



## NEW JERSEY LAW REVISION COMMISSION

### Tentative Report on Revised Standard Form Contracts

**May 24, 2018**

The New Jersey Law Revision Commission is required to “[c]onduct a continuous examination of the general and permanent statutory law of this State and the judicial decisions construing it” and to propose to the Legislature revisions to the statutes to “remedy defects, reconcile conflicting provisions, clarify confusing language and eliminate redundant provisions.” *N.J.S. 1:12A-8*.

This Report is distributed to advise interested persons of the Commission's tentative recommendations and to notify them of the opportunity to submit comments. Comments should be received by the Commission no later than **August 23, 2018**.

The Commission will consider these comments before making its final recommendations to the Legislature. The Commission often substantially revises tentative recommendations as a result of the comments it receives. If you approve of the Report, please inform the Commission so that your approval can be considered along with other comments. Please send comments concerning this Report or direct any related inquiries, to:

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## Introduction

The New Jersey Law Revision Commission published a Report on Standard Form Contracts in 1998. The Report recognized that the overwhelming majority of contracts are not negotiable and recommended replacement of the current law applicable to those contracts with a statute that more accurately reflects their nature.

The Report rejected the common approach based on mutual consent or constructive consent mitigated by amorphous concepts of unconscionability based on differing bargaining power of the parties. Any consent is entirely fictional as neither party has the power to vary the contract terms, regardless of the perceived bargaining power the party has. The customer of a dry cleaner or parking lot may be more financially powerful than the dry cleaner or lot owner, but neither party can vary the terms on the back of the receipt. Instead, the contract is part of the product purchased.

As a result, the Report treated the contract like any other aspect of the product. Terms are enforced generally unless commercially unreasonable as provided in current law. The approach is entirely different, but the results are more predictable and consistent and not radically different. The approach avoids issues that have been the subject of some statutes. Can the consumer really be said to have consented to the “click wrap” that was in use at the time the initial Report was released, or to changes in terms of the contract after the relationship is established?

While the Commission’s 1998 Report gained some academic recognition, a bill to enact it was not introduced until a number of years after it was released. A bill to do so has been reintroduced in the current legislative session. With this introduction, the issues in the Report assume renewed importance. After 20 years, the Commission decided to reconsider the Report and revise it to bring it up to date.

The Act provides a legislative solution to the legal problem posed by standard form contracts. These contracts, which represent the majority of contracts used in commerce, pose the legal problem of whether the terms that they contain, which are set beforehand and usually unread by the non-authoring party, are enforceable. Ordinarily, contract terms are enforced because they are the subject of consent and the result of mutual give and take between the parties. The formation of standard form contracts is not based on consent and does not result from bargaining. To negotiate and to read standard form contracts prior to their formation would be impractical and wasteful.

Scholars and courts alike have expressed concern and skepticism concerning the enforceability of terms not subject to the typical contract bargaining process. E.g. W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 Harv. L. Rev. 529, 530-31 (maintaining that all standard form contracts are unfair because not supported by consent); *Wheeler v. St. Joseph Hospital*, 133 Cal. Rptr. 775 (Cal. Ct. App. 1976) (refusing to enforce arbitration clause in standard form contract because patient did not explicitly consent to

it). Courts have used a family of concepts, notably the doctrines of “unconscionability,” “reasonable expectations” and “contract of adhesion,” to justify refusing to enforce terms in standard form contracts deemed unfair. The courts reason that, because there was unequal bargaining power in the formation of the contract, the buyer cannot be said to have consented to all contract terms or to have expected them to be contained in the standard form contract. Therefore some terms should not be enforced against the buyer.

The judicial approach does not provide predictability as to which terms in a standard form contract are enforceable and which terms are not. Notions of “unconscionability” and “public interest” are vague and variable. In addition, the judicial approach relies on assigning “unequal bargaining power” to one of the parties. The buyer usually is considered the victim in the transaction because the buyer is assumed to be a consumer and the seller is assumed to be a large retail dealer or manufacturer. However, these assumptions do not always reflect commercial realities since the economic power of the buyer may exceed the seller’s. For example, a large corporation that buys from a retailer may purchase under the same standard terms as a consumer and, despite the buyer’s economic power, be no less a victim of the contract.

This Act determines the enforceability of standard form contract terms by providing a framework of legislatively defined rules to measure the validity of non-negotiated terms. The objective is to introduce greater degrees of certainty, predictability and clarity into the law governing standard form contracts.

Terms found in standard form contracts are divided into primary terms and secondary terms. Primary terms, those that are negotiated or based on consent, are enforced according to traditional contract law principles. Secondary terms, those that are neither negotiated nor based on consent, are enforced only as provided in the Act. The court applies the rules found in Sections 8, 9, 10 and 11 to determine the validity of secondary terms. This change of focus should produce more predictable judicial responses because the Act’s concepts are more precisely defined than is unconscionability. As a result, drafters of standard form contracts should be able to predict judicial reaction to secondary terms and thus the Act should reduce litigation of terms.

While this Act applies only to consumer transactions, it is not intended to be a consumer fraud statute and it does not replace or supersede existing consumer protection statutes.

