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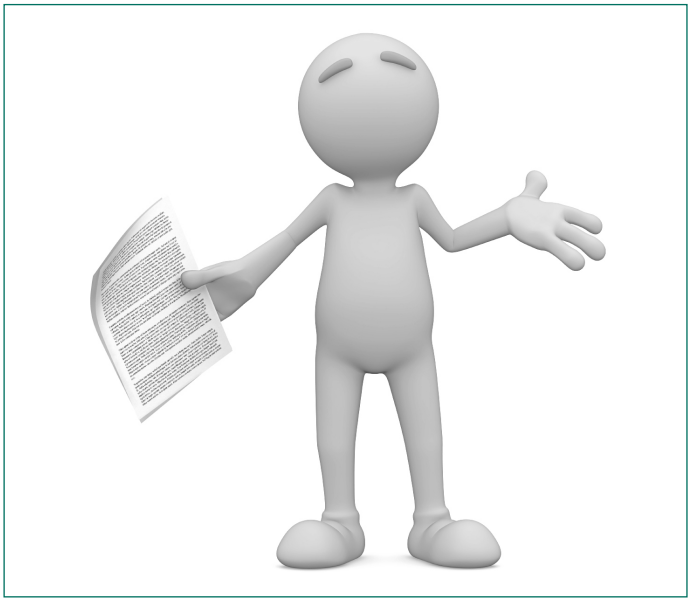
Unfair Terms in Consumer Contracts: a new approach?
Summary of the Issues Paper



July 2012

The Law Commission
and
The Scottish Law Commission

UNFAIR TERMS IN CONSUMER CONTRACTS: A NEW APPROACH?

Summary of the Issues Paper

THE LAW COMMISSIONS: HOW WE CONSULT

About the Commissions: The Law Commission and the Scottish Law Commission were set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

- The Law Commissioners are: The Rt Hon Lord Justice Munby (*Chairman)*, Professor Elizabeth Cooke, Mr David Hertzell, Professor David Ormerod and Frances Patterson QC. The Chief Executive is Elaine Lorimer.
- The Scottish Law Commissioners are: The Hon Lady Clark of Calton (*Chairman*), Laura J Dunlop QC, Patrick J Layden QC TD, Professor Hector L MacQueen and Dr Andrew J M Steven. The Chief Executive is Malcolm McMillan.

Topic: This consultation covers unfair terms in standard form contracts between businesses and consumers.

Geographical scope: England and Wales, Scotland.

An impact assessment is available on our websites.

Previous engagement: In 2001, the Department of Trade and Industry asked the Law Commissions to rewrite the law of unfair contract terms as a single regime, in a clearer and more accessible style. Subsequently, in 2005, we published a Report on Unfair Terms in Contracts with a draft Bill. This can be found on our websites.

Duration of the consultation: 25 July 2012 to **25 October 2012**.

How to respond

Send your responses either –

By email to: commercialandcommon@lawcommission.gsi.gov.uk

By post to: Donna Birthwright, Law Commission,
Steel House, 11 Tothill Street, London SW1H 9LJ
Tel: 020 3334 0282 / Fax: 020 3334 0201

If you send your comments by post, it would be helpful if, where possible, you also sent them to us electronically (in any commonly used format).

After the consultation: We plan to publish an Advice to the Department for Business, Innovation and Skills in spring 2013.

Freedom of information: We will treat all responses as public documents. We may attribute comments and publish a list of respondents' names. If you wish to submit a confidential response, it is important to read our Freedom of Information Statement on the next page.

Availability: You can download this Issues Paper and the other documents free of charge from our websites at: http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and http://www.scotlawcom.gov.uk (See News column).

CODE OF PRACTICE ON CONSULTATION

The Law Commission is a signatory to the Government's Code of Practice described below.

THE SEVEN CONSULTATION CRITERIA

Criterion 1: When to consult
Formal consultation should take place at a stage when there is scope to influence the policy outcome.

Criterion 2: Duration of consultation exercise
Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

Criterion 3: Clarity and scope of impact
Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

Criterion 4: Accessibility of consultation exercises
Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

Criterion 5: The burden of consultation
Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

Criterion 6: Responsiveness of consultation exercises
Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

Criterion 7: Capacity to consult
Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

CONSULTATION CO-ORDINATOR

The Law Commission's Consultation Co-ordinator is Phil Hodgson. You are invited to send comments to the Consultation Co-ordinator about the extent to which the criteria have been observed and any ways of improving the consultation process.

Contact: Phil Hodgson, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ
Email: phil.hodgson@lawcommission.gsi.gov.uk

Full details of the Government's Code of Practice on Consultation are available on the BIS website at http://www.bis.gov.uk/policies/better-regulation/consultation-guidance.

Freedom of Information statement

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (such as the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002 and the Data Protection Act 1998 (DPA)).

If you want information that you provide to be treated as confidential, please explain to us why you regard the information as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Law Commissions.

The Law Commissions will process your personal data in accordance with the DPA and in most circumstances this will mean that your personal data will not be disclosed to third parties.

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

UNFAIR TERMS IN CONSUMER CONTRACTS: A NEW APPROACH?

SUMMARY OF THE ISSUES PAPER

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(The Issues Paper and the Appendices available on our websites at http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and http://www.scotlawcom.gov.uk (See News column))

PART 1
BACKGROUND

S.1 The Law Commission and Scottish Law Commission are seeking views on the reform of unfair terms legislation as it affects consumer contracts.

S.2 We welcome responses by **25 October 2012**.

How to respond
Send your responses either –

By email to: commercialandcommon@lawcommission.gsi.gov.uk or

By post to: Donna Birthwright, Law Commission,
Steel House, 11 Tothill Street, London SW1H 9LJ
Tel: 020 3334 0282 / Fax: 020 3334 0201

We welcome responses in any form, but consultees may wish to use the response forms at: http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and at http://www.scotlawcom.gov.uk (See News column).

S.3 This summary accompanies a longer Issues Paper and Impact Assessment. These papers may be downloaded from our websites at http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and www.scotlawcom.gov.uk (See News column).

