CONSUMER FINANCIAL SERVICES LAW REPORT

FOCUSING ON SIGNIFICANT CASELAW AND EMERGING TRENDS

APRIL 18, 2019 | VOLUME 22 | ISSUE 20

EXPERT ANALYSIS

A RESTATEMENT THAT IS NOT REALLY A RESTATEMENT

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The American Law Institute could soon enact a Restatement of the Law Consumer Contracts. Consistent with the ordinary meaning of the term "restatement," the Introduction to the ALI Restatement of Conflict of Laws (1934) explained that the objective of the original Restatements was to present an orderly statement of the general common law.

Unfortunately, along the road, the ALI deviated from this approach. For example, the ALI Handbook for Reporters, as revised in 2015, states that the Institute's goal is for the Restatements to provide an informed consensus on what the law is, *or should be*, for a given subject. (*Emphasis supplied.*)

That is precisely the approach of the Restatement of the Law Consumer Contracts. As explained in its prefatory note, while the Consumer Contracts Restatement generally describes common law and respects precedent, it is not bound by precedent that is inappropriate or inconsistent with the law as a whole.

In other words, when faced with such precedent, the Restatement's drafters were not compelled to reflect the preponderant authority, but were instead allowed to offer what is, in their view, a better rule. By taking this approach, ALI has effectively delegated to its reporters something akin to legislative authority, with ALI's reputation suppling the force of law that only a statute would ordinarily have.

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What is the common law?

The purpose of this article is to provide examples of how this approach has produced a Restatement of the Law Consumer Contracts that goes beyond the common law and encroaches on the legislative function. To provide such examples, it is first necessary to identify the "common law" to which the Restatement should be compared.

The common law of contracts is not the same in all states, with some states having more comprehensive common law than others and some states having codified some common-law contract principles. Given that *Farnsworth on Contracts* (3rd ed. 1999) is perhaps the most accessible distillation of the common law, this article looks to that treatise for the "common law."

It may be helpful to begin with two policy comparisons between the Restatement and the common law as discussed in *Farnsworth* § 1.10.

First, as stated by *Farnsworth*, the American common law tradition has not been to articulate a separate set of consumer contract rules as the Restatement does. Rather, the common-law tradition has been to formulate general rules of contract law applicable to all contracts. Until the advent of the Uniform Commercial Code, the notion of special rules for merchants was also foreign to American lawyers. In creating separate rules for consumer contract, the Consumer Contracts Restatement more closely resembles statutory law, such as the U.C.C. and consumer protection statutes, than it does common law.

Second, most common-law rules are default rules that are binding only on the parties to the particular decision and can be varied by agreement. To the extent the Restatement creates a protective rule, such as its provision limiting the enforceability of modifications of standard contract terms, it affords no ability to change the rule by agreement (which indeed must be the intent given that the rule is based on the premise that businesses would take advantage of consumers if freedom of contract were allowed.)

Definitions and coverage

Section 1 contains seven definitions in subsection (a) and a scope provision in subsection (b) that limits the Restatement to "consumer contracts," except to the extent a matter is governed by statute or regulation. Because it is derived more from statutes than the common law, Section 1 is a precursor to the approach taken by the balance of the Restatement.

"Consumer" is a term not known at common law but is derived from statutes such as the federal Truth in Lending Act. "Consumer contract" is defined as a contract, other than an employment contract, between a consumer and a "business."

The definition of "business," as discussed in Comment 2, is derived from the UCC and not the common law. The definitions of other terms such as "good faith" and "affirmation of fact or promise" are also derived largely from the UCC rather than common law.

Good faith

Restatement § 3(c) provides in part that a modification of standard contract terms in a consumer contract is enforceable only if it is proposed in "good faith." Another provision requiring "good faith" is § 4(a), which requires business discretion to be exercised in good faith, (and perhaps also § 9(3), dealing with terms placed in a contract by a business in "bad faith," to the extent "bad faith" is the opposite of "good faith").

