

Inequality of Bargaining Power and the Doctrine of Unconscionability: Towards Substantive Fairness in Commercial Contracts

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Abstract: The issues on unconscionability and inequality of bargaining power are common legal dictums, which are constantly and continuously discussed in consumer contracts. However, the predicaments caused by unconscionability and inequalities of bargaining power in commercial contracts are often left side ways despite the alarm, which had been set on by the contractual parties in commercial contracts. Terms on earnest payment, performance bond, pre-determined damages, standard exemption and limitation terms in commercial contracts are examples of practices which arise from the unconscionability and inequality of bargaining power of the contractual parties. This paper looks into the *raison de-etre* and legal discussion on the principles of unconscionability and inequality of bargaining power under the law of contract law and to highlight its application and effect in commercial contracts. References of the discussion are mainly made to the common law principles with occasional reference to the Australian law and Malaysian law. Research methodologies applied in this research are doctrinal and statutory analysis.

Key words: Inequality of bargaining power, commercial contracts, unfair contracts, unfair contractual terms.

INTRODUCTION

'Classical' contract law, which denotes the law of contract as developed during the nineteenth century and the first part of the twentieth century, has as its cornerstone the notion of 'freedom of contract' which emphasizes on parties' autonomy and founded upon the centrality of the individual, the creed in the creative power of his will and consequently a restricted role of intervention for the state and the court. As such, within the classical law of contract, the relative bargaining strength of the contracting parties is not a question for any inquiry by the courts of law, as any superiority in bargaining power is itself a matter for the market to rectify (Atiyah, P.S., 1979).

However, the modern view might not be as straightforward and it can be argued that the tendency to move from 'freedom of contract' to a notion of 'contractual justice' is beginning to shape the re-formulation of several areas of contract law, even if admittedly in baby steps.

Materials and Discussion:

The Doctrine of Inequality of Bargaining Power:

On the issue of inequality of bargaining power (in modern time), perhaps a good starting point is Lord Reid's speech in *Suisse Atlantique Société d' Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 36, remarking on the court's concern with exemption clauses in standard form contracts:

"Exemption clauses differ greatly in many respects. Probably the most objectionable are found in the complex standard conditions, which are now so common. In the ordinary way the customer has no time to read them, and if he did read them, he would probably not understand them. And if he did understand or object to any of them, he would generally be told he could take it or leave it. And if he then went to another supplier the result would be the same. Freedom to contract must surely imply some choice or room for bargaining.

At the other extreme is the case where parties are bargaining on terms of equality and a stringent exemption clause is accepted for a quid pro quo or other good reason."

It has been said that Lord Reid's remarks foreshadowed three major doctrinal developments in this area (Grubb, A., 1999). The first development was the accentuation of the burgeoning divergence in the law between the rules applicable to consumer contracts and those applicable to commercial contracts. For the modern law of contract therefore, the transactional world is to be viewed as class-divided, with consumer contracts on the one hand, and commercial contracts on the other.

The second application of the idea of relative bargaining strength can be seen in the statutory regimes that regulate the validity of exclusion clauses nowadays, for example in the U.K.'s Unfair Contract Terms Act 1977

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(UCTA). Where the validity of a controlled exemption clause is at issue, the statutory guidelines in Schedule 2 of the UCTA make the relative bargaining strength of the parties a relevant factor to be considered by the courts. Although in principle Schedule 2 applies to exemption clauses in both consumer contracts as well as commercial contracts (provided the exemption clauses in commercial contracts are contained in a standard form contract or what is sometimes termed as “contracts of adhesion”, as provided under section 3 of the UCTA), and thus the relative bargaining strength between the commercial parties to a contract is a factor to be considered if the issue of validity of the exemption clause were to be raised in court, this has caused some clear “tensions” on the part of the English courts. Lord Wilberforce in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 had decided that parties in commercial matters generally are free to apportion the risks as they think fit (and where risks are normally borne by insurance), and took this view as the intention of the Parliament behind the regime of the UCTA and therefore the courts are to respect the decisions of the commercial parties as to the apportionment of risks. However in contrast, the House of Lords in *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 seemed to regard as appropriate a case-by-case approach where although it might generally be true that commercial parties to a contract deal on a roughly equal footing, the point of the statutory guidance in the UCTA is to check the bargaining position in each particular case. Indeed support can be found in the evolving jurisprudence of the “reasonableness test” under the UCTA, where if parties are presented with a ‘take it or leave it’ conditions of dealing, even in purely commercial disputes, then the inequality of bargaining strength is likely to be a factor which would weigh against the validity of the conditions (Grubb, A., 1999).

The third doctrinal development, albeit a still controversial one, is the more general recognition of the significance of inequality of bargaining power, which stretches beyond consumer contracts and beyond exemption clauses. The turning point can be said to be the judgment of the House of Lords in the case of *Schroeder Music Publishing Co Ltd v Macaulay* [1974] 1 WLR 1308 which is a case involving a contractual term in restraint of trade contained in a standard form contract between a music publishing house and a young songwriter, where Lord Reid himself said that whilst there might be good reason for respecting contracts ‘made freely by parties bargaining on equal terms’ or ‘moulded under the pressure of negotiation’, there was no evidence in the instant case that the contract fitted such description. In pursuing this theme, Lord Diplock (in the same case) drew a distinction between those standard forms that have been negotiated for use in a particular trade by parties ‘whose bargaining power is fairly matched’ and those standard form that have been negotiated in a one-sided way where ‘they have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others providing similar goods and services, enables him to say: ‘if you want these goods or services at all, these are the only terms on which they are obtainable. Take it or leave it.’’ The force of this distinction is that where contracts are the outcome of negotiations that are not manifestly one-sided, there is a presumption in favour of treating the terms as fair and reasonable, but where on the other hand contracts are dictated in a one-sided way, there will be no such presumption.

