Unconscionability Under UCC § 2-302: How It Applies to Commercial and Government Contracts

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How has Section 2-302 of the UCC—the section of the Code dealing with unconscionable contracts—been applied in federal government contracting disputes and litigation? To answer this question, the author first reviews the theory of contractual unconscionability—both procedural and substantive—and some of the more significant aspects of its application under Section 2-302 generally; then he analyzes recent government contract cases involving bid and proposal mistakes as well as questions of contract performance.

The Uniform Commercial Code has met with wide acceptance, both in state and federal litigation. And its supporters continually urge that its influence be broadened. For example, the late Justice Tom C. Clark, in an opinion that he wrote while sitting by designation in the Ninth Circuit noted that he would like "Congress to adapt, in the not distant future, the UCC for federal application, as our fifty states have already done for local application." [1]

In the area of federal government contracts, on both the administrative and judicial level, the UCC has for some years been utilized to a considerable extent. For example, nearly fifteen years ago the Armed Services Board of Contract Appeals (ASBCA) concluded (in a case involving implied warranties) that "the Code governs as reflecting the best in modern decision and discussion. . . ." [2] The Court of Claims had earlier expressed similar concepts in *Padloc Co. v. United States*,[3] where it held that the matter at hand was to be decided "by the uniform federal 'common law' which governs the contracts of the United States." And federal district courts have also followed this pattern in contract cases.[4]

Therefore, in the government contracting area at least, the boards and courts have (in the absence of contrary federal regulations or precedents) used the UCC and its principles in resolving contracting problems for some time and appear inclined to continue doing so, even without a "federal" UCC. However, where a contrary federal precedent does exist, they have generally chosen not to utilize the UCC view.[5] In *Machlett*, for example, the Board observed that "Appellant's reliance upon . . . the Uniform Commercial Code is of little assistance because (of) Federal precedent in this area. . . ."

A key section of Article 2 of the UCC deals with unconscionable contracts. It has its origins in equitable concepts and it is based upon the very sound premise that there are certain extreme situations where a contracting party must be protected against himself. Thus, while the concept of freedom of contract remains a fundamental of our law (and certainly of the UCC), and while it remains true that courts will normally allow persons to enter into unwise, unprofitable, even foolish contracts, there are limitations. And once these limitations are reached, a court may, because it finds gross unfairness, determine that a contract (or a portion of a contract) is unconscionable and take appropriate corrective measures. Note that we are not here discussing "hard bargaining" or "clever deals," but contractual situations that go far beyond the bounds of skillful negotiation, or as the *Oxford Dictionary* (3d ed.) rather picturesquely puts it, ones that are "monstrously extortionate."

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[1] Bank of America Nat'l Trust & Sav. Ass'n v. United States, 21 U.C.C. Rep. 821 (9th Cir. 1977).

[2] Reeves Soundcraft Corp., ASBCA No. 9030, B.C.A. ¶ 4317 (1964).

[3] 161 Ct. Cl. 369 (1963).

[4] See, e.g., United States v. Wegematic Corp., 360 F.2d 674 (2d Cir. 1966), where the court applied the UCC and noted that the Code "is well on its way to becoming a truly national law of commerce," and that "when the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce . . . consisting of transactions with the United States." *Id.* at 676.

[5] Meeks Transfer Co., Inc., ASBCA No. 11819, 67-2 B.C.A. ¶ 6567; Machlett Labs, Inc., ASBCA No. 16194, 73-1 B.C.A. ¶ 9929.

Defining the Concept

An unconscionable contract (or clause) is one that is grossly and unjustifiably unfair. One often quoted definition characterizes an unconscionable contract as one "which no man in his senses, nor under a delusion would make, on the one hand, and which no fair and honest man would accept on the other."[6] Unconscionability has been more sharply defined in recent cases, like *Williams v. Walker-Thomas Furniture Co.*,[7] where the Court said that the test of unconscionability must include, "an absence of meaningful choice on the part of one of the parties, together with contract terms which are unreasonably favorable to the other party," and characterized by "a gross inequality of bargaining power."

The UCC Application

Section 2-302 of the Code deals with unconscionability; it reads as follows:

> "Sec. 2-302. Unconscionable Contract or Clause.
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> "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
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> "(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

The Draftsmen's Comments

The comments to Section 2-302 offer some good insights into its main purposes as envisaged by its draftsmen.