THE SCOPE OF THE CONSULTATION

S.4 In 2005 the two Law Commissions published a joint Report on Unfair Terms.[1] In May 2012, the Department for Business, Innovation and Skills (BIS) asked us 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 currently set out in Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 (UTTCR). We therefore seek views on the following two issues.

The exemption for the main subject matter and price

S.5 Under Regulation 6(2) of the UTCCR, terms cannot be assessed for fairness if they relate to the "main subject matter of the contract" or "the adequacy of the price or remuneration as against the goods or services supplied in exchange". These words have generated considerable litigation, most notably over bank charges. We think they are fundamentally uncertain and propose that they should be re-written.

[1] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199.

Combining the two separate unfair terms regimes affecting consumers

S.6 As the law currently stands, two major pieces of legislation deal with unfair contract terms. The Unfair Contract Terms Act 1977 (UCTA) sets out the traditional UK approach, while the UTCCR implement an EU Directive. The co-existence of two overlapping schemes for unfair terms in the UK has long been criticised for its complexity and obscurity. In 2005, the two Law Commissions recommended reform to simplify the law.[2] So far that Report has not been implemented.

S.7 During 2012, BIS are consulting on a package of measures to clarify consumer law, to be introduced by both primary and secondary legislation. This provides an opportunity to clarify the law on unfair terms as it affects consumers. We therefore ask whether consultees still support the recommendations we made in 2005.

S.8 The BIS package of measures will focus on the law as it affects contracts between businesses and consumers. Our 2005 Report also made recommendations for contracts between businesses, but we do not discuss them here.

THE PURPOSE OF UNFAIR TERMS LEGISLATION

S.9 Consumers enter into multiple standard form contracts each year, as a routine part of daily life. Consumer contracts are particularly significant where goods or services are delivered over time. Examples are utilities, mobile phones, financial services and gyms.

S.10 Research shows that consumers rarely read contracts thoroughly before purchase. Instead they focus on headline elements such as price.[3] Consumers lack the time to plough their way through small print, and even if they do read it, there is often little they can do about it. The business will not agree to remove the term, and the consumer is likely to find that other suppliers' terms are similar.

S.11 This led to the paradox identified by the influential economist Professor Peter Diamond in 1971. If no consumers read the small print, a firm cannot attract custom by offering efficient contracts, and if all firms offer the same terms, it is not worth any consumer spending time to discover this.[4] Even in a competitive environment, all providers may end up offering standard terms which are unfavourable to consumers; and where this position is reached, it becomes entrenched. Traders have more to gain by offering low headline prices than in offering fair terms.

[2] Above.

[3] OFT1312,(February 2011): *Consumer Contracts Market Study*, available at http://www.oft.gov.uk/shared_oft/market-studies/consumercontracts/oft1312.pdf, p 17.

[4] P Diamond, "A model of price adjustment" (1971) 3(2) *Journal of Economic Theory* 156. For discussion, see paras 3.5 to 3.14 of the Issues Paper.

S.12 To protect consumers against unfair surprise, the legislature stepped in, passing UCTA in 1977. In 1993, this was supplemented by the Unfair Terms Directive (UTD).[5]

S.13 Unfair terms legislation continues to be important to consumers. In the current economic climate, where the popularity of price comparison websites is rising, there is pressure upon traders to compete on low headline prices, whilst earning their profits through hidden terms. Hidden terms make it difficult to compare traders' deals as consumers do not know at the outset what the true price is.

UNFAIR TERMS LEGISLATION: A BRIEF OVERVIEW

S.14 UCTA and the UTCCR contain inconsistent and overlapping provisions, using different language and concepts to produce similar but not identical effects.[6]

The Unfair Contract Terms Act 1977

S.15 UCTA is a complex Act, written in a dense style. It contains two Parts: one for England, Wales and Northern Ireland; and one for Scotland. The two Parts produce almost the same effect but use different language to do so.

S.16 UCTA applies to a broad range of contracts, but a narrow range of terms. It focuses on exclusion clauses. It covers terms or notices which purport to exclude or restrict liability for: causing death or personal injury;[7] other loss or damage caused by breach of a duty of care;[8] breaches of certain terms implied by law;[9] and breach of contract generally.[10]

S.17 UCTA renders some terms of no effect. For example, a term in a consumer contract is automatically void if it purports to exclude the trader's liability for causing death or personal injury, or for supplying goods which are not of satisfactory quality. Other terms are only effective if they are fair and reasonable. For example, if a term purports to entitle the trader to render a contractual performance which is substantially different from that which the consumer reasonably expected, it is valid only if it is fair and reasonable.[11]

[5] Council Directive 93/13/EEC, OJ 1993 L 95.

[6] For more detail, see paras 2.3 to 2.34 of the Issues Paper.

[7] Defined in s 14 (England, Wales and Northern Ireland) and s 25(1) (Scotland).

[8] For Scotland, s 16 refers to "breach of duty". For the rest of the UK, s 2 refers to "negligence".

[9] Implied by statute or common law in contracts for the sale of goods (s 6), hire purchase (s 6) and other contracts for the sale of goods (s 7). The equivalent sections for Scotland are ss 20 and 21.

[10] See s 3 (England, Wales and Northern Ireland) and s 17 (Scotland).

[11] See s 11 (England, Wales and Northern Ireland) and s 24 (Scotland) and Sch 2 for the reasonableness test.

S.18 UCTA is not just a consumer measure but also includes contracts between two businesses, employment contracts and even, to a limited extent, "private" contracts where neither party is a business. There are, however, some important exemptions from UCTA, including insurance contracts and interests in land.[12]

The Unfair Terms in Consumer Contracts Regulations 1999

S.19 The UTCCR are both narrower and broader than UCTA. They are narrower in that they only apply to consumer contracts. For consumer contracts, however, they are wider. There are no exemptions for insurance or land contracts. Furthermore, the UTCCR apply to all non-negotiated terms, unless the term is specifically exempt.

