faith is a general constraint its application to avoid a contract or terms thereof would duplicate the function of unconscionability under section 2-302, but without the additional safeguards imposed by that provision.

This argument ignores the distinction between inherently unfair terms and the illegitimate use of otherwise fair terms.\textsuperscript{112} In the hypothetical, the disputed terms are not inherently unfair; indeed, they enjoy express statutory approval.\textsuperscript{113} The buyer objects, rather, to their particular use in his transaction. Such abuse is not cognizable under UCC section 2-302 which, properly construed, aims at control of inherently unfair terms,\textsuperscript{114} viz., ones that unduly distort the balance immanent in the statutory regulation of the contract for sale.\textsuperscript{115} When the abusiveness of the term depends upon the

\textsuperscript{110} See note 96 supra.

\textsuperscript{111} The special regulation of warranty disclaimer would preclude application of UCC § 2-302 to such contract provisions. See Leff, supra note 9, at 522-25. The most frequently litigated version of this question is whether, in franchise termination cases, the special rule in UCC § 2-309(2) precludes application of UCC § 1-203. Compare Arnott v. American Oil Co., 609 F.2d 873 (8th Cir. 1979), with Corenswe, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir.), cert. denied, 100 S. Ct. 288 (1979).

\textsuperscript{112} See text accompanying note 10 supra.

\textsuperscript{113} See U.C.C. § 2-316 (limited warranties), id. § 2-209(2) (certain type of merger clauses).

\textsuperscript{114} See text accompanying note 10 supra.

\textsuperscript{115} This standard is implicit in the usual expositions of substantive unconscionability in which "one party is deprived of all the benefits of the agreement or left without a remedy for another party's nonperformance or breach." Bank of Indiana v. Holyfield, 476 F Supp. 104, 110 (S.D. Miss. 1979) (citation omitted) (lease of dairy cows held unconscionable by reference to this standard). See Ashland Oil, Inc. v. Donahue, 223 S.E.2d 433 (W. Va. 1976)
particular circumstances surrounding its use, there is no need for a hearing, like that contemplated under UCC section 2-302(2), to explore the general commercial background. Code sections 1-203 and 2-311(1), by their reference to enforcement and validity, fairly imply that remedies for bad faith shall include avoidance of the particular term. Moreover, numerous illustrations of good faith and bad faith in the official comments indicate the propriety of denying enforceability or implying terms as a remedy for bad faith.\textsuperscript{116}

Reallocation of the evidentiary burden represents a potentially effective alternative to damages and avoidance as a remedy for bad faith. In the instant case, the traditional allocation of burden of proof, in respect to integration \textit{vel non} and "basis of the bargain," frequently prevents the nondrafter from enforcing liability under the otherwise favorable substantive law.\textsuperscript{117} A shift in evidentiary burden to the drafter undoubtedly would enhance the probability of a probuyer result. This remedy does not entail, as does avoidance, any overt tampering with the contract terms or, as does damages, any modification of traditional remedial principles. Moreover, under the law of evidence, the allocation of evidentiary burdens follows primarily from considerations of fairness, relative access to evidence,\textsuperscript{118} and, more recently, due process principles. As discussed above, the equities clearly lie with the nondrafter. Moreover, the drafting party's unquestioned control over the contracting process places him in a superior position to insure documentation and compliance with the intent requirements of UCC sections 2-202 and 2-313(1). Finally, due process militates against recognition of presumptions—for example, that merger clauses are conclusive evidence of integration—that have no basis in fact.\textsuperscript{119} Reallocation of the burden of proof prevents the drafter

\textsuperscript{116.} See U.C.C. § 2-209, Comment 2 (good faith as prerequisite for enforceable modifications); id. § 2-305(2) & Comment 3 (good faith as prerequisite for enforceability of unilaterally specified price term); id. § 2-309, Comment 5 (good faith requiring notice); id. § 2-313, Comment 6 (good faith mandates fair drawing of a sample from existing bulk); id. § 2-609, Comment 6 (good faith as constraint upon enforceability of certain cancellation clauses).

\textsuperscript{117.} See notes 102-04 \textit{supra} & accompanying text.

\textsuperscript{118.} See note 104 \textit{supra}.