"Good faith" is defined in Restatement § 1(a)(7) as honesty in fact and the observance of reasonable commercial standards of fair dealing. Courts have often supplied a term requiring both parties to a contract to exercise good faith. (*Farnsworth* § 7.17.) But the Restatement would appear to differ from the common law at least to some extent as to whether:

- More than honesty in fact always is required in the common-law duty.
- The Restatement's duty of good faith is subordinate to an express contract provision as was the general rule at common law.
- The duty arises when an agreement is not already in existence.

CONSUMER FINANCIAL SERVICES LAW REPORT (ISSN 1098-9315) (USPS 017-468) is published BI-WEEKLY EXCEPT 1 ISSUE OMITTED IN JAN, MAR, JUL, NOV, & DEC by Thomson Reuters, 610 Opperman Drive, Eagan, MN 55123-1340. Periodicals postage paid at St. Paul, MN. Customer Service: (800) 328-4880.

POSTMASTER: Send address changes to *CONSUMER FINANCIAL SERVICES LAW REPORT*, 610 Opperman Drive, Eagan, MN 55123.

With regard to the first point above, even if it is assumed that a duty of good faith as defined in the Restatement can arise in the performance or enforcement of a contract at common law, it has not been that long since the UCC adopted the expanded definition of "good faith" that includes fair dealing.

In addition, the fact that this definition was adopted only after a contentious debate suggests that the duty of "good faith" at common law may not universally include "fairness" (as opposed to mere "honesty in fact") even though some cases did include it as a matter of equity. (*See, e.g.*, *Hilton Hotels v. Butch Lewis Prods.*, 808 P.2d 919 (Nov. 1991) and Farnsworth § 4.27).

With regard to the second point, in contrast to the common law, the Restatement makes "good faith" a mandatory duty in various types of contracts that may not be contractually eliminated. (*See Farnsworth* § 7.17.) The Restatement also provides no guidance on other issues, such as whether the remedy for breach of the duty is in contract or tort or whether the duty can be asserted affirmatively or only as a defense.

While the Restatement's silence on these issues might reflect the common law's lack of clarity, more discussion would be useful if the Restatement seeks to go beyond the common law.

Adoption of standard terms

Restatement § 2 establishes a process for determining whether a "standard contract term" is adopted as part of a consumer contract. Subsection (a) provides that a standard contract term is adopted as part of a consumer contract if the consumer manifests assent to the transaction after receiving both reasonable notice of the standard contract term and of the intent to include the term as part of the consumer contract; and a reasonable opportunity to review the standard contract term.

Subsection (b) addresses the adoption of a standard contract term when a term is made available for review for the first time after the consumer manifests assent to the transaction, and subsection (c) supplies terms if some standard contract terms were not adopted.

There is also much that is not in the blackletter law, such as what conduct "manifests assent" — which the Comments indicate can be done in many ways such as by parking in a garage that has a conspicuous sign about the fee). In addition, the Comments make clear that the process is mandatory.

Illustration 12 of the Comments makes that point by describing a scenario where a car purchase includes a trial subscription for satellite radio service, but no reference is made to a separate contract regarding the radio service when the consumer manifests assent to the purchase. After the purchase, the consumer receives a service agreement notifying the consumer of the standard contract terms governing the service.

Since the consumer had no prior notice that his or her manifestation of assent would apply to the service contract, no contract is formed regarding the service and the standard terms are not adopted. Some of these detailed illustrations may indeed reflect the developing common law. However, because it is premature to conclude that Restatement § 2 reflects the common law as a whole, § 2 borders on legislation.

Of course, as discussed in *Farnsworth* § 4.26, the common law has focused on how modern realities deviate from the idealistic picture of two informed principals directly negotiating the terms of their contract. However, the Restatement adopts none of the three common-law techniques (*i.e.* no offer, terms not in offer, and interpretation) used to resolve issues regarding what terms are part of a contract. Arguably, as *Farnsworth* § 4.26 points out, none of these techniques are truly adequate because the underlying issue is a lack of real assent.