First, the comments note that the section was intended to formally make it possible for courts to explicitly police against contracts (or contract clauses) which they find to be unconscionable. Previously, such "policing" had to be accomplished indirectly

[6] Earl of Chesterfield v. Janssen, 28 Eng. Reprint 82, 100; cf. Hume v. United States, 21 Ct. Cl. 328, 330 (1886), *aff'd* 132 U.S. 406, 411 (1889).

[7] 350 F.2d 445 (D.C. 1965).

(1) by adverse construction of the contract language, or (2) by manipulation of the rules of offer and acceptance, or (3) by determinations that the clause in question was contrary to public policy or the dominant purpose of the contract. As one authority has noted, any indirect approach of this sort can have shortcomings, for example:

> "A court can 'construe' language into patently not meaning what the language is patently trying to say. It can find inconsistencies between clauses and throw out the troublesome one. It can even reject a clause as counter to the whole purpose of the transaction. It can reject enforcement by one side for want of 'mutuality' though allowing enforcement by the weaker side because 'consideration' in some other sense is present. The net effect is unnecessary confusion and unpredictability. . . . Covert tools are never reliable tools."[8]

Thus, Section 2-302 was designed to allow courts to dispense with the necessity of employing these "covert tools" and instead, to allow them to directly confront the problem of unconscionability and deal with it on that basis.

Second, the comments contain what the draftsmen characterized as the "basic test" of unconscionability. This test includes consideration of three elements, namely, whether:

(1) In view of the commercial background and the commercial needs of the particular trade or case;

(2) the clauses involved are so one-sided, that they were unconscionable;

(3) under the circumstances existing at the time of the making of the contract.

Third, the draftsmen note that three remedies are made available in the event that a contract is determined to be unconscionable. The court (1) may refuse to enforce the contract as a whole, or it (2) may refuse to enforce the unconscionable portion, or it (3) may modify the unconscionable portion, "so as to avoid unconscionable results."

Fourth, the comments emphasize that questions of unconscionability are to be resolved by the court. They believed that since questions regarding unconscionability are often subtle and difficult to determine, evidence should be reserved for a court's consideration, not a jury's.

[8] Llewellyn, "The Standardization of Commercial Contracts," 52 Harv. L. Rev. 700, 702-703 (1939).

Finally, the draftsmen wanted the section to be considered in the light of the "circumstances existing at the time of the making of the contract." Thus, if later circumstances render a contract (that was initially equitable) unconscionable, relief (in their view) should not be granted. This concept is illustrated by *Cone Mills Corp. v. Hurdle,*[9] one of a series of lawsuits brought to enforce contracts involving the sale of the 1973 cotton crop. Many farmers sought to be relieved from their obligations because "the price of raw cotton fiber on world markets rose in a sudden and spectacular fashion" between the time they entered into their contracts and the time the cotton was ready for harvest (thus—it was alleged—making their contract prices unconscionably low). The court denied relief to the farmers, primarily because (1) the contract prices were consistent with the market price at the time the contracts were entered into, and (2) there was no indication that the buyers were in any better position than the farmers to know that the price of cotton would more than double.

The Basic Rules

A number of prominent commentators[10] have, in analyzing the concept, divided unconscionability into two types, namely (1) *procedural* and (2) *substantive* unconscionability. These "types" of unconscionability have been rather informally (but accurately) characterized by another authority who referred to "bargaining naughtiness as 'procedural unconscionability' and to evils in the resulting contract as 'substantive unconscionability.'"[11] More often than not, the two types overlap. Thus, it is not at all uncommon to be faced with a situation where both procedural and substantive unconscionability (or at least elements of both) are present. For example, in one case, the New York State Supreme Court stated that a contract for a lease (construed as a sale) of incinerator equipment was unconscionable and unenforceable because it disclaimed all express and implied warranties. The Court noted that although the disclaimers were properly made, the contract could not be enforced because it (1) replaced a contract with

[9] 14 U.C.C. Rep. (Miss. 1974).

[10] See, e.g., Briefing Papers 75-3, 3 B.P.C. 199 (Shedd, "Unconscionability In Contracts").

