Law Commission
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Unfair Terms in Consumer Contracts: a new approach?
Issues Paper

25 July 2012

The Law Commission
and
The Scottish Law Commission

UNFAIR TERMS IN CONSUMER CONTRACTS: A NEW APPROACH?

Issues Paper

A Joint Issues Paper

THE LAW COMMISSIONS: HOW WE CONSULT

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

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

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

Geographical scope: England and Wales, Scotland.

An impact assessment is available on our websites.

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

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

How to respond
Send your responses either –

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

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

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

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

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

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

CODE OF PRACTICE ON CONSULTATION

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

THE SEVEN CONSULTATION CRITERIA

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

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

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

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

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

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

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

CONSULTATION CO-ORDINATOR

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

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

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

Freedom of Information statement

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

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

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

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

UNFAIR TERMS IN CONSUMER CONTRACTS: A NEW APPROACH?

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(The appendices and impact assessment are available separately at http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and at http://www.scotlawcom.gov.uk (See News column).

TABLE OF ABBREVIATIONS

ACL	Australian Consumer Law
AGBG	German Unfair Contract Terms Act 1976
BBA	British Bankers' Association
BIS	Department for Business, Innovation and Skills
BGB	German Civil Code
BGH	German Federal Supreme Court (*Bundesgerichtshof*)
CBI	Confederation of British Industry
CDPA	Copyright, Designs and Patents Act 1988
CID	Consumer Injunctions Directive
CJEU	Court of Justice of the European Union
CPRs	Consumer Protection from Unfair Trading Regulations 2008
CRD	Consumer Rights Directive 2011
EULA	End User Licence Agreement
FSA	Financial Services Authority
Ofcom	The Office of Communications
Ofgem	The Gas and Electricity Markets Authority
OFT	Office of Fair Trading
Ofwat	The Water Services Regulation Authority
NCC	National Consumer Council
TSS	Trading Standards Services
UCPD	Unfair Commercial Practices Directive 2005
UTCCR	Unfair Terms in Consumer Contracts Regulations
UCTA	Unfair Contract Terms Act 1977
UTD	Unfair Terms Directive 1993
VCAT	Victorian Civil and Administrative Tribunal

PART 1
INTRODUCTION

1.1 In 2005, the Law Commission and Scottish Law Commission noted that the law on unfair terms is particularly complex. It is contained in two separate pieces of legislation, the Unfair Contract Terms Act 1977 (UCTA)[1] and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR),[2] both with their own inconsistent and overlapping provisions. We recommended reform to clarify the law and published a draft Bill.[3]

1.2 Although the previous Government accepted the Report in principle, so far it has not been implemented.[4] In September 2011, the then Consumer Minister, Edward Davey, announced a new Consumer Bill of Rights. He stated that:

> Consumer law in the UK comes from a variety of Acts and regulation, making it complex and confusing. … The Consumer Bill of Rights will consolidate, clarify and strengthen the consumer laws already in place, which will make it easier for everyone to understand and consumer rights in the UK will be stronger than ever.[5]

1.3 During 2012, the Department for Business, Innovation and Skills (BIS) is consulting on a package of measures to clarify consumer law, to be introduced by both primary and secondary legislation. The aim is to put a Bill to the UK Parliament in the 2013 to 2014 Parliamentary session. This provides an opportunity to clarify the law on unfair terms as it affects consumers.

1.4 We have therefore been asked to review and update our 2005 Report in relation to our general consumer recommendations.[6] At the same time we have been asked to address one issue of particular concern: namely which terms should be exempt from review under the UTCCR. This issue came to prominence during the litigation over bank charges, culminating in the 2009 Supreme Court decision: *Office of Fair Trading v Abbey National plc*.[7]

1 SI 1977 No 50.

2 SI 1999 No 2083.

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

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

5 Department for Business, Innovation and Skills press release, *New bill will strengthen consumer rights* (19 September 2011), http://news.bis.gov.uk/Press-Releases/New-bill-will-strengthen-consumer-rights-66d86.aspx.

6 Our 2005 Report on Unfair Terms also covered business issues. They are outside our current project.

7 [2009] UKSC 6, [2010] 1 AC 696.

1.5 This paper, therefore, has two purposes. We start with the 2005 recommendations, before considering the UTCCR exemption in the light of the bank charges litigation. Given the many developments in this area, we make new proposals for reform and ask for views. For other areas we have reviewed our previous recommendations and we think they remain appropriate. We ask whether consultees still agree with the recommendations which we made in 2005.

HOW TO RESPOND

1.6 We are seeking responses by 25 October 2012.

How to respond
Send your responses either –

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

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

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

WHICH TERMS SHOULD BE EXEMPT FROM REVIEW UNDER THE UTCCR?

1.7 The Unfair Contract Terms Directive (UTD) has been part of UK law since 1995.[8] It is now implemented through the UTCCR. These Regulations enable consumers to challenge non-negotiated terms on the ground that they are unfair.[9] They also enable bodies such as the Office of Fair Trading (OFT) to investigate complaints and seek injunctions against the use of unfair terms.[10]

1.8 Under the UTD, all terms in consumer contracts[11] may be assessed for fairness, unless the term falls within a specific exemption. The main exemption is contained in article 4(2),[12] which has been implemented in Regulation 6(2) of the UTCCR. Regulation 6(2) states:

[8] The Unfair Terms in Consumer Contracts Regulations 1994 (SI No 3159 of 1994) came into force on 1 July 1995. The 1994 Regulations were reproduced with some limited changes in the Unfair Terms in Consumer Contracts Regulations 1999 (SI No 2083 of 1999). See para 2.9 of this Issues Paper for discussion of the implementation process.

[9] Reg 7(1). The Regulations also stipulate that terms in written contracts should be in "plain and intelligible language". For further discussion, see para 2.15.

[10] These bodies are listed in Sch 1 of UTCCR and discussed at para 2.11 of this Issues Paper.

[11] We discuss the meaning of a "consumer contract" at paras 2.38 and 9.12 to 9.17. We propose to define a consumer as "an individual who enters into the contract wholly or mainly for purposes unrelated to a business".

[12] The full text of art 4(2) is set out at para 4.5 below.

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

1.9 As we explore below, there is considerable uncertainty over the meaning of these words.

The bank charges litigation

1.10 In 2009, the issue came before the Supreme Court in *Office of Fair Trading v Abbey National plc*.[13]

1.11 This was a test case brought by the OFT in 2007 with the agreement of seven banks and one building society. The issue was whether charges for unauthorised overdrafts fell within the Regulation 6(2) exemption or whether they could be assessed for fairness. Thousands of consumers across the UK had taken cases to local county and sheriff courts, claiming that terms allowing these charges were unfair. The OFT started an investigation and subsequently entered into a litigation agreement with the banks to bring the test case. Most county and sheriff court proceedings were stayed (sisted in Scotland) pending the outcome of the test case.[14]

1.12 The High Court and the Court of Appeal found in favour of the OFT. They held that the relevant charges did not fall within Regulation 6(2) of the UTCCR because they were not part of the essential bargain between the parties, and a typical consumer would not recognise the charges as part of the price.[15] The banks appealed to the Supreme Court, which found for the banks.[16] The Supreme Court stated that the UTD did not distinguish between main price and incidental price, and no such distinction should be read into it. The price should be determined objectively, rather than from the point of view of a typical consumer. Therefore the overdraft charges fell within the exemption and could not be assessed for fairness.

Reactions to the bank charges litigation

1.13 The case has generated considerable debate. Many businesses supported the Supreme Court decision,[17] but other stakeholders have been critical. These reactions are discussed in detail in Part 6.

[13] [2009] UKSC 6, [2010] 1 AC 696.

[14] There is a detailed discussion of the bank charges litigation at paras 5.22 to 5.67 of this Issues Paper.

[15] [2008] EWHC 875 (Comm), [2008] 2 All ER (Comm) 625; [2009] EWCA Civ 116, [2009] 2 WLR 1286.

[16] [2009] UKSC 6, [2010] 1 AC 696. See paras 5.44 to 5.67 of this Issues Paper for a more detailed discussion of the Supreme Court's decision.

[17] Clydesdale Bank Press Release, *OFT Court Case Ruling*, available at http://www.cbonline.co.uk/media/news-releases/2009/oft-court-case-ruling.

1.14 Our main concern is the uncertainty surrounding the law in the wake of the decision. In *OFT v Ashbourne Management Services*,[18] the High Court held that a term requiring customers to remain as members of a gym for a minimum period was assessable for fairness under the UTCCR. We think this was the right decision, but that the reasoning is confused.

1.15 The judge ruled that the relevant term was in plain, intelligible language and was the main subject matter of the contract. This did not, however, prevent an assessment of the term so long as the assessment did not relate to its definition. The judge then proceeded to consider the fairness of the term on the basis that the assessment did not relate to the definition of the main subject matter. Rather the assessment related to the consequences for consumers who wished to terminate gym membership contracts early.[19]

1.16 As we explain below, this is not an easy judgment to follow. The current state of the law makes it difficult for traders, consumer advisers and enforcement bodies to identify which terms are exempt and which are not.

1.17 In initial consultations, consumer groups were particularly concerned about the complexity of the law. They told us that litigation has rendered the law so unclear that it is difficult to advise consumers. Furthermore, it was suggested that some enforcement bodies have also become wary of using the UTCCR, which may undermine consumer protection.

1.18 We think that traders may also suffer from the current uncertainty. The UTCCR implement an EU Directive, which means that the final decision on the meaning of Regulation 6(2) rests with the Court of Justice of the European Union (CJEU). Academics have expressed concern that the Supreme Court decision in *Abbey National*[20] may be overturned by the CJEU. If this were to happen, traders who have built their business model on a wide interpretation of exempt terms may be faced with expensive litigation.

Calls for legislative reform

1.19 The Supreme Court, aware of the significance and controversy of the decision, explicitly invited Parliament to legislate on the issue. Lord Walker stated:

> Ministers and Parliament may wish to consider the matter further. They decided, in an era of so-called 'light-touch' regulation, to transpose the Directive as it stood rather than to confer the higher degree of consumer protection afforded by the national laws of some other member states. Parliament may wish to consider whether to revisit that decision.[21]

[18] [2011] EWHC 1237 (Ch), [2011] ECC 31. This case is discussed in more detail at paras 5.74 to 5.83 of this Issues Paper.

[19] Above at [175].

[20] [2009] UKSC 6, [2010] 1 AC 696.

[21] Above at [52] by Lord Walker.

1.20 In 2010, BIS published a Call for Evidence on the issue.[22] At the time, it appeared likely that the European Commission would revisit this issue as part of the new Consumer Rights Directive, and the Call for Evidence was designed to inform the Government's negotiating position in relation to the Directive.

1.21 BIS noted that the Supreme Court had held that the exemption applied to all price terms in plain, intelligible language, including contingent and ancillary charges. BIS asked whether ancillary, contingent and non-transparent charges should be reviewed for fairness. They suggested that if such charges did not form part of the "the essential bargain", competition may not work to drive down their level.[23]

1.22 Responses were split. Respondents from business were opposed to any change and supported the Supreme Court view. Conversely, consumer groups and regulators/enforcement bodies argued that charges outside of the "essential bargain" should be assessable for fairness. They argued that contingent charges were largely unanticipated by consumers and poorly understood, and therefore not subject to competitive pressure.[24]

1.23 The Government concluded that the arguments were finely balanced. The immediate pressure for reform was reduced when changes to unfair terms provisions were omitted from the Consumer Rights Directive, and BIS decided to take no further action at the time. BIS added, however, that they would revisit the question in the future.[25]

OUR TERMS OF REFERENCE

1.24 In May 2012, Mr Norman Lamb, Parliamentary Under-Secretary of State for Employment Relations, Consumer and Postal Affairs asked the Law Commission and Scottish Law Commission to review and update the recommendations we made in 2005 on Unfair Terms in Contracts. We were also asked to consider which terms should be exempt from review under the UTCCR and to consult on the issue.

1.25 Our formal terms of reference are:

(1) to review and update the recommendations made by the two Law Commissions in their 2005 Report on Unfair Terms in Contracts (Law Com No 292; Scot Law Com No 199) in so far as they affect contracts made between businesses and consumers;

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

[23] For example, Question 1 asked: Do you agree with the Government premise that because charges are contingent, ancillary or not transparent, or otherwise, not part of what a typical consumer would understand as "the essential bargain", competition may not drive down the level of such charges as it ordinarily would? In Part 3 we consider the economic rationale of the unfair terms legislation generally. The rationale of the exemption is explored in Part 4.

[24] Department for Business, Innovation and Skills, *Government Response to the Call for Evidence on the Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness* (October 2010), p 2. For more details of responses to the Government's Call for Evidence see paras 6.21 to 6.24 of this Issues Paper.

[25] Above, para 10.

(2) in particular to examine article 4(2) of the Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts on terms exempt from review in the light of recent case law; and

(3) following full consultation with relevant stakeholders, to advise BIS on how best to implement article 4(2), bearing in mind the following:

(a) the need to ensure that the UK meets its minimum harmonisation obligations;

(b) the desirability of a single consumer regime to incorporate both the Unfair Terms in Consumer Contracts Regulations 1999 and the Unfair Contract Terms Act 1977, without reducing the existing level of consumer protection; and

(c) the need for clarity.