S.20 The UTCCR, unlike UCTA, may be enforced by public bodies as well as individual consumers. They permit the Office of Fair Trading (OFT) and a list of 11 "qualifying bodies" to go to court to prevent unfair terms from being used. These powers have proved to be an important way of regulating the market.

S.21 The UTCCR subject consumer contracts to two requirements: they should be written in "plain, intelligible language";[13] and they should be "fair".[14] We look at each below.

Plain, intelligible language

S.22 The "plain, intelligible language" concept applies in three ways:

(1) If the meaning of a term is in doubt a court will follow the interpretation most favourable to the consumer.[15]

(2) Enforcement bodies may exercise powers to remove terms which are not in plain, intelligible language.

(3) Even if a term is concerned with the "adequacy of the price" or "main subject matter" it will be reviewable for fairness if it is not drafted in "plain, intelligible language".

Fairness

S.23 A court may assess any term in a consumer contract for fairness, unless the term falls within one or more of three exemptions. The exemptions cover:

(1) negotiated terms;

(2) terms that reflect the existing law;

(3) the main subject matter or price, discussed in Part 2.

[12] See sch 1, para 1(a) and 1(b) for England, Wales and Northern Ireland. For Scotland, see s 15(3)(a)(i) and s 15(2)(e).

[13] UTD, art 5; UTCCR, Reg 7.

[14] UTD, arts 2 and 6; UTCCR, Regs 4 and 8.

[15] UTCCR, Reg 7(2).

S.24 Regulation 5(1) of the UTCCR sets out the basic test of unfairness, using the words of the Directive:[16]

> A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

S.25 This must be judged at the time the contract was concluded, looking at "all the circumstances attending the conclusion of the contract".[17]

The "grey list"

S.26 In Schedule 2, the UTCCR contain an "indicative and non-exhaustive" list of terms which may be regarded as unfair. This is copied from the UTD.[18] It covers a variety of commonly encountered terms, including penalty clauses and price escalation clauses.

S.27 The grey list is not definitive. A term may be fair even if it is on the grey list, and it may be unfair even if it is not. In practice, however, the grey list has been an important guide to understanding the purpose of the Directive.

S.28 As we discuss in Part 2, we do not think that a term which is on the grey list can also be exempt from review under Regulation 6(2).

The importance of the Unfair Terms Directive (UTD)

S.29 The UTCCR stay close to the words of the UTD, effectively copying it out. The courts must interpret the Regulations in the light of the wording and purpose of the UTD.[19]

S.30 Any uncertainty about the meaning of the UTD can only be resolved authoritatively at a European level by the Court of Justice of the European Union (CJEU).

[16] UTD, article 3(1).

[17] UTCCR, Reg 6(1). This follows the wording of UTD, art 4(1).

[18] UTCCR, Reg 5(5), Sch 2, para 1.

[19] Case 14/83 *Von Colson and Kavann v Land Nordrein-Westfalien* [1984] ECR 1891, para 26; Case C-106/89 *Marleasing* [1990] ECR I-4135, para 8; see Cabinet Office Legal Advisers, European Division, *European Law in Government* (25 February 2011) at [375].

PART 2
THE EXEMPTION FOR THE MAIN SUBJECT MATTER AND PRICE

THE EXEMPTION

S.31 The exemption for the main subject matter and price has proved to be particularly problematic. We have therefore been asked to consider it in detail.

S.32 The exemption is currently set out in Regulation 6(2) of the UTCCR, which states:

> (2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-
>
> (a) to the definition of the main subject matter of the contract, or
>
> (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

S.33 This reflects the exclusion as set out in article 4(2) of the UTD:[1]

> Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.

S.34 These five lines have generated considerable litigation, and have proved difficult to interpret.

THE BANK CHARGES LITIGATION

S.35 The issue came to prominence during the bank charges litigation, culminating in the 2009 Supreme Court decision, *Office of Fair Trading v Abbey National*.[2]

S.36 This was a test case brought by the OFT against seven banks and one building society. The issue before the court was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms within the meaning of Regulation 6(2). 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. Conversely, the Supreme Court found that the terms were exempt on the ground that the price should be determined "objectively", rather than from the viewpoint of a typical consumer. The overdraft charges could not, therefore, be assessed for fairness.

[1] Council Directive 93/13/EEC, OJ 1993 L 95.

[2] [2009] UKSC 6, [2010] 1 AC 696.

THE UNCERTAINTY OF THE LAW

S.37 We have reviewed the law on this issue, taking account of the purpose of the Directive, UK litigation, decisions of the CJEU and the approach of other Member States. This legal review is discussed in detail in Parts 4 to 7 of the Issues Paper.

S.38 We have concluded that the law in this area is fundamentally uncertain. The Supreme Court decision can be interpreted in several ways, and the courts could use it to justify a variety of approaches:

(1) Some judicial statements in the case say that price terms in plain, intelligible language are exempt from review – and suggest that any term requiring the consumer to pay money may constitute the price if it forms part of the trader's revenue stream.

(2) Other statements suggest that not all payments constitute the "price or remuneration" of goods or services supplied in exchange. In particular, terms on the grey list, including default payments and price escalation charges are not exempt from review.

(3) Some statements say that even price terms can be challenged as unfair, provided the challenge is on grounds which do not relate to the appropriateness of their amount.

S.39 These various statements are not always easy to reconcile, which allows for differing interpretations of the decision. This can be seen in subsequent decisions and in the various ways the case has been interpreted by enforcement bodies and business groups.

S.40 Furthermore, academics have suggested that the Supreme Court decision may be overturned by the CJEU. The exemption has been approached differently in other Member States. As we discuss in Part 7 of the Issues Paper, the German Federal Supreme Court (*Bundesgerichtshof*) has consistently assessed ancillary bank charges for fairness.

CALLS FOR LEGISLATIVE REFORM

S.41 The Supreme Court, aware of the significance and controversy of the decision, explicitly invited Parliament to legislate on the issue. Lord Walker stated: "Ministers and Parliament may wish to consider the matter further."[3]

[3] [2009] UKSC 6, [2010] 1 AC 696 at [52] by Lord Walker.