[11] Leff, "Unconscionability and the Code—The Emperor's New Clause," 115 U. Pa. L. Rev. 485, at 487.

another party which did preserve warranties, (2) it was entered into in an atmosphere of haste and pressure on the lessee/buyer, (3) the lessee/buyer did not have equal experience in the field, and (4) the incinerator did not work, had never worked and was in effect worthless.[12]

The term "unconscionable" has proven itself to be flexible, and it must be construed within the framework of the transaction under scrutiny, and considered in light of the commercial climate as it now exists. Applying these criteria in the area of remedy limitations, courts have found unconscionability in cases which involved: a waiver of all defenses against the seller if the seller assigned the contract[13]; a provision barring any claim for consequential damages[14]; a provision unreasonably limiting the time within which the buyer could give notice of defects[15]; a provision giving an automobile dealer the right to indefinitely continue its efforts to correct a mechanical problem[16]; and an attempt to limit a product's warranty coverage in the case of personal injury because of a defect.[17]

Applying Unconscionability to Government Contracts

One of the first federal government contracts cases in which the theory of unconscionability was raised by a party (in this case the government) was *United States v. Bethlehem Steel Corp.*[18] The case involved a World War I cost reimbursement shipbuilding contract which contained a "half savings" clause (i.e., one-half the amount saved over a specific target amount was returned to the contractor). Bethlehem Shipbuilding eventually made a profit of $25 million on costs of $109 million, and this did not include such profits as may have been made by its parent corporation which sold it 43,000 tons of steel at the maximum prices established by the War Industries Board.

The government sued to recoup a portion of the profits and argued that the half savings clause was unconscionable on a "gen-

[12] Industralease Automated & Scientific Equip. Corp. v. R.M.E. Enterprises, Inc., 22 U.C.C. Rep. 4 (N.Y. 1977).

[13] Unico v. Owen, 4 U.C.C. Rep. 542 (N.J. 1967).

[14] U.S. Fibres v. Procter & Schwartz, Inc., 13 U.C.C. Rep. 254 (Mich. 1972).

[15] Wilson Trading Corp. v. David Ferguson Ltd., 5 U.C.C. Rep. 1213 (N.Y. 1968).

[16] Ford Motor Co. v. Mayes, 24 U.C.C. Rep. 1057 (Ky. 1978).

[17] Tuttle v. Kelly-Springfield Tire Co., 24 U.C.C. Rep. 1070 (Okla. 1978).

[18] 315 U.S. 289 (1941).

eral doctrine of unconscionability at common law," because of "duress" and "profits grossly in excess of customary standards." The Court rejected the government's argument by applying the essentials of the test of unconscionability set out in the Section 2-302 comments. That is, the Court considered the half savings clause in light of "the circumstances existing at the time of the making of the contract," and determined that there was "no indication . . . that the profits realized by other shipbuilders were any less than Bethlehem's." The Court concluded that

> "the profits made in these and other contracts entered into under the same system may arouse indignation. But indignation based on notions of morality . . . cannot be justly transmitted into a principle of law. . . ."

Bid and Proposal Mistakes

Earlier litigation such as the *Bethlehem Steel* case provided an introduction to unconscionability in government contracting that has extended to evaluation problems as well as to questions involving contract performance.

Obviously, in the evaluation area the Comptroller General and the General Accounting Office (GAO) have been the most active. However, there have also been a number of significant court decisions. One of the most frequently cited is *Kemp v. United States*,[19] where the Court (without mentioning unconscionability), stated that where a mistake in bid was so gross that it could be said that the government "was obviously getting something for nothing," relief from the consequences of the mistake may be granted. And in another case,[20] a federal district court granted relief to a contractor for an item mistakenly omitted from his bid. The Court reasoned that since the contractor's price was \$3.91 per item and the third through ninth bids ranged from \$18 to \$39.50, the government should have known that a gross mistake had been made. The Court spoke in terms of unjust enrichment rather than unconscionability, and it stated that

> "it is not believed that an honest, fair-minded and reasonable man in good conscience would seek to maintain such a gross and unequitable advantage of a mistaken bidder when as in this case he had reason to know of the mistake."

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[19] 38 F. Supp. 568 (1941).

