



UNFAIR TERMS IN CONTRACTS

A Joint Consultation Paper

EXECUTIVE SUMMARY

Scottish Law Commission Discussion Paper No 119

Law Commission Consultation Paper No 166

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UNFAIR TERMS IN CONTRACTS

Executive summary

THE BACKGROUND TO THE CONSULTATION PAPER

- S.1 Without adequate legal controls, there is a risk that the terms of contracts will be unfair to one of the parties. This applies to both contracts between a business and a consumer (“consumer contracts”) and business-to-business contracts, and is particularly the case where the terms of the contract have been drawn up by one party in advance. Although the other party may “agree” to the contract, he may not be aware of the term in question, or may not understand its implications. Even if he does realise what the term means, he may find that the other party is unwilling to change its “standard terms” just for him. Both Parliament and the courts have been concerned about unfair contract terms for many years.
- S.2 Legislation to combat unfair terms was first passed in the 19th century. Until 1994 the controls centred on clauses which exclude or limit liability; the principal Act is now the Unfair Contract Terms Act 1977 (UCTA). However, in 1993 the European Council of Ministers passed a Directive on Unfair Terms on Consumer Contracts¹ which applies (with limited exceptions) to unfair terms of any type in consumer contracts. The Directive was implemented in the UK by Regulations made under the European Communities Act 1972; these have now been superseded by the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).² The Regulations did not amend or repeal UCTA; they provide an additional set of controls. Thus potentially unfair terms in contracts are at present subject to one or both of two quite separate legal regimes.
- S.3 If the term in question is one that purports to exclude or restrict the liability of one of the parties, it is likely to be subject to UCTA. UCTA applies both to consumer contracts and to contracts between businesses.³ It may have the effect that the exclusion or restriction of liability is completely ineffective; or it may invalidate the term unless it “satisfies the requirement of reasonableness”.
- S.4 If the term is in a consumer contract it will normally be subject to UTCCR. UTCCR can apply to almost any type of term that has not been “individually negotiated”, and will invalidate the term if it is “unfair”. However, UTCCR do not apply to “core” terms involving the subject matter or the price of the goods or services.
- S.5 The principal differences between UCTA and UTCCR are as follows:

¹ Council Directive 93/13/EEC on unfair terms in consumer contracts (OJ L95, 21.4.93, p 29).

² SI 1999 No 2083. See also Unfair Terms in Consumer Contracts (Amendment) Regulations 2001 (SI 2001 No 1186).

³ UCTA also applies to notices that purport to exclude or restrict liability in tort [delict] for negligence [breach of duty] and to some exclusions and restrictions in contracts even where neither party is acting in the course of a business.

S.6 UCTA:

- (1) applies to both consumer and business-to-business contracts, and also to terms and notices excluding certain liabilities in tort [or, in Scotland, delict];
- (2) applies only to exclusion and limitation of liability clauses (and indemnity clauses in consumer contracts);
- (3) makes certain exclusions or restrictions of no effect at all;
- (4) subjects others to a “reasonableness” test;
- (5) contains guidelines for the application of the reasonableness test;
- (6) puts the burden of proving that a term within its scope is reasonable on the party seeking to rely on the clause;
- (7) applies for the most part whether the terms were negotiated or were in a “standard form”;
- (8) does not apply to certain types of contract, even when they are consumer contracts;
- (9) has effect only between the immediate parties; and
- (10) has separate provisions for Scotland.

S.7 In contrast, UTCCR:

- (1) apply only to consumer contracts;
- (2) apply to any kind of term other than the definition of the main subject matter of the contract and the price;
- (3) do not make any particular type of term of no effect at all;
- (4) subject the terms to a “fairness” test;
- (5) do not contain detailed guidelines as to how that test should be applied, but contain a list of terms which “may be regarded” as unfair;
- (6) leave the burden of proof that the clause is unfair on the consumer;
- (7) apply only to terms that have not been “individually negotiated”;
- (8) apply to consumer contracts of all kinds;
- (9) are not only effective between the parties but empower various bodies to take action to prevent the use of unfair terms; and
- (10) apply to the UK as a whole.

S.8 Thus the two regimes have different scopes of application; to some extent they overlap; and they have different effects. In addition they use different concepts and terminology. The resulting complexity and inconsistency have been severely criticised.