1.26 There are three points to note about these terms of reference. First, we have only been asked to review our recommendations in so far as they affect contracts between businesses and consumers. Our 2005 Report also made recommendations for contracts between businesses. In particular, we recommended new protections for micro-businesses. The Government is not planning to implement these reforms and we do not discuss them here.

1.27 Second, our room for manoeuvre is limited. The UTD is a minimum harmonisation measure. This means that Member States may legislate to give consumers greater protection than the UTD provides, but they may not legislate for less. It is therefore important to understand the UTD, and ensure that it is correctly implemented.

1.28 Finally, we have been asked to bear in mind the need for clarity. The current uncertainty is potentially costly to both businesses and consumers.

THE STRUCTURE OF THIS PAPER

1.29 This paper is divided into 10 Parts.

(1) **Part 1** is the Introduction.

(2) In **Part 2**, we provide a brief overview of the current law and summarise our 2005 Report.

(3) In **Part 3** we discuss the purpose of unfair terms legislation.

(4) In **Part 4**, we outline our previous recommendations on the exemption under Regulation 6(2) for the main subject matter of the contract and the price.

(5) **Part 5** analyses three recent cases on the exemption: *Office of Fair Trading v Foxtons Ltd*; *Office of Fair Trading v Abbey National plc*; and *Office of Fair Trading v Ashbourne Management Services*.

(6) **Part 6** looks at reactions to the *Abbey National* decision.

(7) In **Part 7** we consider the European case law.

(8) In **Part 8** we set out proposals for reform and ask for views.

(9) In **Part 9** we outline the main recommendations on consumer contracts made in our 2005 Report. We ask if these retain support, or whether some updating may be required.

(10) **Part 10** lists the questions we ask.

1.30 There are five appendices, which are available on our websites at: http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm and http://www.scotlawcom.gov.uk (See News column).

(1) **Appendix A** looks at comparative law.

(2) **Appendix B** is two versions of the "grey list" of terms which may be considered to be unfair under the UTD: the version in the UTCCR, and the re-written grey list in our 2005 draft Bill.

(3) **Appendix C** looks at end user licence agreements, which are commonly used in the software industry. These licences are governed by both copyright and contract law, which makes the law in this area particularly confusing. We were therefore asked to consider how the UTCCR apply to them. We conclude that the law in this area is adequate, but needs to be better understood.

(4) **Appendix D** is the UTD.

(5) **Appendix E** is the Impact Assessment.

NEXT STEPS

1.31 Our aim is to publish an Advice to BIS in spring next year.

THANKS

1.32 We would like to thank the OFT, Ofcom, the Financial Services Authority, the British Bankers' Association, Citizens Advice and Which? for meeting us at a preliminary stage of this project. We would also like to thank the Institute of Consumers Affairs, the Confederation of British Industry, Vodafone UK, and Virgin Media for their input. Finally, we are most grateful for the assistance of Professor Simon Whittaker, Professor Hugh Beale, Professor Sergio Cámara Lapuente, Professor Stefan Vogenauer, Christopher Bisping, Professor Sir John Vickers and Professor Christian Twigg-Flesner.

PART 2
OVERVIEW OF THE LAW AND THE 2005 REPORT

2.1 As the law currently stands, there are two major pieces of legislation dealing with unfair contract terms. The Unfair Contract Terms Act 1977 (UCTA) sets out the traditional UK approach, while the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) implement an EU Directive. The two laws contain inconsistent and overlapping provisions, using different language and concepts to produce similar but not identical effects.

2.2 Here we outline each provision in turn. We then summarise the recommendations made by the Law Commission and Scottish Law Commission in 2005 to bring the two pieces of legislation into a single regime.

THE UNFAIR CONTRACT TERMS ACT 1977

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

2.4 UCTA focuses on exemption clauses. It applies to a broad range of contracts, including contracts between two businesses, contracts between businesses and consumers and even, to a limited extent, to "private" contracts where neither party is a business. It deals with four broad types of exclusion clauses. It covers terms or notices which purport to exclude or restrict liability for:

(1) causing death or personal injury;[1]

(2) other loss or damage caused by breach of a duty of care;[2]

(3) breaches of certain terms implied by law;[3] and

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

[2] This is phrased differently for Scotland and the rest of the UK. For the rest of the UK, s 2 refers to "negligence" which is defined in 1(1) as a the breach of: a) a contractual obligation to exercise skill and care; b) the common law obligation to take or use reasonable care; or c) the duty of care imposed by the Occupiers' Liability Act 1957 and Occupier's Liability Act (Northern Ireland) 1957. For Scotland, s 16 refers to "breach of duty". Broadly, this is defined in s 25(1) as any obligation to take reasonable care arising from a contract, or from a common law duty, or from s 2(1) of the Occupiers' Liability (Scotland) Act 1960.

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

(4) breach of contract generally. This is defined broadly to cover not only explicit exclusion clauses but also terms which purport to entitle the trader to render a contractual performance substantially different from that which the consumer reasonably expected. It also covers terms which enable the trader to render no performance at all.[4]

2.5 As far as consumers are concerned, some terms are automatically void. A business may not exclude its liability for causing death or personal injury in any circumstances. Similarly, in a consumer contract, a business may not exclude the implied terms in the Sale of Goods Act 1979 and similar legislation to ensure the quality of goods.[5]

2.6 Other terms which restrict liability are only valid if the business can prove that they are "fair and reasonable" within the meaning of the Act.[6] Schedule 2 provides guidelines for relevant factors to which the court may have regard, including: the strength of the bargaining position of the parties; whether the customer agreed to an inducement; whether the customer knew or ought to have known of the term; and whether the goods were part of a special order.[7]

2.7 There are some exclusions from UCTA. As far as consumers are concerned, the most important are those relating to insurance contracts or interests in land.[8] In England, Wales and Northern Ireland there is also an exclusion concerning "the creation or transfer" of intellectual property rights, but this has been interpreted restrictively.[9] The intellectual property exclusion does not apply in Scotland.

THE UNFAIR TERMS IN CONSUMER CONTRACTS REGULATIONS 1999

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

4 See s 3 (England, Wales and Northern Ireland) and s 17 (Scotland).

5 See s 6 (England, Wales and Northern Ireland) and s 20 (Scotland).

6 See s 11 (England, Wales and Northern Ireland) and s 24 (Scotland) and sch 2 for the reasonableness test.

7 Technically these factors apply only to terms which exclude the implied terms, but they have been taken to apply across all exclusion clauses.

8 For England, Wales and Northern Ireland, see sch 1, para 1(a) and 1(b). For Scotland, see s 15(3)(a)(i) and s 15(2)(e). Other exclusions mainly concern business contracts, and include company formation, securities, and shipping.

9 For further discussion, see Appendix C.

Implementing the Unfair Terms Directive

2.9 The UTCCR implement the Unfair Terms Directive 1993 (UTD).[10] The UTD was first implemented in the UK through the Unfair Terms in Consumer Contracts Regulations 1994.[11] The 1994 Regulations, however, were found to be in breach of the UTD because they did not allow enforcement by a sufficient range of organisations. They were replaced by the 1999 Regulations, which stay close to the wording of the UTD. Essentially, the 1999 Regulations "copy out" the UTD.

2.10 The UTD remains highly relevant because a national court must interpret the UTCCR in the light of the wording and purpose of the UTD.[12] Any uncertainty about the meaning of the UTD can only be resolved authoritatively at a European level by the Court of Justice of the European Union (CJEU).

Enforcement

2.11 Importantly, the UTCCR, unlike UCTA, may be enforced by public bodies as well as individual consumers. They permit the Office of Fair Trading (OFT) and a list of 11 other "qualifying bodies"[13] to go to court to prevent unfair terms from being used. These preventive powers have proved to be an important way of regulating the market.

2.12 The UTCCR impose duties and grant powers to these public enforcement bodies.[14] Additionally, Part 8 of the Enterprise Act 2002 puts in place "a further layer of support" by giving enforcement bodies strengthened powers to obtain court orders (known as "enforcement orders") against businesses which do not comply with the UTCCR. [15]

Two requirements

2.13 The UTCCR subject consumer contracts to two requirements:

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

[11] SI 1994 No 3159.

[12] Case 14/83 *Von Colson and Kavann v Land Nordrein-Westfalien* [1984] ECR 1891, para 26; Case C-106/89 *Marleasing* [1990] ECR I-4135, para 8; see Cabinet Office Legal Advisers, European Division, *European Law in Government* (25 February 2011) at [375]; for example, see the reasoning of the Court of Appeal in *Office of Fair Trading v Foxtons* [2009] EWCA Civ 288 at [42] and House of Lords in *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52 at [31].

[13] These are the Information Commissioner, the Gas and Electricity Markets Authority (Ofgem), the Director General of Electricity Supply for Northern Ireland, Director General of Gas for Northern Ireland, the Office of Communications (Ofcom), the Water Services Regulation Authority (Ofwat), the Rail Regulator, every weights and measures authority in Great Britain (generally Trading Standards Services), the Department of Enterprise, Trade and Investment in Northern Ireland, the Financial Services Authority and the Consumers' Association (Which?). These bodies may investigate complaints that contract terms are unfair and can apply for an injunction or, in the application of the Regulations to Scotland, an interdict against its use.

[14] See UTCCR Regs 10 to 16.

[15] H Beale & Ors, *Chitty on Contracts* (30th ed incorporating 3rd cumulative supplement 2011), para 15-132.

(1) they should be written in "plain, intelligible language";[16] and

(2) they should be "fair".[17]

2.14 Below we outline each test in turn.

Terms must be in "plain, intelligible language"

2.15 Regulation 7 states that sellers or suppliers shall ensure that any written term of a contract is expressed in "plain, intelligible language".[18] This concept is central to the UTCCR, and applies in three ways:

(1) If the meaning of a term is in doubt a court will follow the interpretation most favourable to the consumer.[19] This reflects the long standing common law rule that an ambiguous written term should be construed against the party putting it forward.[20] An example of the application of Regulation 7 is *Peabody Trust Governors v Reeve*, where two sub-clauses contradicted each other and the court upheld the sub-clause more favourable to the consumer.[21]

(2) Enforcement bodies acting under Part 8 of the Enterprise Act 2002 can exercise their powers to remove terms which are not in "plain, intelligible language". The UTCCR are not entirely clear on this point, but the Consumer Injunctions Directive (CID) requires Member States to designate either the courts or enforcement bodies as competent to seek orders requiring the cessation or prohibition of any infringement of any part of the UTD.[22] The CID was implemented by Part 8 of the Enterprise Act 2002, which aims to protect the collective interests of consumers where there is "any act contrary" to the directives listed in its annex. This includes the entirety of the UTD.[23] There is no corresponding right for consumers.

(3) Even if a term is concerned with the "adequacy of the price" or "main subject matter" it will be reviewable for fairness if it is not drafted in "plain, intelligible language". The concept of "plain, intelligible language" is therefore central to the exemption in Regulation 6(2) and we consider it in depth in Part 8.

16 UTD, Art 5; UTCCR, Reg 7.

17 UTD Arts 2 and 6; UTCCR Regs 4 and 8.

18 UTCCR Reg 7.

19 UTCCR Reg 7(2).

20 This is sometimes referred to as the "*contra proferentem"* rule.

21 [2008] EWHC 1432 (Ch), [2009] L&TR 6 at [33].

22 Directive 98/27/EC on injunctions for the protection of consumers' interests OJ1998 L 166/51. This was replaced by the codifying Directive 2009/22/EC OJ 2009 L 110/30: see art 2(1)(a).

23 Above, art 1, Annex 1, No 5.

Terms must be fair

2.16 Under the UTCCR, a court may assess any term in a consumer contract for fairness, unless the term falls within one of the exemptions. A claim may be brought before the court by either an individual consumer or an enforcement body.

The exemptions

2.17 There are three exemptions.

NEGOTIATED TERMS

2.18 First, the UTD does not extend to negotiated terms. This exemption was included at a late stage in negotiations, reflecting a forceful submission to the European Commission by Professors Brandner and Ulmer that control of negotiated terms "would represent a drastic restriction of the autonomy of the individual".[24] It reflected the free market base of the Directive.

2.19 Regulation 5(2) of the UTCCR defines negotiated terms narrowly:[25]

> A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.

2.20 If disputed, it is for the business to show that a term was individually negotiated.[26]

2.21 The mere fact that the consumer had the opportunity of influencing the content of terms is insufficient. In *UK Housing Alliance Ltd v Francis* the Court of Appeal held that the fact that a consumer had instructed solicitors who had the opportunity to consider and negotiate terms, did not mean that the terms were individually negotiated.[27]

TERMS WHICH REFLECT THE EXISTING LAW

2.22 The second exemption is for contractual terms which reflect the existing law. Regulation 4(2) states that the UTCCR do not apply to contract terms which reflect "mandatory statutory or regulatory provisions" or the provisions of international conventions.