[20] Monroe Mfg. v. United States, 143 F. Supp. 449 (D.C. Mich. 1956).

The GAO Standards

The GAO's criteria for recommending administrative relief based on the unconscionability theory is illustrated very well by a case involving a supply contract that the contractor requested be cancelled because of a mistake in his low bid. The questioned bid prices were:

Low bidder	\$10
Second low bidder	\$38
Third low bidder	\$39.54

Because of this significant price spread, the government's contracting officer (CO) advised the low bidder of the other prices, and also of the considerably higher prices paid for the item by the government under previous contracts. Despite this information, the low bidder twice verified his bid (on the telephone and again in writing), and the award was made. The question presented to GAO was whether or not it could grant relief based on an unconscionably low price, although the bidder (1) knowingly submitted a bid without obtaining essential specifications and drawings, (2) unequivocally verified his price before award, and (3) would suffer no great loss if he performed the contract. This is how GAO responded to these three items:

(1) Submitting a bid without obtaining essential information. Relief from mistakes may be granted in "appropriate circumstances," even if caused by negligence on the part of a bidder.

(2) Verifying his bid. Verification does not preclude relief from a mistake in bid after award, if it would be unconscionable to require the contractor to perform at his bid price.

(3) Financial ability to perform at the mistaken price. While the dollar amount of loss should be considered, "unconscionability may exist even where the potential dollar loss is relatively small."

Thus, GAO recommended that the contract be cancelled, observing that "unconscionability is grounded on the theory that where a bidder's mistake is so great that it could be said the Government was obviously getting something for nothing relief should be allowed." [21] In another similar situation the mistaken bidder (1) took several days to recheck and orally verify the figures used

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[21] 53 Comp. Gen. 187 (1973).

in his bid, (2) stated that while he would make only a "little profit" he still wanted the contract because his company was new and needed contracting work with the government, (3) was advised by the CO of the procedures for correcting bid mistakes but chose not to follow them, and (4) later reverified the bid in writing at the CO's request. Here again, the GAO departed from the normal rule that an unequivocal verification is binding and granted a price increase, because the CO (despite the verifications) continued to believe that an error had been made and because, under the circumstances, it "would be inequitable to hold (the bidder) to its original bid." [22] In another case, the spread between the low bidder's price (approximately $200,000) and the next low bid was $106,000, and the highest of the ten bids received was for nearly $700,000. The CO's verification attempt was found to have been adequate, but after verification and award, the contractor alleged mistake (and included a CPA's finding that its bid was "totally unrealistic") and requested a contract modification to compensate for the error. The GAO granted relief, "notwithstanding verification of the bid or the extent thereof," on the basis that enforcement of its contract "would be overreaching unconscionable conduct on the part of the Government." [23]

Where the CO's verification is somewhat suspect, GAO's willingness to grant relief is even more apparent. In Comptroller General Decision B-177405 of November 29, 1972, the only indication regarding why a bid verification was requested "was that a disparity in price existed," and the bidder was not told that the disparity existed not only between his and the next low bid, but also between his bid and the government's estimate. Thus, stated the GAO, "as it would, in our view, be unconscionable for the Government to require (the bidder) to furnish (the equipment) at its unreasonably low bid price, we concur with the administrative recommendation of rescission."

Moreover, relief is possible even when the CO is not on notice of the possible mistake. In Comptroller General Decision B-174266 of February 22, 1972, the mistake involved the contractor's failure to indicate under its "Buy American" certification that it intended to furnish a foreign product under one item of its bid. Having so failed, the contractor would be obligated to furnish domestic

[22] Comp. Gen. Dec. B-171858 (April 22, 1971).
[23] Comp. Gen. Dec. B-180573 (June 19, 1974).

meprobamate powder at $25.30 a pound instead of foreign powder at something over $2 a pound, thereby incurring a loss (on a $11,556 purchase order) of $56,614. Thus, even though the CO had no notice of the error, the GAO (on reconsideration) stated that the contract could be cancelled without liability to the contractor because "it would be unconscionable to require (the bidder) to furnish domestic (articles) at its original bid price." The lack of notice issue was even more pronounced in *Decisions of the Comptroller General*,[24] where the CO had no actual notice of the error until after work was completed, since the procurement was on a sole source basis and there was no opportunity to compare bid prices. The GAO, citing the absence of any cost or price analysis as required by Section 3-807.2 of Defense Acquisition Regulation (DAR) (which would have disclosed a marked difference in price between this procurement and earlier ones for the same item), authorized an additional payment to the contractor because "it would be unconscionable for the Government to retain the items at such a low price."