## Section 1. Definitions

a. “Consumer” is a person that buys, leases, licenses or otherwise acquires an interest in, or incurs an obligation with respect to, a product in an open market not for resale but as an ultimate user of the product.

b. “Product” is a good, service, license or other right to personal property, tangible or intangible, or extension of credit offered in an open market.

c. “Open market” is a market where a merchant offers its product to consumers or classes of consumers.

d. “Sale” includes a purchase, lease, license or other disposition of a product in an open market.

e. “Merchant” is a person:

(1) regularly engaged in the business of offering to sell a product;

(2) that uses a standard form contract to regulate legal obligations with a consumer.

f. “Standard form contract” is a record of legal terms used by a merchant offering to sell a product to a consumer in an open market for the purpose of specifying the rights and obligations of consumer and merchant in a sale.

### COMMENT

This section defines terms used in this Act. The terms are commonly used in the law and in commercial discourse. However, in some cases, the meaning of the terms in this Act differs from their commonly understood meanings.

Subsection (a) defines the term “consumer.” This term includes anyone takes the product for consumption rather than for resale. The use of the word, “consumer” makes it clear that the act would regulate *only* consumer transactions. The definition is designed to be the same as that for consumer transactions as that term is defined for purposes of consumer fraud acts. The phrasing of the definition is derived from *Hundred East Credit Corp v. Eric Schuster*, 212 N.J. Super 350 (App. Div. 1986) construing the commercial fraud acts.

Subsection (b) defines the term “product.” The term “product” covers not only goods and services, but also covers licenses and certain financial products. The category of “licenses or other rights to personal property” includes the purchase of intellectual property or rights to information contained in software and databases. The category of “extension of credit” includes financial products such as bank loans, credit card agreements and store charge accounts. The rationale for expanding the definition of “product” beyond goods recognizes that the issue of a contract’s enforceability transcends product differences and justifies treatment of diverse contracts under a single statute.

Subsection (c) defines the term “open market.” The term “open market” means the public sale of a product. If the seller makes the product available to a large population of persons having the money to buy it, then the transaction is an open market sale. The use of the phrase “class of persons” recognizes that some sellers do not offer to sell their products to every potential buyer. For example, car lease companies cannot enter into contracts with anyone; by law, the buyer must have a license and have attained a certain age. Limitations of this sort do not change the public nature of the sale. Additionally, the market itself need not be a physical place like a retail store. It can be a mail order system, an Internet market or the like.

Subsection (d) defines the term “sale” beyond its generally accepted meaning in the law. The statutory definition covers not only sales but also covers leases, licenses or other dispositions of a product in an open market. The broad definition of the term “sale” establishes that the method of contract formation, not the form of the transaction, triggers application of the Act. If a seller uses a standard form contract, then any disposition of the product in the open market is a sale.

Subsection (e) defines the term “merchant.” The term “merchant” means any person, regularly engaged in the business of selling products that sets or adopts the record of uniform legal terms governing the relationship between itself and the buyer and that enters into the contract relationship with the consumer. The breadth of the definitions of “product” and “sale” means that a merchant could include any party in the chain of distribution if that party uses a standard form contract.

Subsection (f) defines the term “standard form contract.” A standard form contract is a contract used in an open market transaction to govern the legal relationship between the parties. These contracts are forms used by the merchant and offered to the consumer on a “take it or leave it basis.” Merchants and consumers routinely enter into standard form contracts. Examples of these contracts are parking lot and theater tickets, software licenses, and department store charge slips.

Standard form contracts are ancillary to the acquisition of goods and services; the contract terms are not the focus of the transaction. Most people do not read the contract terms because terms are not negotiable. They concentrate only on price, financing and product characteristics. The purpose of the contract is to standardize terms for the mass distribution, marketing and sale of a product to consumers. The contract is offered to any person or class of persons intending to purchase the product, that is, the contract is offered to buyers in the market whose identity is not usually known in advance by the seller. The uniformity and standardization of the contract are analogous to the uniformity and standardization of the mass manufactured product to which the contract is attached. The merchant selling the product does not intend that the pre-set contract be altered as a result of individualized negotiations at the point of sale. Rather, the merchant expects the buyer to accept or reject the contract as a whole.

Negotiation of central terms does not exclude a contract from this Act. The central terms of a standard form contract, such as price, are often negotiated in a large number of transactions. Other central terms are the product description, finance charges and options such as the purchase of insurance. Buyers tend to focus on these terms. Section 7 treats them as primary terms governed by ordinary contract rules and not subject to the Act’s special rules for secondary terms.

The term “written or other record of legal terms” includes a writing or any other record that can be reproduced, including an electronic document. The significance of this requirement is that the contract of the parties is limited to an agreement that can be reproduced in tangible form. If the contract can be reproduced in tangible form, it is a record for purposes of this Act. In addition, the parties cannot use parole evidence to alter the standard form contract. See Section 13(a). Most merchants’ representatives do not have the authority to alter the terms of standard forms, and most consumers know that they cannot rely on the statement of a store clerk or seller’s representative. Allowing parties to attempt to rely on parole evidence to alter terms is inconsistent with the purpose of the Act to establish certainty, predictability and clarity to transactions.

## **Section 2. Scope**

a. Except as provided in subsection (b), this act governs standard form contracts used in an open market.

b. This statute does not apply to any term of a standard form contract that is required to be filed with and subject to approval or disapproval by a federal or state regulatory agency prior to the sale of a product in an open market.