\textsuperscript{119.} Due process protection extends to any contract with the state or one involving "state
from bootstrapping himself around the intent requirement of the applicable legal norms by reference to standardized terms that run counter to specific nondrafter intent created by the behavior of the drafting party.

**Example 2: Conflict Between Standardized Terms and Factual Contract Referents**

Debtor signs a standardized security agreement which entitles the creditor to payments within the first ten days of the month. The contract also provides that time is of the essence and that the creditor can declare default for breach of any specific obligation imposed by the agreement or upon feeling insecure for any reason. Although the debtor performs erratically (late payments, skipped payments, or double payments), the creditor accepts all payments without objection. When the debtor is one payment in arrears and two days late on the current payment, the creditor exercises, without notice to the debtor, his contractual and statutory default rights. Debtor resists the resulting claim for deficiency and counterclaims for conversion damages.

Liability for either deficiency or conversion depends ultimately upon whether the debtor's conduct constituted default.

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120. "Factual contract referents" refer to trade usage, course of dealing, course of performance, or other party behavior that serves, in addition to the parties' agreement and law itself, as a source for contract terms. See U.C.C. §§ 1-201(3), 1-205, 2-204(1), 2-207(3), 2-208.

121. For recent cases involving this fact pattern, see note 61 supra; Universal C.I.T. Credit Corp. v. Shepler, 164 Ind. App. 516, 329 N.E.2d 620 (1975); Fontaine v. Industrial Nat'l Bank, 111 R.I. 6, 298 A.2d 521 (1973).

122. In the absence of default, the creditor may not proceed under UCC §§ 9-501 to -507, and his seizure of the collateral is an unauthorized disposition for purposes of conversion. See Restatement (Second) of Torts § 222A (1966).
creditor justifies the declaration of default by reference to the debtor's failure to meet his monthly installment obligation as construed in light of the "time is of the essence" clause and/or the "for any reason insecure" clause. To avoid deficiency liability and succeed with the conversion claim, the debtor must refute both allegations. The debtor relies primarily upon the doctrine of good faith to avoid the "for any reason insecure" argument under UCC section 1-208 and upon the doctrine of waiver as found in the parties' course of performance to avoid the impact of the "time is of the essence" clause.

Although debtors enjoy success under the facts of the hypothetical, their case is not without theoretical and practical difficulties. The good faith challenge under UCC section 1-208 may fail both for want of a satisfactory definition of bad faith and the statutory allocation of the burden of proof. So long as bad faith remains vaguely defined solely in terms of some state of mind on the part of the creditor, it eludes proof by the debtor. Creditors can resist the waiver challenge on the grounds that the course of performance rules only apply to Article 2 disputes and that, even if they

123. The debtor prevailed in the four cases cited in notes 61 and 121 supra. The vast preponderance of cases under UCC § 1-208 are decided in favor of the creditor. The author, however, was unable to find a single procreditor decision that involved the type of lax collection practices presented by the hypothetical.


are applicable, a prodebtor result would violate UCC section 2-208(2) in that course of performance would control an express term.

The proposed test for good faith somewhat alleviates the debtor's difficulties under UCC section 1-208. The test applies because the dispute involves the enforcement of standardized terms. Moreover, the "for any reason insecure" clause invites unilateral jural determination in its purest form. As applied to the secured party's act in enforcing the clause, the test states the good faith issue in a manner amenable to proof by the aggrieved party. The debtor undoubtedly harbored an expectation that his conduct would not result in default. The creditor's role in creating that expectation suffices to take the knowledge issue to the jury. The creditor omitted to undertake that step which would have respected the expectation without sacrificing the creditor's benefit of the bargain, viz., warning the debtor that continued laxity would result in acceleration and repossession.