Note however that GAO relief in this area is by no means automatic. The Comptroller General will continue to closely scrutinize the circumstances, and particularly the relevant price information. For example, in Comptroller General Decision B-190865 of July 19, 1978, GAO denied relief because it did not believe that the bid price spread justified a finding of unconscionability. It noted that

> "our office has found contracts to be unconscionable where the second low bid was between 280 and 300 percent greater than the contract price; on the other hand, differences of 53 and 58 percent have been held insufficient to demonstrate unconscionability."

Other decisions, under comparable factual situations, have also denied relief.[25]

GAO's Exception

In any case, the GAO (although its decisions do not specifically refer to the UCC) will, in appropriate situations, apply the general

[24] 45 Comp. Gen. 305 (1965).
[25] See Comp. Gen. Dec. B-190623 (April 25, 1978) (difference of 25 percent between low and next low bid not unconscionable); Comp. Gen. Dec. B-191647 (June 26, 1978) (difference of 6.9 percent between low and next low bid not

principles of Section 2-302 to mistake cases and in so doing, note an exception to its general rule that once a price is properly verified, correction after award will not be allowed.

As a result, as one authority notes, the CO may sometimes be confronted with a situation where he properly verifies a bid and the low (and erroneous?) bidder insists that he is entitled to award. If award is made, "he may well be faced with a contractor claim for more money, or a Government claim of poor performance, or even failure to perform. If he refuses award . . . he may be accused of failure to comply with the statutory requirements to make award only to the low, responsive, responsible bidder."[26] One possible solution (as suggested by Mr. Shnitzer) is for the CO, in addition to verification, to insist upon "an explanation of how the bidder expects to do the job at the quoted price." Such an explanation will probably insulate the government against a later mistake claim, while no explanation (or an unsatisfactory one) may allow the CO to properly disqualify the bidder for lack of responsibility. This rationale was used to allow correction (despite a previous verification),[27] because the verification received by the CO (where the proposed contract price was less than half the next low bid and approximately 60 percent of the government estimate) did not provide a reasonable explanation for the difference in the bids. Conversely, a contractor (whose price situation was nearly as obvious as in the last case) was denied relief after the CO (1) obtained verification and (2) held a meeting at which the contractor gave a reasonable explanation for the price discrepancy.[28]

The Boards and Courts

The boards and courts have not followed any particularly consistent pattern in deciding the relatively limited number of cases involving unconscionability questions to come before them. They have, however, been faced with many of the same types of problems that the Section 2-302 drafters envisaged, and they have disposed of them primarily on an individual, case-by-case basis. To some extent, the decisions can be categorized in the procedural and substantive divisions mentioned earlier.

unconscionable); 54 Comp. Gen. 545 (1974) (differences of 53 percent and 58 percent determined insufficient to demonstrate unconscionability).

[26] Shnitzer, *Government Contract Bidding* 479 (1st ed. 1976).

[27] Comp. Gen. Dec. B-187534 (Oct. 5, 1977).

[28] Comp. Gen. Dec. B-187101 (Feb. 11, 1977).

Procedural Unconscionability

In *Siam A.E.C. Co.*,[29] a contractor abandoned performance of a fixed-price well-digging contract when he was unable to obtain water of the quality that he had guaranteed, and the government refused to make any further contract payments. The contractor argued that the contract guarantee provisions were unconscionable because of the difference in the parties' bargaining power. The ASBCA (noting that there were no negotiations conducted regarding any of the contract's terms) refused to hold the contract unconscionable solely because of a disparity in bargaining power. As the Board observed, such a broad approach (since the government admittedly had superior bargaining power) would invalidate almost all government contracts.

