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Unfair Terms in Consumer Contracts: a new approach? Appendices A to D

25 July 2012

**The Law Commission
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The Scottish Law Commission**

**UNFAIR TERMS IN CONSUMER CONTRACTS:
A NEW APPROACH?**

Appendices A to D of Issues Paper

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

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A NEW APPROACH?**

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APPENDIX A

COMPARATIVE LAW

- A.1 With the help of a number of leading academics,¹ we have considered the implementation of the Unfair Terms Directive (UTD) in France, Spain and Germany. Further, we have considered Part 2-3 of the Australian Consumer Law, which is modelled on the UTD. In doing so we hoped to identify any issues or solutions as a result of the way in which they tackled the article 4(2) exemption.
- A.2 As we explore below the French legislation essentially copies out the terms of the exemption, in a similar way to the UK. Whilst there has not been any real discussion of the significance of the exemption in France, our comparison has shown that the French courts have applied the “plain, intelligible language” requirement differently to UK enforcement bodies. Interestingly, France has extended the unfair terms protections to commercial contracting parties and has chosen not to extend the exemption.
- A.3 By contrast, the Spanish legislation omits the article 4(2) exemption in its entirety, subjecting terms which define the price and main subject matter of a contract to an assessment of fairness. As we will see below, this has not been well received by all.
- A.4 The German legislation adopts a unique approach to the exemption. Applying this law to a very different banking framework the German courts have assessed the fairness of bank charges, contrasting with the decision in *Office of Fair Trading v Abbey National plc*.²
- A.5 Finally, we look at Australia’s decision to import the UTD protection and the way in which they have interpreted the division to be drawn between terms which are and are not assessable for fairness.

FRANCE

- A.6 The French legislative regulation of unfair terms in consumer contracts dates back to the 1978 *Loi Scrivener*.³ This was consolidated, together with other provisions, in the *Code de la consommation* in 1993 (the Consumer Code) which was amended in 1995 to implement the UTD.⁴

¹ We are most grateful for the assistance of Professor Simon Whittaker, Professor Hugh Beale, Professor Sergio Cámara Lapuente, Professor Stefan Vogenauer and Christopher Bisping.

² [2009] UKSC 6, [2010] 1 AC 696.

³ This empowered the administration to make decrees rendering certain terms ineffective but was later interpreted by the Cour de cassation as giving the Courts a power of assessment of unfair terms within its scope: *Loi Scrivener* no 78-23 of 10 January 1978 article 35; Civ. (1) 14 May 1991, JCP 1991.II.21763 note Paisant.

⁴ *Loi* no 95-96 of 1 February 1995.

A.7 The unfair contract terms provisions in the Consumer Code apply to contracts made between “*professionnels*” (persons in business or a profession) and “*non-professionnels ou consommateurs*”.⁵ Discussion has arisen as to whether “*non-professionnels*” includes businesses acting outside their business activities.⁶ In this respect the French legislation may differ as the Unfair Terms in Consumer Contracts Regulations (UTCCR) apply only to natural persons. The French provisions apply to all contract terms, whether individually negotiated or in standard term contracts⁷ and whether or not they reflect “mandatory statutory or regulatory provisions”.⁸ Again, the French legislation appears to differ from the UTCCR in these respects.

A.8 The structure of the Consumer Code’s assessment of terms which are potentially unfair has changed significantly since the UTD was first implemented. Originally, the Consumer Code followed the UTD in setting a general test of unfairness and then provided a grey list of terms which may be unfair, although (unlike the UTD) the French legislation explicitly provided that the burden of proof as to unfairness remained on the consumer.⁹ However, in 2010¹⁰ the Consumer Code was amended to allow the creation by decree of a black list of contract terms which are unfair and automatically ineffective (literally, “deemed not written”) and a grey list of clauses that are presumed to be unfair, imposing a burden on a business to prove otherwise.¹¹

A.9 Accordingly, article L – 132 – 1 of the amended Consumer Code provides:

Any term contained in a contract concluded between a person acting in the course of his trade, business or profession and a person who is not so acting or a consumer is unfair if its object or effect is to create, to the detriment of such a person or consumer, a significant imbalance in the rights and obligations of the parties to the contract.

A decree by the Council of State issued upon the advice of the committee set up under article L. 534-1, shall set a list of terms which are presumed to be unfair; in the case of litigation involving a contract containing such a contract term, the person acting in the course of his trade, business or profession must establish that the term in question is not unfair.

⁵ Article L 132-1(1) of the *Code de la consommation*.

⁶ See J Calais-Auloy and F Steinmetz, *Droit de la consommation* (6th ed 2003) no 178, pp 199 to 200.

⁷ Article L 132-1 of the *Code de la consommation*.

⁸ UTD, article 1(2). J Calais-Auloy and F Steinmetz, no. 180, p 201 note that any assessment of a contract term which reflects an administrative regulation must be undertaken by an administrative court following French law’s divided jurisdiction.

⁹ Art 132-1 of the *Code de la consommation* as amended in 1995.

¹⁰ *Loi* no. 2010-737 of 1 July 2010, article 62.

¹¹ Decree n° 2009-302 of 18 March 2009 concerning the application of article L 132-1 of the Consumer Code, which introduced provisions in art R 132-1 *Code de la consommation*. This scheme was apparently modelled on the EU Commission’s Proposal for a Directive on Consumer Rights COM (2008) 614 final arts 30 to 39.

A decree issued under the same conditions shall set the types of contract term which, having regard to the seriousness of their harmful effect on the balance of the contract, must be presumed irrebuttably to be unfair within the meaning of the first paragraph of this article.

These provisions apply irrespective of the form of the contract or the medium in which it appears. The foregoing shall apply inter alia to any purchase order, invoice, guarantee, delivery note or delivery order, ticket or coupon containing stipulations, whether or not the same have been freely negotiated, or references to general conditions drawn up in advance.

Without prejudice to the rules of interpretation laid down in articles 1156 to 1161, 1163 and 1164 of the Civil Code, the unfairness of a clause shall be assessed by reference, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract. It shall also be assessed in the light of the clauses contained in another contract where the conclusion or performance of each of those two contracts is legally dependent on the conclusion or performance of the other.

Unfair clauses shall be deemed not to have been included in the contract.¹²

A.10 Under article L 132-1 alinéa 7 the Code essentially “copies out” article 4(2) of the Directive:¹³

Assessment of the unfair nature of a contract term within the meaning of the first paragraph shall relate neither to the definition of the main subject-matter of the contract nor to the adequacy of the price or remuneration as against the goods sold or the service offered as long as the terms are drafted in a clear and intelligible manner.

¹² Albeit without explicitly mentioning the requirement of good faith as stated in article 3(1) of the UTD. This omission can be justified either on the basis that article 1134 alinéa 3 of the Civil Code contains a very general provision on good faith which is interpreted as applicable to all stages of the conclusion and performance of the contract or, by contrast, on the basis that this omission intensifies the controls on fairness contained in the UTD to the benefit of consumers as permitted by article 8 of the UTD.

¹³ The proviso at the end of the provision was added by Ordonnance no 2001-741 of 23 August 2011, article 16.

- A.11 There has not been very much discussion of the significance of the exemption in the French legal literature nor considerable case law applying it. So, for example, a leading commentary on consumer law briefly states that the purpose of the scheme in the Consumer Code is to combat imbalances in the terms of a contract and not to ensure the overall equivalence between the subject-matter of the trader's obligation and the price demanded.¹⁴ This follows the general tenor of French law which "does not sanction *la lésion* [substantive inequality in the parties' undertakings]" therefore the UTD provisions are similar to domestic French law – "the law of consumer protection follows in this respect the line taken by the civil law."¹⁵
- A.12 There is no reported decision of the Cour de cassation on the application of the exemption.¹⁶ However, in a rare example of its application, the Court of Appeal of Toulouse considered its significance in the context of a contract for the provision of private detective services.¹⁷ Here a wife engaged a detective to watch her husband and discover whether or not he was unfaithful. Having done so, she refused to pay the detective's final invoice of some 7,000€ (having paid 1,500€ in advance), arguing that the contract term determining the price was unclear and unfair within the meaning of article L 132-1 of the Consumer Code. This was because she was unable to know what price would later be charged to her, in particular as regards the treatment of the detective's expenses. The court did not agree. The terms in question were drafted in a clear and legible way which meant they were easily understandable and therefore, the term was exempt from an assessment of fairness by way of application of article 132-1 alinéa 7 of the Consumer Code.¹⁸
- A.13 This would appear to contrast with the way in which UK enforcement bodies are interpreting the "plain intelligible language" requirements under the UTCCR. As we discuss in Part 6, UK enforcement bodies have taken a purposive approach finding that terms which are clear and legible may not be intelligible where the trader is afforded a great degree of discretion.¹⁹

¹⁴ J Calais-Aulois and F Steinmetz, *Droit de la consommation* (6th ed 2003) no 178, p 203.

¹⁵ As above. Here, the 'civil law' refers to the position under the Civil Code as distinct from the Consumer Code: for the general rule on *lésion* see art 1118 Code civil. For a similar allusion to *lésion* see C Noblot, *Droit de la consommation* (2012), p 42.

¹⁶ It formed part of the grounds of application in Com. (3) 9 March 2005, Bulletin civil 2005 III no 59, p 51, but the Cour de cassation did not require to refer to it in its decision.

¹⁷ CA Toulouse 25 September 2007, Case number 06/02410 available at <http://www.legifrance.gouv.fr/>.

¹⁸ The Court of Appeal further held, however, that, given the uncertain elements in the calculation of the detective's expenses, there was no agreement between the parties as to the amount of the detective's remuneration, which could therefore be assessed by the court. The court referred for this purpose to arts 1171 & 1174 Code civil on 'potestative conditions' ie. where one party has the power to determine its content.

¹⁹ See Part 6, paras 6.49 – 6.51.