S.42 In 2010, BIS published a Call for Evidence, asking whether ancillary, contingent and non-transparent charges should be reviewed for fairness.[4] Responses were split. Consumer groups and enforcement bodies supported the proposal, whilst business groups opposed it. The Government concluded that the arguments were finely balanced.[5] BIS decided to take no further action at the time but has now asked us to look at the issue.

S.43 Although businesses expressed concern about assessing ancillary charges for fairness, there was widespread support for the idea that charges should be transparent. For example, the Confederation of Business Industry wrote that "transparency … is at the heart of the UTD and … is the most effective and proportionate way to ensure that consumers can make informed choices".

S.44 We think that the argument over transparency is central to the debate. Our preliminary meetings with stakeholders[6] revealed a strong common desire for certainty, and a shared recognition that consumers should be told about how much they have to pay and what they will get in return.

THE CASE FOR REFORM

S.45 The current law on which terms are exempt from review under the UTCCR is unacceptably uncertain. The state of the law requires significant legal expertise to navigate it, and even then the outcome is unpredictable. This disadvantages smaller traders and individual consumers who do not have access to sophisticated legal resources and do not want to take the risk of litigation.

S.46 In our initial consultations on this project, stakeholders expressed concern about the complexity of the law. Consumer groups told us that the bank charges case has rendered the law so unclear that it is difficult to advise consumers. Furthermore, it was suggested that enforcement bodies have to dedicate significant legal resources to interpret the law. Consequently, some Trading Standards Services (TSS) and consumer advisers have become wary of using the UTCCR, which could undermine consumer protection.

S.47 We think that traders may also suffer from the current uncertainty. The CJEU may take a narrower approach to interpreting the exemption than the Supreme Court. If this were to happen, traders who have built their business model on a wide interpretation of exempt terms may be faced with expensive litigation and not be able to enforce terms.

[4] Department for Business, Innovation and Skills, *Call for Evidence – Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness* (July 2010).

[5] Department for Business, Innovation and Skills, *Government Response to the Call for Evidence on the Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness* (October 2010), para 9.

[6] During January to May 2012, we met with Which?, the Financial Services Authority, the OFT, Citizens Advice, Ofcom and the British Bankers' Association.

S.48 In Part 8 of the Issues Paper we conclude that there is a strong case for replacing Regulation 6(2) with a new provision. This would implement the purpose and thinking behind article 4(2) of the UTD, but would do so in clearer terms. We welcome evidence on whether the uncertainty of the law has caused problems in practice.

S.49 **We ask whether consultees agree that:**

(1) The current law on which terms should be exempt from the assessment of fairness under the Unfair Terms Directive is unduly uncertain; and

(2) The UTCCR should be reformed. (Issues Paper, paragraph 8.14)

S.50 **We welcome evidence of the effect of the Supreme Court decision in *Office of Fair Trading v Abbey National plc* on your organisation, business or consumer experience**. (Issues Paper, paragraph 8.15)

CONSTRAINTS

S.51 Developing proposals has not been easy, as we are constrained by the following factors:

(1) The law should be compatible with European Union law. As the UTD is a minimum harmonisation measure, the UK may not provide a lower standard of consumer protection;[7]

(2) Although our proposals may go beyond what is strictly required by the UTD, we should not gold-plate the UTD to the extent that it imposes significant costs on traders;[8]

(3) The law should be compatible with the grey list set out in Schedule 2 of the UTCCR. We think the intention of the UTD is that the exemption should not apply to these terms;

(4) The law should preserve consumer rights under UCTA;[9] and

(5) The CJEU has stressed that implementing legislation must be "precise and clear".[10] Stakeholders have asked for more certainty over the meaning of the exemption, though that certainty is not always easy to deliver.

[7] Minimum harmonisation means that the UK must not implement the measure in a way which provides less protection to consumers, but may provide more protection.

[8] "Gold-plating" means transposing EU legislation in a way which goes beyond what is required by that legislation, for example providing additional consumer rights.

[9] Under UCTA, s 3 (in England and Wales) and s 17 (in Scotland), where one party deals as a consumer, the other party may not exclude liability for breach of contract or claim to be entitled to render a contractual performance substantially different from that which was reasonably expected.

[10] Case C-478/99 *Commission of the European Communities v Kingdom of Sweden* [2002] ECR I-04147 at [18].

PROPOSALS FOR REFORM

A new approach

S.52 In view of the deadlock among stakeholders over the interpretation of the exemption, we have taken a fresh look at which terms should be exempt from review. This is discussed in detail in Part 8 of the Issues Paper.

S.53 The aim of this new approach is to ensure that consumers know what they have to pay and what they will receive in return. Our proposals would also benefit traders, by giving them a clearer understanding of how to avoid unfair terms, which will help them to price products and develop business models appropriately.

S.54 Our starting point is the purpose behind the UTD: namely to distinguish between terms which are subject to competition and those which are buried in "small print". Where consumers know about the terms, they are able to take them into account in making decisions. If the information is available, the law should not seek to protect consumers from the consequences of their own decisions.

S.55 By contrast, consumers rarely read "small print". "Small print" is a concept instantly understood by consumers in their daily lives, though it is difficult to pin down in legal terms. It is not just about font size. It can also be marked by poor layout, dense paragraphs, legal jargon, and inadequate sign-posting. Often simply labelling a hyper-link as "terms and conditions" is sufficient to ensure that most consumers do not read the document.

S.56 Our proposals therefore focus on whether a term is transparent and prominent. If so, it will be subject to competitive pressures, and should not be assessed for fairness. If, however, it is hidden in a document that even an observant and circumspect consumer is unlikely to read, it should not contain unfair surprises.

PRICE TERMS

S.57 We think that a price term should be excluded from review, but only if it is transparent and prominent. In the Issues Paper we discuss the definition of each of these terms.

(1) **Price** is a "monetary obligation". Where the consumer buys goods or services, it would be an obligation on the consumer to pay money. Where the consumer sells or supplies goods or services, it may mean an obligation on the trader to pay money.