[24] Professor Brandner and Professor Ulmer, "The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission" (1991) 28 *Common Market Law Review* 647, p 652. Professor Dr Hans Erich Brandner was an advocate at the German Federal Court of Justice, Karlsruhe at the time of writing. Professor Peter Ulmer was a Professor of Law at the University of Heidelberg.

[25] This reflects UTD art 3(2).

[26] UTD art 3(2); UTCCR Reg 5(4).

[27] [2010] EWCA Civ 117, [2010] Bus LR 1034 at [19] by Longmore LJ.

2.23 In 2005, we pointed out that this exemption is wider than it first seems. Recital 13 of the UTD states that the exclusion 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". Thus, the court cannot review any term which reflects the default law which would exist if the term were not there. For example, the court could not assess the fairness of a term which prevents the consumer from breaching the trader's copyright if it simply reflects the consumer's existing obligation under copyright law.[28] In any event, reviewing a clause which reflected the existing law would be pointless. Even if the clause was found not to be binding, the default law would still apply.

TERMS WHICH RELATE TO THE MAIN SUBJECT MATTER OR THE PRICE

2.24 This exemption is set out in Regulation 6(2) and discussed in detail in Parts 4 to 8.

The fairness test

2.25 Regulation 5(1) of the UTCCR sets out the basic test of unfairness, using the words of the UTD:[29]

> 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.

2.26 This must be judged at the time the contract was concluded:

> … 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.[30]

2.27 Recital 16 to the UTD explains that the test should take account of the factors listed in Schedule 2 of UCTA, suggesting that there is substantial similarity between the two tests:

> 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.

[28] This is discussed further in Appendix C.

[29] UTD article 3(1).

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

2.28 In 2002, we noted that there had been considerable debate in the legal literature about the correct interpretation of the fairness test.[31] We concluded that there was no substantive difference between the fair and reasonable tests in UCTA and the UTCCR. We return to this issue in Part 9.

The "grey list"

2.29 In Schedule 2, the UTCCR contain an "indicative and non-exhaustive" list of terms which may be regarded as unfair, which is copied from the UTD.[32] The CJEU has described these as being of "indicative and illustrative value" which should be readily available to the public in each Member State.[33]

2.30 Terms on this grey list which are commonly encountered include:

(1) penalty clauses;[34]

(2) cancellation clauses which allow the seller or supplier (but not the consumer) to end a contract on a discretionary basis;[35]

(3) terms which irrevocably bind the consumer to terms which they had no opportunity of reading before the conclusion of the contract;[36]

(4) variation clauses which unilaterally enable the business to alter the terms of the contract without a valid reason specified in the contract;[37] and

(5) price escalation clauses which do not give the consumer a corresponding right to cancel the contract.[38]

2.31 The case of *Peabody Trust Governors v Reeve* provides a good example of a variation clause which may be unfair. Here a term in a standard tenancy contract used by a registered social landlord was held to be unfair. It sought to reserve:

> almost *carte blanche* in the field of variations, apart from the areas of rent and statutory protection, so as to provide in effect that the terms of the tenancy agreement will be whatever the [landlord] says they are to be from time to time.[39]

[31] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No166; Scottish Law Commission Discussion Paper No 119, para 3.57.

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

[33] *Commission v Kingdom of Sweden* Case C 478/99 [2002] ECR I-04147 at [22]; [2004] 2 *Common Market Law Reports* 34.

[34] Sch 2, para 1(e): if the potential effect of a term is penal it may be subject to the test of fairness under the regulations whether or not the term would be classed as a penalty in the technical common law sense.

[35] Sch 2, para 1(f).

[36] Above, 1(i).

[37] Above, 1(j).

[38] Above, 1(l).

[39] [2008] EWHC 1432 (Ch), [2009] L&TR 6 at [56].

The tenant's right to walk away from the contract was illusory because there was no real choice.[40]

2.32 The grey list is merely "indicative and non-exhaustive". This means that a term may be fair even if it is on the grey list, and it may be unfair even if it is not. Although it is sometimes suggested that there is a presumption that a term on the grey list is unfair, this is not formally part of the UTD or UTCCR.

2.33 In practice, however, the list has been a useful illustration of the sort of problems the UTD was meant to deal with. It is also important to note that article 3(3) of the UTD states that terms on the grey list "may be regarded as unfair". This means that the exemption for the main subject matter and price terms is not intended to apply to the categories of terms set out in the grey list. The grey list therefore serves as a guide to how the exemption should be interpreted.

The effect of an unfair term

2.34 Regulation 8 of the UTCCR states that if a term is found to be unfair, it "shall not be binding on the consumer". The rest of the contract "shall continue to bind the parties if it is capable of continuing in existence without the unfair term".

THE LAW COMMISSIONS' PROJECT

2.35 The co-existence of two overlapping schemes for unfair terms in the UK has long been criticised for its complexity and obscurity. It has even been suggested that the UK may be in breach of its Treaty obligations because the law is so inaccessible.[41] The UCTA and the UTCCR have their own concepts and definitions, and these differ in confusing ways. For example, they use different definitions of "consumer" and "unfair", and they require different burdens of proof.

2.36 In 2001, the Department of Trade and Industry asked the Law Commission and Scottish Law Commission to rewrite the law of unfair contract terms as a single regime, in a clearer and more accessible style. At the same time we were asked to consider whether to extend the legislation to protect businesses, particularly small businesses.

2.37 In February 2005 we published a final Report setting out our detailed recommendations, together with a draft Bill. Our recommendations were in four parts:

(1) *For contracts between a business and a business with 10 or more employees*, the draft Bill merely restated the current law in a more accessible form;

(2) *For contracts between a business and a micro-business*, the Law Commissions recommended an extension of protection;

[40] Above at [56] to [57].

[41] FMB Reynolds, "Unfair Contract Terms" (1994) 110 *Law Quarterly Review* 1. The point is discussed in Unfair terms in contracts (2002) Law Commission Consultation Paper No166; Scottish Law Commission Discussion Paper No 119, para 2.22.

(3) *For contracts between a business and a consumer*, the draft Bill combined UCTA and the UTCCR into a single unified regime to cover the whole of the UK;

(4) *For other contracts,* the draft Bill preserved the existing law.[42] At present, UCTA has some limited effect on employment contracts and private sales between two consumers. The draft Bill restated these provisions.

Consumer contracts

2.38 The current paper is only concerned with contracts which are made between a business and a consumer (consumer contracts).

2.39 For consumer contracts, the 2005 Report attempted to bring together the UCTA and the UTCCR in one coherent regime, using the same concepts and definitions. We did not intend to make any major policy changes, but where the two regimes differed we "rounded up", so as to preserve the existing level of consumer protection. Unlike the UTCCR we did not simply copy out the UTD. Instead, we sought to explain the UTD in words which would be more familiar to a UK audience.

2.40 In 2005, we made the following recommendations:

(1) There should be a common definition of a "consumer contract", based on the definition in the UTD.

(2) Terms which limit liability for death or personal injury, or which exclude basic undertakings about the quality and fitness of goods, should continue to be ineffective.

(3) In claims brought by consumers, the burden of proof should lie on the business to show that the term is fair. This follows UCTA. Under the UTCCR, technically the burden of proof is on the consumer, though the European case law makes clear that the court can raise the issue of its own motion.

(4) The legislation should include negotiated terms. At present, UCTA includes negotiated terms, while the UTCCR do not. We thought it was better to "round up" rather than "round down".

(5) There should be a single fairness test, based on UCTA. We thought that in substance the tests in UCTA and the UTCCR were identical, but the words of the UCTA test were more familiar to a UK audience.

(6) The grey list should be re-written in clearer, simpler terms. Our new version is set out in Appendix B, together with the original Schedule.

[42] See Part 9 of this Issues Paper.

(7) Preventive powers should be available for any breach of the new consumer regime. At present, preventive powers are available for breaches of the UTCCR, but not for UCTA. Our recommendation would give the OFT and the other qualifying bodies the right to take action against notices which purport to exclude business liability to consumers, but which do not have the status of consumer terms.

(8) The exclusion for terms which reflect the existing law should be rewritten to reflect the UTD recitals. This means that the exemption would apply not only to terms which reflect mandatory provisions but also those which lead to "substantially the same result as would be produced as a matter of law if the term were not included".[43]

2.41 We still think these recommendations are correct. In Part 9 we set them out in more detail and ask whether consultees agree that the recommendations should be implemented as part of the Government's programme to simplify consumer legislation. We also ask whether, as a matter of policy, we should attempt to implement the UTD in clearer simpler language, rather than simply copy it out.

2.42 Two other recommendations dealt with the exemption under Regulation 6(2) and are more controversial. In 2005 we recommended that:

(1) The legislation should be amended to clarify that "plain, intelligible language" referred not only to the language used, but was a short hand for transparency. Under the draft Bill, a term would only meet the requirement if it was in reasonably plain language, legible, clear and available to the consumer.

(2) Terms relating to the main subject matter of the contract or the price should only be exempt from review if they were part of the core bargain. Under the draft Bill, they were only exempt if they were substantially the same as the consumer reasonably expected.

2.43 Given that these recommendations relate to rules that have since been the subject of a major test case before the Supreme Court we discuss them in more detail in Parts 4 to 8.

[43] We also recommended removing the exception in UCTA for cross border contracts for the sale of goods. We do not address it in this paper as it is discussed by BIS in their recent consultation paper: BIS, *Enhancing Consumer Confidence by Clarifying Consumer Law* (July 2012), p 24.

PART 3
THE PURPOSE OF UNFAIR TERMS INTERVENTION

3.1 A discussion of the policy behind unfair terms legislation needs to start with its purpose. As discussed below, unfair terms legislation was a response to the problems raised by standard form contracts. It has played an important role in protecting consumers against hidden terms, especially in new or growing markets such as the mobile phone market in the late 1990s.

3.2 Unfair terms legislation assumes that consumers are rational but too busy to read the many complex standard terms presented to them. When presented with the right information in a way they can understand, they make good decisions.

3.3 Recent economic literature suggests that consumers are only rational up to a point.[1] As we discuss below, consumers approach products with many forms of behavioural biases, which may be exploited by traders. There are no easy answers to problems caused by behavioural biases. Some problems can be corrected by improved competition or improved information. Other problems are addressed by the Consumer Protection from Unfair Trading Regulations 2008 (CPRs),[2] which protect consumers from traders' misleading or aggressive practices. In some other cases, consumers must live with the consequences of their decisions.

3.4 As we argue in Part 8, it is important that unfair terms legislation continues to fulfil its primary role, which is to protect consumers against unfair surprise. Unfair terms legislation cannot, however, solve all the problems of the market place and it should not protect consumers against the consequences of their own poor decisions.

THE PROBLEMS OF STANDARD FORM CONTRACTS

3.5 In our 2002 Consultation Paper, we explained that the courts found it difficult to deal with the problems which emerged in the nineteenth century from the development of standard form contracts. Standard terms can be beneficial to both parties, provided that they strike a fair balance between them. They enable the parties to make complex contracts with the minimum of time or trouble.

3.6 The problem, however, is that standard terms are usually not subject to any competitive pressure. We quoted Lord Reid in *Suisse Atlantique*, who neatly summed up the problem with standard terms:

[1] See D Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (2008); D Kahneman, *Thinking Fast and Slow* (2011); and R Thaler and C Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (2008). The implications for enforcement bodies are discussed in OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report for the OFT by S Huck, J Zhou and C Duke, p 6.

[2] SI 2008 No1277

> In the ordinary way the customer has no time to read them, and if he did read them he would probably not understand them. And if he did understand and object to any of them, he would generally be told he could take it or leave it. And if he then went to another supplier the result would be the same.[3]

3.7 This statement highlights two problems. First, consumers rarely have the time or opportunity to read standard terms, let alone understand them. This opens the possibility that they will be taken by an unfair surprise.

3.8 Secondly, even if consumers are aware of the term, there is not a lot they can do about it. The business will not agree to remove the term, and the consumer is likely to find that other suppliers' terms are similar.

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

3.10 The problem is similar to that identified by Professor Akerlof in his Nobel prize winning essay on the "market for lemons".[5] In the US, a "lemon" is a second hand car which looks adequate but proves defective. Akerlof explained that without legal protection, poor quality cars would drive out the good. The owners of good cars would not be paid an adequate price, and would withdraw their cars from the market. As better cars are withdrawn, the average quality would fall. This would lead to a reduction in price, leading more and more owners to withdraw. The same analysis can be applied to hidden contract terms. Information asymmetry would lead a race to the bottom.[6]

3.11 The difficulties caused by standard terms were eloquently expressed by Lord Denning, in his "uniquely colourful and graphic style":[7]

[3] *Suisse Atlantique Société d'Armement Maritime SA v Rotterdamsche Kolen Centrale* [1967] 1 AC 361, p 406.

[4] P Diamond, "A model of price adjustment" (1971) 3(2) *Journal of Economic Theory* 156. For discussion, see M Armstrong and J Vickers, "Consumer Protection and Contingent Charges" (2012) *Journal of Economic Literature* 50:2, 477, p 489.