- A.14 Finally, it should be noted that recently the Commercial Code (*Code de commerce*) was amended to create new controls on unfair terms in commercial contracts.²⁰ The context of this provision was the control of unfair competition, but the new provision gives the court a power to hold a term in a purely commercial contract unfair where it “creates a significance imbalance in the rights and obligations of the parties”. Where a court considers a term is unfair the party relying on the term can be subject to both penal sanctions and civil liability. The similarities between the fairness assessment under the Commercial Code and Consumer Code were cemented in a case challenging the legal certainty of the Commercial Code. In holding that the Consumer Code provision conformed with the constitutional requirement of legal certainty, the French Constitutional Court (the *Conseil constitutionnel*) relied on the fact that article L 132-1 of the Consumer Code already used the notion of “significant imbalance in the rights and obligations of the parties” and that this phrase was already understood by the courts.²¹
- A.15 Strikingly, however, the new controls on unfair terms in the Commercial Code do not contain any provision equivalent to the exemption in article L 132-1 alinéa 7 of the Consumer Code and therefore are said to be available to control unfair price clauses,²² whether or not they are “clear and intelligible”.

GERMANY

- A.16 In Germany the 1976 Unfair Contract Terms Act (commonly referred to as the AGBG) codified the previous case law on unfair standard terms.²³ The UTD only required minor amendments to be made to German law, which were duly inserted into the 1976 Act. Finally, the Act to Modernise the Law of Obligations,²⁴ which came into force on 1 January 2002, incorporated most of the AGBG provisions into §§ 305 - 310 of the Civil Code (‘BGB’) without major alterations.²⁵ The procedural provisions on consumer injunctions were moved to a new Act concerning Actions for Injunctions.²⁶

²⁰ Art L 442-6 al. I(2) Code de commerce as inserted by *Loi* no 2008-776 of 4 August 2008 and amended by *Loi* no 2010-874 of 27 July 2009, article 14(V).

²¹ Conseil constitutionnel 13 January 2011 décision no. 2010-85 QPC, paras 3 – 4 and see *Petites Affiches* 13 April 2011, no. 73, p 17.

²² M Malaurie-Vignal *Droit de la distribution* (LMD, 2012) p 112.

²³ *Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen* of 9 December 1976. For an overview, see Hugh Beale, Bénédicte Fauvarque-Cosson, Jacobien Rutgers, Denis Tallon and Stefan Vogenauer, *Ius Commune Casebooks for the Common Law of Europe: Cases, Materials and Text on Contract Law* (2nd ed 2010), pp 782 to 4.

²⁴ *Gesetz zur Modernisierung des Schuldrechts* of 26 November 2001.

²⁵ *Bürgerliches Gesetzbuch* of 8 August 1896. For an English translation, see http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0930.

²⁶ *Gesetz über Unterlassungsklagen bei Verbraucherrechts- und anderen Verstößen* of 26 November 2001 (*Unterlassungsklagengesetz - UKlaG*).

A.17 The BGB now contains a grey list of clauses that are “prohibited with a possibility of evaluation”²⁷ (*Klauselverbote mit Wertungsmöglichkeit*) and a “blacklist” of clauses that will always be ineffective (*Klauselverbote ohne Wertungsmöglichkeit*), for example where a seller seeks to exclude liability for defective goods entirely.²⁸ In addition to the two lists, §307 lays down a general test (*Inhaltskontrolle*) rendering standard business terms ineffective if, contrary to the requirement of good faith (*Treu und Glauben*), they unreasonably disadvantage the other party to the contract (*unangemessene Benachteiligung*). An unreasonable disadvantage is presumed:

if a provision

(no 1) is not compatible with essential principles of the statutory provision from which it deviates, or

(no 2) limits essential rights or duties inherent in the nature of the contract to such an extent that attainment of the purpose of the contract is jeopardised.²⁹

A.18 For example, an exemption clause may constitute an unreasonable disadvantage if it touches on the essential obligations (*Kardinalpflichten*) of the contract.³⁰

A.19 A term which is not in plain, intelligible language would constitute an “unreasonable disadvantage” applying §307(1)(2) BGB. This would also apply to unintelligible price terms which would otherwise not be assessable. There are many examples where the courts have held that a price term that lacks transparency constitutes such a disadvantage. For example, in BGH NJW 1980, 2518, a clause providing for an increase in bank charges without being specific about the requirements and extent of the eventual increase was held to constitute an “unreasonable disadvantage” and was ineffective.

²⁷ § 308 BGB.

²⁸ § 309 BGB.

²⁹ § 307(2) BGB.

³⁰ Paolisa Nebbia, *Unfair Contract Terms in European Law: A Study in Comparative and EC Law* (2007), p 26.

- A.20 Under § 307(3) the provisions of the BGB which render an unfair contract term ineffective only apply to standard terms that deviate from, or add to, default rules (“apply only to standard terms on the basis of which arrangements derogating from legal provisions, or arrangements supplementing those provisions, are agreed”). This phrase stems from § 8 AGBG and was not amended after the Directive entered into force. It was considered to be broadly in line with the exclusions in article 4(2) of the Directive on the basis that the nature and content of a product or service and its price are, in principle, not regulated by law. As such, the German courts have consistently held (both before and after the Directive came into force) that an agreement as to the price or subject matter of a contract cannot deviate from default rules because such rules do not exist.³¹ This has been interpreted as including both sides of the bargain: “the terms which define the seller’s or supplier’s main obligation under the contract, as well as the consumer’s main obligation”.³² Such clauses are not subject to an assessment of fairness.³³
- A.21 In contrast, “ancillary provisions” (*Nebenbestimmungen*) and “ancillary agreements as to the price” (*Preisnebenabreden*) are considered to be subject to an assessment of fairness: such clauses may have an “indirect effect” on the price or the counter performance, however, “a default rule will step in for them if there is no valid contractual agreement” on the particular issue (*an deren Stelle aber, wenn eine wirksame vertragliche Regelung fehlt, dispositives Recht treten kann*).³⁴ The default rules are too numerous to mention. However, a well known example would be a term in a tenancy agreement requiring the tenant to pay for minor repairs. The statutory default rules place this obligation on the landlord and so, as a default rule exists, the term would be classed as ancillary and would not fall within the exemption.
- A.22 There are a number of banking cases which illustrate this principle well. However, it should be noted that the German banking system is structured very differently to the UK – account holders are typically charged a general current account fee. Further, there is a whole raft of default rules which readily identify other banking charges as ancillary. No such framework by which to classify charges exists in the UK.

³¹ Michael Schillig, Directive 93/13 and the ‘price term exemption’: a comparative analysis in the light of the ‘market for lemons’ rationale, (2011) *International and Comparative Law Quarterly* 933, p 946.

³² Above, p 947.

³³ Above, p 947. See for example BGH 14 October 1997, XI ZR 167/96, [1998] *Neue Juristische Wochenschrift* which held that foreign use fees for credit cards are price terms and as such are not subject to a fairness assessment.

³⁴ BGH 24 November 1988, BGHZ 106, 42, 46, NJW 1989, 222, 223; BGH 18 May 1999, BGHZ 141, 380, 383, NJW 1999, 2276, 2277.

- A.23 On the basis that default rules exist, the German Federal Supreme Court (*Bundesgerichtshof – BGH*) has consistently held that the standard terms of banks are subject to an assessment of fairness if they provide for specific fees to be charged on top of the general current account fees where the bank incurs expenses because it renders an additional service. Thus the Court assessed the fairness of fees charged to a customer who wished to withdraw cash at the counter rather than from an ATM³⁵ or who was notified by the bank that his account has been seized by his creditors³⁶ or was overdrawn.³⁷
- A.24 The BGH has considered a term resembling that litigated in the *Abbey National* decision of the Supreme Court. The relevant term entitled the bank to charge a fee in the event that the customer’s account was overdrawn and the bank therefore did not make a transfer or returned a cheque. Interestingly, the Court immediately assessed whether the clause was unfair (and answered the question in the affirmative). It did not even discuss whether the clause was subject to an assessment of fairness under § 8 AGBG.³⁸
- A.25 In a further case, a bank had instructed all of its branches to charge a fee of €6 if a debit had to be returned due to the customer account being overdrawn. The case mainly turned on the question of whether an internal instruction amounted to a circumvention of the statutory provisions for the policing of standard terms, in which case those provisions would still apply (§ 306a BGB). Once the Court had answered this question in the affirmative, it went on to assess the fee in accordance with the fairness control under § 307 BGB and held that a “similar clause in standard terms, by which the supplier is promised payment of a fixed sum by way of damages in the event of a return of debit because of a lack of cover, is not compatible with essential principles of the statutory provision from which it deviates (§ 307(2) no 1 BGB) and unreasonably disadvantages the customers concerned (§ 307(1) BGB)”.³⁹

SPAIN

- A.26 The UTD was first implemented in Spanish law by article 10 bis (1) of General Law 26/1984 for the protection of consumers and users (*Ley 26/1984 general para la defensa de los consumidores y usuarios*).⁴⁰ This provision stated that:⁴¹

³⁵ BGH 30 November 1993, BGHZ 124, 254, NJW 1994, 318.

³⁶ BGH 19 October 1999, NJW 2000, 651.

³⁷ BGH 13 February 2001, BGHZ 146, 377, NJW 2001, 1419.

³⁸ BGH 21 October 1997, BGHZ 137, 43, NJW 1998, 309.

³⁹ BGH 8 March 2005, NJW 2005, 1645, 1647. For a slightly different translation of the case, see Hugh Beale, Bénédicte Fauvarque-Cosson, Jacobien Rutgers, Denis Tallon and Stefan Vogenauer, *Ius Commune Casebooks for the Common Law of Europe: Cases, Materials and Text on Contract Law* (2nd ed 2010), pp 818 to 20.

⁴⁰ As amended by Law 7/1998 of 13 April 1998 on general contractual conditions.

⁴¹ As amended in 2006.