Farnsworth also notes other ways that common law addresses the terms adopted as part of a contract, such as public policy, precursors of unconscionability, and finding a fiduciary relationship, but observes that the development of a general standard had to await the advent of legislation. Based on the illustrations in the Comments to § 2, the cases cited in the Reporters' Notes, as well as the fact that the essence of § 2 has been codified in modern statutes such as the Uniform Computer Information Transactions Act (*See*, *e.g.*, UCITA §§ 112-114 and 208), Restatement § 2 may be more of a statement of "principles" with respect to common-law development than a reflection of the common law as a whole.

Contract modification

Restatement § 3 speaks to the modification of "standard contract terms," (*i.e.,* a term that has been drafted prior to the transaction by a party other than the consumer for use in multiple transactions between a business and consumers in an ongoing relationship). The Restatement's focus is primarily on what constitutes assent, and in that context essentially addresses, in conjunction with Restatement § 2, assent to a modification of standard contract terms.

Thus § 3(a) sets out a process for modification that requires:

- Reasonable notice of the proposed modification and an opportunity for review.
- An opportunity to reject and continue on the original terms.
- A manifestation of assent.

§ 3(b) allows a consumer contract to provide for a procedure under which the business can propose a modification of the standard business terms that must be consistent with subsection (a), but which can replace an opportunity to reject the modified terms with an option to terminate the transaction.

§ 3(c) provides that a modification of standard contract terms is enforceable only if proposed in good faith and it does not have the effect of undermining an affirmation or promise made by the business that was part of the original bargain between the business and consumer.

While Comment 1 to § 3 states that many modifications are justified, it is entirely unclear how § 3(a)(2) and (c) of the Restatement Square with the common law — which, as described in *Farnsworth* §§ 4.17, 4.21 and 4.22, allows appropriate change particularly when the modification is fair and the reason for it is substantial and unforeseen.

In contrast, the Restatement appears to deny a business that option. The Restatement "rule," as reflected for example in Comment 6, illustrations 14 and 15 (which involve a price increase on a service) seems to posit a far more rigid approach to modifications than the common law.

Discretionary obligations

Discretionary obligations, or so-called illusory promises, are addressed in two subsections of Restatement § 4. Subsection (a) requires a contract or term granting a business discretion in determining its rights and obligations to be interpreted to require that such discretion be exercised in good faith and, subject to the discussion above about good faith, seems to reflect the common law. *Farnsworth* § 2.13.

Subsection (b) provides that a contract term that gives a business absolute and unlimited discretion to determine its contractual rights and obligations without regard to good faith is unenforceable. Given that common-law rules are generally default rules, the Restatement's rule would seem to be legislative in nature.

Nonetheless, overall subsection (b) seems in accord with the common law as it once stood. *Farnsworth* in § 2.13 states that allowing an illusionary term to render the agreement unenforceable was "once fashionable." However, the common law has moved on and limits such discretion instead by an implied duty of good faith.

At the same time, by stating in the Reporters' Notes that discretion cannot be varied by an implied duty of good faith when written as explicitly unrestricted, Restatement § 4 seems inconsistent with the progress of the common law. (*Farnsworth* § 2.13.)

Unconscionability

The unconscionability doctrine is addressed in Restatement § 5. Subsection (a) states that a contract or term that is unconscionable is unenforceable. The doctrine of unconscionability existed at common law, including the remedy of unenforceability stated in subsection (a). *See Farnsworth* § 4.27.

That said, the details for unconscionability at common law were unclear, although in addition to unfairness and one-sidedness, something more than substantive unfairness typically was involved, such as an absence of bargaining ability but less than incapacity or the presence of misrepresentation, duress, or undue influence. The question of whether damages as a remedy were available if equitable relief was denied was also unclear. (*Farnsworth* § 4.27.)