This was taken further by Lord Denning in his famous judgment (which is the subject of much controversy in the continuing debate in this area) in the case of *Lloyds Bank Ltd v Bundy* [1975] QB 326, where his Lordship attempted to deduce an underlying general concept of inequality of bargaining power in cases relating to ‘unconscionable bargains’ as well as cases of duress and undue influence. Although the majority in the Court of Appeal decided on the basis of undue influence, Lord Denning however took a different line as his main ground (and undue influence only as his alternative ground). The case involves a guarantee and charge over property by a father in favour of the bank in order to secure his son’s overdraft. Lord Denning began his analysis by saying that in the vast majority of cases involving bank guarantee or charge, even if the terms of the transaction are harsh, the general rule is that the transaction stands, as ‘no bargain will be upset which is the result of the ordinary interplay of forces’. However there are exceptions to this rule ‘in which the courts will set aside a contract, or a transfer of property, where the parties have not met on equal terms- when the one is so strong in bargaining power and the other so weak- that as a matter of common fairness, *it is not right that the strong should be allowed to push the weak to the wall*’ (emphasis ours). Lord Denning formulated this principle on the basis of five categories of case, namely (1) Duress of goods (which can now be understood as ‘economic duress’); (2) Unconscionable transactions (the principle in the old case of *Fry v Lane* (1888) 40 Ch. D. 312 as had been developed into a general principle of ‘unconscientiously taking advantage of a party at a special disadvantage’); (3) Undue Influence, both actual and presumed; (4) Undue pressure (which can actually be better categorized as part of undue influence); and (5) Salvage agreements, in cases of ‘distress at sea’.

It has been said that the principle as formulated by Lord Denning (i.e. the underlying principle of inequality of bargaining power) can indeed be a useful tool in analyzing the said vitiating factors (and therefore advance the development of those vitiating factors in a more coherent way by taking into account their similar underlying basis), however the choice of ‘inequality of bargaining power’ as the catchword for the principle is rather unfortunate, as it can suggest that the courts will give relief simply on the basis of the unequal position of the parties per se, rather than on an *abuse* of that position, when in fact it is clear from Lord Denning’s own statement of principle that he did not intend mere inequality to give rise to a remedy: he said that there needs to

be an unfairness in the bargain and an impairment of bargaining power of the weaker party, 'coupled with undue influences or pressures brought to bear on him' (Cartwright, J., 1991). Perhaps it is on such basis (of the formulation of the principle being liable to said *suggestion*), and the judgment of Lord Denning being subsequently widely used by contracting parties who agreed to terms under pressure and who subsequently regretted such agreement to plead the general exception of inequality of bargaining power (Grubb, A., 1999), that the idea of the underlying principle of inequality of bargaining power as a wider notion to regulate unfair terms in the bargain was strongly disapproved subsequently by Lord Scarman in two of his judgments. The first judgment was handed down by Lord Scarman in the Privy Council case of *Pao On v Lau Yiu Long* [1980] AC 614, where the idea that English law should adopt a general rule that a contract could be void for public policy on the basis of unfair use of a dominant bargaining position (as argued by the defendant) was rejected by His Lordship in no uncertain terms:

"Their Lordships' conclusion is that where businessmen are negotiating at arm's length it is unnecessary for the achievement of justice, and unhelpful in the development of the law, to invoke such a rule of public policy. It would also create unacceptable anomaly..."

It is unnecessary because justice requires that men, who have negotiated at arm's length, be held to their bargains unless it can be shown that their contract was vitiated by fraud, mistake or duress...

Such a rule of public policy as is now being considered would be unhelpful because it would render the law uncertain. It would become a question of fact and degree to determine in each case whether there had been, short of duress, an unfair use of a strong bargaining position."

Lord Scarman's second judgment was handed down in the case of *National Westminster Bank plc v Morgan* [1985] AC 686, where the case was decided on the basis of undue influence, where the case sought to emphasize that undue influence requires the victimization of one party by the other; the presumption of influence being raised by a manifestly disadvantageous transaction entered into with a person in a position to dominate the other. Consequently Lord Scarman said that undue influence has been sufficiently developed not to need the support of the principle stated by Lord Denning, and that it is inappropriate to use such language as 'inequality of bargaining power' which His Lordship doubted is a useful term in the law of contract, drawing attention to certain instances where Parliament had already intervened via legislations in order to protect such inequalities, which His Lordship also maintained is essentially a legislative task. His Lordship cited the hire-purchase and consumer protection legislations such as the Supply of Goods (Implied Terms) Act 1973, Consumer Credit Act 1974, Consumer Safety Act 1978, Supply of Goods and Services Act 1982, and Insurance Companies Act 1982 in support of his view.