(2) **Transparent** means that the term is in plain, intelligible language, legible and readily available to the consumer. All terms should be transparent in this sense, but it may not be enough in itself to bring the term to the consumer's attention. A company may produce well-written, well laid out terms, readily available if the consumer clicks the link at the bottom of a web-page marked "terms and conditions". The document may still retain the essential characteristic of "small print", which is that most consumers will not read it.

(3) **Prominent**. The definition we suggest is that the term should be presented in such a way that a "reasonably well informed, reasonably observant and circumspect" consumer would be aware of it. This concept of the hypothetical, well informed consumer is widely used in the European Union consumer law and referred to as "the average consumer" test. The "average consumer" is a legal construct, who is better informed than "real" consumers who are often careless, and may sometimes be vulnerable.

S.58 In the Issues Paper we explain that in an individual challenge (brought by a consumer) the court should consider evidence of how the term was actually presented, including the material the consumer was sent, and what the salesperson said. In a general challenge (brought by an enforcement body), the court will need to look at the firm's general business practices. This might include evidence about the advertising material used, the structure of the firm's website, any key fact documents or information leaflets provided and the instructions given to sales staff. The nature of the written contract may also be important. In some cases contract documents are divided into "key information" sections, brought to the consumer's attention, and "small print", which is not. The court may well conclude that the "key information" is prominent, while other terms are not.

S.59 We ask if the court should have regard to statutory guidance when deciding whether a term is transparent and prominent.

A comparison with our 2005 recommendations

S.60 Our 2005 draft Bill included a clause to state that the price exemption did not include payments which would be "incidental or ancillary to the main purpose of the contract". In *Abbey National,*[11] the Supreme Court criticised this approach, on the ground that in many contracts it was impossible to distinguish between main and ancillary charges. Some business groups also considered these words to be too uncertain.

S.61 We now propose that the focus should be on whether a term is transparent and prominent, rather than on whether it is incidental or ancillary. We do not think there is a substantive difference between these two approaches. The emphasis on prominence, however, offers a practical way of distinguishing between a headline price and what are commonly thought of as incidental and ancillary terms. It also emphasises that whether a term is exempt is within the control of the trader. A trader may ensure that a price term is exempt from review by making it prominent.

Grey list terms

S.62 In practice, much of the concern about unfair price terms has focused on three particular types of term: price escalation clauses, early termination charges and default charges.

[11] [2009] UKSC 6, [2010] 1 AC 696.

S.63 In our view, under the current law, the exemption set out in Regulation 6(2) does not apply to these types of term. We think that this follows from the UK case law,[12] and from the decision of the CJEU in *Nemzeti.*[13] In *Abbey National* the Supreme Court confirmed that the exemption does not apply to terms on the grey list, and that the grey list should be interpreted in a wide, purposive way. As Lord Walker put it, "traders ought not to be able to outflank consumers by 'drafting themselves' into a position where they can take advantage of a default provision".[14]

S.64 The issue is not beyond all doubt, however. We think that the law would be clearer if the Regulations stated explicitly that the exemption does not apply to price escalation clauses, early termination charges and default charges. This is not to suggest that such terms are necessarily unfair. Many are fair. They are rarely subject to competitive pressure, however, and have the potential for unfairness. We ask for views on this issue.

Terms which give the trader discretion over price

S.65 One particular problem addressed in the grey list is terms which grant the trader discretion to determine the amount of the price after consumers have committed themselves to the contract. Price escalation clauses are one example of this, but there are others. An example would be a plumbing firm which charged £50 an hour for "the number of hours which we deem to be required". A consumer faced with a gushing pipe may agree to such a term, even if it is presented prominently.

S.66 Should it be open to a court to assess the fairness of the term after the event? If such a term was held to be invalid, then section 15 of the Supply of Goods and Services Act 1982 would apply. This states that where no price has been agreed, there is an implied term that the service recipient will pay a "reasonable charge", as determined by a court.[15]

S.67 Enforcement bodies have argued that a term granting the trader unfettered discretion cannot be in "plain, intelligible language" because it does not tell consumers how much they must pay. On other hand, the language may be sufficiently plain and intelligible to convey the essential message, which is that the trader may decide how much to charge at a later stage.

S.68 We ask if it would be helpful to put this issue beyond doubt by stating that the exemption does not apply to any term which purports to give the trader discretion to decide the amount of the price after the consumer has become bound by the contract.

[12] See *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481 and *Office of Fair Trading v Ashbourne* [2011] EWHC 1237 (Ch), [2011] ECC 31. The issue is discussed in paras 8.45 to 8.51 of the Issues Paper.

[13] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [23]. For the discussion of the case see paras 7.31 to7.39 of the Issues Paper.

[14] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696 at [43].

[15] S 15 does not apply in Scotland; instead the common law concept of *quantum meruit* applies. See W W McBryde, *The Law of Contract in Scotland* (3rd ed 2007), para 9-45.

Should price terms be assessable for things other than the amount?

S.69 There has been a technical debate over the correct interpretation of article 4(2) of the UTD. Does it exempt particular types of term (the excluded term approach) or only a particular type of assessment (the excluded assessment approach)?

S.70 In 2005, we thought that the exclusion should relate to terms rather than the way in which terms were assessed. This means that if a term is excluded, the court could not look at it at all. By contrast, if a term is assessable for fairness, the court should look at all the circumstances, including the amount. When assessing a price escalation clause, for example, a court must distinguish between a clause which permits only a small increase, and one which permits an increase which was hugely disproportionate to the value of the goods or service supplied.

S.71 Under our new proposed test, we consider that if a term is transparent and prominent, and not one of the terms on the grey list, it forms part of the essential bargain. Therefore, it should not be assessed at all. We think this meets the minimum standards required by the European Union law.

S.72 There is an argument, however, that the UTD requires that all price terms may be assessed for fairness, provided that the assessment does not relate to the amount of the price. We welcome views on this point.

QUESTIONS ON PRICE TERMS

S.73 **Do consultees agree that**:

(1) A price term should be excluded from review, but only if it is transparent and prominent?

