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Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills

SUMMARY

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THE LAW COMMISSION
AND
THE SCOTTISH LAW COMMISSION

UNFAIR TERMS IN CONSUMER CONTRACTS: Advice to the Department for Business, Innovation and Skills

SUMMARY

S.1 For many years, the law on unfair contract terms has been criticised for its complexity. It is set out in two separate pieces of legislation:

(1) The Unfair Contract Terms Act 1977 (UCTA) focuses on exclusion clauses. It applies to a broad range of contracts, including those made between businesses and between businesses and consumers.

(2) The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR)[1] implement the Unfair Terms Directive 1993 (UTD).[2] They apply only to contracts between businesses and consumers, but cover a greater variety of non-negotiated terms. Terms may be challenged not only by consumers but by 12 designated enforcement bodies.

S.2 In 2005 the Law Commission and Scottish Law Commission published a joint Report on Unfair Terms.[3] We recommended a single harmonised regime to replace both UCTA and the UTCCR.

S.3 In May 2012, the Department for Business, Innovation and Skills (BIS) asked the two Law Commissions to review and update this Report in so far as it affects contracts made between businesses and consumers. We were also asked to consider one particularly controversial area: namely the exemption for main subject matter and price currently set out in Regulation 6(2) of the UTCCR.

S.4 In July 2012 we published an Issues Paper seeking views and received 58 responses.[4] The responses showed strong support for reform.

1 SI 1999 No 2083.

2 Council Directive 93/13/EEC of 5 April 1993, OJ 1993 L 95.

3 Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199.

4 Unfair Terms in Consumer Contracts: a new approach? (July 2012), A Joint Issues Paper by the Law Commission and the Scottish Law Commission.

MINIMUM HARMONISATION

S.5 The UTD is a minimum harmonisation measure, which means that the UK may provide more protection to consumers than is required by the Directive, but may not provide less protection. Where it has been necessary to depart from the words of the Directive, we have ensured consumer rights are not reduced.

THE EXEMPTION FOR MAIN SUBJECT MATTER AND PRICE

The current law (Part 2)

S.6 The UTD exempts certain contract terms from review, provided that they are "in plain intelligible language". Article 4(2) states that a fairness assessment may not relate to "the definition of the subject mater of the contract" or "the adequacy of the price and remuneration…as against the services or goods supplied in exchange". These words have been copied out into the implementing regulations and are now in Regulation 6(2) of the UTCCR.

S.7 The exemption has proved particularly difficult to interpret. It has generated complex litigation, culminating in the 2009 Supreme Court decision, *Office of Fair Trading v Abbey National plc*.[5] This was a test case against seven banks and a building society. The issue was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms.

S.8 The High Court and Court of Appeal found that the terms were not exempt, because they were not part of the essential bargain between the parties, and a typical consumer would not recognise the charges as part of the price. By contrast, the Supreme Court said that overdraft charges were exempt. It rejected the idea that price terms could be divided into those which formed the essential bargain and those which were ancillary. It said that the price should be determined "objectively", rather than from the viewpoint of a typical consumer. The judgment has proved difficult to interpret, with regulators and businesses expressing different views.

The case for reform (Part 2)

S.9 In the Issues Paper we asked whether the law in this area was unduly uncertain. A large majority of consultees agreed that it was. Consumer groups and enforcement bodies felt that this undermined the effectiveness of the legislation:

> It is virtually impossible for consumers to apply the rules confidently. [Which?]
>
> Any law that is so complex and could lead to such great delays through judicial interpretation does not meet a fitness for purpose test for consumer protection legislation. [Trading Standards Institute]
>
> The Supreme Court decision has led us to be very cautious in our assessment of unfair terms [Civil Aviation Authority]

S.10 Only a small minority of consultees thought that the law was certain. HSBC commented:

[5] [2009] UKSC 6, [2010] 1 AC 696.