All those terms not individually negotiated [and all those not expressly agreed practices] which, contrary to the requirement of good faith, cause a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer, shall be regarded as unfair terms. In any event, the terms listed in the additional provision of this Law shall be regarded as unfair.⁴²

Terms which failed this test of unfairness were void.⁴³

- A.27 In 2007 the main consumer laws were recast in the “Consolidated Text of the General Law for the Protection of Consumers and Users and other supplementary Laws” (Royal Decree-Law 1/2007 of 16 November, *Texto Refundido de la Ley General para la Defensa de los Consumidores y Usuarios y otras leyes complementarias*). The fairness test became article 82.1 of Royal Decree-Law 1/2007 (RDL 1/2007), adopting wording identical to article 10 bis. A “black list” of terms automatically considered to be unfair is currently located in articles 85 to 91 of the RDL 1/2007. Interestingly, a relevant addition to that list is a general mention in article 86 *ab initio* of the unfairness of terms “which limit or eliminate consumers’ and users’ rights granted by mandatory *or non mandatory law* and in particular...”.
- A.28 The Spanish legislation differs from the UTD in a number of ways. There are more clauses in the Spanish “black list” of clauses which are automatically considered to be unfair. Further, “one of the main characteristics”⁴⁴ of the Spanish system is a Standard Terms Register which lists terms that have been declared unfair by final court decisions. The Notaries and Registrars of the Land Registry and the Commercial Registry must adhere to this Register and so must refuse to authorise contracts containing any of the listed terms.
- A.29 And notably, the Spanish legislation omits any provision based on article 4(2) of the UTD. This has been very much criticised by Spanish legal academics and has been interpreted in two ways. Most scholars and practitioners consider that this omission should be construed in the light of the whole Spanish legal system (including the liberal approach of the Spanish Constitution to free commerce) and in accordance with the UTD and therefore hold that article 4(2) is in force in Spain. It is argued that this would give an interpretation to Spanish law which conforms to the UTD. On the other hand, a minority of Spanish legal academics consider that the omission implies a tacit and lawful enhancement of consumer protection in Spain.⁴⁵

⁴² The words in square brackets were inserted by Law 3/2006 of 29th December on the improvement of consumers' and users' protection.

⁴³ Article 8(2) of Law 7/1998 of 13 April 1998 on standard contract terms.

⁴⁴ Consumer Law Compendium, *Comparative Analysis*, p 373.

⁴⁵ A full explanation of the debate and arguments in favour of the first position can be found in S Cámara Lapuente, *El control de las cláusulas abusivas sobre elementos esenciales del contrato* (2006). See also J M Miquel González, *Commentary on article 82* and S Cámara Lapuente, *Commentary on articles 86-87* in S Cámara Lapuente, (ed), *Comentarios a las normas de protección de los consumidores*, Colex, (2011) pp 720 ff and 888 ff, respectively (criticising the European Court's decision in *Caja de Ahorros*).

A.30 In *Caja de Ahorros*⁴⁶ the Court of Justice of the European Union (CJEU) considered whether the omission of article 4(2) from the Spanish legislation constitutes a breach of EU law. The CJEU reference arose from proceedings brought by a bank customers' association to stop a major Spanish bank from relying on "rounding-up clauses" in its standard home loan contracts. These clauses rounded up a variable interest rate, following an agreed point of reference, up to the nearest quarter of a percent. Although it was not clear whether article 4(2) would actually exclude the "rounding-up clause" from review, the Spanish Supreme Court asked the CJEU whether the omission of the exclusion in the Spanish legislation was compatible with the UTD. The CJEU concluded that the Spanish legislation was compatible on the basis of article 8 of the UTD. This is a "minimum harmonisation" provision which allows Member States to adopt more stringent provisions for the protection of consumers. In the opinion of the CJEU, the power granted by article 8 extends to the entire "material scope" covered by the UTD and this includes the matters dealt with by article 4(2).⁴⁷

A.31 Further, *Caja de Ahorros* confirmed that terms which fall under article 4(2) will only be exempt from review if they are transparent:

The terms referred to in Article 4(2) ... escape the assessment as to whether they are unfair only in so far as the national court having jurisdiction should form the view, following a case-by-case examination, that they were drafted by the seller or supplier in plain, intelligible language.⁴⁸

A.32 Interestingly, contrary to the conclusions at first instance in the *Abbey National*,⁴⁹ this case also appears to suggest that article 4(2) of the UTD excludes a particular type of assessment rather than the assessment of a term in its entirety.

⁴⁶ Case 484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785.

⁴⁷ Above [32].

⁴⁸ Above at [32].

⁴⁹ *Office of Fair Trading v Abbey National plc* [2008] EWHC 875 (Comm) (Andrew Smith J) at [422] to [435], conclusion at [436]. On appeal, this point was conceded by the Banks and was therefore not in issue before the Court of Appeal or the Supreme Court: see [2009] UKSC 6 at [29], [57] to [60] and [95].

- A.33 Following the CJEU's decision, the Spanish Supreme Court did not give its own view of the significance of Spain's lack of implementation of article 4(2) of the UTD since the defendant in that case (*Caja de Ahorros*) abandoned the litigation in the light of the CJEU judgment.⁵⁰ Later judgments of the Spanish Supreme Court cite the CJEU's decision in *Caja de Ahorros* as support *a fortiori* for the assessment of unfair terms, not all of which would fall within the scope of article 4(2) being related to ancillary elements of the contract,⁵¹ although no trend towards widespread control by Spanish courts of "core terms" can yet be clearly discerned.

AUSTRALIA

- A.34 The Australian Commonwealth Parliament has recently implemented a comprehensive Australian Consumer Law (ACL). This is contained in schedule 2 of the Competition and Consumer Act 2010 (Cth).⁵² Part 2-3 of the ACL regulates unfair terms in standard form consumer contracts⁵³ and is modelled on the UTD.⁵⁴ The States and Territories have agreed to introduce and enact legislation mirroring the ACL as part of their respective laws.⁵⁵
- A.35 In Victoria, prior to the ACL, unfair consumer contracts were regulated under part 2B of the Fair Trading Act 1999 (Vic) which drew inspiration from the UTD. However, the new ACL draws on the UTD more closely than the Victorian legislation; for example, the Victorian legislation applied to all consumer contracts whereas the new law only applies to non-negotiated contracts.⁵⁶
- A.36 The similarities between the ACL and the UTD are instantly evident. Under Part 2-3, a term in a standard form consumer contract will be void if the term is unfair.⁵⁷ A term will be unfair if:

- (1) it would cause a significant imbalance in the parties' rights and obligations arising under the contract;

⁵⁰ Spanish Supreme Court Order of 6th of July of 2010.

⁵¹ See the judgments of the Spanish Supreme Court of 1 July 2010 (insurance); 29 October 2010 and 4 November 2011 (both on 'round-up clauses').

⁵² Formerly the Trade Practices Act 1974; Trade Practices Amendment (Australian Consumer Law) Act (No 2) 2010 (Cth).

⁵³ See generally, Treasury, Australian Government, *The Australian Consumer Law: Consultation on Draft Provisions on Unfair Contract Terms* (2009) 24-9. The unfair contract terms law follows recommendations of the Productivity Commission in its *Review of Australia's Consumer Policy Framework*, Inquiry Report No 45 (2008).

⁵⁴ See Sirko Harder, Problems in interpreting the unfair contract terms provisions of the Australian Consumer Law, (2011) 34 *Australian Bar Review* 306 at 307. The provisions do not apply to financial services however equivalent provisions regulating unfair terms in these contracts have been introduced into the Australian Securities and Investments Act (2001) (Cth).

⁵⁵ Council of Australian Governments, *Intergovernmental Agreement for the Australian Consumer Law* (2009) cl 3.2.

⁵⁶ The Victorian law has now been amended to follow the ACL; Fair Trading Amendment (Unfair Contract Terms) Act 2010 (Vic).

⁵⁷ ACL, s 23(1).

- (2) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- (3) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.⁵⁸

A.37 In determining whether a term of a consumer contract is unfair, a court “may take into account such matters as it thinks relevant” and must take into account “the extent to which the term is transparent” and “the contract as a whole”.⁵⁹ Further, the ACL sets out a grey list of examples of the kinds of terms in standard form consumer contracts that may be unfair, such as termination and penalty clauses,⁶⁰ based on schedule 2 of the UTD.⁶¹

A.38 Under the ACL:

A term is transparent if it is:

- (a) expressed in reasonably plain language;
- (b) legible;
- (c) presented clearly; and
- (d) readily available to any party affected by the term.⁶²

This is essentially the way in which we sought to clarify the test in our 2005 Report recommendations and again in this Issues Paper.

A.39 As under the Directive, Part 2-3 excludes certain terms from an assessment for fairness. However, this is expressed slightly differently. The ACL does not apply to a term that:

- (1) defines the main subject matter of the contract; or
- (2) sets the upfront price payable under the contract; or
- (3) is a term required, or expressly permitted, by a law of the Commonwealth, a State or Territory.⁶³

⁵⁸ ACL, s 24(1).

⁵⁹ ACL, s 24(2).

⁶⁰ ACL, s25(1)

⁶¹ Jeannie Paterson, “The elements of a Prohibition on Unfair Terms in Consumer Contracts” (2009) 37 *Australian Business Law Review* 184, pp 193 to 198.

⁶² ACL, s 24(3). The definition of “transparent” in the ACL is based on a similar definition proposed in Law Commission and Scottish Law Commission, *Unfair Terms in Contracts* (2002), Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119 (2002), p 97.

⁶³ ACL, s 26(1). In addition, the ACL does not apply to “a contract of marine salvage or towage”, “a charterparty of a ship”, “a contract for the carriage of goods by ship”, or “a contract that is the constitution ... of a company, managed investment scheme or other kind of body”: s 28.

A.40 The “upfront price” is defined further:

The *upfront price* payable under a consumer contract is defined as the consideration that:

- (a) is provided, or is to be provided, for the supply, sale or grant under the contract; and
- (b) is disclosed at or before the time the contract is entered into;

but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.⁶⁴

A.41 The explanatory memorandum further illuminates the meaning of the exclusion:

5.63 Consideration includes any amount or thing provided as consideration for the supply of a good, service, financial service, financial product or a grant of land. It would also include any interest payable under a consumer contract.

5.64 The exclusion of upfront price means that a term concerning the upfront price cannot be challenged on the basis that it is unfair. Having agreed to provide a particular amount of consideration when the contract was made, which was disclosed at or before the time the contract was entered into, a person cannot then argue that that consideration is unfair at a later time. The upfront price is a matter about which the person has a choice and, in many cases, may negotiate.

5.65 The upfront price covers the cash price payable for a good, service, financial service, financial product or land at the time the contract is made. It also covers a future payment or a series of future payments.