## COMMENT

This section defines the class of contracts to which the Act applies. The Act applies to market transactions in which the merchant uses a standard form contract to set the legal terms of the transaction. The nature of the contract, not the identity of the parties, triggers the application of the Act. There are three essential elements to the Act's breadth. First, the transaction must take place in an open market. This excludes transactions where the merchant closes the market by predefining the identity of potential buyers. Second, the object of the transaction must be a product. While the definition of product is broad, it specifically excludes contracts governed by subsection (b), as explained below, and other types of contracts such as franchise agreements. Third, the contract must qualify as a standard form contract under Section 2(f).

Subsection (b) removes from the scope of the Act any term of a standard form contract required to be filed, prior to the marketing of the product, with a federal or state agency. For example, state insurance boards exercise substantial supervisory authority over insurance companies and the standard form contracts used in their business. The Act excludes these contracts to avoid the effect of having the judicial branch second guess the judgment of the executive branch on how to regulate terms contained in these contracts.

### **Section 3. Effect on other laws**

- a. Except as provided by subsection (b), this act supersedes any law that:
  - (1) conflicts with this act; or
  - (2) makes a term in a standard form contract unenforceable because the term is unfair, unconscionable, or the result of unequal bargaining power.
- b. This Act does not supersede other statutes that:
  - (1) require the inclusion of specific terms in standard form contracts;
  - (2) prohibit the inclusion of specific terms in standard form contracts;
  - (3) impose formal requirements, other than those specified in this Act, to make a contract effective, or
  - (4) regulate consumer fraud.

## COMMENT

This section clarifies how this Act modifies existing decisional and statutory law governing standard form contracts. There are three major effects. First, the Act modifies the common law requirements for the establishment of a contract. Under the Act, a standard form contract becomes effective on purchase and delivery of the contract without respect to any indicia of consent or knowledge of the contract terms. Second, the Act abolishes the family of judicially created concepts to determine the enforcement of non-consensual terms found in a standard form contract. The standard of review for the enforcement of contract terms is the set of rules applicable to secondary terms. Third, the Act co-exists with statutes that prohibit or require the inclusion of specific terms in contracts.

*Effect on decisional law.* This Act supersedes the common law of contract developed in response to standard form contracts. Specifically, it supersedes the tests of “unconscionability,” “reasonable expectations” and “contract of adhesion” to deal with legal problems posed by non-consensual standard form contracts. It replaces these common law concepts with legislatively defined rules found in Sections 8 (default rule for secondary terms), 10 (risk of loss) and 11 (remedies for nonconforming and defective products, choice of forum and damage limitations), 12 (attorney’s fees) and 13 (unilateral change of contract terms).

*Effect on statutory law.* This Act supersedes any statute providing rules for the formation, enforcement and cancellation of standard form contract terms that conflicts with it. For example, it supersedes any statutory law making a term unenforceable because it is “unfair, unconscionable or the result of unequal bargaining power.” Because this Act and the UCC may apply to the same contracts, it is useful to discuss in some detail the interaction of the two statutes in the context of standard form contracts.

*The interaction of the Uniform Commercial Code and this Act.* The UCC applies to terms of standard form contracts and therefore overlaps with this Act. E.g., Article 2 (involving sales of goods contracts); Article 2A (involving lease contracts); Article 9 (involving security agreements in personal property). In many cases, the contract or agreement covered by the UCC may constitute a standard form contract subject to this Act. In any given case, a court must determine (1) when this Act supersedes the UCC, and (2) when the UCC supersedes this Act. The following examples illustrate these two categories.

*Example of when this Act supersedes the UCC.* This Act supersedes N.J.S. 12A:2-302(1) and N.J.S. 12A:2A-108(1) (giving a court the authority to invalidate a contract term that is deemed to have been “unconscionable” at the time the contract was made). Because this Act abolishes the doctrine of unconscionability applied to standard form contracts, buyers cannot bring a cause of action for damages and attorneys’ fees under N.J.S. 12A:2-302(1) and N.J.S. 12A:2A-108(1). The Act also is intended to preclude a court from finding that a provision is “unconscionable” because it is the product of “unconscionable conduct” under N.J.S. 12A:2A-108(2). The court must apply the relevant provisions of this Act to determine whether a secondary term is enforceable against the buyer.

Likewise, this Act supersedes the provisions of Articles 2 and 2A permitting the total exclusion of implied warranties of merchantability. N.J.S. 12A:2-316 (allowing a merchant to exclude the implied warranty of merchantability in a sales contract) and N.J.S. 12A:2A-214(2)(allowing a merchant to exclude the implied warranty of merchantability in a lease contract) in so far as those provisions apply to consumer transactions. This Act fuses the contract and tort obligations of a merchant to produce merchantable products, that is, goods that work for their intended purpose. See Section 11(a)(1) and (2). The Act permits merchants to alter this warranty only with respect to the right of refund. A merchant may require a buyer to give the merchant an opportunity to replace or repair a defective product. See Section 11(b)(2).