(2) A price term should be defined as follows: where the consumer buys goods or services, it means an obligation on the consumer to pay money; where the consumer sells or supplies goods or services, it means an obligation on the trader to pay money?

(3) Transparent should be defined as:

(a) in plain, intelligible language;

(b) legible;

(c) readily available to the consumer?

(4) The exclusion from review should not apply to terms on the grey list, which should include the following:

(a) price escalation clauses;

(b) early termination charges; and

(c) default charges? (Issues Paper, paragraph 8.67)

S.74 **Would it be helpful to explain that:**

(1) a term is prominent if it was presented in a way that the average consumer would be aware of the term?

(2) in deciding whether a term is transparent and prominent, the court should have regard to statutory guidance?

(3) the exemption does not apply to any term which purports to give the trader discretion to decide the amount of the price after the consumer has become bound by the contract? (Issues Paper, paragraph 8.68)

S.75 **In order to implement the Unfair Terms Directive fully, is it necessary to specify that even transparent, prominent price terms may be assessed for matters other than "the adequacy of the price as against the goods or services supplied in exchange"**? (Issues Paper, paragraph 8.69)

MAIN SUBJECT MATTER

S.76 We make similar proposals in relation to the "main subject matter of the contract". We propose that the court should not assess a term which relates to the main subject matter of the contract, provided the term is transparent and prominent. We also propose to clarify that the exemption does not apply to terms on the grey list. Finally, we ask whether a term should not be exempt from review if it permits the trader discretion to decide the subject matter after the consumer has become bound by the contract.

S.77 The 2005 draft Bill provided that a term should only be exempt if it was transparent and "substantially the same as the definition the consumer reasonably expected". This incorporated the test used in UCTA.[16] Concern has been expressed that "reasonable expectations" is a vague test.

S.78 We now think that it is better to focus on whether a term is transparent and prominent rather than on whether it is reasonably expected. We do not think that there is any real difference between these two concepts, but the point is clearer if one focuses on how the deal was presented rather than what a reasonable consumer may have expected. This highlights that the issue is within the control of the trader.

QUESTIONS ON MAIN SUBJECT MATTER

S.79 **Do consultees agree that a term relating to the main subject matter of the contract should be exempt from review, but only if it is transparent and prominent?** (Issues Paper, paragraph 8.81)

S.80 **Do consultees agree that a term does not relate to the main subject matter of the contract if it is included in the grey list?** (Issues Paper, paragraph 8.82)

[16] See s 3(2)(b) (England, Wales and Northern Ireland) and s 17(1)(b) (Scotland).

S.81 **Would it be helpful to state that the exemption does not apply to any term which purports to give the trader discretion to decide the subject matter after the consumer has become bound by the contract?** (Issues Paper, paragraph 8.83)

PART 3
IMPLEMENTING OUR 2005 RECOMMENDATIONS

S.82 Our 2005 Report recommended bringing together UCTA and the UTCCR into a single regime. Our aim was to simplify and clarify the law without reducing the current level of consumer protection. Where the two regimes differed we "rounded up" in favour of consumers. Unlike the UTCCR we did not simply copy out the UTD. Instead we sought to explain the UTD in words which would be more familiar to a UK audience.

S.83 When we consulted on these issues in 2002, we received 97 responses, a substantial majority of which were in support of our proposals. In 2005, we made final recommendations, which were accepted in principle by the Government.[1] We are not minded to re-open our 2005 recommendations outside the specific issues raised by the exemption for the main subject matter and price. Given the time that has elapsed since our original consultation, however, we summarise our recommendations and ask if there are any areas where updating may be required. These questions are dealt with in more detail in Part 9 of the Issues Paper.

COPY OUT OR REWRITE?

S.84 Government guidance on transposition requires the copying out of Directives, unless the alternative is preferable.[2] In 2005 we argued strongly that the UTD should be rewritten in a clear way, using terminology familiar in the UK. The great majority of consultees agreed. If the UTD is to succeed in its purpose it must be sufficiently clear and accessible to be used by ordinary consumers. We think that the current language is too obscure to be accessible.

S.85 **Do consultees agree that the Unfair Terms Directive should not be "copied out" into the law of the UK, but should be rewritten in a clearer, more accessible way**? (Issues Paper, paragraph 9.11)

THE DEFINITION OF A "CONSUMER"

S.86 In their recent consultation paper, BIS propose to follow our recommended approach in all consumer protection legislation. They propose that UK legislation should define a consumer by reference to action for purposes which are "wholly or mainly" outside their business, trade or profession.[3]

[1] The Government accepted in principle the recommendations in the Report, subject to further consideration of the issues and potential cost impacts. The Government subsequently decided to await the outcome of Consumer Rights Directive negotiations, and in October 2010 said it would revisit the issue when it implemented that Directive.

[2] UK Department for Business, Innovation and Skills Transposition Guidance: How to implement European Directives effectively (April 2011) part 1, available at: http://www.bis.gov.uk/assets/biscore/better-regulation/docs/t/11-775-transposition-guidance.pdf.

[3] BIS, *Enhancing Consumer Confidence by Clarifying Consumer Law* (July 2012), p 26.

S.87 **Do consultees agree that the new legislation should define a consumer by reference to whether an individual's actions are "wholly or mainly unrelated to their business, trade or profession"?** (Issues Paper, paragraph 9.17)

S.88 **Should it also be made clear that the definition of "consumer" in the new legislation excludes employees, or is the wording "wholly or mainly unrelated to their business, trade or profession" adequate?** (Issues Paper, paragraph 9.19)

TERMS OF NO EFFECT

S.89 Under UCTA, some terms are not permitted in any circumstances. This includes terms which limit liability for death or personal injury. In 2005, we recommended that such terms continue to be ineffective.[4]

S.90 **Do consultees agree that terms which purport to exclude or restrict a business's liability to a consumer for death or personal injury should continue to be ineffective**?(Issues Paper, paragraph 9.22)

THE BURDEN OF SHOWING THAT A TERM IS FAIR

S.91 Under UCTA the burden of showing that a term is fair lies on the party claiming that it is fair – that is, the business.[5] In contrast, the UTCCR do not specifically allocate the burden of proof.