It has been convincingly argued that such legislations as cited by Lord Scarman fail to tackle two significant cases of bargaining inequality. Firstly, it was argued that if we have good reason to protect consumers in their dealings with business contractors, then we have equally good reason to protect small business contractors in their dealings with larger, more powerful commercial contractors (Grubb, A., 1999), and that one of the common oversimplifications of the debate on modern contract law is to equate the need to protect the consumer with inequality of bargaining power (Furmston, M., 1996). For example, where there is a systematic inequality of bargaining strength where small business contractors are locked-in to, and reliant upon, the patronage of a major manufacturer who will be in the position to dictate terms to all the parties, both consumers and commercial parties, that trade in its economic network. Furthermore, business contractors might on an occasional basis be vulnerable too, a precedent can be seen in the case of *L'Estrange v Graucob Ltd* [1934] 2 KB 394 where an unskilled business contractor was caught out by the small print employed by a standard form dealer. Although to some extent small business contractors are protected under the UCTA, and even allowing for occasional judicial attempts to expand the scope of the UCTA, the legislative as well as common law protection of small business in the UK is limited (Grubb, A., 1999). The second argument propounded, interestingly, that Lord Scarman's remarks are only directed at the problem of inequality of bargaining power at the time of the formation of the contract which does not take into account that in situations where there is a gap between the time of formation and the time of performance, the balance of bargaining power might alter and the initial inequality might be reversed, as evident in cases which had highlighted that pressure to renegotiate in commercial contracts can take place at the point of performance in a setting of extreme inequality of bargaining power, as seen in *B&S Contracts and Design Ltd v Victor Green Publications Ltd* [1984] ICR 419, *Atlas Express Ltd v Kafco (Importers and Distributors) Ltd* [1989] QB 833 and *Vantage Navigation Corp'n v Suhail and Saud Bahwan Building Materials Inc, The Alev* [1989] 1 Lloyd's Rep 138 (Grubb, A., 1999). Furthermore, the case of *D&C Builders v Rees Ltd* [1966] 2 QB 617 illustrates a situation where the party applying the pressure can, at worst, engineer the change of circumstances in order to demand renegotiation at precisely the time that the other party is most vulnerable. Although Lord Scarman had indicated in the case of *Pao On* (above) that in those situations the doctrine of economic duress might be of application, it is to be noted at this juncture that another challenge for the law in this area is for the conceptual uncertainty in the relationship between this principle with other relieving doctrines such as economic duress and undue influence, and perhaps also the doctrine of unconscionability (as understood in the English jurisdiction) needs to be clarified (which

will be discussed, to some extent, below). It has also been argued that Lord Scarman was viewing the principle stated by Lord Denning as involving the vitiation of contracts simply by virtue of the inequality of position of the parties or simply because of a bargain which is unfair to one party, however, the key element is actually the *link* between the unequal position of the parties and the bargain i.e. the *abuse* of that position of inequality is required (the argument is actually linked to the issue of the related 'doctrine of unconscionability' which will be discussed next) (Cartwright, J., 1991).

It has been said that in England a consensus developed among judges during the 1960s, formed at a time when the legislature was relatively active in the matter of private law, that major developments in contract law, even in areas hitherto the preserve of the common law, should be achieved by legislation. This meant that a broad principle of inequality of bargaining power and unconscionability were less likely to be imported judicially (Beatson, J. and Friedman, D., 1995). However, this attitude of the English courts could perhaps be best understood by the long-held jurisprudence of the classical contract theory which distinguishes between fairness in the process of forming a contract (procedural fairness) with fairness in the outcome or terms of the contract (substantive fairness), whereby only the former is of any concern to the courts but not the latter (again, this is the notion of 'freedom of contract' being at play). This explains the traditional and well-entrenched concern of the courts giving rise to long-standing rules on fraud, misrepresentation, coercion, undue influence and mistake as vitiating factors when the *bargaining* process, rather than the *bargain* (the outcome) is tainted with issues of unfairness.

However, it has been argued that the distinction between procedural and substantive fairness is often more theoretical than practical, or in other words this distinction can be rather artificial since both procedural and substantive fairness often impact on, as well as interact with each other (Atiyah, P.S., 1986) In any event, where there is a risk that the traditional procedural rules (governing the said vitiating factors) are too narrow, the courts should turn their attention to the substantive outcome of a contract and include this in their assessment of whether or not the contract is valid. Arguing in that vein, it has been suggested that judges might be expected to care about substantive fairness because of a concern for unconscionable contracts, the idea behind it being that it is wrong to take advantage of another's weakness, a notion which is known under English law as the 'doctrine of unconscionability' (but which we would see in the proceeding discussion, is not much different than the principle formulated by Lord Denning in *Lloyd's Bank v Bundy* (above), albeit having been formulated in a narrower sense than that of Lord Denning's) (Atiyah, P.S. and Smith, S.A., 2005). Our discussion will now turn to the English 'doctrine of unconscionability'.

The Doctrine of Unconscionability:

Unconscionability does not have a fixed meaning in law, but in contractual context it is generally used to describe situations in which it is believed that, although no duress or fraud took place, one contracting party took advantage of the other party's weakness by extracting an unfair bargain. The test for unconscionability is thus partly procedural and partly substantive (i.e. it looks at procedural unfairness as well as substantive unfairness). This is because under this doctrine there are two elements that must be proven. The first element is that the party seeking relief was vulnerable in some respect (or otherwise known as 'suffering from special disability') which is a procedural test usually thought to be satisfied by proof of cognitive impairment (e.g. suffering from a reduced ability to understand) or that she had little real choice but to enter into a contract (because she was in 'a state of necessity' or, what arguably amounts to the same thing, because the other party had a monopoly over an important good or service), and the second element is that the other party *takes advantage* of the weaker party's vulnerability or 'special disability', which is a substantive test, i.e. proof that the contract was substantively unfair (Atiyah, P.S. and Smith, S.A., 2005).

However, it is important to note at this juncture that the English court's general acceptance of this broader doctrine is still shrouded in uncertainty, stemming from the fact that while the English courts have rarely been willing to apply such a doctrine outside a limited class of cases, they have also been unwilling to renounce it entirely; a recurring question also being whether unconscionability is a coherent, as well as a morally attractive notion (i.e. the question of "whether it is legitimate for a court to set aside a contract merely because it is unconscionable" is essentially a moral question), either as a general defence or as applied to specific situations (Atiyah, P.S. and Smith, S.A., 2005; Smith, S.A., 2004; Phang, A., 1998).