Where inconsistent, the provisions of this Act, and not the UCC, apply to govern a standard form contract between a merchant and a consumer. For example, Section 10(a)(4) gives a New Jersey buyer the right to bring an action in New Jersey against the seller. By contrast,

N.J.S. 12A:2A-106(2) limits the choice of forum selection in consumer leases to the jurisdiction where the consumer resides, the jurisdiction where the consumer will use the goods or the jurisdiction in which the lease is executed if the goods are used in more than one jurisdiction none of which is the residence of the consumer. In a choice of forum dispute involving a standard form lease, Section 10(a)(4) would apply and would displace the UCC rule to the extent of any inconsistency.

*Example of when the UCC supersedes this Act.* Revised Article 5 allows a bank to choose any law to govern a letter of credit. N.J.S. 5-116(a)(ch.395 §1). A letter of credit is usually a standard form contract and its secondary terms are subject to this Act where the transaction involves a consumer either as a service or extension of credit. In the overwhelming majority of cases, a choice of law term would be considered a secondary term under this Act and subject to the rule of Section 10(a)(4) (making unenforceable a choice of law clause unrelated to the parties). However, the Legislature permits banks to include any choice of law term in their credit letters. Consequently, the Section 10(a)(4) rule is superseded by the specific rule of Art. 5-116(a), and a choice of law term in an Article 5 letter of credit is not subject to review under this Act. The UCC also supersedes this Act when it forbids parties from varying legal obligations by contract. E.g. N.J.S. 12A:9-501(3)(giving rights to consumers who have defaulted under a security agreement and prohibiting the secured party from varying these rights by contract).

*Co-existence of this Act and the UCC.* This Act regulates the time when a standard form contract becomes effective and the enforcement of primary and secondary terms. It thus addresses fewer issues than does the UCC. However, both Acts may apply to any particular standard form contract.

*Effect of other statutory law on this Act.* Other statutes, containing provisions that forbid or require the inclusion of certain terms in standard form contracts, supersede this Act. Under the Act, secondary terms are unenforceable if, in the context of negotiation, the term would have caused the buyer to reject the deal. The Section 8 default rule to measure the enforceability of secondary terms does not apply to contract terms that are required to be included in standard form contracts, or are forbidden to be included in them as a matter of law.

*Illustrations of effect of other law on this act.* Subsection (c) clarifies that this statute is intended to provide a general rule for the enforcement of contract terms, but it is not intended to be the exclusive rule on that subject. The legislature has enacted a large number of statutes forbidding the inclusion of particular terms in contracts, or requiring the inclusion of particular terms in contracts. Each statute embodies an individual judgment as to a particular kind of term and is more precise in effect than any general rule can be. As such, they should continue in effect notwithstanding the general rule for enforcement of statutory terms provided by this statute. The general rule controls the overwhelming majority of cases that are not affected by individualized statutes.

Examples of statutes that require particular terms are: N.J.S. 17:11A-51 (requiring certain notices in contracts for second mortgage loans); N.J.S. 17:11C-26 and N.J.S. 17:16C-26 (requiring a term making payments on a mortgage or a retail installment contract substantially

equal); N.J.S. 56:8- 69 and 70 (requiring a minimum warranty term for used cars); N.J.S. 56:8-42(f), (g) and (h) (requiring terms on cancellation of health club contracts).

Examples of statutes that bar particular terms are: N.J.S. 17:10-13 (prohibiting wage assignments and real estate liens for small loans); N.J.S. 17:11A-49 (prohibiting insurance as part of second mortgage loans); N.J.S. 17:11C-27 (prohibiting terms: assigning wages; requiring the payment of anything but the loan and permitted charges; limiting liability of lender); N.J.S. 56:12-11 (prohibiting waivers of the plain language act); N.J.S. 56:12-15 (prohibiting certain warranty terms); N.J.S. 56:8-42(d)(prohibiting duration of health club contract beyond three years); and N.J.S. 56:8-43 (prohibiting terms that limit rights of action against third parties or assignees of health club contracts).

Other statutes regulate the content of particular kinds of contract terms. These statutes have the effect of allowing terms in a particular form or in particular circumstances but otherwise of forbidding terms on that subject. E.g., N.J.S. 17:10-14 (regulating variable rate of interest provisions); N.J.S. 17:10-14.1 (restricting life, health and disability insurance on borrowers); N.J.S. 17:10-14.3 et seq. (placing specific limits on terms of open-ended loans); N.J.S. 17:11A-53 (establishing conditions as to when terms providing for payment of attorney fees for collection of loans may be enforced); and N.J.S. 56-73 (regulating disclaimers of warranty on used cars).

*Special formation requirements.* Subsection (c)(3) pertains to the small class of contracts for which the Legislature imposes special formal requirements for the valid formation of contracts. For example, the Door-to-Door Home Repair Sales Act of 1968 requires the home repair contractor to provide the buyer with a receipt that conspicuously sets forth terms specified by the statute, N.J.S. 17:16C- 100(a). The latter statute also gives the buyer a three-day cancellation period. N.J.S.A. 17:16C-99(a)(1). The Door-to-Door Home Repair Sales Act thus contains formal requirements related to the validity of a contract that the Act does not require for the formation of a standard form contract. Consequently, a contract covered by the Door-to-Door Act is enforceable under this Act only if the contract meets the formal requirements of the Door-to-Door Home Repair Sales Act. The same reasoning applies to similar statutes imposing special formal formation requirements on certain contracts.