[5] G Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism" (1970) 84 *Quarterly Journal of Economics* 488.

[6] See Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the "market for lemons rationale" (2011) *International & Comparative Law Quarterly* 933, p 936.

[7] *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 at 812G by Lord Bridge.

> None of you nowadays will remember the trouble we had – when I was called to the Bar – with exemption clauses. They were printed in small print on the back of tickets and order forms and invoices. They were contained in catalogues or timetables. They were held to be binding on any person who took them without objection. No one ever did object. He never read them or knew what was in them. No matter how unreasonable they were, he was bound. All this was done in the name of "freedom of contract". But the freedom was all on the side of the big concern which had the use of the printing press. No freedom for the little man who took the ticket or order form or invoice. The big concern said, "Take it or leave it". The little man had no option but to take it. The big concern could and did exempt itself from liability in its own interest without regard to the little man. It got away with it time after time. When the courts said to the big concern, "You must put it in clear words", the big concern had no hesitation in doing so. It knew well that the little man would never read the exemption clauses or understand them.[8]

3.12 This, Lord Denning stated, "was a bleak winter for our law of contract".[9]

3.13 Against such a background the legislature stepped in. In 1975, the Law Commission and Scottish Law Commission published a report on exemption and limitation clauses,[10] which led to the Unfair Contract Terms Act 1977 (UCTA). In 1993, UCTA was supplemented by the Unfair Terms Directive 1993 (UTD).

3.14 It is still the case that consumers rarely read or attempt to understand the many terms with which they are presented. The point can be demonstrated by an April Fools' joke. On 1 April 2010, Gamestation added a term to their contract to require consumers to sell their souls. The term granted the trader a "non-transferable option to claim, for now and ever more, your immortal soul". Consumers were entitled to opt out by clicking a link, and if they did were given a £5 voucher. Only 12% of customers clicked the option; the other 7,500 customers sold their souls without bothering to read the clause.[11]

[8] *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284, pp 296 to 297.

[9] Above, p 297. See for example *Thompson v London, Midland and Scottish Railway Co* [1930] 1 KB 41 in which a train company's exemption from liability in small print on the back of a train timetable was upheld and *L'Estrange v F Graucob Ltd* [1934] 2 KB 394 in which an exemption in small print at the bottom of an order form was upheld.

[10] Exemption Clauses: Second Report (1975) Law Com No 69; Scot Law Com No 39. Although the report included draft two Bills (for England and Wales and for Scotland), UCTA does not fully follow these drafts.

[11] See Appendix C, para C.41.

THE IMPORTANCE OF THE UTCCR

3.15 When the Unfair Terms in Consumer Contracts Regulations 1994 (UTCCR) were introduced into UK law in 1995, they were hailed as ground-breaking.[12] Geoffrey Woodroffe and Robert Lowe commented that their effect was measured not in the volume of litigation but in the amount of enforcement action:

> In the decade or so since the 1994 Regulations came into force … there has been a great deal of activity out of court – and on that basis consumers have been in a much stronger position than before.[13]
>
> … Very few cases under the Regulations reach the courts but many thousands of clauses have been, and are still being, considered by the OFT.[14]

3.16 The Office of Fair Trading (OFT) has pointed out that its success in achieving amendments to potentially unfair terms without litigation in thousands of cases has saved hundreds of millions of pounds in litigation costs.[15]

3.17 The UTCCR are also used by 11 other bodies qualified to bring a complaint,[16] including the Financial Services Authority, Ofcom and individual trading standards services.

The mobile phone market: an example

3.18 An example of the use made of the UTCCR can be seen in the mobile phone market. In 1996, the OFT undertook an investigation into the terms used in standard form mobile phone contracts. These included terms relating to the lack of a "cooling off period", the length of time that consumers were tied into the contract, and the fees payable for disconnecting a service. The OFT were also concerned that mobile phone contracts were not intelligible: they were often too lengthy, not expressed in plain English and contained terms hidden in small print.

[12] G Woodroffe and R Lowe, *Woodroffe and Lowe's Consumer Law and Practice* (8th ed 2010), para 9.01. In 2002 Elizabeth Macdonald described the UTCCR as "possibly the single most significant piece of legislation in the field of contract law": "Scope and Fairness of the Unfair Terms in Consumer Contracts Regulations: *Director General of Fair Trading v First National Bank*" (2002) 65(5) *Modern Law Review* 763.

[13] G Woodroffe and R Lowe, *Woodroffe and Lowe's Consumer Law and Practice* (8th ed 2010), para 9.02.

[14] Above, para 9.30.

[15] In press release 33/2000 The OFT has challenged thousands of clauses, eg OFT Bulletins 21 and 22 list 765 clauses which were amended or deleted within a six month period.

[16] These are listed at para 2.11 of this Issues Paper.

3.19 As a result of the investigation, the OFT asked nine out of ten of the country's leading mobile phone suppliers[17] to stop using particular terms which it considered to be unfair. In 1997, the OFT had remaining concerns about seven providers.[18] Following OFT intervention, these companies introduced revised contracts and agreed not to use or enforce unfair terms.

3.20 Oftel, the industry regulator at the time, supported the OFT's actions, citing approximately 4,000 complaints and queries per year that it received from customers with mobile phones.[19] In 1996, Mr Don Cruickshank, the Director General of Telecommunications, put forward the argument for early enforcement action:

> The mobile telecoms industry has grown rapidly in the past few years. By taking action now over customer concerns, it can help build customer confidence so its continual growth can be assured.[20]

3.21 The mobile phone sector saw rapid growth in the late 1990s.[21] It is believed that better regulation, pay-as-you-go options and supermarket deals encouraged competition and growth in the sector.[22]

Other uses of the UTCCR

3.22 The UTCCR are also an important component of the OFT Consumer Codes Scheme,[23] as traders have to show that their standard terms and conditions comply with the UTCCR. Many Trading Standards Services (TSS) also supervise local approved trader schemes, designed to give consumers a reliable way of finding trustworthy local businesses. As part of these schemes, traders are required to show that their standard terms and conditions comply with the UTCCR.

[17] Orange, Vodafone, Cellnet, Mercury, Astec Communications, British Telecom, The Peoples Phone Company, Motorola Telco and UniqueAir.

[18] BT, Call Connections (owned by BT), Unique Air, Motorola Telco, Astec Communications, Peoples Phone and One 2 One.

[19] See Oftel press release, *Oftel supports action on 'unfair' mobile phone contract terms*, available from PR Newswire at http://www.prnewswire.co.uk/cgi/news/release?id=48309; see also The Independent, *Mobile phone contracts 'unfair* (8 June 1996) available at: http://www.independent.co.uk/news/mobile-phone-contracts-unfair-1335916.html.

[20] Oftel press release, *Oftel supports action on 'unfair' mobile phone contract terms*, available from PR Newswire at http://www.prnewswire.co.uk/cgi/news/release?id=48309.

[21] In the third quarter of 1999, the biggest four mobile phone companies (Vodafone, Cellnet, Orange and One 2 One) added 2.7 million new UK subscribers. BBC News, *Mobile phones – a growth industry* (29 October 1999), available at: http://news.bbc.co.uk/1/hi/business/business_basics/469294.stm.

[22] See, for example, BBC News, *Mobile phones – a growth industry* (29 October 1999) available at: http://news.bbc.co.uk/1/hi/business/business_basics/469294.stm.

[23] Section 8(2) of the Enterprise Act 2002, gives the OFT the power to approve consumer codes (codes of practice regarding the conduct of traders in the supply of goods and services to consumers), and section 8(3) imposes a duty to specify criteria for approval.

THE MODEL OF THE RATIONAL BUT BUSY CONSUMER

3.23 UCTA and the UTD were not designed to protect vulnerable consumers. As we explained in 2002, there were cases in which some consumers paid quite exorbitant prices through ignorance of the normal price.[24] Unfair terms legislation, however, was not intended to deal with this problem.

3.24 Instead, the legislation assumes that consumers are rational economic actors, who when presented with the right information make good decisions over what to buy. The problem is that consumers are busy – or "time poor". They do not have time to read and understand all the small print, especially when that small print is made difficult to read and complex to understand.

3.25 This emphasis on protecting consumers only against information deficits emerges from the article by Professors Brandner and Ulmer in 1991, which heavily influenced the text of the final draft of the UTD. Brander and Ulmer said that "the protection of consumers against unfair contract terms is to contribute to the balance of the parties' rights and obligations", and this should be achieved by "improving the transparency in this area". They continued:

> The requirement of transparency is directed against terms which may *conceal* the principal obligations or the price and thus make it difficult for the consumer to obtain an overview of the market and to make what would (relatively speaking) be the best choice in a given situation. The improvement of information helps the market mechanisms to prevent any imbalance between the parties' rights and obligations.[25]

3.26 In 2002, therefore, we distinguished between the core bargain, which consumers would know about, and other terms which contained the possibility of unfair surprise. The distinction between the two would depend on how the deal was presented to the consumer.[26] In this regard, we thought that there were similarities between UCTA and the UTD.

[24] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 4.63.

[25] Hans Brandner and Peter Ulmer, "The Community Directive on Unfair Terms in Consumer Contracts: some critical remarks on the proposal submitted by the EC Commission" (1991) 28 *Common Market Law Review* 647, p 656.

[26] Unfair Terms in Contracts (2002) Law Commission Consulation Paper No 166; Scottish Law Commission Discussion Paper No 119, paras 3.23 to 3.24.

BEHAVIOURAL BIASES

3.27 In the last five years, some economists have doubted the model of a rational consumer. A growing literature suggests that consumers display "behavioural biases" which lead them to make "predictably irrational" decisions.[27]

3.28 There are many ways in which consumers may be "predictably irrational". For our purposes, examples of relevant behavioural biases include:

(1) *An undue focus on the present*. As a study for the OFT puts it, "consumers never like to incur pain immediately but are always keen to have pleasures now".[28] They therefore put more weight on a price that must be paid immediately, and less weight on a price that need only be paid in the future, such as a high interest rate on credit charges.

(2) *Over-confidence*. Consumers think that they can handle their lives better than they actually can. This optimism leads them to think that they will go to the gym more often than they actually do,[29] and that they will seek unauthorised overdrafts less often. Similarly, consumers may take out a payday loan convinced that they will repay their debt before incurring penalties but then fail to pay.

(3) *Loss aversion to sunk costs.* Once consumers have invested time and effort into finding a product, they are often reluctant to walk away if unappealing terms are revealed late in the booking process. An example is where a consumer is attracted to a cheap airline ticket, which is revealed to be much more expensive by the end of the booking process. By then consumers feel committed to the product and will continue to buy, even if the original reasoning behind the purchase has been shown to be inaccurate.

The solutions

3.29 There are no easy solutions to preventing traders from exploiting behavioural biases in the way that they price and promote products. A study for the OFT identifies three possible strategies: competition, learning and transparency. We look briefly at each.

[27] OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report by S Huck, J Zhou and C Duke; S DellaVigna and U Malmendier "Paying not to go to the Gym" (2006) *American Economic Review* 96(3) 694 ; P Heidhues and B Koszegi "Competition and Price Variation When Consumers are Loss Averse" (2008) *American Economic Review*, 98(4), 1245; M Armstrong and J Vickers, "Consumer Protection and Contingent Charges" (2012) *Journal of Economic Literature* 50:2, 479; DG SANCO (2010): *Consumer Decision- Making in Retail Investment Services: A Behavioural Economics Perspective, a report by N.Chater, R.Inderst and S.Huck*.

[28] OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report by S Huck, J Zhou and C Duke p 25, para 3.34 citing S DellaVigna and U Malmendier "Paying not to go to the Gym" (2006) *American Economic Review* 96(3) 694.

[29] S DellaVigna and U Malmendier "Paying not to go to the Gym" (2006) *American Economic Review* 96(3) 694.

Intensifying competition

3.30 In some markets, intensifying competition may serve to protect consumers. If sophisticated consumers react against hidden booking charges, this may act to reduce their amount. In other markets, however, naïve and sophisticated consumers may have opposing interests. For example, in the current personal current account market, sophisticated customers benefit from free banking which is subsidised by the minority of consumers who incur bank charges.

3.31 Mark Armstrong and John Vickers have contrasted situations where the naïve benefit from the presence of sophisticated consumers, and situations where the sophisticated consumer benefits at the expense of the naïve. They call for more analysis of distributional issues in retail markets.[30]

Learning

3.32 Some behavioural biases can be combated through learning. This can be through experience – for example if consumers misinterpret their future demand for gym membership they will eventually find this out when their actual demand is realised.[31] This means that behavioural biases may be less easily exploited in a market where consumers make many repeat transactions, than where a product is bought only rarely. This may also be through learning from others – friends or family may point out better deals available elsewhere.[32]

Transparency and standardisation of information

3.33 One major study for the OFT concluded that "more information and market transparency is generally predicted to improve market outcomes" for most consumer biases.[33] Further, where consumers find it difficult to compare products because the information is too complex, "standardisation of the way in which information is presented to the consumer can have a significant beneficial effect".[34]

3.34 The answer is not straightforward, however. Standardised information may encourage traders to further differentiate their products, making them even harder to compare.[35] It may also stifle innovation.