The Supreme Court's decision was clear that, in relation to price terms, "any monetary price or remuneration payable under the contract" would naturally fall within the exemption.

S.11 We think that the words of the judgment may be lulling some businesses into a false sense of security. There are other ways to interpret the judgment – and it could be overturned by the Court of Justice of the European Union (CJEU). The German Federal Supreme Court takes a different view on the UTD and has reviewed ancillary bank charges for fairness.[6]

S.12 In a world of price comparison websites, there is increasing pressure on traders to advertise low headline prices, whilst earning their profits through other charges. Given this potential undermining of competition, the law should provide effective tools to prevent abuse.

S.13 The current uncertainty has the potential to damage businesses as well as consumers. If a business uses an ancillary price term to subsidise a low headline price, the business is put at risk if the term is later found to be unfair. It faces the substantial costs of litigation; the reputational damage to its business; the cost of repaying consumers; and the demise of its business model.

S.14 We recommend that the exemption for subject matter and price should be reformed. The current law is unacceptably uncertain. It requires significant legal expertise to navigate, and even then the outcome is unpredictable. Both consumers and traders may suffer from this uncertainty.

The need to protect against small print (Part 3)

S.15 We think that the exemption should distinguish between terms which are subject to competition and those which are buried in "small print". Where consumers know about the terms proffered by traders, they are able to take them into account in their choices: the law should not seek to protect consumers from the consequences of their own decisions.

S.16 By contrast, consumers rarely read "small print". "Small print" is a concept instantly understood by consumers in their daily lives. It is not just about font size. It is also marked by poor layout, densely phrased paragraphs and legal jargon. Often simply labelling a hyper-link as "terms and conditions" is sufficient to ensure that most consumers do not read the document. We think that all small print terms should be assessable for fairness.

A new approach based on transparency and prominence (Part 3 and 4)

S.17 The 2005 Report proposed that the exemption should not apply to payments which are "incidental or ancillary to the main purpose of the contract". In *Abbey National* this test was considered too uncertain.

[6] For further discussion, see Issues Paper, paras 7.56 to 7.61.

S.18 We now recommend that price or main subject matter terms should be exempt from review only if they are transparent and prominent. Both approaches distinguish between the terms which consumers take into account in their decision to buy the product and those which become lost in small print. The emphasis on prominence, however, offers a practical way of distinguishing between a headline price and other charges. It also emphasises that whether a term is exempt is within the control of the trader.

S.19 We recommend that:

(1) "Transparent" should be defined as in plain, intelligible language; readily available; and, if in writing, legible.

(2) The test of "prominence" should refer to the "average consumer" test, which is widely used in European consumer law. It refers to a hypothetical consumer who is "reasonably well informed, reasonably observant and circumspect".[7] A term would be prominent if it is presented in such a way that the average consumer would be aware of the term. The more unusual or onerous the term, the more prominent it needs to be.

S.20 All terms of a contract should be transparent. As discussed below, if they are not, enforcement agencies should be able to challenge them. Clearly not all terms can be prominent. Simply because a term is not prominent does not make it unfair; nor does it raise a presumption that it is unfair. It could, however, be assessed for fairness.

Consultees' views

S.21 More than half of those responding agreed that a price term should be excluded from review, but only if it is transparent and prominent. Support came from all categories of consultee: businesses and business groups; consumer groups; public bodies; academics; and the judiciary and lawyers.

> Transparency and prominence would not only ensure fairness but also further promote competition. [Direct Line Group]
>
> Prominence of the price is key to ensure that consumers know what they are getting for their money [MoneySavingExpert.com]
>
> Traders can be expected to welcome the degree of control which they would have over the application of the exemption. [Malcolm Waters QC]

S.22 Only two consultees disagreed with the tests in their entirety. Several businesses had concerns, however, particularly about how they would work in practice. We think that many of these concerns can be met by guidance from regulators.

[7] See Case C-210/96 *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung* [1998] ECR I-4657.