*Consumer protection statutes.* Subsection (c)(4) clarifies that this Act does not disturb the scheme of consumer protection statutes in this State. E.g., Consumer Fraud Act, N.J.S. 56:8-1 et seq.

#### **Section 4. Time of Effectiveness of Standard Form Contracts**

A standard form contract becomes effective when the sale occurs and the merchant either transfers the contract to the consumer or makes the contract accessible to the consumer.

#### **COMMENT**

This section defines when a standard form contract becomes effective and enforceable. A standard form contract becomes effective when two events occur. First, the buyer purchases the product. Second, the seller delivers the contract to the buyer. The question of when a sale occurs

is left to case law. However, generally a sale occurs when payment is made in exchange for a product. The formation of a standard form contract is strictly a function of a sales transaction. The contract arises solely out of the act of buying a product in an open market and the act of delivery of the contract, both of which are measurable characteristics. The formation of the contract tracks the ordinary sequence of events surrounding the purchase of most products. The acts of purchase and delivery of the contract are typical events in the process of acquiring goods and services as cases are beginning to recognize. E.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991)(enforcing choice of forum clause attached to passenger ticket for cruise); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (enforcing list of terms contained in box along with computer equipment); and *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), rev'g 908 F.Supp. 640 (W.D. Wis. 1996) (enforcing shrinkwrap license). Formation does not depend on metaphysical inquiries into the buyer's mental state at the time of sale.

The facts of *Hill v. Gateway 2000, Inc.*, supra, provide an excellent illustration of this buying process. In *Hill*, the buyers placed a telephone order for a Gateway 2000 computer by giving the Gateway representative their credit card number. Later, they received a box containing the computer and a list of terms governing the purchase. Under the Act, a standard form contract has been formed and has become effective upon the act of charging the purchase on a credit card and delivery of the contract terms. The contract is formed regardless of whether the buyer has read the contract terms and consented to them. This result follows from the presumption that the enforcement of non-negotiated terms does not depend on the buyer's consent.

This Act assumes that the buyer has not deliberated or read the terms of the contract even though the buyer has signed the contract or manifested consent in some other way prior to purchase. These assumptions are based on marketplace realities. For example, buyers order airline tickets over the telephone, and pay for them by giving a credit card account number. The buyer does not sign a document and usually, after receipt of the ticket, the buyer does not read the standard terms found on the ticket or on accompanying documentation. Other transactions fit this pattern. Purchases of theater tickets and computer software are two of them. In these cases, the act of purchase and delivery of the standard form contract result in contracts under the Act. The same pattern is followed in the resale market. E.g. *Step-Saver Data Systems, Inc. v. Wyse Technology*, 939 F.2D 91 (5th Cir. 1991)(demonstrating the practice that commercial sellers of software relied on standard form contract inserted in the box).

The "formation" definition goes beyond the rule set forth by Judge Easterbrook in *Hill v. Gateway 2000, Inc.*, supra, and *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), rev'g 908 F.Supp. 640 (W.D. Wis. 1996)(requiring an opportunity to read and to reject the contract as a necessary element of contract formation). This Act does not use the "read and reject" criterion to measure whether a contract is formed and has become effective (see Section 6 for right of cancellation). To depend on the "read and reject" rule imposes uncertainty on the status of contracts prior to the time when this "read and reject" right expires. It is preferable to define a specific point in time when the contract comes into existence.

The Supreme Court stated in *Carnival Cruise Lines*:

“In this context, it would be entirely unreasonable for us to assume that respondents – or any other cruise passenger – would negotiate with petitioner the terms of a forum selection clause in an ordinary commercial cruise ticket. Common sense dictates that a ticket of this kind will be a form contract the terms of which are not subject to negotiation, and that an individual purchasing the ticket will not have bargaining parity with the cruise line.” *Carnival Cruise Lines*, supra at 591.

The court concluded that it “stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.” Id. at 593. Under this Act, a contract is delivered if: (1) a seller physically transfers a copy of a standard form contract to a buyer or (2) a seller makes the contract accessible to a buyer. Two examples illustrate delivery. First, a seller delivers a contract to a buyer by putting the contract in the box. Second, a seller delivers a contract to a buyer by displaying the contract electronically on a computer screen at the time of purchase. Under this Act, delivery is completed based on the conduct of the seller. Delivery does not depend on a buyer’s knowledge of the contract’s terms or awareness of the contract’s existence. For example, assuming a seller has made delivery, a buyer cannot argue delivery was ineffective because the buyer discarded the standard form contract.

## **Section 5. Cancellation of Standard Form Contracts**

The consumer may cancel a standard form contract if:

- a. the terms of the contract are accessible only after the consumer has purchased the product;
- b. the consumer does not open the package more than is necessary to access the terms of the contract;
- c. the consumer does not use the product; and
- d. the consumer returns the product in its original condition and packaging within a reasonable time not to exceed 30 days.