[30] M Armstrong and J Vickers, "Consumer Protection and Contingent Charges" (2012) *Journal of Economic Literature* 50:2, 477, p 493. Professor M Armstrong is a Professor of Economics at the University of Oxford; Professor Sir John Vickers is the Warden at All Souls College, Oxford and former Chief Economist to the Bank of England. In 2010 he was Chair of the Independent Commission on Banking.

[31] OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report by S Huck, J Zhou and C Duke, p 57.

[32] Above, p 58, para 4.11.

[33] Above.

[34] Above, p 59 citing DG SANCO (2010): *Consumer Decision- Making in Retail Investment Services: A Behavioural Economics Perspective,* a report by N.Chater, R.Inderst and S.Huck.

[35] Above, citing M Piccione and R Spiegler "Framing competition" (2009), available at http://sticerd.lse.ac.uk/seminarpapers/et21052009.pdf.

Behavioural biases and the UTCCR

3.35 The UTD was designed to protect consumers from terms which lack transparency because they are in standard terms. It addresses the problems caused by behavioural biases only to a limited extent.

3.36 Some of the terms on the grey list reflect common ways in which traders may exploit behavioural biases. For example, paragraph (e) covers terms requiring a consumer "who fails to fulfil his obligation to pay a disproportionately high sum in compensation". Although consumers should not be protected from paying a disproportionately high sum for goods or services generally, paragraph (e) recognises that consumers may be over-optimistic. They may therefore give too little attention to the consequences of failing to do what they expect to do.

3.37 Similarly, paragraph (d) addresses terms which permit the seller to "retain sums paid by the consumer" where the consumer "decides not to conclude or perform the contract". This recognises that consumers may be focused on their present intentions, and give too little attention to possible changes of mind in the future.

3.38 In general, however, the UTD assumes that if consumers are told about terms in an open and upfront way, they will be able to protect their own interests. As we explain in Part 4, the exemption in article 4(2) reflects the importance given to freedom of contract.[36] It prevents the courts from assessing whether the price is disproportionate in relation to the costs and services supplied in exchange.

OTHER CONSUMER PROTECTION MEASURES

3.39 The UTD is only one of a basket of measures available to enforcement bodies to enable competition to work better. It works alongside the Unfair Commercial Practices Directive 2005 (UCPD),[37] and the Consumer Rights Directive,[38] which we describe briefly below.

Unfair Commercial Practices Directive

3.40 The UCPD has been implemented by the CPRs.[39] The CPRs replaced 23 previous enactments, including most of the Trade Descriptions Act 1968. Under the CPRs, traders may not engage in misleading or aggressive practices which would be likely to cause "the average consumer to take a transactional decision he would not have taken otherwise".[40] The UCPD also contains a blacklist of 31 banned practices which are always unfair.[41]

[36] See paras 4.4 to 4.10 of this Issues Paper.

[37] Directive 2005/29/EC of 11 May 2005, OJ 2005 L 149.

[38] Directive 2011/83/EU of 25 October 2011, OJ 2011 L 304/64.

[39] For a description of the UCPD, see our Consumer Redress for Misleading and Aggressive Practices (2011) Law Commission Consultation Paper No 199; Scottish Law Commission Discussion Paper No 149, Part 2.

[40] See for example CPRs Regs 5(2)(b) and 7(1)(b).

[41] Above, Sch 1.

3.41 The CPRs are generally enforced by the TSS and the OFT through criminal sanctions and enforcement orders.[42]

3.42 Although courts may award compensation following a criminal conviction, the CPRs do not permit consumers to bring civil actions on their own behalf.

3.43 In our March 2012 Report, "Consumer Redress for Misleading and Aggressive Practices", we made recommendations for a private right of redress in this area.[43]

Late information

3.44 The CPRs are particularly useful where information is presented late in the booking process, such as where a misleading advertisement for a low fare encourages consumers to spend a long time on a website, before discovering that the fare is much higher than originally thought. The essential question is whether the misleading advertisement would encourage "the average consumer to take a transactional decision he would not have taken otherwise". Transactional decisions are not confined to purchases. The concept includes matters such as the decision to spend 20 minutes on a website trying to book a flight.

3.45 Furthermore, some of the banned practices are specific examples of the problems caused by "loss aversion to sunk costs". For example, Banned Practice 6 covers "bait and switch", where a trader makes an invitation to purchase an item which is not for sale with the intention of promoting a different product.[44]

Vulnerable consumers

3.46 The CPRs are also intended to protect particularly vulnerable consumers. Although the general test is based on the average consumer, vulnerable consumers are protected in two circumstances, where:

(1) the commercial practice was "directed to a particular group" of consumers; or

(2) a "clearly identifiable group of consumers is particularly vulnerable … because of their mental or physical infirmity, age or credulity" and a trader could be reasonably expected to foresee this.

3.47 These provisions aim to prevent traders from exploiting particular vulnerabilities, such as misleading treatments aimed at those who are seriously ill,[45] or mediums who exploit the bereaved by pretending to talk to dead loved-ones.

[42] In Scotland, all criminal prosecutions are conducted by the Crown Office and the Procurator Fiscal Service on behalf of the Lord Advocate.

[43] Consumer Redress for Misleading and Aggressive Practices (2012) Law Com No 332; Scot Law Com No 226.

[44] SI 2008 No 1277, Sch 1, para 6.

[45] Above, Sch 1, para 17 states that "falsely claiming that a product is able to cure illnesses, dysfunction or malformations" is a banned practice.

3.48 There is a clear difference, however, between the CPRs, which aim to protect vulnerable consumers against core bargains which are misleading and exploitative, and the UTCCR, which are aimed at preventing unfair standard terms. We do not think it is the role of the UTCCR to replicate the CPRs or, for example, provisions on extortionate credit bargains.

Consumer Rights Directive

3.49 On 23 June 2011, the European Parliament adopted the Consumer Rights Directive (CRD).[46] This updates and merges two existing directives (on Distance Selling and Doorstep Selling). It will increase protection for consumers in off-premises and distance contracts. The measure is fully harmonised, only allowing Member States to depart from it to the extent allowed by the CRD. Healthcare, social services, gambling, real estate and financial services are excluded from its scope.

3.50 The CRD is another means of addressing the problem of hidden terms. For present purposes, the key element is the information requirement. The CRD provides that, before a consumer concludes a contract, the trader must provide the consumer with the listed information in "a clear and comprehensible manner". This includes not only the main characteristics of the goods or services and the identity of the trader but also "the total price of the goods or service inclusive of taxes". The CRD goes on to state that where the price "cannot reasonably be calculated in advance" the trader must provide "the manner in which the price is to be calculated".[47] For distance and off-premises sales, the CRD also specifies that in contracts of indeterminate duration, the total price shall include the total costs per billing period.

3.51 The CRD is not yet in force, and it will take time for traders and enforcement bodies to become familiar with how it operates. In Part 8 we discuss the example of a plumbing firm which charges £50 an hour for "the number of hours which we deem to be required". There is some uncertainty about how far this provides the consumer with clear and comprehensible information about how the price is to be calculated.

3.52 If it does not provide the information, there are further questions about the consequences of this failure. In distance and off-premises contracts, if the trader has not complied with the information requirements on "additional charges or other costs", then the consumer does not have to bear those costs.[48] This raises the question of whether any failure to provide price information relates to the main price or to "an additional charge".

3.53 In all other cases, the consequences of a breach of the information provisions are for Member States to decide. Under article 24, it is up to Member States to "take all measures necessary" to ensure that the provisions are implemented. Penalties must be "effective, proportionate and dissuasive". BIS has announced that it will soon consult about what these consequences should be.

[46] The CRD must be implemented by Member States by the end of 2013.

[47] Directive 2011/83/EU of 25 October 2011, OJ 2011 L 304/64. For distance and off-premises contracts, see art 6(e). For other contracts, see art 5(c).

[48] CRD, art 6(6).

CONCLUSION

3.54 Unfair terms legislation assumes that consumers are rational but busy. They do not have the time or resources to plough their way through the many standard form contracts they are given. On the other hand, if consumers are told about the price or the subject matter the legislation assumes that they will take these terms into account when choosing whether to enter into the contract. The terms will be subject to competition and should not be assessable for fairness.

3.55 Recent work in the field of behavioural economics shows that consumers are only rational up to a point. They are subject to a range of behavioural biases, which can be exploited by traders. The UTD addresses these biases only to a very limited extent. Greater protection against misleading and aggressive practices is provided by the CPRs. In some cases, however, consumers are simply expected to live with the consequences of their decisions.

PART 4
THE EXEMPTION: PREVIOUS RECOMMENDATIONS

4.1 Under Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), a court may not assess the fairness of a term if it is in "plain, intelligible language", and relates to the "definition of the main subject matter of the contract" or the "the adequacy of the price or remuneration". This exemption was added at a late stage in the negotiations over the Unfair Terms Directive (UTD)[1] and has proved difficult to understand.

4.2 The House of Lords considered the meaning of the exemption in 2001, in *Director General of Fair Trading v First National Bank*,[2] and we drew heavily on this case in our 2002 Consultation Paper.

4.3 In this Part we give the background to the debate. We introduce the exemption and summarise the decision in *First National Bank*. We then outline the thinking in our 2002 Consultation Paper and our 2005 Report. In the next Part we summarise the case law since our 2005 Report.

THE EXEMPTION

4.4 Regulation 6(2) of the UTCCR states:

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

4.5 This reflects the exclusion as set out in article 4(2) of the UTD:

> 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.[3]

4.6 These words were inserted into the text of the UTD at a late stage by the European Council following a "particularly influential" article by Professors Brandner and Ulmer.[4]

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

[2] *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481.

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

[4] *Office of Fair Trading v Abbey National* [2009] UKSC 6, [2010] 1 AC 696 at [6] by Lord Walker.

4.7 Originally, the European Commission sought to subject every term in a consumer contract to a standard of fairness whether or not they were individually negotiated.[5] However, Professors Brandner and Ulmer forcefully argued against such wide-reaching controls:

> In a free market economy parties to a contract are free to shape the principal obligations as they see fit. The relationship between the price and the goods or services provided is determined not according to some legal formula but by the mechanisms of the market. Any control by the courts or administrative authorities of the reasonableness or equivalence of this relationship is anathema to the fundamental tenets of a free market economy. It would partially abrogate the laws of the market and hence prevent the offerers of goods or services from acting in accordance with those laws; the consumer would no longer need to shop around for the most favourable offer, but rather could pay any price in view of the possibility of subsequent control of its reasonableness.[6]

Instead, they argued that consumer protection should be ensured by "improving the transparency in this area".[7]

4.8 This free market approach reflected the legislative base of the UTD. The European Community had a competence for the harmonisation of contract law only in order to facilitate the establishment of the internal market.[8] Michael Schillig noted that "a market based approach was always bound to prevail in order to justify the Directive in light of its legal basis".[9]

4.9 The European Commission heeded the comments of Professors Brandner and Ulmer and introduced article 4(2) and Recital 19 in the final text of the UTD. The purpose was to "clarify the procedures for assessing the unfairness of terms and to specify their scope while excluding anything resulting directly from contractual freedom of the parties (eg quality/price relationship)".[10]

[5] See Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons rationale'" (2011) *International & Comparative Law Quarterly* 933, p 937.

[6] Professor Brandner and Professor Ulmer, "The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission" (1991) 28 *Common Market Law Review* 647, p 656.

[7] Above.

[8] Article 95 EC (now article 114 of the Treaty on the Functioning of the European Union (TFEU)).

[9] Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons rationale'" [2011] *International & Comparative Law Quarterly* 933, p 939.

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

4.10 The changes sought to reconcile the consumer rights and free competition approaches. Michael Schillig comments that this "inherent conflict renders a coherent and consistent interpretation very difficult".[11] As Lord Steyn stated in *Director General v First National Bank Plc*:

> The directive is not an altogether harmonious text. It reflects the pragmatic compromises which were necessary to arrive at practical solutions between member states with divergent legal systems.[12]

THE FIRST NATIONAL BANK CASE

4.11 The House of Lords considered the interpretation of the UTD exemption in *Director General of Fair Trading v First National Bank*.[13] The case was brought under the 1994 Regulations, but for the purposes of this discussion there is no difference between the 1994 and the 1999 Regulations.

4.12 The case concerned a term in a consumer credit agreement which applied when the borrower defaulted. It gave the bank the right to demand further interest at the contractual rate even after judgment had been given in the county court. Without such a term the bank would not have been entitled to post-judgment statutory interest.[14]

4.13 The bank contended that the term fell within the exemption as it concerned the amount (or "adequacy") of the remuneration.[15] The court disagreed. Lord Bingham and Lord Hope considered the term to be a "default provision" which was "an ancillary term, well outside the bounds of reg 3(2)(b) [now Reg 6(2)(b)]".[16]

4.14 Lord Bingham quoted Professor Treitel in noting that the Regulations "are not intended to operate as a mechanism of quality or price control". The exemption is therefore of "'crucial importance in recognising the parties' freedom of contract with respect to the essential features of their bargain".[17] He then went on to say:

[11] Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons rationale'" (2011) *International & Comparative Law Quarterly* 933, p 936.