5.66 The definition also requires that the upfront price must be disclosed at or before the time the contract was entered into by the parties. In the case of most transactions this is reasonably straightforward, as a key pre-condition of the transaction occurring is an understanding of the price to be paid.

5.67 A key consideration for a court in considering whether a future payment, or a series of future payments, forms the upfront price may be the transparency of the disclosure of such a payment, or the basis on which such payments may be determined, at or before the time the contract is made.

⁶⁴ ACL, s 26(2).

5.68 In the context of non-financial services contracts, another relevant consideration is compliance with section 53C of the TP Act (which commenced on 25 May 2009), which imposes specific obligations in relation to the disclosure of a single price in many cases.

5.69 Other consideration (that is, further forms of consideration which are not part of the upfront price) under the consumer contract that is contingent on the occurrence or non-occurrence of a particular event, is excluded from the determination of the upfront price.

5.70 Terms that require further payments levied as a consequence of something happening or not happening at some point in the duration of the contract are covered by the unfair contract terms provisions. Such payments are additional to the upfront price, and are not necessary for the provision of the basic supply, sale or grant under the contract.

A.42 This test is not confined to obligations to pay upfront in the true sense. For example, regular payments made under a contract for a gym membership or a mobile phone would be the “upfront price”, even though those payments (other than the very first one) are due after a part of the relevant services have been rendered. This is because they are disclosed before the contract is entered into and are not contingent on the occurrence of a particular event.⁶⁵ However, there are unresolved areas of uncertainty. For example, it is not clear whether obligations arising under a contract for a gym membership or a mobile phone which specify the contract term as one year together with an option to renew the contract for another year, or renews automatically if neither party “opts out”, would be the “upfront price” because they are contingent on the exercise of the “opt in” or failure to exercise the “opt out”.⁶⁶

A.43 However, the Australian interpretation of the rationale for the exemption and their application of it by segregating out price terms which are “upfront” lends support to the way in which we have understood the exemption to operate. The Australian test exempts from review the price which the consumer knew about and agreed to before the contract was entered into. This ensures that the upfront price term is regulated by competition whilst other monetary terms can be assessed against a standard of fairness.

⁶⁵ Sirko Harder, “Problems in interpreting the unfair contract terms provisions of the Australian Consumer Law”, (2011) 34 *Australian Bar Review* 306, p 314.

⁶⁶ Above, p 315.

- A.44 The assessment of fairness under the ACL is not confined to procedural matters - it extends to regulate terms that are unfair in substance.⁶⁷ In *Jetstar Airways Pty Ltd v Free*,⁶⁸ the Honourable Justice Cavanough said that the earlier Victorian regime regulating unfair contract terms⁶⁹ “proceeds on the assumption that some terms in consumer contracts, especially in standard form consumer contracts, may be inherently unfair ... regardless of how comprehensively they might be drawn to the consumer’s attention”.⁷⁰ Given the similarity of wording it is possible this approach will apply to the ACL too.
- A.45 Here, Ms Free bought two return air tickets from Melbourne to Honolulu for herself and her sister with Jetstar Airways. Prior to making the booking she viewed Jetstar’s fare rules as published on their website. Ms Free had paid a special, very cheap, “Jetsaver” fare of just \$437.39 per person for return travel, including all taxes and charges. Of that sum, the “Jetstar Base Fare” comprised only \$82 return. Nearly three months before the flight, Ms Free’s sister was unable to travel and so Ms Free decided that she would like to take her 11 year old niece on the trip instead and sought to change the name on her sister’s ticket. Jetstar referred Ms Free to its fare rules and told her it would cost approximately \$900 to make the change. Jetstar refused to waive the charge.
- A.46 The Victorian Civil and Administrative Tribunal (VCAT) held that the term imposing the charge was unfair. In applying the fairness test the VCAT weighed up the detriment to Ms Free and the benefits to Jetstar. In particular, the Tribunal considered the term to be unfair because it applied indiscriminately in two ways. First, the charge applied equally to name and date changes: Jetstar may suffer detriment if a customer changed the date of a flight, creating the possibility of an empty seat, but there was no such detriment where a name was changed. Instead Jetstar would gain a “windfall”, obtaining a higher price for the seat than was originally paid for.⁷¹ Second, whilst recognising there were legitimate reasons why Jetstar would want to discourage resale of tickets for a profit, the VCAT considered the term operated unfairly on a customer who sought to change a name for personal reasons with no view to financial gain.⁷²

⁶⁷ See Jeannie Paterson, “The Australian Unfair Contract Terms Law: The rise of substantive unfairness as a ground for review of standard form consumer contracts” [2009] *Melbourne University Law Review*, Vol 33 934 at 952 echoing the comments of Lord Steyn in *Director of Fair Trading v First National Bank* [2002] 1 AC 481, p 500.

⁶⁸ [2008] VSC 539.

⁶⁹ Fair Trading Act 1999, s 32W, later amended by Fair Trading and Other Acts Amendment Act 2009 (Vic), s 5.

⁷⁰ [2008] VSC 539 at [115]. See also *Director of Consumer Affairs Victoria v AAPT Ltd* [2006] VCAT 1493 at [48].

⁷¹ *Free v Jetstar Airways Pty Ltd (Civil Claims)* [2007] VCAT 1405 (27 July 2007) at [36].

⁷² Above at [38].

- A.47 Jetstar appealed the VCAT's finding, claiming the Tribunal erred in law in two key respects, that: (a) it considered the "good faith" element of the fairness test to describe the extent of the imbalance in the parties' rights and obligations; and (b) it only considered the benefits and detriments of the single term in issue. Instead Jetstar claimed "good faith" should be a separate element of the fairness test to be considered and the VCAT should have considered the parties' rights and obligations under the contract as a whole.
- A.48 On appeal the Honourable Justice Cavanough, sitting in the Supreme Court, found the VCAT had not erred in its interpretation of the role of "good faith". His Honour followed Lord Bingham's approach in *Director of Fair Trading v First National Bank* in holding that a term assessable for fairness was to be:
- regarded as unfair if, in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirements of good faith.⁷³
- A.49 However, the Supreme Court agreed that the VCAT had erred in failing to consider other terms of the contract in determining whether the fare rules were unfair. In particular, the VCAT should have had regard to the fact that the extremely low price was a special introductory fare which tended to counterbalance the offending term.⁷⁴ Further, the VCAT should have considered the availability of other more expensive, but more flexible, fares.⁷⁵ Without reaching a conclusion on the terms themselves, the Supreme Court upheld the appeal and referred the matter back to the VCAT for a determination according to the law as stated by the Supreme Court.⁷⁶

⁷³ [2008] VSC 539 at [107].

⁷⁴ Above at [128].

⁷⁵ Above at [133] to [135]

⁷⁶ Above at [143] to [145].

APPENDIX B

THE GREY LIST

UTCCR SCHEDULE 2

Indicative and non-exhaustive list of terms which may be regarded as unfair

1 Terms which have the object or effect of –

- (a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
- (b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
- (c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
- (d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- (f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- (g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- (h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early;
- (i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
- (l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- (m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;
- (n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;

- (o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- (p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
- (q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

2 Scope of paragraphs 1(g), (j) and (l)

- (a) Paragraph 1(g) is without hindrance to terms by which a supplier of financial services reserves the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.
- (b) Paragraph 1(j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.

Paragraph 1(j) is also without hindrance to terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.

- (c) Paragraphs 1(g), (j) and (l) do not apply to:
 - transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;
 - contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency.
- (d) Paragraph 1(l) is without hindrance to price indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

RE-WRITTEN GREY LIST FROM OUR 2005 REPORT

SCHEDULE 2

CONTRACT TERMS WHICH MAY BE REGARDED AS NOT FAIR AND REASONABLE

PART 1

INTRODUCTION

- 1 (1) A term of a consumer contract or small business contract may be regarded as not being fair and reasonable if it—
 - (a) has the object or effect of a term listed in Part 2, and
 - (b) does not come within an exception mentioned in Part 3.

- (2) In this Schedule—
 - (a) in relation to a consumer contract, “A” means the consumer and “B” means the business, and
 - (b) in relation to a small business contract, “A” and “B” mean, respectively, the persons referred to as A and B in section 11.

PART 2

LIST OF TERMS

- 2 A term excluding or restricting liability to A for breach of contract.

- 3 A term imposing obligations on A in circumstances where B’s obligation to perform depends on the satisfaction of a condition wholly within B’s control.

- 4 A term entitling B, if A exercises a right to cancel the contract or if B terminates the contract as a result of A’s breach, to keep sums that A has paid, the amount of which is unreasonable.

- 5 A term requiring A, when in breach of contract, to pay B a sum significantly above the likely loss to B.

- 6 A term entitling B to cancel the contract without incurring liability, unless there is also a term entitling A to cancel it without incurring liability.

- 7 A term entitling B, if A exercises a right to cancel the contract, to keep sums A has paid in respect of services which B has yet to supply.

- 8 A term in a fixed-term contract or a contract of indefinite duration entitling B to terminate the contract without giving A reasonable advance notice (except in an urgent case).

- 9 A term—
 - (a) providing for a contract of fixed duration to be renewed unless A indicates otherwise, and
 - (b) requiring A to give that indication a disproportionately long time before the contract is due to expire.

- 10 A term binding A to terms with which A did not have an opportunity to

become familiar before the contract was made.

- 11 A term entitling B, without a good reason which is specified in the contract, to vary the terms of the contract.
- 12 A term entitling B, without a good reason, to vary the characteristics of the goods or services concerned.
- 13 A term requiring A to pay whatever price is set for the goods at the time of delivery (including a case where the price is set by reference to a list price), unless there is also a term entitling A to cancel the contract if that price is higher than the price indicated to A when the contract was made.
- 14 A term entitling B to increase the price specified in the contract, unless there is also a term entitling A to cancel the contract if the business does increase the price.
- 15 A term giving B the exclusive right (and, accordingly, excluding any power of a court) to determine—
 - (a) whether the goods or services supplied match the definition of them given in the contract, or
 - (b) the meaning of any term in the contract.
- 16 A term excluding or restricting B's liability for statements or promises made by B's employees or agents, or making B's liability for statements or promises subject to formalities.
- 17 A term requiring A to carry out its obligations in full (in particular, to pay the whole of the price specified in the contract) in circumstances where B has failed to carry out its obligations in full.
- 18 A term entitling B to transfer its obligations without A's consent.
- 19 A term entitling B to transfer its rights in circumstances where A's position might be weakened as a result.
- 20 A term excluding or restricting A's right—
 - (a) to bring or defend any action or other legal proceedings, or
 - (b) to exercise other legal remedies.
- 21 A term restricting the evidence on which A may rely.