### **COMMENT**

This section gives the buyer a limited right to rescind the contract when, due to the nature of delivery of the contract, the buyer did not have access to the contract until the contract became effective. For example, boxes of software often contain the following notice on the outside of the box: “You must accept the enclosed License Agreement before you can use the software accompanying this product. If you do not accept the terms of the License Agreement, you should promptly return the product for a refund.” In this case, the buyer cannot read the contract prior to the purchase of the software since it is enclosed within the package. Despite the inaccessibility of the contract, a contract was formed and became effective at the point of sale because payment was made and the contract was delivered in the box. This section allows the buyer to rescind the contract.

To rescind the contract, the buyer must return the product, without using it, within the time period set by the seller unless that time period is unreasonable. If the seller does not set a time period, the buyer must return the product within 30 days. A seller may set a short time

period when justified by the nature of the product. For example, in the case of ticket to a ball game or theater event, a 30-day period might extend until after the event. In most such cases, a reasonable period for cancellation could be very limited, perhaps only until the buyer has left the ticket window. In effect, under certain circumstances, a buyer may not have the option to cancel the contract.

Determining whether a product is used is obvious in most cases. However, in some cases, this determination may be difficult. For example, it is difficult to determine whether intellectual property is used. Subsection (b) provides a special rule for this class of products. Computer programs often are sold on disks that are separately sealed. If the inner seal has been broken, there is no way for the seller to know that the program has not been loaded onto the buyer's computer. Some books are similarly sealed to prevent the book from being read and returned. Subsection (b) allows a seller to protect its copyright.

## **Section 6. Primary and Secondary Terms**

- a. A term in a standard form contract is either a primary or secondary term.
- b. A primary term is a term that:
  - (1) establishes the price, financing or product specifications disclosed at the time of sale;
  - (2) identifies the product; or
  - (3) is negotiated by the consumer and the merchant at or prior to sale.
- c. A secondary term is any other term of a standard form contract. A consumer is bound by secondary terms of a standard form contract only as permitted by this Act.

### **COMMENT**

This section recognizes that terms of a standard form contract differ in the degree to which they are supported by the consent of the buyer. Some terms, such as price, are supported by the buyer's consent; other terms, such as choice of law, are not supported by the buyer's consent. This distinction justifies treating one class of terms differently from another class of terms. Subsection (a) divides contract terms into two groups: primary and secondary terms. The distinction determines which rules apply to different classes of terms contained in a single contract.

Subsection (b) defines primary terms as those to which the buyer gives express consent. The Act presumes that the buyer expressly consents to price, financing and product identity disclosed to the buyer. Terms that the buyer and seller negotiate and reduce to writing also are primary terms. The term "negotiation" implies a process of genuine give and take. Each party must have the authority to bargain for terms; a negotiated term must result from a mutual exchange of promises. While negotiated terms are rare in standard form contracts, they do occur in some markets. Primary terms bind the buyer whether or not they are advantageous to him. The only defenses to primary terms are contract defenses that negate the existence or formation of the

contract itself, such as fraud, duress, illegality or mutual mistake. No unconscionability analysis applies to enforceability of primary terms.

Subsection (c) defines secondary terms as all non-primary terms in the standard form contract. The buyer has not expressly consented to them. In fact, the buyer may not have read them. Secondary terms generally are enforceable only as permitted under Section 8 codifying a “deal-breaker” standard. The Act displaces the principles of unconscionability, commercial reasonableness and implied covenant of good faith and fair dealing to measure the enforceability of standard form contract terms. These principles are no longer necessary.

## **Section 7. Primary Terms**

A consumer is bound by primary terms of a standard form contract unless the contract is unenforceable because of fraud, illegality, duress or mutual mistake.

### **COMMENT**

As “primary terms” are defined in Section 6, these terms are supported by the consent of the buyer. Enforcement of these terms is justified by ordinary contract law.

## **Section 8. Secondary Terms: Default Rule**

a. A secondary term is enforceable unless:

(1) the term conflicts with a primary term;

(2) the term is violates a statute or regulation; or

(3) at the time of sale, the term would have caused a reasonable consumer to reject the sale.

b. Notwithstanding subsection (a), a secondary term governed by another section of this Act is enforceable as provided in that section.

c. The determination of whether a secondary term is enforceable is a question of law.

### **COMMENT**

This section contains the default rule to determine the enforceability of secondary terms. Most secondary terms will be governed by subsequent, more specific sections. The default rule applies to secondary terms when the Act’s other specific rules governing secondary terms do not apply. It is a rule of last resort.

The default rule of subsection (a) contains standards to give courts specific guidance in determining the enforceability of secondary terms. There are three components to the default rule. First, the buyer is a reasonable hypothetical buyer, not the actual buyer involved in the litigation. Second, the disadvantage of the secondary term must cause the reasonable buyer not only to reject the term itself but also to reject the entire transaction. The court does not look at the secondary term in isolation; rather the court determines whether the buyer, given the adverse

effects of the secondary term, nevertheless would have entered into the transaction. Third, if the economic benefit of the contract to the buyer outweighs the disadvantages of the secondary term, the term is enforceable. Many uniform terms in standard form contracts have the effect of reducing the cost of products thereby conferring a direct benefit on buyers. To find a secondary term unenforceable, the court must find that the reasonable buyer would have rejected the sale despite the contract's general advantages. In other words, the term is a "deal breaker." The default rule specifically rejects the conventional analysis of standard form contracts based on the two most frequently used tests: "reasonable expectations" of the buyer and "unconscionability." The reasonable expectations and unconscionability tests fail to give courts concrete guidelines as to how to resolve contract disputes. With regard to reasonable expectations, most buyers do not have any expectations concerning the subject matter of secondary terms found in standard form contracts. This observation is especially true for terms covering sophisticated legal issues. When courts ascribe expectations about secondary contract terms to buyers, courts engage in pure speculation. The better approach is to assume that buyers have never thought of secondary contract terms. This assumption reflects the behavior of actual buyers in the market. With regard to unconscionability, the term is too difficult to define. Unconscionable terms are those that are oppressive or offend public policy. But what constitutes an "oppressive" term and which "public policy" applies to any secondary term? The test of unconscionability can justify opposite results.