The remaining element of the test, the legal cognizability of the expectation, is not so obviously satisfied. As discussed above, factors involved in determining legal cognizability include (1) source of the expectation, (2) ease of accommodation, and (3) absence of specific regulation by the contract, statute, or other rules of law. Here, the fact that the creditor created and could have accommodated easily the expectation without any sacrifice of his bargain militates in favor of legal cognizability. On the other hand, insofar as the expectation rests upon a course of performance, recognition may violate specific UCC regulation. Specifically, it would make course of performance relevant to Article 1 problems in the absence of specific recognition in UCC section 1-205. Even if course of performance did apply to Article 1 disputes, perhaps by reference to the definition of agreement in section 1-201(1), a prodebtor result based on good faith may contravene UCC section 2-208(2) by giving precedence to course of performance over express contract language to the contrary. Such a result also may cir-

126. See text accompanying notes 58-69 supra.
127. See note 125 supra.
128. See Corenswe, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir.) (holding in a distributorship termination suit that "good faith obligation can[not] properly be used to override or strike express contract terms"), cert. denied, 100 S. Ct. 288 (1979).
cumvent the requirements for waiver under UCC sections 2-208(3) and 2-209(4). Although superficially attractive, these arguments cannot withstand closer scrutiny.

The proposed good faith test does not contravene or distort, either in its prerequisites or results, the statutory regulation of course of performance. As a general proposition, a single precept seldom exhausts the legal significance of a particular real world event.129 Even if the course of performance rules in UCC sections 2-208 and 2-209 apply only to Article 2,180 the parties' nonverbal conduct is nonetheless significant for other legal precepts such as good faith. The official comments, as well as the case law anent the general contract principles preserved under UCC section 1-103, underscore the relevance of nonverbal conduct outside Article 2.131 Indeed, the reference to "performance" in UCC section 1-203 alone should defeat the creditor's challenge to the cognizability of an expectation based upon the parties' performance. Finally, when viewed in terms of Code structure and philosophy, the regulation of course of performance in Article 2 represents one implementation of the general good faith mandate in UCC section 1-203132 and, as such, provides inferential support for basing legal cognizability upon party performance.

UCC section 2-208(2) does not preclude a finding of bad faith

129. Thus a buyer's conduct in taking possession of goods can be relevant under UCC §§ 2-206 (acceptance of offer) and 2-606 (acceptance of goods).

In an action under 15 U.S.C. § 78j(b) (1976) and 17 C.F.R. § 240.10b-5 (1979), the nature of the misrepresented or omitted fact is relevant to the elements of causation, materiality, and reliance. See generally Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976).

130. The reference to "course of performance" in UCC § 1-201(3) is specifically limited by the phrase, "as provided in this Act." Hence, the Article 9 definitional cross-references to "agreement" do not incorporate UCC § 2-208(1). See note 125 supra.


132. Although the official comment to UCC § 1-203 mentions only trade usage and course of dealing as implementations of that section, the same reasoning justifies a similar interpretation of UCC § 2-208. See U.C.C. §§ 1-205, Comments 1 & 2; 2-208, Comment 1.
even though such a finding would weight the parties' conduct more heavily than the language of their agreement. On the one hand, the rule probably does not apply to disputes outside of Article 2.\textsuperscript{133} Moreover, the rules in section 2-208 act not as independent constraints upon application of the good faith mandate but as specific examples of the good faith obligation.\textsuperscript{134} Accordingly, application of the rule in section 2-208(2) must always accord with the basic purposes of section 1-203. For instance, as stated in the official comments, UCC section 2-208(2) must yield whenever its application would result in surprise,\textsuperscript{135} the prevention of which represents the principal objective of the good faith obligation. The rule in section 2-208(2) orders various contract referents according to their relative indicativeness of mutual intent. Arguably its reference to "express language" should not include standardized terms because such terms have no bearing whatsoever upon the actual intent of one of the parties.\textsuperscript{136}

Nor does the proposed test for good faith duplicate the doctrine of waiver. The elements of waiver differ markedly from those proposed to determine bad faith. Waiver requires a (1) voluntary relinquishment of a (2) known right and, (3) in some jurisdictions or contexts, an additional validating cause such as consideration, a writing, or promissory estoppel.\textsuperscript{137} In contrast, the proposed test