The jurisdiction over 'unconscionable' contracts has its basis in equity and in order to understand this complex doctrine better we need to see its historical development. It began with the jurisdiction of Equity Courts to set aside unconscionable contracts made by heirs and expectants, of what is usually termed as 'catching bargains', where expectant heir who was just of age made an improvident bargain with respect to the inheritance yet to be received (*Earl of Aylesford v Morris* (1873) 8 Ch. App 484). This doctrine was later extended to bargains made by 'poor or ignorant person' acting without independent advice which cannot be shown to be a fair or reasonable transaction (*Fry v Lane* (1888) 40 Ch. D 312), and the understanding of 'poor and ignorant person' in *Fry v Lane* has been clarified for purposes of the 20th century in the case of *Creswell v*

Potter [1978] 1 WLR 255 where the word 'poor' is now replaced by 'a member of the lower income group' and the word 'ignorant' is now replaced by 'less highly educated'.

The development of *Fry v Lane* can be seen in the principle referred to as 'unconscientiously taking advantage of a party at a special disadvantage' (or the principle on 'unconscientious dealings' or 'unconscientious bargains'), which is in essence the doctrine of unconscionability as applied narrowly by the English courts (Cope, M., 1985). This principle shows a shift in emphasis whereby it is not so much that there must be poverty and ignorance (or their 20th century equivalence), but that there must be inequality between the parties (which arises out of such factors as the poverty and ignorance). Furthermore, for a contract entered into by such persons to be vitiated as an unconscientious or unconscionable bargain, there must be 'victimisation', 'which can consist of either of the active extortion of a benefit or the passive acceptance of a benefit in unconscionable circumstances' (according to the Privy Council in *Hart v Connor* [1985] AC 1000), in other words the court requires more than just an unfair bargain or unfair terms (the substantive unfairness) but more importantly, the *taking advantage* of the other's weakness is also required (Cartwright, J., 1991).

Therefore, as stated above while discussing Lord Denning's principle from *Lloyd's Bank v Bundy*, the key element is the *link* between the unequal position of the parties (the unequal position being due to the 'special disability' of the weaker party, such as being poor or ignorant, and arguably can be extended to other factors giving rise to a 'special disability') and the *abuse* of that position. However, more importantly for our discussion on substantive fairness, is the question of whether the *abuse* of the position of inequality must be specifically proven, *or the fact that the terms of the contract are unfair in itself goes towards proving there was an abuse of position?* It is our position that arguably the true answer should be the latter, and we take lead from the statement of Lord Brightman in *Hart v Connor* (above), which explains succinctly the interplay between procedural unfairness and substantive unfairness:

*"If a contract is stigmatized as 'unfair', it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this 'procedural unfairness'. It may also, in some contexts, be described (accurately or inaccurately) as 'unfair' by reason of the fact that the terms of the contract are more favourable to one party than to the other. In order to distinguish this 'unfairness' from procedural unfairness, it will be convenient to call it 'contractual imbalance'. The two concepts may overlap. Contractual imbalance may be so extreme as to raise a **presumption** of procedural unfairness, such as undue influence or some other form of victimization. Equity will relieve a party from a contract which he has been induced to make as a result of victimization. Equity will not relieve a party from a contract on the ground only that there is contractual imbalance not amounting to unconscionable dealing."* (emphasis ours)

What this means to us as a matter of analysis, is that when the terms of the contract shows a "contractual imbalance" (which is "so extreme" in the words of Lord Brightman above), a *presumption of unconscionable conduct* is then raised against the party in superior position, and the burden of proof is then shifted to that stronger party *to prove that there was in fact no unconscionable conduct* or conduct that goes against conscience in securing the term(s) of the contract that has now been proven to be unfair.

However, it is important to note that it is not any mere "contractual imbalance" that can give rise to such a presumption under English law. In English law a high degree of transactional or contractual imbalance must be shown, where 'the complainant must show that the terms of the transaction were "harsh or oppressive" or "overreaching and oppressive"' (Enonchong, N., 2006). This can be seen from the words of Millet LJ in the Court of Appeal case of *Credit Lyonnais Bank Nederland NV v Burch* [1997] 1 All ER 144, where Millet LJ was of the view that the transaction was not merely manifestly disadvantageous to the defendant, but was also one that '*shocks the conscience of the court*'.

It is also imperative to note at this juncture that Lord Millet's judgment in this case also concerns the possible role that a broader application of the doctrine of unconscionability can play, where the learned judge referred to two other leading cases in this area, namely the case of *Multiservice Bookbinding Ltd v Marden* [1979] Ch 84 and to his own judgment in *Alec Lobb (Garages) Ltd v Total Oil (Great Britain) Ltd*. [1983] 1 WLR 87, and proceeded to observe as follows:

"In such a context the two equitable jurisdictions (to set aside harsh and unconscionable bargains and to set aside transactions obtained by undue influence) have many similarities. In either case it is necessary to show that the conscience of the party who seeks to uphold the transaction was affected by notice, actual or constructive, or by the impropriety by which it was obtained by the intermediary, and in either case the court may in a proper case infer the presence of impropriety from the terms of the transaction itself."(emphasis ours)

This judicial pronouncement by Lord Millet can be powerful, for purposes of us arguing in favour of substantive fairness, in three ways (pursuant to the emphasized parts as above), namely:

(1) As the doctrine of unconscionability by its nature *looks at the conduct of the stronger party*, there must be some impropriety on the part of the stronger party, and as the issue of how much moral wrongdoing must be demonstrated by the stronger party's conduct is one of the recurring questions surrounding this doctrine

(Enonchong, N., 2006), the least that must be shown is that the stronger party knew of the disadvantage of the weaker party, and the test is one of constructive knowledge and not of actual knowledge. To put it another way, the impropriety consists in making (or accepting) a substantively unfair offer *in the knowledge* that one is thereby taking advantage of the other party's weakness or vulnerability which means that unconscionability requires proof that the claimant's actions were such as to 'affect his conscience' as put by the court in *Multiservice Bookbinding Ltd v Marden* (above) (Atiyah, P.S. and Smith, S.A., 2005).