S.23 Some regulators and consumer groups argued that prominence and transparency alone may not always be sufficient. Relying on the insights of behavioural economics, they said that consumers may ignore remote or contingent charges, even if they are prominent. We note that the Directive already makes provisions for behavioural biases in the annex or "grey list" of terms which may be regarded as unfair. We think it is helpful to clarify that grey list terms cannot fall within the exemption.

Excluded term or excluded assessment?

S.24 One particular difficulty in understanding the exemption is whether it excludes the whole term (the excluded term construction) or only an aspect of the term (the excluded assessment construction).

S.25 The case law suggests that the courts may consider some aspects of price terms, such as their timing or calculation. It is only the amount (or "adequacy") of the price which cannot be assessed for fairness. In *Foxtons v O'Reardon*, for example, the term concerned the payment of the estate agent's commission, which was due on exchange of contracts rather than on completion of the sale.[8] Although this was a price term, the court was able to consider the timing of the payment, as this did not involve an assessment of "the adequacy of the price".[9]

S.26 In the Issues Paper we argued that it would be simpler to concentrate on the term. Following consultation we have been persuaded that this would under-implement the Directive. To ensure that the UK meets its minimum harmonisation obligation, we recommend that the legislation should follow the approach of the Directive in stating that it is only the amount of the price which is excluded from review. Other aspects of price terms, such as timing, may be assessed for fairness.

S.27 By contrast, we think that the exemption for main subject matter applies to *all* aspects of the term. Thus if the term specifies the main subject matter, the court may not consider its fairness at all. We considered, but rejected, the idea that a court could assess the fairness of any aspect of the main subject matter, provided that it did not consider how the main subject matter had been defined.

Suggested redraft

S.28 Although the wording will be a matter for Parliamentary Counsel, we conclude that the exemption should be redrafted along the following lines:

> No assessment of fairness shall be made-
>
> (a) of a term which specifies the main subject matter of the contract; or
>
> (b) of the amount of the price, as against the goods or services supplied in exchange,

[8] [2011] EWHC 2946 (QB).

[9] The court did not consider this to be unfair and, in any event, it decided that the term was exempt as a result of the operation of the first limb of the exemption (Regulation 6(2)(a)).

provided that the term in question is transparent and prominent.

Guidance

S.29 It is important that the practicalities of making price charges prominent should fit in with other regulations, particularly for financial services, utilities or mobile phone contracts. We recommend that regulators should publish sector-specific guidance on the meaning of "transparent and prominent" to assist businesses.

THE GREY LIST (PART 5)

S.30 Schedule 2 of the UTCCR contains an indicative and non-exhaustive list of terms which may be regarded as unfair (the grey list). It reproduces word for word the Annex to the UTD. We recommend that the legislation should specifically state that all terms on the grey list are assessable for fairness.

S.31 Following consultation we have been persuaded that the grey list should be retained in its current form with some limited additions. We recommend three additions to the grey list. These are terms which have the object or effect of:

(1) permitting the trader to claim disproportionately high sums in compensation or for services which have not been supplied, where the consumer has attempted to cancel the contract;

(2) giving the trader discretion to decide the amount of the price after the consumer has become bound by the contract;[10] and

(3) giving the trader discretion to decide the subject matter of the contract after the consumer has become bound by it.[11]

COPY OUT AND THE FAIRNESS TEST (PART 6)

S.32 In the Issues Paper we asked whether the UTCCR should be rewritten in more accessible language. We have been persuaded by the strong arguments put to us that the words of the UTD should be changed only if there is a good reason to do so. We therefore recommend that the fairness test set out in articles 3(1) and 4(1) of the UTD should be replicated in the new legislation.

THE NEED FOR TRANSPARENCY (PART 6)

S.33 Article 5 of the UTD states that written contracts "must always be drafted in plain intelligible language". Recital 20 expands this concept to say that "the consumer should actually be given an opportunity to examine all the terms". We have concluded that article 5 goes beyond the words used, and also requires that terms are legible and readily available. We therefore recommend that the legislation should require terms to be "transparent", which incorporates all three concepts.