Restatement § 5(b) sets forth the circumstances under which a contract term is unconscionable, requiring both substantive and procedural unconscionability, and endorses a sliding scale, *e.g.*, more of one element of unconscionability allows less of the other. However, subsection (c) permits an exceptionally high degree of substantive unconscionability to suffice to make a contract term unconscionable.

Subsection (d) further defines substantive unconscionability and subsection (e) directs a court to allow the parties an opportunity to present evidence when determining whether a contract or term is unconscionable.

These provisions, in the main, reflect U.C.C. § 2-302 and other U.C.C. provisions such as § 2-719(3) (*see, e.g.,* illustration 1 in Comment 4(a)) and § 2-718(1) on liquidated damages (*see, e.g.*, illustration 4 in Comment 4(b)). As such, they bear little resemblance to the common law that is described in *Farnsworth* § 4.27 and instead reflect his discussion of U.C.C. § 2-302 in § 4.28.

In addition, Restatement § 5 fails to deal with a number of issues. For example, while the Reporters' Notes to § 5(d)(3) wade into the controversy concerning certain arbitration provisions, they offer no substantial insight into federal preemption issues and cite several questionable or possibly outdated court decisions. Nor does § 5 go beyond UCC § 2-302 and address whether the doctrine of unconscionability can be used affirmatively instead of only as a defense or result in damages instead of just making terms unenforceable at equity. (*See Farnsworth* § 4.28.)

It would seem logical that if the Restatement is to go beyond the common law, it should go further than UCC § 2-302, which was formulated more than a half century before the Restatement.

Deception

Restatement § 6, which deals with "deception" (meaning a deceptive act or practice), is another provision that has far less to do with restating the common law than with restating a statute. Subsection (a) provides for avoidance of a term or contract arising from deception, and subsection (b) defines in part what constitutes a deceptive act or practice.

Rather than restating the common law (*Farnsworth* has no discussion of "deception" as a topic), Restatement § 6 can best be considered an inadequate discussion of § 5 of the Federal Trade Commission Act (unfair or deceptive acts or practices) and § 1031 of the Dodd-Frank Act, (unfair, deceptive, or abusive acts or practices).

Indeed, the Reporters' Notes states that the section "explicitly incorporates doctrines originally developed under... specifically, Section 5 of the [FTC Act] and state unfair and deceptive acts and practices statutes."

This is not to say that conduct recognized by the common law as fraud or constituting misrepresentation (*see Farnsworth* § 4.10) might not qualify as deception in certain circumstances (*see Farnsworth* §§ 4-11 – 4.15). However, § 6 is not so limited. The Restatement would have been better served if it had discussed the common law of fraud and misrepresentation in consumer transactions.

Affirmations of fact and promises

Restatement § 7 encompasses a breathtakingly broad array of principles but boils down to:

- An affirmation of fact or promise made by a business to a consumer may become part of the contract.
- An affirmation of fact or promise made by a third party to a consumer may become a "contractual obligation" between the third party and the consumer and may become part of the contract between the business and the consumer.
- A provision that negates or limits these rules is ineffective. The first situation covered in § 7(a) and (c) would include a salesperson's statement to induce the sale that does not constitute "puffing," and overrule a clause in the contract that states the contract is only the writing. *See* Comment 1.

The second situation covered in § 7(b) and (c) would cover a manufacturer's warranty or advertising that is not "puffing" even when there is no direct contact. (*See* Comments 5 and 6 and illustration 5 discussing a limited warranty in owner's manual that comes with a car).

It is difficult to tell if Restatement § 7 tracks the common law because it crosses so many topics and does not fit well into modern contracting frameworks as discussed in *Farnsworth* (*see, e.g.*, §§ 2.2, 2.6, 2.10, 3.3, 3.5, 4.12, 4.13, 4.14, 7.2, 7.3,10.2-10.3).