PART 3

EXCEPTIONS

Financial services contracts

- 22 (1) Sub-paragraph (2) applies where a term in a financial services contract of indefinite duration provides that B may terminate the contract—
 - (a) by giving A relatively short advance notice, or
 - (b) if B has a good reason for terminating the contract, without giving A any advance notice.
- (2) Paragraph 8 (termination without reasonable notice) does not apply to the term if the contract also provides that B must immediately inform A of the termination.

- (3) Sub-paragraph (4) applies where a term in a financial services contract of indefinite duration provides that B may vary the interest rate or other charges payable under it—
 - (a) by giving A relatively short advance notice, or
 - (b) if B has a good reason for making the variation, without giving A any advance notice.
- (4) Paragraph 11 (variation without good reason) does not apply to a term if the contract also provides that—
 - (a) B must as soon as practicable inform A of the variation, and
 - (b) A may then cancel the contract, without incurring liability.
- (5) “Financial services contract” means a contract for the supply by B of financial services to A.

Contracts of indefinite duration

- 23 Paragraph 11 (variation without good reason) does not apply to a term in a contract of indefinite duration if the contract also provides that—
 - (a) B must give reasonable notice of the variation, and
 - (b) A may then cancel the contract, without incurring liability.

Contracts for sale of securities, foreign currency, etc.

- 24 (1) None of the following paragraphs applies to a contract term if subparagraph
 - (2) or (3) applies—
 - (a) paragraph 8 (termination without reasonable notice),
 - (b) paragraph 11 (variation without good reason),
 - (c) paragraph 13 (determination of price at time of delivery),
 - (d) paragraph 14 (increase in price).
- (2) This sub-paragraph applies if the contract is for the transfer of securities, financial instruments or anything else, the price of which is linked to—
 - (a) fluctuations in prices quoted on a stock exchange, or
 - (b) a financial index or market rate that B does not control.
- (3) This sub-paragraph applies if the contract is for the sale of foreign currency (and, for this purpose, that includes foreign currency in the form of traveller’s cheques or international money orders).

Price index clauses

- 25 Neither paragraph 13 nor paragraph 14 (determination of price at time of delivery or increase in price) applies to a contract term if—
 - (a) the term provides for the price of the goods or services to be varied by reference to an index of prices, and
 - (b) the contract specifies how a change to the index is to affect the price.

**SCHEDULE 3
EXCEPTIONS**

Legal requirements

- 1 (1) This Act does not apply to a contract term—
 - (a) required by an enactment or a rule of law,

- (b) required or authorised by a provision in an international convention to which the United Kingdom or the European Community is a party, or
 - (c) required by, or incorporated as a result of a decision or ruling of, a competent authority acting in the exercise of its statutory jurisdiction or any of its functions.
- (2) Sub-paragraph 1(c) does not apply if the competent authority is itself a party to the contract.
- (3) “Competent authority” means a public authority other than a local authority.

Settlements of claims

- 2 (1) This Act does not apply to a contract term in so far as it is, or forms part of—
- (a) a settlement of a claim in tort;
 - (b) a discharge or indemnity given by a person in consideration of the receipt by him of compensation in settlement of any claim which he has.
- (2) In sub-paragraph (1)—
- (a) paragraph (a) does not extend to Scotland, and
 - (b) paragraph (b) extends only to Scotland.

Insurance

- 3 The following sections do not apply to an insurance contract (including a contract to pay an annuity on human life)—
- (a) section 1 (exclusion of business liability for negligence),
 - (b) section 9 (exclusion of liability for breach of business contract where one party deals on written standard terms of the other),
 - (c) section 11 (non-negotiated terms in small business contracts),
 - (d) section 12 (exclusion of employer’s liability under employment contract).

APPENDIX C

END USER LICENCE AGREEMENTS

INTRODUCTION

- C.1 In this Part we look at the effect of unfair terms legislation on End User Licence Agreements, or “EULAs”. Typically, a EULA gives a consumer a limited right to use computer software, subject to various terms and conditions. An increasing range of products is now supplied in digital form – films, music, books, games and social networking. As the range of digital products expands, so does the variety and importance of EULAs to govern the way in which we consume these media.
- C.2 The law governing EULAs can be complicated, as it involves both copyright law and contract law. Below we look briefly at the copyright and contract elements, before addressing when a EULA might have the status of a contract.

LICENCES UNDER COPYRIGHT LAW

- C.3 Copyright law grants a bundle of statutory protections to those who create original literary, dramatic, musical and artistic work. Under section 3 of the Copyright, Designs and Patents Act 1988 (CDPA), a literary work includes a computer program.
- C.4 As the word “copyright” suggests, one of the main protections given to a copyright holder is the exclusive right to copy the work.¹ This includes “the making of copies which are transient or incidental to some other use of the work”.² Other people are not entitled to copy the work unless they have permission to do so. This permission is generally referred to as a licence.³
- C.5 Clearly, a consumer could infringe copyright in a wide variety of settings, not just when using a computer: a consumer may infringe copyright by photocopying a book or a board game. Most EULAs, however, are about software. This is partly because it is impossible to run software on a computer without making a temporary copy in the computer’s RAM.⁴ It is also because copying software is particularly easy. Traders are much more concerned that consumers will copy computer games than that they will copy board games.

¹ Copyright, Designs and Patents Act 1988, s 16(1)(a).

² Above, s 17(6).

³ See *British Actors Film Co v Glover* [1918] 1 KB 229, pp 307 to 308.

⁴ For example, in *R v Higgs* [2008] EWCA 1324, [2009] 1 WLR 73 playing a pirated computer game on a console was considered to infringe s 17(6) because a transient copy was made in the RAM.

LICENCES UNDER CONTRACT LAW

- C.6 Under copyright law, a licence is simply a permission to do something which would otherwise be an infringement of copyright law. It does not necessarily have to be a contract: in some circumstances, tacit consent may be enough, whether or not the copyright holder intended to enter into a contract.⁵
- C.7 Most EULAs, however, are intended to operate as contracts. Partly, they aim to bolster the copyright holder's rights so that if the consumer infringes copyright the holder can sue in both copyright and contract. They may also contain clauses which have nothing to do with copyright, such as exclusion clauses.
- C.8 Where a trader simply wishes to prevent unlawful copying, it does not need to rely on a contractual EULA. If it wishes to enforce other terms, however, it would need to show that the term forms part of a valid contract. That contract would then be subject to the Unfair Terms in Consumer Contracts Regulations (UTCCR).
- C.9 Below we outline briefly the ways in which a EULA may (or may not) be a contract. Assuming EULAs are contracts, we then consider how the UTCCR apply to them.

THE REQUIREMENTS FOR A CONTRACT

- C.10 Under English law, a contract requires:
- (1) *An offer*: one party must express a willingness to contract on specified terms;
 - (2) *Acceptance*: the other party must agree to the terms by statement or conduct;
 - (3) *Consideration*: both sides must offer something to the other.
- C.11 In Scots law there is no requirement for consideration. Instead the parties' agreement must manifest objectively an intention to be legally bound.
- C.12 These principles produce different results, depending how the EULA was presented to the consumer. Below we outline three common ways in which EULAs are presented, though there may be others.

The online "click wrap" licence

- C.13 This form of EULA applies to a download which takes place entirely on-line. Before buying the download, the consumer is asked to "click" that they agree to the terms presented to them. Sometimes, the consumer is required to scroll through the terms. Sometimes the consumer may be allowed to click that they have "read and understood" the terms without actually looking at them.

⁵ See *Barnett v Universal-Island Records Ltd* [2006] EWHC 1009 (Ch), [2006] EMLR 21 at [362].

- C.14 In these circumstances, the courts would almost certainly find that there was a contract. The trader has offered the terms; the consumer has indicated agreement by clicking the button; and both sides have made a bargain. The trader gives something (the licence) in return for consideration from the consumer. This may be money, or may simply be agreeing to act in a certain way or to exclude certain rights.

Online “browse wrap” licences

- C.15 Here the consumer is told that by downloading material they will be taken to have agreed to the owner’s terms and conditions, but the consumer does not need to take any action. There is no box or icon to click.
- C.16 Browse wrap licences are ubiquitous, but are often given low profiles. A typical example would be the BBC News website. At the bottom of the screen is a link to “Terms and Conditions”. This eventually takes the consumer to a screen which states:

These terms of use ("Terms of Use") tell you how you may use BBC Online Services to access, view and/or listen to BBC Content for your personal and non-business use so please read them carefully.

- C.17 There is then a long list of terms which spell out the limited nature of the right to use the website. For example, Term 3.2.3(d) states:

you may not, and you may not assist anyone to, or attempt to, reverse engineer, decompile, disassemble, adapt, modify, copy, reproduce, lend, hire, rent, perform, sub-license, make available to the public, create derivative works from, broadcast, distribute, commercially exploit, transmit or otherwise use in any way BBC Online Services and/or BBC Content in whole or in part except to the extent permitted in these Terms of Use, any relevant Additional Terms and at law.

- C.18 The terms constitute a licence under copyright law, but we think that a court would be unlikely to find that they are a contract. There is no mechanism for the consumer to indicate agreement to the terms, so there would be no acceptance. Many people who use the website will be unaware that the terms exist.

- C.19 The US courts have held that licences of this type do not have contractual status.⁶ Simon Stokes comments that it is probable that the UK courts would take a similar approach.⁷

⁶ See *Specht and Others v Netscape Communications Corp and America Online Inc* 306 F.3d 17 (2d Cir. 2002) and *Ticketmaster Corp v Tickets.com, Inc* 2000 WL 525390, at 3 (C.D.Cal. March 27, 2000).

⁷ S Stokes, *Digital Copyright: Law and Practice* (3rd Ed2009), p 128.