[10] This would be subject to the exceptions listed in Schedule 2 paragraph 2.

[11] See above.

S.34 Article 5 does not spell out the consequences of failing to make a term transparent. We do not think that non-transparent terms are automatically unfair, though it is an important factor to consider. Under the Consumer Injunctions Directive, however, enforcement bodies must have the power to prevent their use. We recommend that the legislation should clarify that enforcement bodies may use their powers under Part 8 of the Enterprise Act 2002 against terms which are not transparent.

OTHER ISSUES (PART 7)

Terms of no effect

S.35 An aim of this project is to bring all unfair term provisions affecting business to consumer contracts together. Therefore, we recommend that the new legislation should replicate the substance of the provisions of UCTA concerning terms and notices which purport to exclude or restrict traders' liability for causing death or personal injury. Such terms should always be considered unfair.

End user licence agreements and notices

S.36 Many end user licence agreements do not have the status of contract terms, yet they often contain exclusion clauses. The clauses are usually unenforceable but may still have a damaging effect by discouraging consumers from claiming their rights. As the UTCCR only apply to contract terms, enforcement bodies cannot take action against clauses which do not have contractual status.

S.37 By contrast, UCTA protects consumers against exclusion clauses, whether they are contract terms or mere notices. We recommend that the new legislation should cover notices which exclude a trader's liability to a consumer. Where they are unfair, enforcement bodies would have powers to bring actions against them.

Terms which reflect existing law

S.38 The UTD exempts terms from review if they merely reflect the existing law. Article 1(2) of the UTD refers to "mandatory statutory or regulatory provisions" but Recital 13 explains that this covers "rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established". We recommend that the new legislation should reflect the words of Recital 13.

Negotiated terms

S.39 UCTA applies to all consumer contracts, whether or not they are negotiated. By contrast, negotiated terms are exempt under the UTCCR, though negotiated terms are defined narrowly.

S.40 We recommend that the new legislation should follow UCTA and apply to negotiated terms. This will affect very few cases. As Which? point out, in practice the vast majority of negotiated terms fall within the exemption for main subject matter or price. Where terms about other issues are genuinely negotiated, they are unlikely to be found unfair. On the other hand, the current exemption for negotiated terms in the UTCCR encourages unnecessary argument and litigation. The legislation will be simpler and more easily enforced if the distinction between standard terms and negotiated terms is removed.

The burden of showing that a term is fair

S.41 The CJEU recognises that few consumers have the legal expertise to prove that a term is unfair. It has therefore stressed that national courts must consider the fairness of terms on their own motion. We recommend that the new legislation should reflect this case law explicitly, so that the courts are aware of their duty.

S.42 We do not think that it is necessary to make any other statements about the burden of proof. In practice, issues about the burden of proof are unlike to arise.

Definition of a consumer

S.43 We recommend that the definition of a consumer should be consistent across the new consumer legislation being considered by BIS. The new definition is likely to be narrower than the definition of "dealing as a consumer" in UCTA, but the loss of protection for businesses will be negligible. A consistent definition will introduce much needed simplification.

Remaining role of UCTA

S.44 The new provisions on unfair terms would only affect contracts made between businesses and consumers. UCTA is wider. It applies to contracts made between businesses, between businesses and consumers, employment contracts and even, to some extent, "private contracts" where neither party is a business.

S.45 We have considered the effect of a reformed UCTA on employment and private contracts as well as businesses dealing as consumers. We think that all references to "dealing as a consumer" should be removed from UCTA. We also invite BIS to consider whether an opportunity can be found to consolidate the law on private sale contracts.

Full version of this Advice is available at:

http://lawcommission.justice.gov.uk/areas/unfair_terms_in_contracts.htm

and http://www.scotlawcom.gov.uk

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