Perhaps another way to look at this question is to note that § 7 is not even a restatement of U.C.C. Article 2 rules (*see, e.g.*, §§ 2-316(1), 2-318, 2-202, 2-313) or case law interpreting the statute, but more closely approximates the revision of U.C.C. Article 2 attempted by its sponsors in approximately 2003 (which ultimately was recalled as unenactable).

In the end it seems, once again, that while Restatement § 7 may capture the results of a variety of cases in particular contexts as noted in the Reporters' Notes, § 7 is not fully consistent with the common law.

Standard contract terms and the parol evidence rule

The parol evidence rule bars the use of extrinsic evidence to contradict and in some cases supplement a writing setting forth the final agreed upon terms of a complete (integrated) agreement (*see Farnsworth* §§ 7.2, 7.3, 7.4 and 7.5). The parol evidence rule is a universally recognized common-law rule that may arise through agreement in a so-called merger clause.

Restatement § 8 provides that a standard contract term that contradicts, unreasonably limits, or fails to give the reasonably intended effect to a prior affirmation of fact or promise by the business, does not constitute an integrated agreement as to the subject matter of the term and does not have the effect under the parol evidence rule of discharging obligations that would otherwise arise from the prior affirmation of fact or promise.

This provision not only seems to impliedly repudiate merger clauses, but also decrees, in contradiction of the common-law rule, that a term of a consumer contract is subject to an asserted prior affirmation of fact or promise because it deems the writing not to be fully integrated and only looks to the consumer's intent.

Since neither mistake nor fraud is required, this approach essentially abrogates the common-law rule rather than restates it. It also repudiates the rule that one cannot avoid a contractual duty to read.

Effects of derogation from mandatory rules

Section 9, the Restatement's final section, is a clear deviation from the common law. Unlike the common law which consists of default rules, Section 9(a) provides that if a *mandatory rule* is excluded, limited, or violated by the contract or a contract term, the contract may not be enforceable, or the remainder may be enforced, or the derogating term may be limited.

This extraordinary deviation from the common law is necessitated by the Restatement's approach of creating separate rules for consumer contracts. Section 9 largely does not reflect the applicable common-law controls against unfairness in standardized agreements, such as interpretation and public policy. (*See Farnsworth* §§ 4.26, 5.7, 5.8, 7.7-7.13.)

Interestingly, illustration 1 to Comment 2 does not give the choice of the remedy absolutely to the court but instead includes consideration of the consumer's preference as to whether to sever and enforce the remainder of the contract, or not enforce the contract.

If application of § 9(a) results in an incomplete contract, § 9(b) empowers a court to supply a better term for what has been deleted. While the common law has rules to deal with omissions by the parties (*Farnsworth* §§ 7.15 and 7.16), § 9(b) covers new ground by effectively allowing a court or the consumer to rewrite the agreement.

See Comment 3, illustration 4, which says that a court can substitute a range of possible rates when the contract rate of finance charge is usurious. See also Comment 6 which purports to allow a court to supply a term more favorable to the consumer as a penalty to discourage businesses from "overreaching," or as the Reporters' Notes state, supply a term least favorable to the business as a "penalty default rule."

Conclusion

In the end, the Restatement is more suited to be a "principles" of consumer contracts project that accounts for developing case law and recommends best practices — and, as described in the Handbook for ALI Reporters, is primarily addressed to legislatures, administrative agencies, or private actors, and courts when an area is so new that there is little established law.

Perhaps an even better alternative would be for the Comments and Reporters' Notes to serve as a study and then a report. (*See e.g.,* Reporters' Study on Enterprise Responsibility for Personal Injury.) As such, the report could function as a signpost toward future common-law development.

Either approach could further the development of the common law of consumer contracts or future consumer-protection statutes.