- C.20 This means that such a licence may not be effective in defining what rights the consumer does or does not have to exploit copyright material. If a browse wrap EULA is not a contract, however, it cannot give the right holder any additional contractual rights outside the field of intellectual property law. If, for example, the licence purported to curtail the user's rights to sue for negligence or defamation, such a clause would be ineffective.
- C.21 If a browse wrap licence is not a contract, the UTCCR cannot apply. In our 2005 Report, however, we noted that the Unfair Contract Terms Act 1977 (UCTA) was not confined to contract terms. Section 2 also covered notices. If a notice purports to exclude or restrict liability for death or personal injury it is ineffective.⁸ If it excludes or restricts liability for other loss or damage caused by negligence it must be reasonable.⁹
- C.22 The 2005 draft Bill includes these provisions. We argued that even if exclusion notices are ineffective, they may be undesirable because they discouraged people from exercising their rights. We concluded that regulators should be entitled to take enforcement action against such notices. This would include the right to take enforcement action against terms in browse wrap licences which unfairly dissuaded consumers from exercising a right to sue for loss caused by the supplier's negligence.

Shrink wrap licences on products sold through retailers

- C.23 Typically shrink wrap licences apply where the consumer buys software on a CD-ROM from a retailer. The CD is usually in a box, which may make no mention of the licence agreement. Consumers may expect some form of licence agreement, but they only discover the details when they open the box. At this stage, they may be presented with a paper copy of the licence, and told that they agree to the terms by breaking the seal on the CD-ROM. Alternatively, they may only discover the licence when they attempt to install the software. At this stage, they may be presented with a licence on-screen and given a box to click.
- C.24 The legal effect of these licences may be complex because the consumer will already have entered into a contract with the retailer to buy goods, before finding out about the terms of the licence. This raises a fundamental question: when a consumer "buys" software from a retailer, have they bought the right to use the software for its intended purpose?
- C.25 The answer to this is uncertain and controversial. We explore it in more detail below, looking at the EU Directive and at a Scottish case.

⁸ UCTA, s 2(1) for England and Wales; s 16(1)(a) for Scotland.

⁹ UCTA, s 2(2) for England and Wales. In Scotland, s 16(1)(b) requires that a term restricting liability for breach of duty must be fair and reasonable. Little if anything seems to turn on the difference of wording.

The Software Directive

C.26 The issue was addressed by the Software Directive 1991, which was implemented by sections 50A-C of the CDPA. The 1991 Directive and the various amendments made to it were consolidated in the Computer Programs Directive 2009, which now forms the definitive text on the issue.¹⁰

C.27 Recital 13 explains that someone who has lawfully acquired a computer program is entitled to load and run the program. The acquirer may also carry out any other act necessary for its intended purpose, but this is subject “to specific contractual provisions”:

The exclusive rights of the author to prevent the unauthorised reproduction of his work should be subject to a limited exception in the case of a computer program to allow the reproduction technically necessary for the use of that program by the lawful acquirer. This means that the acts of loading and running necessary for the use of a copy of a program which has been lawfully acquired, and the act of correction of its errors, may not be prohibited by contract. In the absence of specific contractual provisions, including when a copy of the program has been sold, any other act necessary for the use of the copy of a program may be performed in accordance with its intended purpose by a lawful acquirer of that copy.

C.28 Article 4 of the Directive gives the rightholder various exclusive rights over a computer program. These include:

- (a) the permanent or temporary reproduction of a computer program by any means and in any form, in part or in whole; in so far as loading, displaying, running, transmission or storage of the computer program necessitate such reproduction, such acts shall be subject to authorisation by the rightholder;
- (b) the translation, adaptation, arrangement and any other alteration of a computer program and the reproduction of the results thereof, without prejudice to the rights of the person who alters the program.

C.29 These rights, however, are subject to a specific exception to allow a lawful acquirer to reproduce a program where this is necessary for its intended purpose. Article 5 states:

- (1) In the absence of specific contractual provisions, the acts referred to [above] shall not require authorisation by the rightholder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose, including for error correction.
- (2) The making of a back-up copy by a person having a right to use the computer program may not be prevented by contract in so far as it is necessary for that use.

¹⁰ Directive 2009/24/EC of 23 April 2009, OJ 2009 L 111/16.

- C.30 In other words, a lawful acquirer of a computer program is entitled to make a backup copy if this is necessary for its intended use.¹¹ A lawful acquirer is also entitled to carry out other acts necessary for the intended purpose, but this right may be subject to “specific contractual provisions”.
- C.31 There are two conflicting interpretations of this right, depending on the correct definition of a “lawful acquirer”.
- (1) On the first view, any consumer who buys a CD from a reputable retailer in good faith would be a lawful acquirer. Thus, on buying the CD the consumer obtains the right to use the program for its intended purpose. When they open the packet, they already have the right to load, display and run the program. Any subsequent licence agreement cannot take these rights away. Furthermore, unless the contract offers the consumer more than their existing legal rights, the contract is void, in England and Wales, for lack of consideration.
 - (2) The second view is that consumers only become lawful acquirers once they are given the right to use the program by the rightholder. On this view, the right to use the program is subject to any limitation in the licence agreement, to the extent permitted by the 2009 Directive. The licence agreement is therefore a valid contract.
- C.32 The way the Directive has been implemented into UK law favours the second interpretation. Sections 50A to C of the CDPA use the term “lawful user” rather than “lawful acquirer”. In normal speech, it is reasonable to think that a consumer lawfully “acquires” a computer program when they buy the CD from the retailer. They only “use” the program, however, when they put the CD into their computer – that is, after they have been told the terms of the licence agreement. Unhelpfully, the CDPA defines a lawful user as “a person who has a right to use the program”,¹² which fails to address the question of how this right is acquired.

Beta Computers v Adobe Systems

- C.33 The only case to consider the nature of the contract for software between a retailer and a buyer is a Scottish one, *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd*.¹³ This suggests that shrink wrap EULAs are valid contracts.
- C.34 The facts were these. Adobe Systems ordered software by telephone from the retailer, who sent it to them with a shrink-wrapped EULA inside the packaging. For reasons which were not explained, Adobe did not agree to the terms of the EULA and returned it to the retailers unopened. The retailers sued for the contract price.

¹¹ This has been interpreted restrictively. In *Kabushiki Kaisha Sony Computer Entertainment v Ball* [2004] EWHC 1738, [2005] ECC 24 it was held that where software is supplied on CDs, which are robust and cannot be erased, it is not necessary to make a back up copy.

¹² CDPA, s 50A(2).

¹³ 1996 SLT 604; 1996 FSR 367.

- C.35 In the Court of Session, Lord Penrose held that contracts for software were a special form of contract. The supplier undertook to provide both the medium (the disk) and the right to use the intellectual property embodied in it. On the other hand, the contract was not entirely within the control of the supplier. It needed the consent of the rightholder. Thus the contract could not be formed until the rightholder's conditions were tendered to the purchaser and the purchaser had accepted them.
- C.36 In other words, the primary contract is between the retailer and buyer, but is not formed until the buyer has seen the terms and undoes the shrink-wrap. At this stage, the contract between retailer and buyer incorporates the rightholder's terms. Lord Penrose found that although the rightholder was not a direct party to the contract, it was nevertheless able to take advantage of the Scottish doctrine of "*ius quaesitum tertio*",¹⁴ which allows a third party to enforce stipulations in the contract indirectly.
- C.37 The decision has been criticised on several grounds. First, the court was not referred to, and so did not consider, the Software Directive.¹⁵ It has also been pointed out that if no contract is formed until the software is delivered, the buyer is deprived of any right to demand performance.¹⁶
- C.38 As far as consumer protection is concerned, it is awkward to think of the EULA as forming a contract between a retailer and the buyer, when the retailer may have no responsibility for drafting the terms. If the EULA contains an unfair term, it would be better for enforcement action to be brought against the rightholder. Professor George Gretton comments that a more attractive solution is to analyse the situation in terms of a double contract, so that the buyer contracts with both the supplier and the software house.¹⁷
- C.39 The decision has been taken to support the validity of shrink-wrapped EULAs,¹⁸ but the full legal analysis of how they operate is far from clear. The issue is outside the terms of reference of the current project. Furthermore, software is increasingly supplied in the form of digital downloads, rather than on a hard medium from retailers, so the importance of the issue is decreasing. It may be that the shrink wrap licence disappears before its legal status is ever conclusively resolved.

¹⁴ Literally, this means "a right acquired by a third party". At the time of the decision, English law did not recognise such rights, but they are now available under the Contracts (Rights of Third Parties) Act 1999.

¹⁵ See J N Adams, "The Snark was a Boojum, you see", [1997] *Edinburgh Law Review* 386; and S J A Robertson, "The Validity of Shrink-Wrap Licences in Scots Law", 1998 (2) *Journal of Information, Law and Technology* 2.

¹⁶ See Adams, above. Also, H L MacQueen, "Software Transactions and Contract Law" in L Edwards and C Waelde (eds), *Law and the Internet: Regulating Cyberspace* (Hart Publishing, Oxford: 1997), pp 121 to 135.

¹⁷ G Gretton, "Software: binding the end-user", (1996) *Journal of Business Law* 524.

¹⁸ For example, in *Microsoft Corporation v Ling and Others* [2006] EWHC 1619 (Ch) at [10] the judge noted that it was common ground that a shrink wrap licence "is effective in law as an agreement".

ARE EULAS TRANSPARENT?

- C.40 The UTD requires contract terms to be expressed in plain, intelligible language,¹⁹ but the requirement appears to have been by-passed by much of the software industry. EULAs are widely criticised for their complexity, obscurity and legal jargon.
- C.41 In 2007, the National Consumer Council (NCC) carried out a shopping survey of 25 popular software products, all in shrink wrapped packaging from an online retailer.²⁰ They found that 14 of the products did not mention that installation depended on a licence agreement. Out of the 9 that did mention a licence agreement, only 4 gave a URL for an online copy. NCC commented that many licence agreements were in hard-to-read formats. Consumers who did attempt to read them were confronted by complex wording, legal jargon and frequent references to legislation in other countries.