THE THREE PARTS OF THE PROJECT

S.9 The project has three parts. The first part is to consider the feasibility of a single, unified regime to replace UCTA and UTCCR. (The new regime will replace both the controls

over consumer contracts and the non-consumer aspects of UCTA.) This part of the project is primarily an exercise in simplification, though it also examines the impact on exclusion clauses of the recent European Directive on certain aspects of consumer sales (SCGD).⁴ Except as required by that Directive, it is not proposed that there should be any significant increase in the extent of controls over terms in consumer contracts, nor any great reduction in consumer protection.

- S.10 The second part of the project considers extending the scope of the legislation to cover the kinds of unfair term in a “business-to-business” contract that are presently outside the scope of UCTA but that, had they been in a consumer contract, would have been within UTCCR.
- S.11 The third part of the project is to produce draft legislation that will be clearer and more accessible to the reader than either UCTA or UTCCR. UCTA is a complex piece of legislation that it is hard to understand without very careful reading. UTCCR are in a much simpler style. However, because they largely “copy out” the Directive, UTCCR sometimes use terminology that is alien to readers in the UK, lawyers and non-lawyers alike; and in order to interpret them in what we believe to be the correct way, it is frequently necessary to “read into” phrases a good deal that is not apparent on the face of the language. We think that the use of simpler language and clearer structures could make the new legislation much easier to understand. This consultation paper includes some draft legislation prepared by Parliamentary Counsel, to give consultees an idea of how we think the new legislation might look.
- S.12 This summary does not cover every point in the consultation paper, and in some cases the proposals are stated in a simplified version. References are to the provisional proposal (or, where we make no proposal, the question on which we invite views) in the body of the consultation paper itself. A full list of proposals and questions will be found in Part IX of the consultation paper.

COMBINING THE REGIMES FOR CONSUMERS

Restraints and policies

- S.13 Any new legislation combining the regimes must implement fully the Directive on Unfair Terms and SCGD. We also consider that there should be no substantial reduction in the protection currently provided to consumers or businesses.⁵ However, we see no need to have different provisions for England and Wales on the one hand and Scotland on the other.⁶
- S.14 As far as consumers are concerned, our provisional proposals are as follows:
- (1) Certain terms that under UCTA are of no effect in any circumstances, should continue to be so.⁷

⁴ Council Directive 99/44/EC on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees (OJ L171, 7.7.99, p 12).

⁵ Para 4.29.

⁶ Para 4.17.

⁷ With the exception of UCTA s 5, which we believe to be redundant.

- (2) All other terms that are not specifically exempted should be valid only if they are “fair and reasonable”.⁸
- (3) The requirement that the term be fair and reasonable should apply whether or not the term was individually negotiated. (This is already the case for terms that are within UCTA. In addition, we think that consumers are unlikely to have a sufficiently full understanding of the implications of other terms, except “core terms”, that a term can be said to be “fair” simply because there was a degree of negotiation over it.)⁹
- (4) The “definition of the main subject matter” of the contract should be exempt from challenge (as under UTCCR), but it should be made clear that the exemption applies only so far as the subject matter is not substantially different to what the consumer should reasonably expect. The definition must also be in plain language (transparent).¹⁰
- (5) Similarly the “adequacy of the price” should be exempt from review provided that having to make the payment is not substantially different to what the consumer should reasonably expect and is not under a subsidiary term. The price must also be stated in plain language (transparent).¹¹
- (6) Terms that merely reproduce what would be the law in the absence of contrary agreement should be exempt, but only if the terms are in plain language (transparent).¹²
- (7) The new legislation should provide detailed guidelines on the application of the “fair and reasonable” test.¹³
- (8) The list of relevant factors should include not just whether the term is in “plain and intelligible language” (as under UTCCR) but whether the term is “transparent” in the sense that, for example, it is reasonably easy to follow and to read.¹⁴ (Transparency should also replace “plain language” as a requirement of the exemptions referred to at (4)–(6) above.)
- (9) The legislation should contain a list of terms that will be unfair unless the business shows otherwise. The list should not follow the list in the Annex to the Directive word for word, but rather should refer to the types of clause found in the UK, and use UK terminology.¹⁵ It should give examples of each type of clause, and it should list common types of unfair term that are not in the Annex to the Directive.¹⁶

⁸ See para 4.40.

⁹ Para 4.52.

¹⁰ Para 4.58.

¹¹ Para 4.66.

¹² Para 4.71.

¹³ Para 4.99.

¹⁴ Para 4.102.

¹⁵ Para 4.120.

¹⁶ Para 4.138.