In a recent case, the contract involved the production of airmen's survival kits. Government furnished material (GFM) valued at $126,000 was stored in the contractor's facility and it was destroyed by fire. A clause in the contract imposed strict liability on the contractor for losses of GFM by fire, and based on this clause, the government collected the $126,000. The contractor sued for return of the money, asking the Court of Claims to reform the contract and replace the strict liability clause with another clause under which the contractor would only be liable for the fire loss in case of fault or wrongdoing. The contractor raised a number of arguments in support of his position, including the contention that enforcement of the strict risk of loss clause was unconscionable under UCC Section 2-302, since two previous contracts between him and the government did not contain the clause, and thus the contract was signed (without being read) on the supposition that the less-than-strict liability clause was included. While the Court acknowledged that it had discretion to deny enforcement of an unconscionable clause, it refused to do so here, because (1) there was no surprise—the clause was clearly printed, in the same size as the rest of the contract, and its language was "quite clear as contract clauses go," indeed it was much clearer than the less-than-strict liability clause argued for by the contractor, (2) the contractor's president was an experienced business man, and "should know better" than to not read a contract prior to signing it, and

[29] ASBCA No. 15470, 73-2 B.C.A. ¶ 10,053.

(3) the fact that two previous contracts contained a less strict clause was "irrelevant and unacceptable." As far as substantive unconscionability was concerned, the Court noted that the clause was not oppressive, requiring only that the contractor insure the GFM for its full value.[30] The "defense" of failure to read the contract was also raised (and also rejected) in *Richardson Camera Co., Inc. v. United States.*[31] There the Court said that "failure to read the terms of a contract, particularly when so directed, cannot be used as a defense to the consequences of such an omission."

Substantive Unconscionability

Stevens Institute of Technology v. United States,[32] involved consideration of a government exculpatory clause. The provisions of Section 2-302 (even though here again no direct reference was made to them) were applied by the Court in holding that the clause —under which the government sought to exculpate itself from its own negligence during delivery of a vessel that had been purchased by the plaintiff—was unenforceable on public policy grounds. The plaintiff (who intended to use the vessel as a floating dormitory) sued when the ship was damaged while being operated by a government officer who had misjudged the force of a tidal wave. The clause in question stated that the government would, *"at the risk of the buyer,* break each ship out from its present location, and make the ship available for delivery to the buyer." (Emphasis added.) The Court declined to enforce the clause and stated that refusing enforcement was "particularly applicable to a situation in which there is a vast disparity in bargaining power and economic resources between the parties, such as exists between the United States and particular Government contractors."

Another example of a clause being unconscionable and therefore unenforceable under Section 2-302 is found in *REDM Corp.*[33] Here, the contractor (before award) specifically inquired regarding whether it would be permissible for him to charge more for contract option quantities than for the basic contract quantity. The CO said that it was permissible, and the contractor sent a telegram to

[30] Fraass Surgical Mfg. Co., v. United States, 571 F.2d 34 (Ct. Cl. 1978).
[31] 467 F.2d 491 (Ct. Cl. 1975).
[32] 309 F. Supp. 986 (1975).
[33] ASBCA No. 17378, 73-2 B.C.A. ¶ 10,167.

him (1) increasing the option prices and (2) expressly making the telegram part of the contract. All this conflicted with the "option for increased quantity" clause of the contract which gave the government the right to order option quantities at the lower of the option price or basic contract price. The ASBCA stated that under these circumstances, enforcement of the clause would be unconscionable, and ruled in favor of the contractor.[34]

However, in another case,[35] the Board declined to rule unconscionable the government's exercise of an option to order additional contract quantities, even though a government act (removal of a price freeze which caused the price of a critical raw material [zinc] to rise) between the date of contract award and the date of the option's exercise had increased the contractor's performance. The Board reasoned that since (1) the contractor (by not insisting on a contract escalation provision and by accepting the option clause) assumed the risk of inflation, and (2) the government (unlike in *Galloway*[36]) did not fail to disclose relevant superior knowledge, the contractor had unfortunately entered into an improvident (but not an unconscionable) bargain and was not entitled to any relief.