S.92 In 2005, we recommended that in proceedings brought by individual consumers, where an issue about the term's fairness is raised, the burden of showing that a term is fair should rest with the business.[6] Conversely, where a claim is brought by the OFT, or a qualifying body, we thought that a reverse burden of proof in preventive proceedings would be unduly restrictive for businesses.[7]

S.93 **Do consultees agree that**:

(1) In proceedings brought by individual consumers, where an issue is raised about the fairness of a term, the business should be required to show that the term is fair.

(2) In proceedings brought by an authorised body under its preventive powers, the authorised body should be required to show that a term is unfair. (Issues Paper, paragraph 9.30)

[4] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, paras 3.43 to 3.47.

[5] See s 11(5) (England, Wales and Northern Ireland) and s 24(4) (Scotland).

[6] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, paras 3.124.

[7] Above, para 3.162.

NEGOTIATED TERMS

S.94 UCTA applies to all consumer contracts, whether or not they are negotiated. Conversely, negotiated terms are exempt under the UTCCR, though negotiated terms are defined narrowly.[8]

S.95 In 2005, we concluded that it was important to maintain the UCTA controls on negotiated terms. The issue was whether to keep a distinction between UCTA and the UTCCR in this regard, or whether to remove the exclusion for negotiated terms across the board. We concluded that the legislation would be simpler if the exclusion of negotiated terms were removed. A large majority of consultees agreed.

S.96 This would make the legislation simpler, while affecting very few cases. It is rare for a consumer to negotiate about any term except the price or main subject matter. The OFT also gave evidence that some negotiations could be exploitative.

S.97 **Do consultees agree that the new legislation should cover terms in consumer contracts, whether or not they are individually negotiated**? (Issues Paper, paragraph 9.36)

THE FAIRNESS TEST

S.98 In the 2002 Consultation Paper, we considered the meaning of the fairness test, set out in Regulation 5(1) of the UTCCR. We thought that it meant the same as the "fair and reasonable" test used in UCTA. We proposed to use the UCTA wording in the legislation.

S.99 We argued that for both tests, one must look at both procedural and substantive aspects. In most cases, there will be some element of procedural unfairness and some element of substantive unfairness. We thought that the reference to "good faith" may be confusing to a UK audience and that it would be better to use the phrase "fair and reasonable".

S.100 We recommended that the test to be applied to a contract term should be whether it was fair and reasonable, looking at: the extent to which it was transparent; the substance and effect of the term; and all the circumstances existing at the time it was agreed.[9] The draft Bill set out a list of factors for the court to take into account.[10]

S.101 **Do consultees agree that the court should consider whether a term is "fair and reasonable", looking at: the extent to which it was transparent; the substance and effect of the term; and all the circumstances existing at the time it was agreed**? (Issues Paper, paragraph 9.50)

[8] See paras 2.18 to 2.21 of the Issues Paper.

[9] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, Appendix A, draft Bill, clause 14(1).

[10] Above, clause 14(2).

RE-WRITING THE GREY LIST

S.102 As we have outlined above, Schedule 2 of the UTCCR sets out an "indicative and non-exhaustive" list of terms which may be regarded as unfair.[11] It is copied from the annex to the UTD. In 2005 we recommended that the indicative list should be reformulated using concepts and language more likely to be understood by readers in the UK.[12] Appendix B to the Issues Paper compares the current list with the equivalent schedule in our 2005 draft Bill.

S.103 **Do consultees agree that the indicative list should be reformulated in the way set out in Appendix B to the Issues Paper? Alternatively would it be preferable to reproduce the list annexed to the Unfair Terms Directive in its original form**? (Issues Paper, paragraph 9.53)[13]

NOTICES

S.104 UCTA covers contract terms and notices, while the UTCCR only cover contract terms. In 2005, we recommended that the preventive powers should apply to UCTA as well as the UTCCR. This would mean that the OFT and the qualifying bodies would be able to take action against notices. For example, the OFT would be able to demand that a sign in a store car-park saying "no liability is accepted for injury" is taken down.

S.105 **Do consultees agree that enforcement bodies should be able to bring enforcement action against unfair notices which purport to exclude the business's liability**? (Issues Paper, paragraph 9.57)

TERMS WHICH REFLECT THE EXISTING LAW

S.106 Regulation 4(2) states that the UTCCR do not apply to contract terms which reflect "mandatory statutory or regulatory provisions" or the provisions of international conventions. This reflects the words of article 19(2) of the UTD.

S.107 This exemption is wider than these words would suggest. Recital 13 explains that it includes "rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established". Thus the exemption applies to all terms that reflect default rules, which would apply even if the contract term did not exist.

S.108 In 2005, we recommended that the legislation should be re-written to make this point explicitly. Clause 4(4) of our draft Bill excludes any transparent term which "leads to substantially the same result as would be produced as a matter of law if the term were not included".

S.109 **Do consultees agree that the exclusion of "mandatory statutory or regulatory provisions" in Regulation 4(2) should be rewritten to include terms which reflect the existing law**? (Issues Paper, paragraph 9.62)

[11] UTCCR, Reg 5(5), Sch 2, para 1.

[12] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.116.

[13] Appendix B is available at: http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and http://www.scotlawcom.gov.uk (see News column).

END USER LICENCE AGREEMENTS

S.110 As we explore in Appendix C to the Issues Paper, contracts for software and other digital products usually involve end user licence agreements (EULAs). These agreements may include unfair terms, such as restrictions of liability. EULAs involve a mix of both copyright law and contract law, which means that their interpretation may be legally complex.

S.111 Terms that simply reproduce existing copyright law cannot be reviewed for fairness under the UTD as they simply reproduce the default law. Other terms can however be reviewed, including clauses which purport to exclude the supplier's liability under the law of privacy, negligence or libel. We think that the way that the UTD applies to EULAs is relatively straightforward and does not require any special adaptation.