[12] [2001] UKHL 52, [2002] 1 AC 481 at [32].

[13] *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481.

[14] Without the term the contractual obligation to pay interest would have been merged with the judgment. The County Court was precluded from awarding statutory interest in such proceedings by the County Courts (Interest on Judgment Debts) Order 1991.

[15] See *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481 at [10].

[16] Above at [11] to [12] by Lord Bingham and at [43] by Lord Hope.

[17] Above at [12] by Lord Bingham, quoting G Treitel, *The Law of Contract* (10th ed 1999).

> But there is an important "distinction between the term or terms which express the substance of the bargain and 'incidental' (if important) terms which surround them" … The object of the regulations and the directive is to protect consumers against the inclusion of unfair and prejudicial terms in standard form contracts into which they enter, and that object would plainly be frustrated if reg 3(2)(b) were so broadly interpreted as to cover any terms other than those falling squarely within it. In my opinion the term, as part of a provision prescribing the consequences of default, plainly does not fall within it.[18]

4.15 Lord Steyn agreed that the term was not exempt because it was a "subsidiary term". The exemption should be given "a restrictive interpretation" because:

> in a broad sense all terms of the contract are in some way related to the price or remuneration. That is not what is intended. Even price escalation clauses have been treated by the Director (sic) as subject to the fairness provision … It would be a gaping hole in the system if such clauses were not subject to the fairness requirement.[19]

4.16 The House of Lords went on to assess the term for fairness and found that it was fair.

THE 2002 CONSULTATION PAPER

4.17 In our 2002 Consultation Paper we described exempt terms as "core terms" because they are intended to reflect the core bargain. We considered the exemption in detail, looking at whether it was needed at all, the meaning of plain intelligible language and how it compared with the Unfair Contract Terms Act 1977 (UCTA).

Is the exemption needed at all?

4.18 We noted that there were problems in defining the scope of the exemption. One possibility would be to follow those Member States such as Spain who have not included the exemption in their legislation.[20] We decided against such a course. Even in relatively competitive markets, prices may vary significantly, and there would be too much scope for argument. We thought that the courts and enforcement bodies would be drawn into arguments on what the price should be, and that they would not be well equipped to deal with these.[21] Instead, we proposed to add to the definition to make "the concept of a core term rather more concrete".[22]

[18] Above at [12] by Lord Bingham. The quotes are taken form *Chitty on Contracts* (28th ed 1999).

[19] Above, at [34] by Lord Steyn.

[20] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 4.56. We noted that Denmark, Finland, Greece, Luxembourg, Portugal, Spain and Sweden did not include the exemption.

[21] Above, para 4.63.

[22] Above, para 4.59.

Plain, intelligible language

4.19 We considered the meaning of "plain, intelligible language". We thought that this was not simply a question of the language, taken in isolation. A term was not plain and intelligible if it was hard to read, not readily accessible or hidden in confusing layout. We thought that all these factors taken together amounted to a requirement of "transparency". A term should only be exempt if it was transparent.[23]

A comparison with the reasonable expectation test under UCTA

4.20 Under UCTA, a term is subject to the "fair and reasonable" test if it purports to allow a trader "to render a contractual performance substantially different from that which was reasonably expected of him".[24] In *Zockoll Group Ltd v Mercury Communications Ltd (No 2)*,[25] Lord Bingham pointed out that reasonable expectations cannot simply reflect what was in the contract, otherwise the provision would be meaningless. We thought that a consumer's reasonable expectations were derived from all the circumstances, including the way that the contract was presented. For example, if a holidaymaker was told that the hotel was still under construction, and they may be put in other accommodation, they may reasonably expect this. If, however, the term permitting alternative accommodation was hidden in small print, they would not reasonably expect it.[26]

4.21 We thought that much the same applied to the UTCCR. Whether a term was "core" depended on how the deal was presented to the consumer. The test of whether the term was one that a consumer would reasonably expect applied to both provisions.

Ancillary and incidental terms

4.22 We went on to say that the UTCCR allowed terms to be assessed which would not fall within UCTA. We argued that even terms which a consumer reasonably expected may be assessable for fairness, though they would probably be found to be fair. This followed from the decision in *Director General of Fair Trading v First National Bank*.[27] A term would not be core if it was merely ancillary or incidental, or if it was only applied in circumstances which a consumer would not anticipate as likely. We argued that "core terms" were subject to the discipline of the market. By contrast, consumers were much less likely to take into account terms which only apply in certain circumstances, and accordingly these should be subject to review.[28]

[23] Above, para 4.105.

[24] See s 3(2)(b). The equivalent Scottish provision is s 17(1)(b).

[25] [1999] EMLR 385.

[26] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 3.21.

[27] [2001] UKHL 52, [2002] 1 AC 481.

[28] Unfair Terms in Contracts (2002)Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No119, para 3.32.

Can one look at any aspects of a price term except its amount?

4.23 Finally, we considered whether the words of article 4(2) of the UTD meant that "price terms" could never be considered for fairness, or whether it was only an assessment of the "adequacy of the price" which was prevented.

4.24 As discussed in Part 2, the grey list states that price escalation clauses may be unfair. There are two ways of interpreting the Schedule. One is to say that price escalation clauses are not included within the article 4(2) exemption. They may always be assessed for fairness. The other way is to say that a price escalation clause may be assessed, but that assessment may not take into account the "adequacy" or amount of the increase, as against the goods or services supplied in exchange. One could, for example, say that a price escalation clause is unfair because it allows the price to rise without giving the consumer a right to cancel the contract,[29] but not that it was unfair because it permitted a large increase which was disproportionate to the overall price of the contract.

4.25 We thought that it would be difficult to review the fairness of a price escalation clause without considering its amount. A term permitting a small escalation may be fair: a term permitting a large escalation may be unfair. It would be difficult and artificial to assess the fairness of the term without taking into account the size of the escalation.[30]

4.26 We thought that it would be better to look at whether the price escalation clause was presented as a main feature of the contract. If so, it should not be assessed. It is more likely, however, to be an incidental term. If so, it would be assessable for fairness, taking into account all relevant circumstances, including the amount.

THE 2005 RECOMMENDATIONS

4.27 In our 2005 Report we noted that most consultees agreed with the views expressed in the Consultation Paper and we maintained the same position.[31]

4.28 We thought that it was important to re-word the exemption to make it clearer which types of terms fell within it. We made a distinction between the essential or "core" bargain (which could not be assessed for fairness), and other terms (which could be assessed). The "core bargain" depended on how the deal was presented to consumers. The main subject matter and the price were both sides of the same coin, and both had to be considered from the point of view of a reasonable consumer. What would a reasonable consumer think they were getting (the main subject matter) and what did they think they were paying (the price)?

4.29 The issue is dealt with in clause 4 of the draft Bill. We said that our new clause followed the substance of the UTD, as implemented in the UTCCR. However, we thought that the words of the UTD needed more explanation, so we added some gloss on what constituted a core term.

4.30 Clause 4 reads as follows:

[29] Above, para 3.27.

[30] Above, para 3.28.

[31] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.62.

The definition of the main subject matter
4(2)… [the assessment for fairness] does not apply to a term which defines the main subject-matter of a consumer contract, if the definition is -

(a) transparent, and

(b) substantially the same as the definition the consumer reasonably expected.

The price
4(3) Nor does [the assessment of fairness] apply to a term in so far as it sets the price payable under a consumer contract, if the price is -

(a) transparent,

(b) payable in circumstances substantially the same as the consumer reasonably expected, and

(c) calculated in a way substantially the same as the way the consumer reasonably expected.

4(5) The reference to price payable under a consumer contract does not include any amount, payment of which would be incidental or ancillary to the main purpose of the contract.

Transparent
14(3) Transparent means

(a) expressed in reasonably plain language

(b) legible

(c) presented clearly, and

(d) readily available to any person likely to be affected by the contract term or notice in question.

4.31 As we see in Part 5, in *OFT v Abbey National*, this view of the law was approved by the Court of Appeal, but is not compatible with the Supreme Court judgment. We can no longer say with confidence that it represents the correct interpretation of the UTD.

PART 5
THE EXEMPTION: RECENT CASES

5.1 At the time of our 2005 Report, the only guidance from the House of Lords on the application of the Unfair Terms Directive (UTD) was *Director General of Fair Trading v First National Bank.*[1] In our Report, we interpreted the UTD in the light of that decision.

5.2 In 2009, the Supreme Court took a different approach. In *Office of Fair Trading v Abbey National plc,* the Court rejected the contention that terms should be divided into core and ancillary terms.[2] The Court held that one could not assess the adequacy of the price, irrespective of whether a price was main or ancillary, and irrespective of how a consumer would approach it.

5.3 In this Part, we summarise three UK cases on the exemption since 2005. These are:

(1) *Office of Fair Trading v Foxtons Ltd*;[3]

(2) *Office of Fair Trading v Abbey National plc*;[4] and

(3) *Office of Fair Trading v Ashbourne Management Services*.[5]

FOXTONS

5.4 In *Office of Fair Trading v Foxtons Ltd,* the Office of Fair Trading (OFT) brought proceedings against a well known estate agent. It claimed that certain terms were unfair in the standard contract between Foxtons and consumer landlords. The Court considered two versions of the terms – those the OFT originally complained about (the old terms) and those Foxtons adopted shortly before the case started (the new terms). Three types of term were alleged to be unfair:

1 *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481.

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

3 [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

4 [2009] UKSC 6, [2010] 1 AC 696.

5 [2011] EWHC 1237 (Ch), [2011] ECC 31. The Supreme Court decision was also briefly mentioned in *Esporta Ltd v Revenue & Customs* [2011] UKFTT 633 (TC) (mentioned in submissions to establish a gym contract was valid for the purposes of considering the VAT due); *Bloomsbury International Ltd v Sea Fish Industry Authority* [2011] UKSC 25, [2011] 4 All ER 721 (referenced at the start of a judgment considering a challenge to a sea fish levy); and *Shaftesbury House (Developments) Ltd v Lee* [2010] EWHC 1484 (Ch) (considering an "entire agreement" clause in an apartment sale contract for the purposes of a misrepresentation claim).

(1) *Renewal commissions* – terms which purported to entitle Foxtons to charge a percentage of rent if a tenant introduced by Foxtons renewed or extended their tenancy, even if Foxtons did not negotiate the renewal or extension. Under the old terms this was still payable if the "incoming tenant is a person, company or other entity associated or connected with the original tenant, either personally or by involvement or connection with any company or other entity with whom the original tenant is or was involved or connected". Under the new terms this commission was payable "Where a tenant introduced by Foxtons is replaced as tenant … by his nominee";

(2) *Sales commissions* – terms which purported to entitle Foxtons to charge a percentage of the purchase price when a landlord sold a property to a tenant introduced by Foxtons, even if Foxtons did not assist in any way with the sale;

(3) *Third party renewal commissions* – terms which purported to entitle Foxtons to recover a commission where the consumer had transferred the property to another landlord, who had renewed the tenancy without any intervention from Foxtons.

The High Court

5.5 The first issue before the High Court was whether the renewal commission was exempt under Regulation 6(2). The Court applied the reasoning of the Court of Appeal in *Abbey National* (discussed below), which was subsequently overturned by the Supreme Court. Accordingly, Mr Justice Mann sought to identify the core bargain and "ascertain how the matter would be viewed by the typical consumer" to determine whether the terms were exempt.[6] Further, he stated that "whether or not the obligation on the consumer is contingent is a "strong indication" that the provisions are incidental or ancillary rather than core".[7]

5.6 Applying this test he concluded that the renewal commission was not exempt for four reasons:

(1) It was presented as something separate to the overall commission payable.[8]

(2) A consumer landlord would not consider it to be part of the core bargain.[9]

(3) It was "nowhere even hinted at, much less referred to" in the publicity.

(4) Given the uncertainty of it becoming payable, it would be a subsidiary matter in the eyes of a consumer landlord.[10]

6 [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133 at [36] and [40].

7 Above at [39].

8 Above at [43].

9 Above at [50].

10 Above at [50].

5.7 Second, the Court considered whether the renewal commission was in plain, intelligible language. The OFT argued that some of the words in the old terms, such as "associated or connected", were "vague and undefined" and that the fact that the clauses were "dotted around" the document obscured them from view.[11] Mr Justice Mann agreed that the phrase "associated or connected" was not in plain, intelligible language:

> In their context their scope would puzzle even lawyers. They are broad terms of uncertain meaning in this concept. When similar words are used in statutes they are closely defined (see for example the Insolvency Act 1986), and rightly so … The point is not that they are void for legal uncertainty. The point is that they are too vague to be classed as plain and intelligible.[12]

5.8 When Mr Justice Mann considered the new terms, he thought that the replacement word "nominee" was still "not plain or intelligible enough". Furthermore, he thought that, given the way the new contracts were structured, "the obligation has become somewhat buried". The result was that it "required some legal mining to bring it to the surface, and the typical consumer is not a miner for these purposes".[13]

5.9 Third, Mr Justice Mann considered whether the terms were fair. Applying the reasoning in *First National Bank,*[14] he found both the old and new terms to be unfair. He considered there to be a "significant imbalance" because the amounts payable were significant, operated adversely to the consumer the more time went on and because commensurate services were not provided as time went on.[15] Further, he concluded that not enough was done to draw the terms to the attention of the typical consumer:

> So far as expectations are concerned, I think it unlikely that the typical consumer who has got a tenant for (say) a year's tenancy, and paid 11% of the rent up-front, would expect a repeat bill in year 2 (and all years thereafter) unless that point is spelled out to him in some way. In the absence of that it becomes a trap, or a time bomb.[16]

5.10 Mr Justice Mann's reasoning was very similar to early common law judgments on incorporation of terms:

[11] Above at [61].