\textsuperscript{133} See note 130 supra.
\textsuperscript{134} See note 132 supra & accompanying text.
\textsuperscript{135} See U.C.C. § 2-208, Comment 3.
for good faith requires (1) the use of standardized terms, (2) legally cognizable expectations on the part of the nondrafter, and (3) knowledge and disregard thereof by the drafting party. Whereas the waiver doctrine regulates the relinquishment of undisputed rights, the good faith doctrine as implemented in the proposed test regulates the protection of certain expectations in a specific context. Application of the waiver doctrine results in a single “remedy,” viz., nonenforcement of the waived right; the remedies for bad faith may include, in addition to nonenforcement of a term, damages or reallocation of evidentiary burdens. It is immaterial that the application of the good faith test to the immediate transaction may lead to the same result as the waiver doctrine. Identical liability allocations frequently follow applications of different legal norms. 138

In summary, neither the waiver doctrine nor rules governing course of performance preclude legal cognizability of the debtor’s expectations in the above example. In fact, viewed as an implementation of section 1-203, UCC section 2-208 strongly favors such a move. The facts of the hypothetical present other factors normally favoring legal cognizability and satisfy the remaining elements of the bad faith test. Under UCC section 1-208, a finding of bad faith will prevent the creditor from establishing default by reference to the “for any reason insecure” clause. As applied to the creditor’s attempt to enforce the “time is of the essence” clause, the proposed test would support a finding of bad faith so as to preclude default based upon the tardiness of the debtor’s payments. The same result would follow under the traditional waiver rules preserved under UCC section 1-103. 139

Example 3: Revival of Code Remedies When Exclusive Contract Remedy Fails of its Essential Purpose

P.2d 589, rev’d, 92 Wash. 2d 30, 593 P.2d 167 (1978) (course of performance as waiver). On necessity of support for a waiver, see generally 3A A. CORBIN, CONTRACTS § 753 (1960); Sussett Co. v. First Fed. Sav. & Loan Ass’n, 304 Minn. 433, 232 N.W.2d 88 (1975) (consideration required for lien waiver); McLellan v. Hamernick, 264 Minn. 345, 118 N.W.2d 791 (1962) (promissory estoppel renders lien waiver binding); U.C.C. § 1-107 (writing required).

138. For instance, as applied to personal injuries resulting from defective goods, Restatement (Second) of Torts § 402A (1965) and UCC §§ 2-314(1), 2-714(1), and 2-715(2)(b) can result in identical liability.

139. See 3A A. CORBIN, CONTRACTS § 754 (1960).
Seller's standardized form disclaims all implied warranties, specifies a minimum technical performance level, confines the buyer's remedy for malfunction to repair or replacement of defective parts, and excludes monetary damages for both tort and contract liability. The equipment, a word processor, covered by the contract becomes inoperative. After dilatory and unsuccessful repair efforts, seller refuses to have anything further to do with the buyer or the machine. Buyer hires a third party who restores the equipment to proper working order and maintains it at the specified level of performance. Buyer sues the seller for the cost of this service contract as well as lost profits and the expenses incurred for additional clerical help during the down time prior to repair by the third party.\footnote{140}

The result in the hypothetical dispute turns upon the interrelationship between the standardized exculpatory clause and the UCC remedial provisions, particularly sections 2-714, 2-715, and 2-719. The contract's exclusive remedy undoubtedly failed of its essential purpose to provide the buyer with equipment maintained in proper working order at the seller's expense. Accordingly, the buyer may have "remedies . . . as provided in this Act." Under UCC section 2-714, the buyer may recover breach of warranty damages\footnote{141} measured by the cost of the alternate service contract.\footnote{142}


141. See S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978); Soo Line R.R. v. Fruehauf Corp., 547 F.2d 1365 (8th Cir. 1977) (recovery of warranty damages permitted after failure of exclusive remedy despite exculpatory clause). Not wishing to retain the equipment, the buyer could have exercised his right to revoke acceptance and to recover the purchase price under UCC §§ 2-608 and 2-711(1). See Polycon Indus., Inc. v. Hercules, Inc., 471 F Supp. 1316 (B.D. Wis. 1979); Murray v. Holiday Rambler, 83 Wis. 2d 406, 265 N.W.2d 513 (1978).