- (10) A term which is unfair should be of no effect except to the extent that it is beneficial to the consumer.¹⁷
- (11) The existing powers given to the Director-General of Fair Trading and various listed bodies to act to prevent the use of unfair terms should continue. We ask who should bear the burden of proof in these cases, and whether there should be powers to prevent practices of negotiating terms that are unfair.¹⁸

S.15 We invite views on whether the burden of proving that a term is fair should *always* rest on the business, or whether the consumer should have to show that the term is unfair unless the term in question is on the list referred to in (9) above.¹⁹

BUSINESS-TO-BUSINESS CONTRACTS

S.16 As far as individual business-to-business contracts are concerned, we think that the somewhat wider range of terms that (for consumer contracts) are subject to UTCCR should equally be subject to control in business-to-business contracts.²⁰ Terms that, for instance, make it hard for a business to cancel a long-term contract, or that commit it to paying price increases, have just as much potential for unfairness as many of the clauses already covered by UCTA. Protection should not depend on the size of the business affected by the term, though relative size should be a factor in determining whether the term is fair and reasonable.²¹ Some of the existing, more stringent controls of UCTA should be maintained. Thus:

- (1) Terms of a business-to-business contract that, under UCTA, are of no effect in any circumstances, should continue to be so.
- (2) Other terms in business-to-business contracts that are “standard” or have not been “individually negotiated” should be subject to a “fair and reasonable test”²² (with similar exceptions for the main definition of the subject matter, the adequacy of the price and terms that reflect the general “default” law as for consumer contracts²³).
- (3) Individually negotiated terms which, under UCTA, are subject to the requirement of reasonableness should no longer be controlled. (We think that businesses can be expected to understand the implications of individually negotiated terms and to take steps to safeguard their position.)²⁴
- (4) The question should be whether the term has been “individually negotiated” rather than whether it is “standard”.²⁵

¹⁷ Para 4.185.

¹⁸ Para 4.196.

¹⁹ Para 4.145.

²⁰ Para 5.24.

²¹ Para 5.39.

²² Para 5.43.

²³ Para 5.60.

²⁴ Para 5.46.

²⁵ Para 5.58.

- (5) The existing exemptions from UCTA (for example, contracts of insurance) should continue, though we invite views on whether international business-to-business contracts, and contracts subject to the law of a part of the UK only by choice of the parties, should be exempt from the controls proposed for domestic contracts.²⁶
- (6) The same basic test of “fairness and reasonableness” as for consumer contracts should apply in business-to-business contracts;²⁷ and “transparency” should be incorporated into the list of factors for business-to-business contracts.²⁸
- (7) The legislation should contain the same list of factors as that for consumer contracts.²⁹
- (8) There should also be a list of terms that will be treated as unfair and unreasonable unless the contrary has been shown. The list should be limited to clauses excluding and restricting liability for breach of contract or for negligence [breach of duty], but there should be power to add to the list by Ministerial Order.³⁰
- (9) Where a term is not on the list, the burden of proving that it is not fair and reasonable should be on the party disputing it.³¹

S.17 We invite consultees to comment on the desirability and the practicability of extending the preventive controls over unfair terms to business-to-business contracts.³²

SALE OR SUPPLY OF GOODS NOT RELATED TO BUSINESS

S.18 The existing controls over clauses excluding or restricting implied obligations as to title, etc in contracts for the sale or supply of goods should be replicated in the new legislation.³³

S.19 Clauses which exclude or restrict liability for breach of the obligations as to correspondence with description or sample should remain subject to a “fair and reasonable” test when the sale is between private parties or is by a consumer to a business, irrespective of whether the clause has been negotiated.³⁴

²⁶ Paras 5.65, 5.69 and 5.71.

²⁷ Para 5.74.

²⁸ Para 5.78.

²⁹ Para 5.82.

³⁰ Para 5.87.

³¹ Para 5.89.

³² Para 5.109.

³³ Para 6.5.

³⁴ Para 6.12.

NON-CONTRACTUAL NOTICES EXCLUDING BUSINESS LIABILITY FOR NEGLIGENCE OR BREACH OF DUTY

- S.20 The existing controls over notices which might otherwise exclude a business's liability in tort [delict] to persons with whom it does not have a contractual relationship and who are killed, injured or harmed by its negligence [breach of duty] should be maintained.³⁵
- S.21 The preventive powers should be extended to cover non-contractual notices that purport to exclude or restrict a business's liability in tort [delict].³⁶

³⁵ Para 7.3.

³⁶ Para 7.8.