[12] Above at [62].

[13] Above at [74].

[14] Whilst *First National Bank* considered the fairness test in the context of the 1994 Regulations it was accepted that the reasoning also applied under the 1999 Regulations (*Office of Fair Trading v Foxtons Ltd* [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133 at [78]).

[15] [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133 at [90].

[16] Above at [91].

> Of course the theory is that the typical consumer, and particularly the circumspect one, will read all the standard terms. But the practice is that even the circumspect one will be unlikely to do so with a great deal of attention. I think that such a consumer will expect a lot of detail be dealt with in what is frequently labelled the "small print", but the whole point of that expression … is that it contains things which are not of everyday concern to the consumer … The consumer would not expect important obligations of this nature with likely and significant impact to be tucked away in the "small print" only, with no prior flagging, notice or discussion. I think that that is what has happened here.[17]

5.11 He did not consider Foxtons' new terms to be fair either, finding them to be "severely camouflaged" and that "the risk of ambush, or time-bombs, or any other similarly graphic surprise metaphor, is even greater and the term more clearly unfair".[18] He also considered the third party renewal commissions (used in the old contracts) to be unfair.[19]

5.12 Mr Justice Mann did not consider that Foxtons' counter arguments about the benefits landlords derived from renewals of tenancies to mitigate the unfairness of the term. The "real question" was "whether the consumer knows that he is paying for that, and, even more to the point, knows how much he is paying for it".[20] On this point, he acknowledged the question of unfairness and of whether the terms fell within the exemption to be "inter-related".[21]

5.13 The Court dealt with the sales commission term briefly. Mr Justice Mann concluded that there was "an obvious imbalance" given the potentially large financial liability imposed on landlords in circumstances where Foxtons have played no material role.[22] Further, it was not a clause a consumer landlord would expect to find – "the typical consumer would not merely be surprised by it if it were pointed out before he signed up; he would be astonished".[23] He dismissed Foxtons' argument that it was sufficiently flagged. He commented that "tucking something like this away in clause 5.1 of the small print, albeit under a heading "Sales Provisions", is not flagging it at all".[24]

The Court of Appeal

5.14 In *Foxtons*, the terms were found to be unfair in a collective challenge brought by the OFT. The main issue before the Court of Appeal was whether Foxtons should be prevented from relying on the terms in their existing contracts, even though there was a possibility that the terms may be fair in light of the individual circumstances of each contract.

[17] Above at [92].

[18] Above at [98].

[19] Above at [100] to [101].

[20] Above at [94].

[21] Above at [94].

[22] Above at [103].

[23] Above at [104].

The effect on individual contracts

5.15 The Court of Appeal held that Foxtons could be prevented from relying on terms in individual contracts. As Lord Justice Waller commented:

> It would be quite inadequate protection to consumers if a court on a general challenge, having found a term as used in current contracts to be unfair, had no general power to prevent the supplier or seller from continuing to enforce that term in current contracts.[25]

5.16 In general challenges, therefore, it was open to the court to grant injunctions to protect individual consumers. This was because "the OFT are given the power to make a general challenge the whole object of which is to affect the rights of the service provider and customers with which he deals".[26] However, the Court recognised that this may not always be appropriate – it would depend on why the term was unfair. Therefore, Lady Justice Arden commented that "the terms of any injunction should be left to the discretion and good sense of the trial judge".[27]

The role of individual circumstances

5.17 The case also raises the question of how far a court should consider consumers' individual circumstances in assessing the fairness of terms. Two articles of the UTD are relevant:

(1) Under article 4, when a court assesses a term for fairness it must take account of "all the circumstances attending the conclusion of the contract". This would include the individual circumstances of the consumer.

(2) Article 7 provides for general challenges and where it may not be possible for the court to consider all the individual circumstances. Instead, the court assesses the position by reference to the typical consumer.[28]

5.18 Article 4 begins "without prejudice to article 7". Lord Justice Moore-Bick explained that these words do not mean that the fairness test in general challenges differs in terms of substance from the fairness test in individual challenges. Rather, the issue was a practical one about the evidence before the court. He commented:

[24] Above at [105].

[25] *Office of Fair Trading v Foxtons Ltd* [2009] EWCA Civ 288, [2010] 1 WLR 663 at [44].

[26] Above at [59].

[27] Above at [73].

[28] See *Office of Fair Trading v Foxtons Ltd* [2009] EWCA Civ 288 at [16] and *Director of Fair Trading v First National Bank plc* [2002] 1 AC 418 at [33] by Lord Steyn.

> In my view those words involve no more than a recognition that the collective procedure envisaged by article 7 cannot take into account all the factors which article 4 requires to be taken into account in an individual case. In other words, they are making room for the collective challenge procedure in which some of the factors which article 4 requires the court to consider will have to be dispensed with.[29]

5.19 Despite these practical difficulties, Lord Justice Waller stated that "to the best of the court's ability" the circumstances that are considered in an individual challenge under article 4 should be taken into account under a collective article 7 challenge.[30]

5.20 The Court reasoned further that an unsuccessful general challenge would not necessarily preclude a subsequent individual challenge – it would depend on the particular circumstances of the individual case which may make a term unfair.[31]

5.21 It is important to clarify, however, that the courts are faced with a two stage test: first, is the term exempt, and secondly (if it is not exempt) is it unfair? A consumer's individual circumstances are only relevant to the second test: is the term unfair? As we discuss below, the Supreme Court held that the question of whether a term is exempt is a purely objective test. The consumer's individual circumstances are irrelevant to that issue.

ABBEY NATIONAL

The issues

5.22 *Abbey National* was a test case brought by the OFT with the agreement of seven banks and a building society (the banks).[32] The question was whether the court could assess the fairness of the banks' unauthorised overdraft charges. Thousands of consumers across the UK had taken cases to local county and sheriff courts claiming that the charges were unfair. Most county and sheriff cases were stayed (sisted in Scotland) pending the outcome of the test case.

[29] Above at [85].

[30] Above at [45].

[31] Above at [46] by Waller LJ, at [94] by Moore-Bick LJ.

[32] [2009] UKSC 6, [2010] 1 AC 696.

5.23 The case went to the heart of the way the banks charged for current accounts, which were offered on a "free-if-in-credit" basis. The charges were paid by a minority of customers – more than three-quarters of current account customers did not incur them.[33] But for those who did incur charges, the amounts could be significant. In 2006 the average "paid item" charge was around £23 per item, so that a consumer on a shopping trip could, perhaps inadvertently, run up substantial charges.[34] About one third of customers who incurred a charge paid more than £200 and about 1.4 million consumers paid more than £500.[35] Therefore the principal monetary consideration the banks received consisted of a package of these charges and the interest consumers forewent when their accounts were in credit.[36]

5.24 These charges made a substantial contribution to the money the banks made on current accounts, totalling more than 30% of the banks' revenue from current accounts. [37] It was suggested that the banks were engaged in a "reverse Robin Hood exercise", taking from the poor to subsidise those with money in their accounts.[38]

5.25 Much was at stake. Following *Kleinwort Benson,*[39] money which is paid by mistake of law may be recovered for up to six years from the date when the mistake could have been discovered. This meant that if the Court had found the charges to be unfair, customers would have had six years to seek repayment of any unfair charges they had paid. It would have been a significant liability for UK banking – the banks' charges income for 2006 alone was put at £2.56 billion.[40] It could also have resulted in a significant liability for the State as a shareholder/guarantor of some of the banks involved.

Overview

5.26 The main question the Court was asked to consider was whether the charges were excluded from assessment under article 4(2) of the UTD, as implemented in Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).

5.27 As we explain below, the OFT won in the High Court and in the Court of Appeal. The Court of Appeal favourably cited the 2005 Law Commissions' Report and said whether a term constituted the "price" or "main subject matter" depended on whether a consumer would recognise the terms in this way.

[33] M Armstrong and J Vickers, "Consumer Protection and Contingent Charges" (2012) *Journal of Economic Literature* 50:2, 477, p 479.

[34] Above.

[35] Above.

[36] [2009] UKSC 6, [2010] 1 AC 696 at [42].

[37] [2009] UKSC 6, [2010] 1 AC 696 at [47] and [88].

[38] [2009] UKSC 6, [2010] 1 AC 696 at [2].

[39] *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, [1998] 4 All ER 513. In Scots law, the relevant period of negative prescription would be five years.

[40] [2009] UKSC 6, [2010] 1 AC 696 at [36].

5.28 The Supreme Court overruled these findings and found for the banks. It took a literal approach to the words of Regulation 6(2)(b). The Regulation did not distinguish between the "essential" price and incidental prices, and no such limitation could be read into it. Whether a term was a price term had to be judged objectively, not from the point of view of the consumer.

The High Court

5.29 At first instance, Mr Justice Andrew Smith held that while most of the charges were in plain, intelligible language, they did not fall within the Regulation 6(2) exemption.[41] He concluded that not every payment for which a customer might be liable under a contract is the "price or remuneration". Instead, the UTCCR contemplate something clearly recognisable as an exchange for the benefit of the customer which will typically be at the core of a consumer contract.[42]

5.30 He thought it was relevant to consider the way in which a typical consumer would view the matter:

> It would, I think, be surprising if the court felt able to conclude that a payment is the price or remuneration within reg 6(2)(b) even though the typical consumer would not recognise it as such when presented with the terms of the seller or supplier.[43]

5.31 He noted that the concept of an "average consumer ... who is reasonably well informed and reasonably observant and circumspect" was often used in interpreting European consumer law, and he thought that it was an appropriate guide in this context.

5.32 He rejected the banks' "whole package" argument, that the banks provide an overall package of services and in return the customer agrees to pay the relevant charges as and when they become payable. He gave two reasons. First, it could not naturally be said that the relevant charges were levied in exchange for the services. Second, this is not the way a typical consumer would recognise the charge when they opened a current account, as they were generally not presented in this way by the banks in their terms or other documentation.[44]

5.33 The banks appealed.

The Court of Appeal

5.34 The Court of Appeal accepted the approach adopted by Mr Justice Andrew Smith. It reached two main conclusions:

(1) the price exclusion is limited to the essential bargain between the parties; and

[41] *Office of Fair Trading v Abbey National Plc* [2008] EWHC 875 (Comm), [2008] 2 All ER (Comm) 625 at [421].

[42] Above at [384] to [389].

[43] Above at [388].

[44] Above at [398].

(2) in determining what the price is, the Court should adopt the position of the typical consumer.

5.35 The Court of Appeal reasoned that not every payment made by a consumer would fall within Regulation 6(2)(b). Therefore, an appropriate analytical tool for working out what did and what did not fall within the exclusion was to ask whether the payment formed part of the essential bargain between the parties.

5.36 In reaching this conclusion, the Court of Appeal looked at the purpose of the article 4(2) exemption, as taken from the UTD's *travaux preparatoires*.[45] It noted that the exception was included to carve out from the assessment of fairness the part of the bargain which represented the consensus between the parties and thus a genuine reflection of freedom of contract.

5.37 In this the Court was particularly influenced by the House of Lords' decision in *First National Bank*.[46] In particular, the Court of Appeal relied on Lord Bingham's statement that the exemption was designed to recognise "the parties' freedom of contract with respect to the essential features of their bargain" - but there is an important "distinction between the term or terms which express the substance of the bargain and 'incidental' (if important) terms which surround them".[47]

5.38 The Court of Appeal was bound by *First National Bank* in its construction of the UTD. It therefore found that the UTD was seeking to exclude the "core bargain" or the "core price" and not "ancillary or incidental provisions".[48] The notion of an "essential bargain" should be imported into both paragraphs (a) and (b) of Regulation 6(2).[49]

5.39 The Court reasoned that the purpose of Regulation 6(2)(b) was to:

> Limit the exclusion to the essence of the price, just as the purpose of regulation 6(2)(a) was to limit it to the main subject matter of the contract ... the reason for the limitation was to reflect the fact that the parties would be likely to (or might well) negotiate the main subject matter of the contract and the essential price but not the detail.[50]

5.40 As an aid to applying this notion to the facts, the Court of Appeal adopted a sliding scale whereby:

[45] See [2009] EWCA Civ 116, [2009] 2 WLR 1286 at [33]. "*Travaux preparatoires*" is French for "preparatory works" and refers to the official record of the negotiations leading to the Directive.