TERMS WHICH SET OUT EXISTING COPYRIGHT LAW

- C.42 Despite the length and complexity of EULAs, most are unnecessary to protect the rightholder's intellectual property rights. In the absence of an express licence, the rights granted to a consumer are extremely limited. Under the Computer Programs Directive 2009, the consumer is only allowed to do that which is necessary for the intended purpose. A consumer does not acquire a right to lend the program to friends, to copy it for others or exploit it commercially.
- C.43 Thus many terms in EULAs merely set out the existing law. In our 2002 Consultation Paper we discussed whether a term which merely set out the default rule which would exist in the absence of the contract could be reviewed for fairness. We concluded that it was exempt from review.²¹
- C.44 To reach this conclusion we relied on Recital 13 which states that the exclusion in article 1(2) covering "mandatory statutory or regulatory provisions" also includes "rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established".
- C.45 We thought that this point did not emerge clearly from the words used in Regulation 4(2) of the UTCCR. In our draft Bill we suggested alternative wording. Under clause 4(4) of the draft Bill, the assessment of fairness does not apply to a clause which is transparent and which "leads to substantially the same result as would be produced as a matter of law if the term were not included".

¹⁹ Art 5.

²⁰ C Belgrove, *Whose licence is it anyway?: a study of end user licence agreements for computer software*, NCC (January 2008).

²¹ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, paras 3.35 to 3.37.

TERMS WHICH MAY BE UNFAIR

- C.46 Even if the copyright terms cannot be considered as unfair, there are many terms in EULAs with the potential to be unfair. NCC lists problems with exclusion clauses, jurisdiction clauses and terms which allow the rightholder to withdraw the service.²² We discuss each of these below. This is not intended to be an exhaustive list. Given that EULAs are so often not in plain intelligible language, it will be rare for terms to fall within the exemption in Regulation 6(2).

Terms which exclude liability for negligence

- C.47 EULAs often contain wide-ranging exclusion clauses. Their main purpose appears to be to protect the trader from actions for negligence if the software damages the consumer's computer. A contemporary example, taken from the LoveFilm EULA of May 2012 is drafted as follows:

In no event shall LoveFilm, its affiliates, directors, employees or licensors be liable for any direct, indirect, incidental, special or consequential damages (including but not limited to any loss of data, service interruption or computer failure) arising out your use of or inability to use the Software or any errors, viruses or bugs contained in the Software, even if you have advised us of the possibility of such loss. Your only right or remedy with respect to any problems or dissatisfaction you have with the Software is to uninstall it or stop using it.

- C.48 Such a term is reviewable under the UTCCR. The grey list suggests that it is the sort of term which may be unfair. Schedule 2, para 1(a) includes terms which have the effect of "inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of ... inadequate performance".

- C.49 In business to business contracts, there is also a question about whether these terms must be fair and reasonable under section 2 of UCTA. In England and Wales, under Schedule 1, para 1(c), sections 2 to 4 of UCTA do not extend to:

Any contract so far as it relates to the creation or transfer of a right or interest in any ... copyright ... or other intellectual property, or relates to the termination of any such right or interest.

There is, however, no such limitation in Scotland with respect to the controls of sections 16 to 18 of UCTA.²³

²² C Belgrove, *Whose licence is it anyway?: a study of end user licence agreements for computer software*, NCC (January 2008).

²³ Note that this exemption applies only to England and Wales. There is no equivalent provision in Scotland: see HL MacQueen, "Software Transactions and Contract Law" in L Edwards and C Waelde (eds), *Law and the Internet: Regulating Cyberspace* (Hart Publishing, Oxford: 1997), pp 121 to 135.

- C.50 In *Salvage Association v CAP Financial Services Ltd* the English and Welsh exemption was interpreted restrictively.²⁴ A marine surveying company entered into contracts with the defendant for the design, development and supply of software. The software was not completed and contained numerous errors. The company sued, claiming repayment of the contract price and damages for wasted expenditure. The defendants sought to rely on an exclusion clause, which the company claimed was unfair. The question was whether the court could consider the fairness of the exclusion clause or whether it was prevented from doing so because the contract related to the creation or transfer of rights in intellectual property.
- C.51 The court held that it could consider the fairness of the term. It found that paragraph 1(c) only excluded those terms of the contract which related to the creation or transfer of the intellectual property right. It did not extend generally to all terms of the contract.
- C.52 In our Consultation Paper on Unfair Terms, we considered this case to be authoritative. We commented that “most intellectual property practitioners regard the point as definitively decided” by the case: one looks at the subject matter of the term, rather than the contract.²⁵

Other exclusion clauses

- C.53 In some cases, exclusion clauses may go further than simply excluding liability for negligence and breach of contract. They may also attempt to protect the right-holder against defamation or breach of privacy actions.
- C.54 Some exclusion clauses are drafted so widely that it is not clear what form of action the trader wishes to exclude. Digital technology is often at the forefront of social developments, and traders may fear new forms of possible legal action, which they cannot quite pinpoint.
- C.55 This is the exclusion clause from the Facebook contract (as of May 2012):

WE TRY TO KEEP FACEBOOK UP, BUG-FREE, AND SAFE, BUT YOU USE IT AT YOUR OWN RISK. WE ARE PROVIDING FACEBOOK AS IS WITHOUT ANY EXPRESS OR IMPLIED WARRANTIES INCLUDING, BUT NOT LIMITED TO, IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, AND NON-INFRINGEMENT. WE DO NOT GUARANTEE THAT FACEBOOK WILL BE SAFE OR SECURE. FACEBOOK IS NOT RESPONSIBLE FOR THE ACTIONS, CONTENT, INFORMATION, OR DATA OF THIRD PARTIES, AND YOU RELEASE US, OUR DIRECTORS, OFFICERS, EMPLOYEES, AND AGENTS FROM ANY CLAIMS AND DAMAGES, KNOWN AND UNKNOWN, ARISING OUT OF OR IN ANY WAY CONNECTED WITH ANY CLAIM YOU HAVE AGAINST ANY SUCH THIRD PARTIES.

²⁴ [1995] FSR 654.

²⁵ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, Part 3, footnote 101 (p 37).

- C.56 It is written in such wide terms that it is difficult to pinpoint exactly what liability Facebook is attempting to exclude.
- C.57 Again, in consumer contracts, a term of this sort may be reviewed for fairness under the UTCCR. This would continue under the draft Bill. For business contracts, however, UCTA only prevents the exclusion of contractual and business liability. It does not deal with the exclusion of other forms of liability such as breach of privacy rights.

Exclusive jurisdiction clauses

- C.58 Some EULAs may purport to oust the jurisdiction of the consumer's local courts. In 2006, Ofcom looked at a term imposed by a mobile phone operator which stated that the parties agreed only to bring legal action in the English courts. The regulator regarded this as unfair because consumers should be entitled to have their disputes heard in the local courts, regardless of where in the UK they lived. The operator subsequently agreed to amend the contract to reflect this.

- C.59 Exclusive jurisdiction clauses remain however. This clause is taken from the Facebook contract as of May 2012:

You will resolve any claim, cause of action or dispute (claim) you have with us arising out of or relating to this Statement or Facebook exclusively in a state or federal court located in Santa Clara County ... You agree to submit to the personal jurisdiction of the courts located in Santa Clara County, California for the purpose of litigating all such claims.

- C.60 This clause is almost certainly void. The contract is made between a company domiciled in Ireland and a UK consumer, so falls wholly within the European Union. It is governed by the Brussels I Regulation.²⁶ Where a business directs its activities to the consumer's home state, the consumer is entitled to bring proceedings against a business either in the courts of the member state where the business is domiciled (Ireland) or in the courts where the consumer is domiciled (the UK).²⁷ These provisions can only be contracted out of in limited circumstances.²⁸

- C.61 The question is whether a void clause of this type is also unfair. There is a strong argument that regulators should be able to require that such terms are removed from contracts. They confuse consumers, by making it more difficult to understand what they are signing up to, and may discourage them from relying on their legal rights.

²⁶ Regulation No 44/2001.

²⁷ Above, art 16(1).

²⁸ Above, art 17.

- C.62 In our 2002 Consultation Paper we consider the argument that a clause can only be unfair under the UTCCR if it is both procedurally and substantively unfair.²⁹ It could be argued that the UTCCR require both procedural unfairness (contrary to the requirement of good faith) and substantive unfairness (a significant imbalance in the parties' rights and obligations). On this basis, it might be said that a void clause cannot be unfair because it does not create a significant imbalance in the parties' rights and obligations.
- C.63 We thought that this was a misreading of the Directive. We concluded that a clause may be unfair because it is procedurally unfair, and that regulators should be able to take action to remove them from contracts.³⁰ The test set out in our draft Bill would allow void terms to be unfair.³¹

Terms allowing the right-holder to withdraw the service

- C.64 Several complaints about unfair terms in EULAs relate to those which allow the supplier to withdraw the service, terminate the contract or destroy the consumer's data.
- C.65 The NCC report gives an example of a clause allowing the supplier to remove the consumer's data without notice. The clause stated:
- Symantec may, at its sole discretion, immediately suspend or terminate use of the Online Backup Feature for failure or suspected failure to comply with these terms.
- C.66 The clause then explained that following termination, the supplier "shall not be obligated to maintain any data" stored online. NCC noted that in 2006, Ofcom ruled that the destruction of the consumer's data without notice may be unfair. The supplier amended the contract to provide for notice.³²
- C.67 Other terms allow the supplier to suspend the service at any time. The grey list states that a term might be unfair where it authorises the supplier to dissolve the contract on a discretionary basis without giving the same facility to the consumer. Terms may also be unfair if they permit the supplier to retain sums for services not yet supplied, where the supplier dissolves the contract.³³
- C.68 It is possible that if a term limiting the duration of the service is sufficiently transparent, it may form the main subject matter of the contract, and therefore be exempt from review. To be sufficiently transparent, however, it would need more than a paragraph in the small print.

²⁹ See Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, draft Bill, clause 14 which sets out a general test of whether a term is fair and reasonable, taking into account both the extent to which the term is transparent and its substance and effect.

³⁰ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 3.69.

³¹ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, draft Bill, clause 14 sets out a general test of whether a contract is fair and reasonable, to be determined by taking into account both its transparency and substance.