S.112 **Do consultees agree that the Unfair Terms Directive applies to end user licence agreements in a satisfactory way, and that it does not require any special adaptation**? (Issues Paper, paragraph 9.65)

THE REMAINING ROLE OF UCTA

S.113 The new legislation we propose would only affect contracts made between businesses and consumers. The role of UCTA, however, is much wider as it also affects business to business contracts, private contracts made between two consumers, and employment contracts. For example, the following protection also applies to employment contracts:

> In standard form contracts, a business can only claim to be entitled to render a contractual performance substantially different from that which was reasonably expected if the term is reasonable.[14]

S.114 At present, that protection may apply to an employment contract either because the contract is a standard form contract, or because the employee is a "consumer" under the quite wide definition of a consumer in UCTA.[15] Following our proposal above (para S.88) that the definition of "consumer" should exclude employees, the effect would be that there would be no controls by way of fairness/reasonableness tests in relation to express terms of non-standard form employment contracts. This is what we recommended in our 2005 Report.[16]

[14] See s 3 (England, Wales and Northern Ireland) and s 17 (Scotland).

[15] In Scotland the general UCTA controls are expressly applied to "contracts of service or apprenticeship", see s 15(2)(b).

[16] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, paras 6.2 to 6.10.

S.115 **We ask whether consultees think that the removal of controls in relation to non-standard form employment contracts, resulting from our proposals, would be problematic in practice. We also ask consultees to provide evidence to support their view**. (Issues Paper, paragraph 9.71)

PART 4
THE IMPACT OF THE REFORMS

S.116 The Issues Paper is accompanied by an Impact Assessment which considers the benefits and costs of our reforms. It may be downloaded from http://lawcommission.justice.gov.uk/consultations/unfair_terms_in_contracts.htm and http://www.scotlawcom.gov.uk (see News column).

BENEFITS

S.117 We anticipate benefits for businesses, enforcement bodies and consumers.

Reduced risks and administrative costs for business

S.118 A Financial Services Authority paper on unfair contract terms in standard consumer contracts identifies four risks for businesses that include unfair terms in their contracts:

> Firms face significant risks if their consumer contracts contain unfair terms. There is the legal risk of not being able to enforce a particular contract term because it has been deemed to be unfair. Similarly, unfair terms give rise to prudential risks. For example, unfair terms relating to the variation of charges could result in those terms being unenforceable leaving firms exposed to costs. Then there is the operational risk of spending management time in redrafting contract terms and providing consumers with new contracts. Finally, there is the reputational risk of consumers not trusting firms and therefore not wanting to do business with them.[1]

S.119 Our proposals aim to provide traders with greater certainty and clarity, to enable them to avoid using unfair terms. This is intended to reduce the four risks identified by the FSA.

S.120 In addition, the administrative burden of complying with the law should be reduced as the law is simplified. The evidence suggests that consumer law can impose a significant administrative burden on business. Administrative burdens created by consumer law have been estimated at around £1.25 billion a year.[2] With such large figures, even comparably minor improvements can lead to significantly lower overheads for the business world. For example, simplified law will make it easier for businesses to train their staff.

1 FSA, *Fairness of terms in consumer contracts: a visible factor in firms treating their customers fairly* (June 2008), p 7.

2 BERR, *Consumer Law Review: Call for Evidence* (May 2008) pp 8 and 9. These are based on the Better Regulation Executive's database of administrative burdens.

S.121 **We invite comments on the costs involved in the following:**

(1) Legal risks. Is it reasonable to estimate that a major court case may cost a business over £1 million in legal fees?

(2) Prudential risks. Please provide examples of the types of prudential risk and the likely costs a business would face if its charging structure was held to be unfair.

(3) Operational risks. How much management time is involved in responding to complaints concerning the fairness of terms?

(4) **Reputational risks. What effect does an unfair term challenge have on the reputation of the business?**

S.122 **We ask whether consultees agree that these risks would be reduced by the proposed clarification of the exemption.**

S.123 **We welcome views from consultees on whether our proposals will reduce the administrative burden on businesses**.

Reduced enforcement costs

S.124 Clarification will make enforcement and application of the law easier. Enforcement bodies currently rely primarily on informal rather than formal enforcement methods. That is, they achieve compliance with the law by explaining the law and reaching agreement with traders about how terms should be amended. Our proposals should make this process quicker and simpler.

S.125 As we discuss in the Impact Assessment, there is very little information about how much enforcement bodies currently spend on unfair terms enforcement, or what saving the reforms may provide. We welcome comments on the tentative estimates set out in the Impact Assessment.

S.126 **We invite comments on the following tentative estimates**:

(1) That enforcing unfair terms legislation costs the public purse around £4 million per year; and

(2) That the reforms may reduce these costs by around £1 million.

Increased consumer confidence and competition

S.127 Consumers will know what the price and the main subject matter of the contract is, that is what they are paying and what they are getting in return; and be able to participate in the market place with confidence. They will make better choices because they will be able to compare deals offered by different traders. This will produce a more efficient market environment and increase competition.

COSTS

S.128 The main cost would be the transitional costs incurred by businesses and enforcement bodies in familiarising themselves with the new law. We do not think that these costs would be large, however, as businesses are already obliged to comply with the unfair terms law and be familiar with the basic concepts. The changes we propose are to consolidate and clarify existing law, to make it easier to apply. We think that the costs are likely to be low – perhaps between £1 and £2 million.

S.129 We do not anticipate ongoing costs for businesses. We think that the number of initial complaints made to traders about unfair terms will remain fairly static or be reduced. Where disputes do arise they should be resolved more quickly without the need to resort to court action. We welcome evidence on this issue.

S.130 **We welcome evidence about the likely transitional costs of the proposed reforms. We invite comments on the tentative estimate that the costs to businesses of familiarising themselves with the changes may be in the region of £1 to £2 million.**

S.131 **We ask whether consultees agree that the reforms would not increase the number of complaints about unfair terms. We ask consultees to give reasons if they do not agree.**

July 2012