By contrast, the default rule focuses the court's analysis on concrete standards. The default rule does not measure whether the buyer would have consented or assented to the secondary term had the buyer had the opportunity to negotiate the contract or had adequate notice of the term. The default rule assumes that the buyer objects to the term and never had notice of it. The task of the court is to determine whether the reasonable buyer, having knowledge of the term at the time of sale, would have gone forward with the purchase even though the term disfavors the buyer. If the court finds that a reasonable buyer would not have accepted the term, even given the overall benefits of the contract, then the term is unenforceable. In that case, the remaining terms of the contract are valid. If necessary, the court fills the missing term by reference to relevant statutory or case law.

Subsection (b) clarifies that, if there is an inconsistency between a primary and secondary term, the primary term governs. Subsection (b) also clarifies that Section 8 is a rule of last resort. If a term is governed by another section of the Act, the enforceability of the term is not determined by Section 8, but by that other section. Finally, subsection (b) contains specific exceptions to the default rule. Section 8 does not apply to terms required by law to be included in contracts or prohibited by law from being included in contracts. Given this legislative decision, it would be inappropriate to allow a court to re-examine the validity or non-validity of the term. See generally Comment to Section 4(c).

Subsection (c) states that the question of whether a secondary term is enforceable is a question of law for the court to decide. This subsection follows the approach taken by UCC Article 2 for determining the legal question of unconscionability, and by UCC Article 5 for determining the legal question of whether a bank observed standard letter of credit practices. In making its determination, a court may take judicial notice of trade customs and business practices in the relevant market. In each case, the court, not the jury, determines the issue. The objective is to promote the disposition of disputes on summary judgment. This procedure should expedite the

resolution of contract litigation. Based on its survey of standard form contracts, the Commission found that most standard form contracts do not contain abusive terms. It is expected that courts will apply the default rule infrequently.

### **Section 9. Secondary Terms: Risk of Loss**

A secondary term placing a risk of loss on the consumer is enforceable only if:

- a. the amount of potential loss does not exceed the sale price of the product;
- b. the merchant makes available to the consumer insurance at a commercially reasonable price and the consumer refuses to purchase the insurance; or
- c. the loss is caused by the fault of the consumer.

#### **COMMENT**

This section applies to standard form contract provisions covering risk of loss. An example of a transfer of a risk of loss is a clause indemnifying the seller against claims for damages. In general, a risk of loss provision is unenforceable if it would impose on the buyer a financial obligation exceeding the cash price of the product. A provision of this sort effectively destroys the economic value of the purchase and therefore would also be unenforceable under Section 8(a)'s default rule.

However, a risk of loss provision is enforceable if it does not transfer a financial obligation exceeding this threshold. It also is enforceable if the seller makes insurance available to the buyer to cover a risk, and the buyer rejects that insurance. The term is enforceable against the buyer on the ground that the buyer voluntarily assumed this obligation. A buyer also is liable for risks generated by the buyer's intentional acts or negligence.

### **Section 10. Secondary Terms: Remedies for Non-Conforming and Defective Products; Choice of Forum; Damage Limitations**

a. A secondary term is unenforceable if it:

- (1) disclaims a warranty that a product matches its description;
- (2) disclaims a warranty that a product is free from defects unless the disclaimer is prominently placed and the defects are disclosed in the disclaimer or would be disclosed by inspection of the product;
- (3) limits the liability of a merchant for risk of physical injury to any person or damage to real or tangible personal property caused by a defect in the product existing at the time of sale; or
- (4) chooses the law of a jurisdiction unrelated to the parties or to the subject matter of the transaction.

b. A secondary term is enforceable if it:

(1) limits the liability of the merchant for consequential damages related to economic losses of the consumer as a result of a defect or non-conformity in the product;  
or

(2) limits a consumer's right of refund of the purchase price in the case of a defective or non-conforming product, provided the term:

(A) does not limit consumer rights under Section 6;

(B) provides the option of replacement or repair;

(C) sets a time limit for submitting a claim provided the time limitation is reasonable in relation to the nature of the product; or

(D) requires the consumer to produce reasonable proof of purchase of the product.

#### COMMENT

Subsections (a)(1) and (a)(2) codify New Jersey case law regarding product liability warranties. These warranties arise by operation of law and do not depend for their existence on contract relationships. Even though these warranties resemble contract type warranties, they cannot be altered or limited by contract. These warranties also ignore the impediments of privity of contract. They are stated to clarify the zone of fixed liability for a maker, distributor or seller of a defective new product.