Seller will oppose the claim for lost profits and clerical expenses as one seeking consequential damages, the recovery of which depends not only upon UCC section 2-715 but also upon section 2-719(3), which permits contractual exclusion of such damages as long as not unconscionable. The issue, one that has split the courts and troubled the commentators, is whether a failure of essential purpose under section 2-719(2) revives not only the basic remedies, such as revocation of acceptance, return of the price, or breach of warranty damages, but also the right to consequential damages in the face of an exculpatory clause. Some courts conclude, with reasoning reminiscent of the English doctrine of "fundamental breach," that the seller's conduct constitutes a repudiation of the contract and therewith also his rights under the exculpatory clause. Other courts hold that the exculpatory

143. See notes 140-41 supra.
144. See Eddy, supra note 92, and J. White & R. Summers, supra note 9, at 469.

The UCC is ambiguous with respect to the effect that a failure of a limited remedy under § 28-2-719(2) has on other contractual provisions. § 28-2-719(2) provides that if a remedy fails of its essential purpose "remedy may be had as provided in this act." The official comment states that if a remedy fails of its purpose, "it must give way to the general remedy provisions of this article [chapter]." I.C. § 28-2-719, Official Comment 1. The remedy provisions of that chapter not only provide for the recovery of consequential damages, I.C. §§ 28-714(3) and -715(2), but also for their exclusion where not unconscionable. Id. at 800.


(1) Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.

(2) Where on a breach the contract is nevertheless affirmed by a party entitled to treat it as repudiated, this does not of itself exclude the requirement of reasonableness in relation to any contract term.

See also 41 Mod. L. Rev. 312 (1978).


This Court would be in an untenable position if it allowed the defendant to shelter itself behind one segment of the warranty when it has allegedly repudiated and ignored its very limited obligations under another segment of the same warranty, which alleged repudiation has caused the very need for relief which the defendant is attempting to avoid.

Id. at 43-44. See notes 140-41 supra.
clause represents an intentional allocation of liability for the event of breach and must be enforced in the absence of unconscionability.\textsuperscript{148}

As applied to standardized contracts, neither approach is satisfactory. The first requires identification of the fundamental duties under the contract. Even in the context of negotiated contracts, this is a question-begging process.\textsuperscript{149} To the extent that the terms "fundamental" and "core" are understood as synonymous with "negotiated" or "dickered,"\textsuperscript{150} they have little or no meaning in the context of standardized contracts.\textsuperscript{151} The second solution purports to give effect to the parties' own chosen liability allocation. As a standardized term, however, an exculpatory clause represents only a unilaterally imposed allocation of liability. Although the courts cite the presence of negotiation as one of several factors mitigating against revival of the right to consequential damages,\textsuperscript{152} the precise role of standardized forms in the revival of remedies issue is unresolved. The doctrine of good faith as articulated in the proposed test provides the answer.

Seller's conduct easily satisfies all but the cognizability element of the proposed test for bad faith. The buyer expected that the equipment would be kept in working order at the expense of the seller. Having drafted the clause that created this expectation, the seller had knowledge thereof. The seller's refusal to effect repairs evidences disregard of the buyer's interests. Application of the cognizability element, however, meets with the argument that the


\textsuperscript{149} See G. FRIDMAN, supra note 146, at 287, 299.

\textsuperscript{150} See generally K. LLEWELLYN, THE COMMON LAW TRADITION 362-71 (1960); Lefèv, Contract as Thing, 19 AM. U.L. REV. 131 (1970); Llewellyn, Book Review, 52 HARV. L. REV. 700 (1939). Although the UCC text does not distinguish between dickered and standardized terms, the official comments frequently make the distinction. See U.C.C. § 2-205, Comment 4; id. § 2-207, Comment 1; id. § 2-313, Comment 1; id. § 2-316, Comment 1; id. § 2-504, Comment 5; id. § 2-508, Comment 2; id. § 2-615, Comment 8. See also RESTATEMENT (SECOND) OF CONTRACTS §§ 229(d), 237(3) (Tent. Draft No. 5, 1970).

\textsuperscript{151} See Dugan, An Introduction, supra note 6, at 1320.