³² Ofcom, *Consumer complaint against UK online about unfair contract terms* (May 2006), CW/00887/01/06.

³³ Sch 2, 1(f).

CONCLUSION

- C.69 The move to plain language has by-passed much of the software industry. Every day, thousands of consumers click online buttons to say that they have read and understood documents which are unreadable and incomprehensible.
- C.70 One problem is that EULAs involve a mix of both copyright law and contract law, which makes their interpretation legally complex. This complexity may have deterred enforcement action against unfair terms in software contracts. Our draft Bill would clarify the effect of unfair terms legislation in two ways:
- (1) The draft Bill follows UCTA in covering notices which purport to exclude or restrict liability for negligence by the supplier. This would enable regulators to take action against such exclusion clauses in EULAs without worrying about whether they are contract terms. For example, action may be taken against exclusion clauses in browse wrap EULAs which do not have contract status.
 - (2) The draft Bill clarifies that a term may be unfair even if it is void. This would enable regulators to take action against complex and confusing terms, even if they are not allowed under other provisions, such as the Brussels I Regulation.
- C.71 At the same time, the draft Bill clarifies that the assessment of fairness does not apply to a clause which is transparent and which “leads to substantially the same result as would be produced as a matter of law if the term were not included”. Thus regulators cannot consider clauses which merely repeat the existing provisions of intellectual property law, provided that these clauses are not written in unduly obscure or misleading language.

APPENDIX D

COUNCIL DIRECTIVE 93/13/EEC ON UNFAIR TERMS IN CONSUMER CONTRACTS

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 A thereof,

Having regard to the proposal from the Commission,¹

In cooperation with the European Parliament,²

Having regard to the opinion of the Economic and Social Committee,³

1. Whereas it is necessary to adopt measures with the aim of progressively establishing the internal market before 31 December 1992; whereas the internal market comprises an area without internal frontiers in which goods, persons, services and capital move freely;

2. Whereas the laws of Member States relating to the terms of contract between the seller of goods or supplier of services, on the one hand, and the consumer of them, on the other hand, show many disparities, with the result that the national markets for the sale of goods and services to consumers differ from each other and that distortions of competition may arise amongst the sellers and suppliers, notably when they sell and supply in other Member States;

3. Whereas, in particular, the laws of Member States relating to unfair terms in consumer contracts show marked divergences;

4. Whereas it is the responsibility of the Member States to ensure that contracts concluded with consumers do not contain unfair terms;

5. Whereas, generally speaking, consumers do not know the rules of law which, in Member States other than their own, govern contracts for the sale of goods or services; whereas this lack of awareness may deter them from direct transactions for the purchase of goods or services in another Member State;

6. Whereas, in order to facilitate the establishment of the internal market and to safeguard the citizen in his role as consumer when acquiring goods and services under contracts which are governed by the laws of Member States other than his own, it is essential to remove unfair terms from those contracts;

7. Whereas sellers of goods and suppliers of services will thereby be helped in their task of selling goods and supplying services, both at home and throughout the internal market; whereas competition will thus be stimulated, so contributing to increased choice for Community citizens as consumers;

8. Whereas the two Community programmes for a consumer protection and information policy⁴ underlined the importance of safeguarding consumers in the matter of unfair terms of contract; whereas this protection ought to be provided by

¹ OJ No C 73, 24.3.1992, p 7.

² OJ No C 326, 16.12.1991, p 108 and OJ No C 21, 25.1.1993.

³ OJ No C 159, 17.6.1991, p 34.

⁴ OJ No C 92, 25.4.1975, p 1 and OJ No C 133, 3.6.1981, p 1.

laws and regulations which are either harmonized at Community level or adopted directly at that level;

9. Whereas in accordance with the principle laid down under the heading "Protection of the economic interests of the consumers", as stated in those programmes: "acquirers of goods and services should be protected against the abuse of power by the seller or supplier, in particular against one-sided standard contracts and the unfair exclusion of essential rights in contracts";

10. Whereas more effective protection of the consumer can be achieved by adopting uniform rules of law in the matter of unfair terms; whereas those rules should apply to all contracts concluded between sellers or suppliers and consumers; whereas as a result *inter alia* contracts relating to employment, contracts relating to succession rights, contracts relating to rights under family law and contracts relating to the incorporation and organization of companies or partnership agreements must be excluded from this Directive;

11. Whereas the consumer must receive equal protection under contracts concluded by word of mouth and written contracts regardless, in the latter case, of whether the terms of the contract are contained in one or more documents;

12. Whereas, however, as they now stand, national laws allow only partial harmonization to be envisaged; whereas, in particular, only contractual terms which have not been individually negotiated are covered by this Directive; whereas Member States should have the option, with due regard for the Treaty, to afford consumers a higher level of protection through national provisions that are more stringent than those of this Directive;

13. Whereas the statutory or regulatory provisions of the Member States which directly or indirectly determine the terms of consumer contracts are presumed not to contain unfair terms; whereas, therefore, it does not appear to be necessary to subject the terms which reflect mandatory statutory or regulatory provisions and the principles or provisions of international conventions to which the Member States or the Community are party; whereas in that respect the wording "mandatory statutory or regulatory provisions" in Article 1(2) also covers rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established;

14. Whereas Member States must however ensure that unfair terms are not included, particularly because this Directive also applies to trades, business or professions of a public nature;

15. Whereas it is necessary to fix in a general way the criteria for assessing the unfair character of contract terms;

16. Whereas the assessment, according to the general criteria chosen, of the unfair character of terms, in particular in sale or supply activities of a public nature providing collective services which take account of solidarity among users, must be supplemented by a means of making an overall evaluation of the different interests involved; whereas this constitutes the requirement of good faith; whereas, in making an assessment of good faith, particular regard shall be had to the strength of the bargaining positions of the parties, whether the consumer had an inducement to agree to the term and whether the goods or services were sold or supplied to the special order of the consumer; whereas the requirement of good faith may be satisfied by the seller or supplier where he deals fairly and equitably with the other party whose legitimate interests he has to take into account;

17. Whereas, for the purposes of this Directive, the annexed list of terms can be of indicative value only and, because of the nature of the minimal character of the

Directive, the scope of these terms may be the subject of amplification or more restrictive editing by the Member States in their national laws;

18. Whereas the nature of goods or services should have an influence on assessing the unfairness of contractual terms;

19. Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject matter of the contract and the price/quality ratio may nevertheless be taken into account in assessing the fairness of other terms; whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;

20. Whereas contracts should be drafted in plain, intelligible language, the consumer should actually be given an opportunity to examine all the terms and, if in doubt, the interpretation most favourable to the consumer should prevail;

21. Whereas Member States should ensure that unfair terms are not used in contracts concluded with consumers by a seller or supplier and that if, nevertheless, such terms are so used, they will not bind the consumer, and the contract will continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair provisions;

22. Whereas there is a risk that, in certain cases, the consumer may be deprived of protection under this Directive by designating the law of a non-Member country as the law applicable to the contract; whereas provisions should therefore be included in this Directive designed to avert this risk;

23. Whereas persons or organizations, if regarded under the law of a Member State as having a legitimate interest in the matter, must have facilities for initiating proceedings concerning terms of contract drawn up for general use in contracts concluded with consumers, and in particular unfair terms, either before a court or before an administrative authority competent to decide upon complaints or to initiate appropriate legal proceedings; whereas this possibility does not, however, entail prior verification of the general conditions obtaining in individual economic sectors;

24. Whereas the courts or administrative authorities of the Member States must have at their disposal adequate and effective means of preventing the continued application of unfair terms in consumer contracts,

HAS ADOPTED THIS DIRECTIVE:

Article 1

1. The purpose of this Directive is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in contracts concluded between a seller or supplier and a consumer.

2. The contractual terms which reflect mandatory statutory or regulatory provisions and the provisions or principles of international conventions to which the Member States or the Community are party, particularly in the transport area, shall not be subject to the provisions of this Directive.

Article 2

For the purposes of this Directive:

(a) "unfair terms" means the contractual terms defined in Article 3;

(b) "consumer" means any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession;

- (c) “seller or supplier” means any natural or legal person who, in contracts covered by this Directive, is acting for purposes relating to his trade, business or profession, whether publicly owned or privately owned.

Article 3

1. 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.
2. A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.

The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract.

Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him.

3. The Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair.

Article 4

1. Without prejudice to Article 7, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.
2. 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.

Article 5

In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail. This rule on interpretation shall not apply in the context of the procedures laid down in Article 7(2).

Article 6

1. Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.
2. Member States shall take the necessary measures to ensure that the consumer does not lose the protection granted by this Directive by virtue of the choice of the law of a non-Member country as the law applicable to the contract if the latter has a close connection with the territory of the Member States.

Article 7

1. Member States shall ensure that, in the interests of consumers and of competitors, adequate and effective means exist to prevent the continued use of unfair terms in contracts concluded with consumers by sellers or suppliers.

2. The means referred to in paragraph 1 shall include provisions whereby persons or organizations, having a legitimate interest under national law in protecting consumers, may take action according to the national law concerned before the courts or before competent administrative bodies for a decision as to whether contractual terms drawn up for general use are unfair, so that they can apply appropriate and effective means to prevent the continued use of such terms.

3. With due regard for national laws, the legal remedies referred to in paragraph 2 may be directed separately or jointly against a number of sellers or suppliers from the same economic sector or their associations which use or recommend the use of the same general contractual terms or similar terms.

Article 8

Member States may adopt or retain the most stringent provisions compatible with the Treaty in the area covered by this Directive, to ensure a maximum degree of protection for the consumer.

Article 9

The Commission shall present a report to the European Parliament and to the Council concerning the application of this Directive five years at the latest after the date in Article 10(1).

Article 10

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive no later than 31 December 1994. They shall forthwith inform the Commission thereof.

These provisions shall be applicable to all contracts concluded after 31 December 1994.

2. When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such a reference shall be laid down by the Member States.

3. Member States shall communicate the main provisions of national law which they adopt in the field covered by this Directive to the Commission.

Article 11

This Directive is addressed to the Member States.

Done at Luxembourg, 5 April 1993.

For the Council
The President
N. HELVEG PETERSEN

[The Annex is effectively identical to Schedule 2 to UTCCR. See Appendix B above.]