(2) As there are many similarities between unconscionability and the leading doctrine of undue influence under English law (which are concerned more with procedural fairness), perhaps the two principles can be merged and one can be subsumed under the other (where arguably undue influence can be subsumed under the doctrine of unconscionability, unconscionability being a broader notion), which has been argued by some contract scholars (see the further discussions on this below)

(3) Most importantly, Lord Millet clearly propounded that the court may in a proper case *infer* the presence of impropriety *from the terms of the transaction itself*, which demonstrates a broader understanding of unconscionability as a wider principle of utility in dealing with unfair contracts and unfair contractual terms.

In *Alec Lobb* (above) Lord Millet had identified three necessary elements before the court would relieve an unconscientious bargain namely:

- (1) One party must have been at a serious disadvantage to the other party;
- (2) This weakness must be exploited by the other party in a morally culpable manner; and
- (3) The resulting transaction must be overreaching and oppressive.

On the other hand, in the case of *Boustany v Pigott* (1993) 63 P & CR 298, the Privy Council referred to *Multiservice Bookbinding* and *Alec Lobb* (above), and also considered New Zealand and Australian authorities, and proceeded to set out four requirements for the doctrine to operate, namely:

- (1) The objectionable terms had been imposed in a morally reprehensible manner (in the language of *Multiservice Bookbinding* above);
- (2) The stronger party behaved with some moral culpability or impropriety, with the presence of unconscientious and extortionate abuse of power (in the language of *Alec Lobb* above);
- (3) Equity will not provide relief merely for "unfair" terms in the absence of 'unconscionable conduct' (in the language of *Hart v O'Connor* above); and
- (4) The Plaintiff has to establish that unconscientious advantage had been taken of his disabling condition (in the language of the High Court of Australia in *Commercial Bank of Australia v Amadio* below).

Having said all that however, it remains a fact under English law that the broader doctrine of unconscionability has not traditionally been recognized as a *general* defence to a claim for breach of contract, and this traditional position remains the law today for United Kingdom. With rare exceptions, the notion of unconscionability is discussed explicitly in English decisions only as part of the background for the applications of a small number of narrowly defined defences (Smith, S.A., 2004; Phang, A., 1998). However, other common law regimes have been more receptive to introducing a general and explicit defence of unconscionability such as in Canada and the United States (Smith, S.A., 2004), and most notably in Australia.

The Development of Unconscionability in the Australian Jurisdiction:

In Australia, the doctrine of unconscionability has developed into a much wider doctrine as compared to English cases, which led Glover to conclude that 'unconscientious dealing' is the doctrinal paradigm in Australia whereas undue influence is the paradigm in the United Kingdom (Glover, J., 2004). The High Court of Australia has several times reasserted the continued existence of a wide jurisdiction over unconscionable contracts in recent years, while also stressing the need to be hesitant in the exercise of this jurisdiction (Atiyah, P.S. and Smith, S.A., 2005) (see for example the case of *Blomley v Ryan* (1956) 99 CLR 362, *Stern v McArthur* (1988) 165 CLR 489 and *Louth v Diprose* (1992) 175 CLR 621).

The leading case on this area in Australia is of course the oft-cited High Court of Australia case of *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, where Deane J. distinguishes between undue influence that looks to the *quality of the consent of the weaker party*, with unconscionable dealing which 'looks to the *conduct of the stronger party* in attempting to enforce, or retain the benefit of a dealing with a person under a special disability in circumstances where it is not consistent with equity and good conscience that he should do so'. The following statement made by Mason J. goes on to show the broader and relatively well-developed approach to unconscionability as an *independent ground for relief* in the Australian context:

"Relief on the ground of unconscionable conduct will be granted when unconscientious advantage is taken of an innocent party whose will is overcome so that it is not independent and voluntary, just as it will be granted when such advantage is taken of an innocent party, who though not deprived of an independent and voluntary will, is unable to make a worthwhile judgment as to what is his best interest."

This was further refined in the following terms by Deane J. in the same case:

"The jurisdiction is long established as extending generally to circumstances in which (i) a party to a transaction was under a special disability in dealing with the other party with the consequence that there was

an absence of any reasonable degree of equality between them and (ii) that disability was sufficiently evident to the stronger party to make it prima facie unfair or “unconscientious” that he procure, or accept, the weaker party’s assent to the impugned transaction in the circumstances in which he procured or accepted it. Where such circumstances are shown to have existed, an onus is cast upon the stronger party to show that the transaction was fair, just and reasonable...”

The elements of unconscionable dealing, as an independent ground of equitable relief in Australia, as extracted from the case law, are as follows (Vout, P., 2006):

- (1) The party seeking relief must, at the time of entering into the transaction, suffer from a ‘special disability’ via-a-vis the other party;
- (2) The ‘special disability’ must seriously affect the disabled party’s capacity to judge or protect his own interests;
- (3) The other party must know of the special disability;
- (4) That party must take advantage of the opportunity presented by the disability; and
- (5) The taking of advantage must have been unconscientious.