Spasors Electronics Corp.[37] involved a contract for electronic components where the contractor (because of a defaulting sole-source subcontractor) experienced schedule difficulties. The government issued an adjusted—but unreasonable—delivery schedule and stated that the contract would be terminated for default if this new schedule was not agreed to by the contractor. The ASBCA declined to find economic duress under these facts because it did not find the requisite coercive acts; however, it held that the threat to terminate for default, which accompanied the unreasonable schedule was improper, unjustified, and amounted to overreaching on the government's part, if not outright coercion. Thus, the modified agreement was found to be unconscionable under Section

[34] See also Singer General Precision, Inc. v. United States, 192 Ct. Cl. 435 (1970), where the court's refusal to enforce the standard "cost ceiling" and "limitation of cost" clauses could have been supported by reference to Section 2-302 although no direct references were made to it; and G.W. Galloway, Co., ASBCA No. 16656, 16657, 73-2 B.C.A. ¶ 10,270, where the Board refused to enforce a GFP "as is" clause, because the government failed to disclose material information regarding the GFP to which it related.
[35] McGail Equip. Co., ASBCA No. 20555, 76-1 B.C.A. ¶ 11,723.
[36] G.W. Galloway Co., note 33 *supra.*
[37] ASBCA No. 12877, 70-1 BCA ¶ 8119.

2-302 and therefore, liquidated damages based on it were returned to the contractor. And in another decision,[38] the Board used Section 2-302 to reach the conclusion that the original agreement between the parties (not a modified agreement reached during performance as in *Spasors*) was unreasonable and unconscionable.

Damage clauses have also been held unconscionable, for instance, in *Superior Disposal*,[39] the Board held that it would not enforce a liquidated damages clause that could have resulted in the contractor (for refuse collection) being assessed for damages far in excess of the contract price even if he failed to perform on only four days in any month. And, in *Flintkote Co.*,[40] the GSA Board refused (without specifically mentioning unconscionability) to literally interpret a "waiver of delivery schedule" clause which would have permitted the government to extend forever the period during which its refraining for proceeding to a default termination would not be considered a waiver of the contract delivery date.

Extraordinary Contractual Relief

Another possible relief alternative exists for a contracting party in the unconscionability area, and that is under Public Law 85-804.[41] Public Law 85-804 authorizes eleven government agencies to enter into contracts and contract modifications, and to make advance payments to contractors, when to do so will "facilitate the national defense." The statute is designed to be a sort of "equitable court of last resort" for contractors (i.e., it gives them an opportunity for relief) even though no legal grounds exist. In order to recover, contractors must, in general, show that (1) legal relief is unavailable, (2) one or more of the required circumstances exists, and (3) relief will facilitate the national defense.

Public Law 85-804 is implemented by Section 17 of DAR, and Part 1-17 of Federal Procurement Regulations (FPR). It is heavily oriented toward the concepts expressed by Section 2-302, although neither DAR nor FPR contain any direct reference to the Section nor to the UCC. This attitude can be seen by examining the three major grounds for granting relief under Public Law 85-804:

38 ITT Defense Communications Div., ASBCA No. 11858, 70-2 B.C.A. ¶ 8415.
39 ASBCA 19350, 75-2 B.C.A. ¶ 11,523.
40 GSBCA Nos. 4223 et al., 76-2 B.C.A. ¶ 12,031.
41 72 Stat. 972, 50 U.S.C. §§ 1431-1435 (1970).

(1) *Amendments without consideration.* Sections 17-204.2 of DAR and 1-17.204-2 of the FPR both refer to situations where a contractor suffers a loss "as a result of Government action" and state that "the contract may be adjusted if fairness so requires."

(2) *Mistakes.* Sections 17-204.3 of DAR and 1-17.204-3 of the FPR both state that amending mistakes (in proper circumstances) with "the least possible delay" will facilitate the national defense by giving contractors "proper assurance that such mistakes will be corrected expeditiously and fairly."

(3) *Informal commitments.* Sections 17-204.4 of DAR and 1-17.204-4 of FPR each provide for relief where contractors furnish the government with property or services "in good faith" but without proper contractual coverage, because providing such relief will assure such contractors that they will be "treated fairly and paid expeditiously."

Moreover, Section 17-204.1 of DAR and 1-17.204-1 of FPR both indicate that the three foregoing categories of relief alternatives are not intended to be exclusive, and that relief may be granted under Public Law 85-804 whenever the circumstances warrant such action.