\textsuperscript{152} See note 148 supra. Other factors supporting nonrevival include the seller's good faith attempt to effectuate the exclusive remedy and the complexity of the equipment. For an attempt to reconcile the holdings by reference to these factors, see Eddy, supra note 92, at 73-84, who considers the significance of standardized terms only in connection with his discussion of procedural unconscionability. Id. at 42-43.
buyer's expectation corresponds to the performance promised by the seller in the contract. In order that good faith not supersede more specific rules, legal cognizability should not be accorded to interests specifically regulated either by the Code or the contract. 153

Further analysis reveals that the good faith obligation protects an interest entirely distinct from that regulated by the terms of the contract. Under the agreement the seller owes the buyer a duty to maintain operation of the equipment. This duty exists whether the parties explicitly negotiated the relevant clauses or whether the drafter imposed them unilaterally as standardized terms. When, however, the relevant clauses appear as standardized terms, UCC section 1-203, as construed in this paper, imposes upon the drafter the additional obligation to exercise the utmost regard for the interests of the nondrafter in the performance and enforcement of those clauses. This additional duty is the price that the dominant party pays for the privilege of unilaterally determining the content of the legal relationship. Thus, even in the absence of bilateral input into contract formation, the contract functions in the mutual interests of the parties.

As applied in the hypothetical, the good faith obligation fills a regulatory gap created by the use of standardized terms. A negotiated exculpatory clause represents an intentional trade-off by the buyer of his right to consequential damages in the event of seller’s breach for some other advantage under the contract. Accordingly, under a negotiated contract the seller may choose between performing the exclusive remedy or breaching it and either returning the purchase price or paying breach of warranty damages under UCC section 2-719(2): Having bargained for the trade-off, the buyer cannot complain of surprise if the seller chooses the second alternative. Conversely, the standardized contract neither meaningfully apprises the buyer of the restriction upon his right to consequential damages nor insures that he received a *quid pro quo* for the limitation. In order to protect the buyer from surprise and to infuse a minimum balance into the relationship, some additional constraint must be imposed upon the seller's freedom to choose between performance and nonperformance. The good faith obliga-

153. See notes 69, 126-28 supra & accompanying text.
tion provides the necessary measure. If the seller's nonperformance of the exclusive remedy constitutes bad faith, he incurs not only the basic liability revived by section 2-719(2), but also whatever sanctions are imposed for bad faith conduct. Because this application of the good faith duty complements the contractual regulation of the seller's performance obligation, it supports granting legal recognition to the buyer's expectations.

There remains only the question of proper remedy for the seller's bad faith in the nonperformance of the exclusive remedy. Possible sanctions include (1) conditioning enforcement upon proof that the buyer received some *quid pro quo* for relinquishing his right to consequential damages, (2) partial nonenforcement of the exculpatory clause by permitting recovery of out-of-pocket losses but not lost profits, and (3) complete avoidance of the exculpatory clause by allowing recovery of all qualifying consequential damages. As a general rule, the sanction should be one that will accommodate the buyer's interest with the minimum sacrifice to the seller's position under the contract.

Because the imposition of the good faith obligation is premised on a presumed absence of negotiation in a standardized contract, the seller should be able to enforce the exculpatory clause if he can rebut this presumption of no bargaining. For example, the seller can rebut the presumption by showing that he offered the buyer at a higher price an alternative standardized contract containing no restriction upon the recovery of consequential damages.

The second proposed sanction, recovery of out-of-pocket loss, imposes upon the seller a burden both more and less severe than the first remedy. It is more severe than the consequences of rebutting the presumption (no liability for consequential damages) but, insofar as it limits damages to out-of-pocket loss, less severe than the consequences of failing to rebut the presumption (liability for


155. See note 99 supra & accompanying text.
all consequential damages including lost profits). The second remedy also represents a rough monetary equivalent of the good faith duty breached by the seller, at least in those cases where seller's compliance with the good faith obligation would have enabled the buyer to avoid the additional clerical expense. For instance, suppose that the seller notified the buyer of his intention to discontinue service, arranged for alternative service, and performed until the alternative service contract took effect. Under these circumstances, the seller could not be accused of bad faith because he acted with regard to the buyer's interest; nor would the buyer have suffered the disruption which called for additional clerical help.