Furthermore, in *Amadio*’s case above, the possibility is raised that the ground of relief might be *more liberal* in two respects than the five elements referred to above would suggest, namely:

- (1) The third element (knowledge of the special disability) might more accurately be regarded as being not only knowledge of the special disability, but, in the alternative, knowledge of ‘facts, which would raise that possibility in the mind of any reasonable person’ (an objective test rather than a subjective test).
- (2) The fifth element (unconscientiousness) might be established by proof of the first to fourth elements, rather than constitute an element to be proved independently (i.e. the fifth element is the natural consequence of the other four elements being present).

Once the five elements are established, a presumption of unconscionable dealing arises. It may be rebutted by proof either that steps were taken which negate the special disability or the unconscientious taking of advantage (e.g. the receipt of independent advice), or that the transaction was otherwise fair, just and reasonable (Vout, P., 2006). As can be seen, unconscionability in Australia, although based on the English doctrine, has been developed along clearer and more lucid terms.

A significant aspect of unconscionability or unconscionable dealings in Australia, which illustrates its broader application than the English counterpart is on its development of the concept of ‘special disability’. According to Australian case law, as can be seen in the case of *Bloomley v Ryan* and *Amadio* (above), it has been made explicit that there are no limits to the categories of matters which may constitute a “special disability”. It can be understood as a fluid concept, as any specification of special disabilities sufficient for the purpose of unconscionable dealing does no more than catalogue applications of general principle, as stated by Mason J. in *Amadio*:

“[N]o more than particular exemplifications of an underlying general principle which may be invoked whenever one party by reason of some condition of circumstance is placed at a special disadvantage vis-à-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created.”

Dean J. in that case expressed a similar view when he said that the “*adverse circumstances which may constitute a special disability for the purpose of the principles relating to relief against unconscionable dealing may take a wide variety of forms*”. A special disability is also assessed by reference to the comparative ability of the parties to safeguard their respective interests, in Dean J.’s words, “*a special disability in dealing with the other party with the consequence that there was an absence of any reasonable degree of equality between them.*” However, mere inequality of bargaining power *per se* without more is not sufficient to constitute ‘special disability’, as the inequality must be substantial, and judged by reference to a ‘norm’ for the general public as a whole (Vout, P., 2006). However, stating the concept as such gives a window for the concept of ‘special disability’ to continuously develop according to the needs of society, and in the context of commercial contracts, it is interesting to note that according to Australian Consumer Law (ACL), (which also deals with some aspect of B2B contracts, since according to ACL “From 1 January 2011, every Australian business will have the same rights and responsibilities under the Australian Consumer Law”), “unconscionable conduct” denotes knowingly exploiting the ‘special disadvantage’ (or disability) of another, and this term *includes* “*small businesses*” (Australian Consumer Law, available at http://www.consumerlaw.gov.au/content/Content.aspx?doc=fact_sheets/business.htm., accessed on 9 November 2012).

An important aspect that has propelled the development of the law on unconscionable dealings in Australia is due to the dual-protection regime, whereby protection is given not only via the common law (judge-made law) doctrine of unconscionability in equity (as discussed above) but also via statutory and legislative protection. “Unconscionable Conduct” is a specific area of protection dealt with under Australia’s trade practice law, which is now contained in the Competition and Consumer Act 2010 (CCA) (whereby it was previously governed by the Trade Practices Act (TPA) before the merger is made for both consumer and commercial contracts in Australia to be governed by the CCA 2010). It is also dealt with under the Contracts Review Act

1980 (NSW). Therefore in Australia, unconscionability is a ground of relief both in equity (known as “unconscionable dealing”) and under statute (known as “unconscionable conduct” under the TPA/CCA and “unjust contracts” under the Contracts Review Act (NSW)) (Vout, P., 2006).

The Malaysian Position:

It cannot be said in the Malaysian context that there has been a clear and unambiguous endorsement and acceptance of the broader doctrine of unconscionability (Phang, A., 1998), save perhaps for the case of *Saad Marwi v Chan Hwan Hua & Anor* [2001] 3 CLJ 98, CA, however, as will be discussed shortly, the case of *Saad Marwi* has been subjected to differing judicial views.

In an earlier case of *Fui Lian Credit & Leasing Sdn Bhd v Kim Leong Timber Sdn Bhd* [1991] 1 CLJ 522, Datuk Cheong Siew Fai J *seemed* to recognize the doctrine of unconscionability, where the court in citing the English cases of *Multiservice Bookbinding Ltd v Marden* and *Hart v O'Connor* (above) stated that:

“In order that a party may free himself from complying with an agreement he had entered into, he must show that, in the eyes of the court, it was unreasonable. A bargain cannot be unfair and unconscionable unless it is shown that one of the parties to it has imposed an objectionable term in a morally reprehensible manner, that is to say, in a way which affects his conscience or has procured the bargain by some unfair means.”

Unfortunately however, having said that, the learned judge did not really elaborate upon the status and implications, in particular of *Hart v O'Connor*, at least in so far as the decision generally militates against a broader development of unconscionability (as discussed above), such as has been developed in the Australian case of *Amadio* (above) as an independent ground for relief (Phang, A., 1998).

Furthermore, Lord Denning’s principle of inequality of bargaining power (which in most English textbooks are dealt with under the topic of ‘unconscionability’) has also not been accepted by the courts on the ground of lack of any established precedent (Fong, C.M., 2009), for example as can be seen in the judgment of Visu Sinnadurai J. in *Polygram Records Sdn Bhd v The Search* [1994] 3 MLJ 127.