This civil obligation has never been harmonized with the Uniform Commercial Code, which establishes an entirely different set of rules for warranties. The Code speaks of an implied warranty of merchantability to refer to the fact that a product should work according to the way it is expected to be normally used. This can mean nothing less than the Henningsen duty of a manufacturer or seller to make a product free from defects. However, the Code allows a seller to exclude or modify this implied warranty of merchantability by disclaiming it. The Code also makes it hard for a buyer to state a claim for breach of this warranty by setting up procedural hurdles, such as notice of the defect. It is contrary to the fundamental purpose of the sale to allow the seller to disclaim its implied promise that its product will work according to the way it is expected to be normally used.

With one exception, subsections (a)(1) and (a)(2) establish that, as a matter of law, the seller cannot disclaim its two fundamental duties: (1) to place a product in commerce free of defects and (2) to deliver a product matching the description of the sale. The exception allows sellers to sell defective products provided the seller discloses the defects to the buyer or provided the defects would have been discovered upon inspection.

Subsection (a)(3) establishes that, as a matter of law, the seller cannot enforce a term that limits its liability for damage to property or to persons caused by a product defect attributable to the seller.

Subsection (a)(4) limits choice of law to a place having a reasonable relationship to the parties or to the transaction. The limitation is based on the policy that individuals cannot choose their sovereigns in the abstract but are held to the law where they reside or have conducted their

business. Subsection (b)(1) permits a seller to limit its liability for consequential damages related to the buyer's economic losses. This limitation is an important risk control for the seller. For example, a seller of a roll of film limits its liability for economic loss to the value of the roll of film. This limitation of liability is an important factor in establishing the price of film. To allow recovery for consequential damages in claims seeking economic loss would subject sellers, such as film manufacturers, to an unpredictable level of liability that would affect the price of the product. Subsection (b)(1) follows the reasoning in *Alloway v. General Marine Industries*, 149 N.J. 620 (1997) (holding that the law of tort does not apply to an action for recovery of economic loss due to a defect in a product), and rejects the holding in *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 64-65 (1965) (finding that a buyer may recover economic loss based on product liability).

Subsection (b)(2) authorizes sellers to limit the refund of price remedy in three narrowly defined ways. First, a seller may require a buyer to return the product and to give the seller an opportunity to repair the product. Alternatively, a seller may replace the product instead of providing a price refund. Second, a seller may stipulate a reasonable time period in which the buyer must submit a claim. Third, a seller may require the production of reasonable proof that the product was purchased from the seller. Cases of cover are governed by the UCC.

Subsection (b)(2) is consistent with the "Refund Policy Disclosure Act." N.J.S.A. 56:8-2.14 et seq. (requiring retail stores to post notice of return policy that varies presumptive right of return within 20 days of purchase date. Additionally, this subsection does not affect rights that a consumer may have as to motor vehicles under the "Lemon Law." N.J.S.A. 56:12-29 through 49. Rights under the "Lemon Law" are separate from any rights under contractual agreements. See N.J.S.A. 56:12-47.

## **Section 11. Attorney fees**

A secondary term that shifts to the consumer the obligation to pay the merchant's reasonable attorneys' fees and costs of litigation shall be enforceable and shall operate to allow a consumer who prevails to recover attorneys' fees and costs of litigation from the merchant.

### **COMMENT**

This section provides that a term shifting the seller's legal fees and expenses of litigation to the buyer shall be interpreted to impose the "English" rule governing the payment of attorney's fees and litigation expenses on the parties. If the buyer prevails, the seller pays the buyer's fees and costs.

## **Section 12. Interpretation of Contract; Unilateral Change of Contract Terms**

a. Terms of a standard form contract may not be contradicted by evidence of a prior, contemporaneous or subsequent oral agreement. A court may use evidence extrinsic to the contract only to interpret an ambiguous term.

b. A merchant may change a term of a standard form contract after the term has become effective if:

- (1) the standard form contract may be terminated by either merchant or consumer at any time without penalty;
- (2) the merchant gives written notice of the change;
- (3) the merchant instructs the consumer how to cancel the contract; and
- (4) the change of terms applies prospectively.

#### **COMMENT**

Subsection (a) establishes that the standard form contract is the final expression of the parties' contract. If the contract contains ambiguous terms or language, subsection (a) authorizes the judge to take into consideration evidence extrinsic to the contract to resolve the ambiguity. However, the parole evidence rule cannot be used to offer evidence of oral agreements that would alter the written terms of standard form contracts. Cf., N.J.S.A. 12A:2A-202(written agreement intended as final expression may not be contradicted by evidence of a prior agreement or contemporaneous oral agreement).

Subsection (b) codifies the market practice whereby sellers of certain products unilaterally change the terms of the contract. Examples of such contracts are revolving account agreements. This Act allows for a unilateral change of contract terms provided that the contract constitutes a continuing commercial relationship over a period of time and that each party has the right to terminate the contract without penalty. A seller may change the terms of the contract unilaterally if the seller gives notice of the change, including a description of the new term; applies the change prospectively and gives the purchaser an opportunity to cancel the contract. The option to change contract terms under this subsection is not available for contracts covering a designated period of time, involving a continuing relationship between the parties and setting definite rights and obligations between buyer and seller, such as a long term car lease.