The third alternative sanction, complete suspension of the exculpatory clause, is more difficult to support without permitting the seller to rebut the presumption that the buyer received no *quid pro quo* for relinquishing his right to consequential damages. Such a result implicitly would contravene UCC section 2-719(3), which predicates nonenforceability of exculpatory clauses solely upon a finding of unconscionability. The first two sanctions, which entail limitations less drastic than complete nonenforceability, do not present the same conflict with section 2-719(3). Additionally, suspension of the exculpatory clause would disregard a standardized term, thereby violating the postulate that standardized forms provide the most appropriate starting point for resolution of disputes. Furthermore, a seller's good faith conduct will prevent out-of-pocket losses but it will not necessarily prevent the loss of profits. For instance, under the circumstances described above, seller's cooperation would have eliminated the need for clerical help but would not have reduced the amount of down time, a design property of complicated equipment.

156. For a case which limits damage relief to recovery of out-of-pocket loss, see Polycon Indus., Inc. v. Hercules, Inc., 471 F Supp. 1316 (E.D. Wis. 1979).

157. Eddy, *supra* note 92, at 85-86, favors revival of consequential damages in the case where seller refuses to perform the exclusive remedy. He relies, however, primarily upon equitable principles and makes no Code-related argument. Later, he states that revival of consequential damages should be keyed to the unconscionability element in UCC § 2-719(3). *Id.* at 89-91. He suggests, without supporting analysis, that the distinction between "willful behavior and simple inability to perform" may be relevant to the unconscionability issue. *Id.* at 91.

158. See notes 21-22 *supra* & accompanying text.
The proposed application of good faith to the problem of remedy revival is limited to the situation in which the seller could have effectuated the necessary repair but chose not to do so. Quite different analysis would be required when, for instance, the equipment could not be placed in working order by any party. This situation would affect the content of the good faith obligation, bring into operation other legal doctrines such as those governing impossibility and frustration of purpose, and require an evaluation of the exculpatory clause in light of this additional factor.\(^{159}\)

**Conclusion**

The proposed test converts "good faith" from a largely precatory abstract to a set of specific working rules capable of shedding light on common legal disputes. The standard inherent in the test requires that the user of standardized forms exercise the utmost regard for the interests of the nondrafter. This standard follows primarily from the UCC text and official comments which consistently use good faith as a constraint upon unilateral jural determination to protect the interests and expectations of the subordinate party.

As applied to the use of standardized terms, the proposed standard furthers the classical contract objective: the contract institution serves the interests of both parties to the transaction. Drafted for use in an indefinite number of similar transactions, the standardized form, in the absence of such a constraint, cannot accommodate the special expectations of the individual nondrafter.

The proposed test duly respects the positions of the various parties involved in the standardized form contracting process. The first element of the test, existence *vel non* of nondrafter expectations, focuses upon the unique interests of the nondrafter, which otherwise necessarily are ignored by the standardized form. The legal cognizability requirement, the second element, establishes judicial control over application of the standard and invites the court to consider the needs of commerce as well as the integrity of the

\(^{159}\) See Eddy, *supra* note 92, at 68-72, 86-88. Although the courts distinguish between inability to perform and unwillingness to perform, see note 154 *supra*, they have not yet formulated a coherent analysis to deal with the distinction in either UCC or traditional contract terminology. *See, e.g.*, RESTATEMENT OF CONTRACTS §§ 454-69 (1932) (impossibility).
legal system. The third element, the requirement that the drafting party have notice of the nondrafter's expectations, keeps the drafting party's burden within manageable bounds and offsets the first element's subjective emphasis upon nondrafter expectations. The final element tests whether the objective of the good faith mandate, accommodation of the nondrafter's interests, has been achieved.

The proposed good faith standard imports into contract law a large measure of private paternalism in that it forces one party to watch out for the interests of another. In the context of standardized form contracting, it completely abrogates the traditional at-arms-length axiom and its corollaries. This development comports with the traditional law governing trust and agency relationships which, as do standardized forms, entitle one party to fix the jural position of another. As applied to standardized form contracts, behavior mandated by the standard represents the price that the drafting party pays for the privilege of dictating the terms of the transaction.

The standard embodies the conviction that, unless checked by offsetting responsibilities, public or private concentrations of power are incompatible with maintenance of a liberal democratic order. Compared with the burdens imposed by recent remedial legislation aimed at protecting the nondrafter class, the responsibilities entailed by the proposed good faith standard lie within the capabilities of all users of standardized forms and redound to the benefit of all nondrafters.