In the case of *Saad Marwi*, Gopal Sri Ram JCA opened his decision by saying *“This is an important case. It has to do with whether our jurisprudence recognizes a doctrine of inequality of bargaining power independent of the well-established doctrine of undue influence. This is the first time, at least as far as I am aware, that this issue has come up for decision at the appellate level”*, and proceeded in his judgment to specifically recognise the doctrine of unconscionability and at the same time referred to the doctrine of inequality of bargaining power, whereby his Lordship made a rather landmark statement that *“the time has arrived when we should recognize the wider doctrine of inequality of bargaining power...What is therefore called for is a fairly flexible approach aimed at doing justice according to the particular facts of a case...That brings me to the third alternative. This is to adopt the English doctrine [of unconscionability] but apply it in a broad and liberal way as in Canada”*. Unfortunately, His Lordship’s suggestion has not generally been taken up by the courts subsequently. In fact, the continuous tension between proponents of fair contracts with the opposing interest for certainty in the law, and the proper balance to be struck between the two (Fong, C.M., 2005), resulted in another Court of Appeal decision whereby Abdul Hamid Mohamad JCA in the case of *American International Assurance Co Ltd v Koh Yen Bee (f)* [2002] 4 MLJ 301, chose not to follow Gopal Sri Ram’s JCA’s views in *Saad Marwi* on the applicability of unconscionability (stating, *inter alia*, that the specific provision of section 14 of our Contracts Act 1950 only recognizes coercion, undue influence, fraud, misrepresentation and mistake as factors that affect free consent), but chose to distinguish the two cases on the facts instead. In light of the two arguably conflicting decisions of the Court of Appeal, the matter needs to be clarified further by our apex court. However, it has been argued that *American International Assurance Co Ltd v Koh Yen Bee (f)* has not totally rejected the decision in *Saad Marwi*, as the Court’s effort to distinguish the facts of the two cases shows the Court’s awareness that certain fact situations may well require justice to be dispensed with which the doctrine of unconscionability might be able to supply (Fong, C.M., 2005), in such particular circumstance when other vitiating factors under our Contracts Act 1950 might not avail.

However, it is important to note that subsequent to *Saad Marwi*, the court continues to raise concern on the introduction of unconscionability premised substantially on the ground of section 16 of our Contracts Act 1950 (on undue influence). This has been most notably expressed by Ian Chin J in *Yewpam Sdn Bhd v Mohd Salleh b Sheikh Ahmad & Another Suit* [2001] 1 LNS 43, whereby His Lordship’s more important pronouncements can be summarised as, *inter alia*, (i) the Contracts Act already contains s. 16 on undue influence which has much similarity with unconscionability, and thus the latter can be developed within s. 16; (ii) including the test of ‘inequality of bargaining power’ would effectively be adding a new section to the Contracts Act; and (iii) the statutory form of law in the Contracts Act is different from the common law which is still developing.

Observation:

A New Approach to Unconscionability?

A possible way to overcome our courts’ aversion to using unconscionability as an independent ground for relief, particularly in light of the other vitiating factors as clearly stipulated under our Contracts Act 1950, would

be to reformulate the law in these areas and to merge the principles under one broad doctrine. In fact, it has been suggested by several scholars, most notably Andrew Phang (in the context of Malaysian and Singaporean law), that undue influence and economic duress, together with unconscionability, should be subsumed under one broad heading of “unconscionable conduct”, an argument which centers around the similarities and linkages amongst these doctrines (Phang, A., 1995; 1997). However, in order to achieve this, perhaps further refinement of the doctrine of unconscionability may be necessary, in order to see more clearly should there be any substantial and doctrinal differences in the doctrine of unconscionability with the doctrine of undue influence and economic duress, in order to see how all three can be better developed into one congruent notion.

Cheong May Fong is of the view, on the other hand, that despite the similar broad overall aims of both doctrines of undue influence and unconscionability which are equitable in origin to prevent fraud, an analysis of both doctrines shows that the elements required for each doctrine are peculiar to the different concern and focus of each doctrine. In other words the two doctrines are quite distinct and that the doctrine of unconscionability merits a separate development (Fong, C.M., 2006). With respect, although Phang’s suggestion is more radical, however it presents a more comprehensive doctrinal analysis that looks into the underlying similarities and linkages between the doctrines, and would ensure the whole law in the area of unfair contracts develop in a more coherent manner, where if they continue to develop incongruently from each other, there are bound to be too many overlap that would render these principles, at least from a doctrinal point of view, highly problematic.

The Unconscionability Doctrine in the Area of Performance Bond in Construction Contracts:

Looking at the applicability of the principle of unconscionability in a pure commercial setting, an interesting point can be gleaned from the position in our neighbouring Singapore, in the area of ‘performance bond’ in construction contracts. In Singapore, the right to payment under a performance bond is subject to there being no evidence of fraud or unconscionability on the part of the beneficiary of the bond, as held in the case of *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604, CA. This principle can also be traced to the case of *Bocotra Construction Pte Ltd v AG (No. 2)* [1995] 2 SLR 733, CA. In the case of *Unitrack*, a call is characterized as unconscionable where there is a drastic revision of the contract sum downwards, the sub-contracted works taken out and the contractor does not have the benefit of similar performance bonds from the sub-contractors to support his performance bond to the extent as originally contemplated. It has been found that as a result of the reduction of the contract sum, the contractor’s commitment will be considerably reduced. Although the owner is only entitled to a performance bond of an amount equal to 10 per cent of the contract sum, the owner by calling on the performance bond for the amount he did would in effect be seeking to obtain a sum which represented about 30 per cent of the revised contract sum. This has been considered to be an unconscionable conduct.