It is not surprising, with this regulatory background, that a number of the Contract Adjustment Board (CAB) decisions under Public Law 85-804 are phrased in terms that are closely analogous to Section 2-302 decisions. For example, in *Midland Constructors*,[42] the contract price was increased (by nearly $500,000) because of what, in essence, amounted to the government's procedural unconscionability. That is, the CAB found that part of the contractor's loss (on a $28 million construction contract) was caused by (1) inadequate and unclear government specifications, (2) "an extremely short time to prepare a bid of this magnitude," and (3) "many drawings, documents and changes associated therewith." It concluded that "it would be unconscionable for the Government to receive the benefits of this work and refuse to make payment therefor. . . ."

Government action is a frequently alleged problem where unconscionability is concerned. In one case,[43] the contractor unsuccessfully argued that it was unfair for the government to exercise

42 ACAB No. 1078, 2 E.C.R. 24 (1967).
43 J & H Smith Mfg. Co., ACAB No. 1105, 2 E.C.R. 94 (1969).

an option when it knew that he would suffer a loss on the option quantity. The CAB "assumed" that the contractor's pricing provided for the possible exercise of the option and thus declined relief when it concluded that "once the bargain is made . . . there is nothing unconscionable or unfair in holding a contractor to the option terms of a contract to which he has fully agreed."

In *ADEC, Inc.*,[44] relief was granted because of government action (or inaction) because of delays in approving preproduction samples. The Board concluded that it had "no difficulty in finding the unconscionable Navy delay in preproduction testing constitutes Government action within the scope of (ASPR)." And, in *Electro-Chem, Inc.*,[45] relief—in the form of an amendment without consideration—was granted, principally because of "unconscionable actions on the part of governmental officials" in making decisions affecting contract performance.

Conclusion

The concept of unconscionability represents one more exception to the general rule that contracts, once entered, will always be enforced according to their terms. It has been utilized with restraint and discretion—and in federal government contract litigation it has been applied on both the administrative and judicial level. With the passage of the Contract Disputes Act of 1978,[46] it is likely that the boards of contract appeals will become involved in a greater number of disputes in the future that will, at least potentially, involve unconscionability questions. At the same time, there is no inclination on the part of the courts to limit their use of Section 2-302 in appropriate situations, even though the goal of a federal UCC as envisaged by Justice Clark does not appear to be on the immediate horizon. Thus, unconscionability appears to be a continuing source of possible relief to contracting parties, both in the non-governmental and governmental areas.

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44 NCAB, 2 E.C.R. 116 (1970).
45 ACAB No. 1170, 3 E.C.R. 29 (1974).
46 Pub. L. 95-563.

Share Drafts and the Draft Issue

*Frederic H. Karr**

The National Credit Union Administration has put forth a regulation allowing federally chartered credit unions to issue share drafts, a check-like instrument. The legality of this regulation is now being challenged in the courts. If the regulation survives legal challenge, will such drafts be subject to the Uniform Commercial Code? This article traces the developments behind the regulation, analyzes the resulting lawsuits and argues that such share drafts should be subject to the Code.

Introduction

One party can transfer funds to another party by using an instrument known as a "draft."[1] The term "draft" is generic because there are several types of drafts by which monies may be transferred from one person or organization to another. Examples of traditional types of drafts include ordinary checks, traveler's checks, and money orders. A third-party instrument[2] which has recently come into vogue is the credit union share draft.[3] Hence, questions have arisen as to whether the credit union share draft is a "draft" subject to the provisions of the Code.

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The views expressed herein are solely those of the author and do not necessarily reflect the official policy of the Federal Deposit Insurance Corporation.

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1 U.C.C. § 3-104(2)(a). "A draft is an *order* to pay money." (Emphasis in original.) Weber, *Commercial Paper* 26 (1975). Cf. U.C.C. § 3-110 ("Payable to Order").

2 In the terminology of commercial law, the first two parties are the party who draws the instrument and the depository institution upon which the instrument (representing funds) is drawn. The third party is the party to whom the instrument is given.

3 12 C.F.R. § 701.34; 42 Fed. Reg. 61,977-61,985 (1977). A traditional check can be used to withdraw funds from an account maintained with a commercial bank. At present, the funds comprising such an account are non-interest-bearing. 12 C.F.R. §§ 217.2(a), 329.2(a).