In *Newtech Engineering Construction Pte Ltd v BKB Engineering Construction Pte Ltd & Ors* [2003] SGHC 141, it was held that a main contractor who had sought to call on the bond in order apparently to ameliorate his own cash flow problems is also considered to have acted unconscionably. In *Royal Design Studios v Chang Development Pte Ltd* [1990] SLR 1116, unconscionability was held to apply where the beneficiary’s call on the bond was based on delays in construction that were caused by the beneficiary’s own default in failing to make timely payments on the interim certificates issued by the architect and a considerable sum due to the account party under the joint venture agreement being retained by the beneficiary. Lastly, in *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Ltd* [2002] 1 SLR 1, the court found that the call was made by the contractor ‘as a bargaining chip’ to compel a sub-contractor to agree to their terms. Such a call was described as ‘an abusive call’ with the court finding that the contractor had acted unconscionably and an injunction was granted restraining him from doing so. It was also held that ‘although every instance of unconscionability would include some element of unfairness, not every example of unfairness can be regarded as ‘unconscionable’.

In Malaysia, similar position has been taken by our High Courts in the case of *Tildamarine Engineering Sdn Bhd v Kerajaan Malaysia (Jabatan Kerja Raya Malaysia Cawangan Terengganu)* [2011] 2 MLJ 400 and *Nam Fatt Corp. Bhd & Anor* [2011] 7 MLJ 305. However, there are uncertainties in the Malaysian jurisprudence, arising from conflicting High Court decisions, on the relevance of unconscionability as an exception to the right under a performance bond, besides the well-entrenched fraud exception. As such, it is extremely heartening to receive a clear judicial pronouncement by our apex court, the Federal Court, recently in February 2012, in the case of *Sumatec Engineering and Construction Sdn. Bhd. v Malaysian Refining Co Sdn Bhd* [2012] 4 MLJ 1. The Federal Court was undoubtedly swayed by counsel’s arguments in referring to the Singaporean position and to the cases of *Bocotra*, *Newtech*, *Unitrack* and *Samwoh* (above). Abdul Hamid Embong FCJ concluded that:

“It would seem from the modern authorities we have read, that in the case of on demand letters of guarantee or performance bonds the courts are now more willing to look beyond the fraud exception and consider unconscionability as a separate and independent ground to allow for a restraining order on the beneficiary.”

The rationale for embracing this equitable exception can be seen from this passage of the Australian High Court decision of *Stern v McArthur* (1988) 165 CLR 489, where it was said:

The general underlying notion is that which has long been identified as underlying much of equity's traditional jurisdiction to grant relief against unconscientious conduct, namely, that a person should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself..."

It is also interesting to note that the learned Federal Court judge had also made reference to "unconscionable conduct" in the Australian legislation, in the following terms:

"In Australia unconscionable conduct is prohibited by her Trade Practices Act 1974 with the introduction of the new Pt IV A in 1992, in both commercial dealings (ss 51AA and 51AC) and in consumer transactions (s 51AB). The Victorian Court of Appeal in *Olex Focas Pty Ltd v Skodaexport Co Ltd* (1998) 3 VR 380 (a case involving the autonomy of standby letter of credit) observed that the effect of this Act 'is to work a substantial inroad into well established common law autonomy of letters of credit and performance bonds and other guarantees'. The Victorian Court of Appeal however affirmed the Supreme Court decision of *Batt J* at first instance to disallow an injunction on the ground of unconscionability under s 51AA opining that the calling of a performance bond in order 'to exert commercial pressure on the account party to achieve an advantageous settlement of a dispute is not itself unconscionable'."

In *Sumatec's* case, at the Court of Appeal level, the court also made reference to the principle laid down by Lord Denning in *Lloyd's Bank v Bundy* (above), as well as to the decision of the High Court of Australia in *Amadio* (above). Subsequent to the Federal Court decision, further judicial blessings on the applicability of unconscionability in this area of the law was received from the Court of Appeal in *Petrodar Operating Co Ltd v Nam Fatt Corp Bhd & Anor* [2012] 5 MLJ 445. It is hoped that the Malaysian courts would take lead from the position taken by the courts (as affirmed by the Federal Court) in this area, and extend the application of the Doctrine of Unconscionability beyond the area of performance bond in construction contracts.

Conclusion:

The above discussion indicated the problem of Malaysian courts' previous tendency to merely refer to the concept of unconscionability in a general and loose sense without much analysis of the necessary elements for its application. The biggest challenge to the clear development of the doctrine of unconscionability or inequality of bargaining power in Malaysia would be the lack of statutory attention being given to contractual unfairness (substantive unfairness or unfair contractual terms) as had been done in Australia, particularly in the area of commercial contracts.

It is understandable that it is difficult for the Malaysian courts to introduce new and a specialized legislation to cater unconscionability and inequality of bargaining power in commercial contracts as practices in Australia. However, this is not a reason not to rectify and change the *lacunae* in law and ineffective legal practices. A practical and realistic approach which could be adopted by our courts to overcome the aversion to using unconscionability as an independent ground for relief, would be the proposed approach by some scholars to reformulate the law and to merge the relevant principles related to unconscionability under one broad doctrine. For example, the doctrine of undue influence and economic duress, together with unconscionability, could be subsumed under one broad heading of "unconscionable conduct". It is observed that such approach shall present a more comprehensive doctrine which focus on the similarities and linkages between the relevant doctrines, and would ensure the whole law in the area of unfair contracts develop in a more coherent manner.

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