[46] In *First National Bank*, the Court considered the 1994 version of UTCCR which was in broadly the same terms as the 1999 version of UTCCR. The case is discussed further at paras 4.11 to 4.16 above.

[47] *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481 at [12] (citations omitted).

[48] *Office of Fair Trading v Abbey National Plc* [2009] EWCA Civ 116, [2009] 2 WLR 1286 at [49].

[49] Above at [86].

[50] Above at [52].

> the more closely related the payment term is to the essential bargain between the parties, the more likely it is to fall within the exception in article 4(2) but ... the more ancillary the payment term is and the less likely it is to come to the direct attention of the consumer at the time the contract is entered into, the less likely it is to be within the concept of 'price or remuneration' within the meaning of the Directive.[51]

5.41 Second, the Court considered that the perspective of the typical consumer was "a useful guide" in ensuring article 4(2) has a suitably restrictive approach.[52]

5.42 The Court referred to the Law Commissions' 2002 Consultation Paper, saying that paragraph 3.32 seems "to be of considerable assistance in identifying the correct approach to the facts in this appeal".[53] Here the Law Commissions had argued that the reason for exempting "definition of the main subject matter" and the "adequacy of the price" was because consumers were aware of these terms:

> We think that the reason for not subjecting these to review is that consumers will generally be aware of the terms in question and (provided they are in plain, intelligible language) understand them. Therefore consumers are unlikely to be taken by surprise, and also the terms will be subject to "the discipline of the market". Consumers are much less likely to take into account terms which will only apply in certain circumstances (whether or not those circumstances involve a default) and accordingly these terms should be subject to review. [54]

5.43 The Court concluded that the relevant charges were not part of the core or essential bargain. The "most important reason" which led the Court to that conclusion was the point raised in the Law Commissions' Report that "consumers are much less likely to take into account terms which will only apply in certain circumstances".[55] The typical consumer would not recognise the relevant charges as being part of the essential bargain with the banks, and they were therefore subject to review.

[51] Above at [90].

[52] Above at [91].

[53] Above at [78] to [79].

[54] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 3.32.

[55] [2009] EWCA Civ 116, [2009] 2 WLR 1286 at [104] to [105].

The Supreme Court

5.44 The Supreme Court disagreed,[56] and found that the unauthorised overdraft charges fell within the exemption. It adopted a textual approach to the UTD, commenting that "the Directive is expressed in terse, simple language".[57] It found that the Court of Appeal "went too far in interpreting the language of the Directive and the 1999 Regulations" and has "departed from the natural meaning of the text".[58]

5.45 The Supreme Court reached two fundamental conclusions:

(1) Regulation 6(2)(b) is not constrained by a "core" or "essential bargain" limitation; and

(2) whether a term constitutes the price or remuneration is to be objectively considered.

5.46 We turn to consider each of these points further.

Not just "core terms"

5.47 First, the Supreme Court rejected the contention that Regulation 6(2)(b) was limited to sums which reflected the "essential bargain" or "core terms" of the contract.

5.48 Lord Walker refused to interpret the two limbs of Regulation 6 together, so as to qualify the reference to "price or remuneration" in a similar way to the reference to "the main subject matter of the contract".[59] Regulation 6(2)(b) contains no indication that only the "essential" price or remuneration is relevant, so no such limitation could be read into the provision: the Court of Appeal had "departed from the natural meaning of the text in order to achieve an unnecessary duplication of the exception for individually negotiated terms".[60]

5.49 Further, the Court thought that such a test may be difficult to apply. Lord Mance considered that the Court of Appeal's sliding scale used to determine whether a term was ancillary converted the apparently simple language of Regulation 6(2)(b) into a "complex and uncertain value judgment".[61] And Lord Walker felt that there were some situations where it would strain the natural meaning of "ancillary" in an attempt to split a contract into its core and ancillary terms.[62]

[56] The appeal was heard by the Appellate Committee of the House of Lords and (under transitional provisions in the Constitutional Reform Act 2005 and the Supreme Court Rules) judgment was delivered by the Supreme Court.

[57] [2009] UKSC 6, [2010] 1 AC 696 at [32] by Lord Walker.

[58] Above at [45] by Lord Walker.

[59] [2009] UKSC 6, [2010] 1 AC 696 by Lord Walker at [31] with whom Lord Phillips (at [90]), Baroness Hale (at [92]) and Lord Neuberger (at [119]) agreed.

[60] Above at [45]; Lord Mance at [108] agreed that the Court of Appeal had wrongly relied on the concept of negotiation or bargain given that the Directive and Regulations are only concerned with contract terms which have not been individually negotiated.

[61] Above at [108].

[62] Above at [46] by Lord Walker.

5.50 Therefore, the Court concluded that "any monetary price or remuneration payable under the contract would naturally fall within the language" of Regulation 6(2)(b).[63] The Court did not consider this conclusion to be at odds with the "fairly complex message" to be derived from the *travaux*, which reflected a compromise between consumer protection and freedom of contract and the contrast between consumer protection and consumer choice.[64]

"A matter of objective interpretation by the court"

5.51 Second, the Supreme Court rejected the suggestion that, in determining what constituted the price or remuneration, the court should have regard to the typical consumer. Lord Mance thought that a test which involved an inquiry into the mind of consumers would be an overly complex rewriting of the Regulation:[65]

> It would re-write the legislation to read art 4(2) of the Directive or reg 6(2) as if they introduced as the test a complex inquiry as to whether or how far consumers had actually exercised contractual freedom when agreeing upon a price or remuneration stated in plain and intelligible language in a contract into which they entered.[66]

5.52 It "led to considerable argument before the House as to who might be regarded as the typical consumer. Was it relevant to look at the whole body of customers, or at those who would or might be likely to incur relevant charges?".[67] He concluded that such a test would threaten the Community principle of legal certainty.[68]

5.53 Instead, the Court held that "the identification of the price or remuneration … is a matter of objective interpretation by the court". The Court should adopt the view which the hypothetical reasonable person would take of the nature and terms of the contract.[69] This led the Court to consider how the banks in fact derived their revenue. They appeared heavily swayed by the evidence that the relevant charges amounted to over 30% of their revenue stream from all personal current account customers.[70]

5.54 The Court therefore concluded that the relevant charges did fall within the exclusion in Regulation 6(2)(b) and hence were not reviewable for fairness.

[63] Above at [41] by Lord Walker at [78] and by Lord Phillips.

[64] Above at [44] by Lord Walker.

[65] Above at [112].

[66] Above at [112].

[67] Above at [108].

[68] Above at [115].

[69] Above at [113].

[70] Above at [47] and [88].

The exclusion relates only to the type of assessment

5.55 It is important to note a technical but significant limit to the Supreme Court decision. Regulation 6(2)(b) does not state that a court cannot review the price, but that it cannot review "the adequacy of the price as against the goods or services in exchange".

5.56 At first instance, the question arose as to whether Regulation 6(2)(b) excludes a price term from any assessment of fairness (the "excluded terms" construction) or whether it excludes only an assessment relating to the adequacy of the price (the "excluded assessment" construction).[71] Mr Justice Andrew Smith decided in favour of the excluded assessment construction. This finding was not challenged on appeal.[72] The question therefore became not whether the OFT was entitled to assess the fairness of the relevant charges but whether, in doing so, it was entitled to take into account "the adequacy of the price or remuneration, as against the goods or services supplied in exchange".[73]

5.57 Whilst this may initially appear to be an abstract point, the Supreme Court pointed out that this is likely to be an issue of great practical importance.[74]

The role of the grey list

5.58 As we have seen, Schedule 2 of the UTCCR follows the UTD in listing terms which may be unfair. The Supreme Court decision includes only limited discussion of this grey list, but it was noted by Lord Walker and Lord Mance.

5.59 Lord Walker stated that the grey list had been added as an element of the drafting compromise. He noted that four items on the grey list "refer in one way or another to the monetary consideration paid by the consumer".[75] He recognised that:

> not every term that is in some way linked to monetary consideration falls within Regulation 6(2)(b). Paragraphs (d), (e), (f) and (l) of the 'greylist' in Schedule 2 to the 1999 Regulations are an illustration of that.[76]

5.60 Similarly, Lord Mance explained that payment terms falling within the grey list are reviewable for reasons which do not concern the amount of the price:

[71] [2008] EWHC 875, [2008] 2 All ER (Comm) 625 at [422].

[72] So as to distinguish *Director General of Fair Trading v First National Bank Plc* [2001] UKHL 52, [2002] 1 AC 481. See [2009] UKSC 6, [2010] 1 AC 696 at [29].

[73] [2009] UKSC 6, [2010] 1 AC 696 at [61].

[74] Above at [29] by Lord Walker.

[75] Above at [7].

[76] Above at [43].

> There can be payments which do not constitute either 'price or remuneration' of goods or services supplied in exchange. Further, payments which do constitute price or remuneration in this sense can be challenged as unfair on grounds which do not relate to their appropriateness in amount as against the goods or services supplied in exchange. Heads (d), (e), (f) and (l) in the grey list of terms set out in Schedule 2 to the Regulations fall within one or both categories.[77]

5.61 These statements suggest that despite the Supreme Court judgment, terms on the grey list may be assessed for fairness. This is either because they are not price terms, or because they contain elements of unfairness which do not relate to the amount. The terms referred to are those which:

> (a) permit the trader to retain sums paid by the consumer when the consumer "decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount" from the trader when the trader cancels the contract;
>
> (b) require a consumer "who fails to fulfil his obligation to pay a disproportionately high sum in compensation";
>
> (c) permit the trader to retain sums paid for services not yet supplied where the trader dissolves the contract; and
>
> (d) allow the trader to increase the price without in both cases giving the consumer the corresponding right to cancel the contract.[78]

5.62 In Part 7 we consider the European case law which also shows that price escalation clauses under paragraph (l) are assessable for fairness.[79]

5.63 In practice, the carve out for grey list terms is an important exception to the Supreme Court judgment.

No reference to the European Court of Justice

5.64 Finally, the Supreme Court decided not to refer the matter to the Court of Justice of the European Union (CJEU). The Court considered there to be a "strong public interest in resolving the matter without further delay"[80] due to the "very large"[81] number of claims stayed (sisted in Scotland) pending the decision. Lord Walker noted that "neither side showed any enthusiasm for a reference".[82] This approach to a matter of Community law was "the lesser of two evils".[83]

[77] Above at [101].

[78] UTCCR, Sch 2, 1(d), 1(e),1(f) and 1(l)

[79] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt*.

[80] [2009] UKSC 6, [2010] 1 AC 696 at [50].

[81] Above at [48].

[82] Above.

[83] Above at [50].

5.65 Lord Phillips did not find the issue to be *acte clair*[84] but felt "it would not be appropriate" to refer the matter. This was because the issue of whether the terms were fair was "academic",[85] given that no challenge was made that the overall remuneration paid was excessive having regard to the package of services received in exchange. Similarly, Lord Neuberger felt that there was a possibility the CJEU could adopt the Court of Appeal's meaning, but that the resolution of the issue was not essential to the appeal and so a reference was not necessary.[86]

5.66 In contrast, Lord Mance considered the matter to be *acte clair* because the Court was interpreting a "relatively simple sentence" meaning that the scope for different readings in different language versions of the UTD "seems very limited". Further, he felt that the likelihood of another court accepting the Court of Appeal's reasoning was "remote indeed".[87]

5.67 As we discuss in Part 6, this aspect of the Court's reasoning has been subjected to some criticisms by academics.

The effect of the judgment on the debate about bank charges

5.68 Following the Supreme Court judgment, the OFT ceased its investigation into unarranged overdraft charges. Nevertheless, it still had concerns about these charges and it entered into discussions with the banks to secure change by voluntary action.[88] During these discussions, the banks voluntarily agreed to introduce "transparency measures", including the following:

(1) Providing customers with annual summaries of the cost of their accounts;

(2) Making charges prominent on monthly statements; and

(3) Producing illustrative scenarios showing unarranged overdraft charges, giving consumers an idea of the costs for different patterns of use.[89]

[84] An issue can be characterised as *acte clair* when the application of Community law is so obvious as to leave no scope for any reasonable doubt. This absolves the court from an obligation to send the question raised before it to the CJEU for a preliminary ruling. In assessing the issue, the court must have regard to the characteristics of EU law and particular difficulties to which its interpretation gives rise. See case C 283/91 *Srl CILFIT and Lanificio di Gavardo SpA v Ministry of Health* [1982] ECR 3415 for a more detailed discussion of the doctrine.

[85] [2009] UKSC 6, [2010] 1 AC 696 at [91].

[86] Above at [120].

[87] Above at [115].

[88] See OFT1154 (December 2009): *Personal Current Accounts – Unarranged Overdraft Charges*, p 27.

[89] See OFT press releases 122/09: *Banks agree to make improvements to personal current account market in the UK* (7 October 2009) and 26/10: *Significant improvements in unarranged overdrafts build on progress in PCA market* (16 March 2010), available at http://www.oft.gov.uk/news-and-updates/press/2009/122-09; and http://www.oft.gov.uk/news-and-updates/press/2010/26-10.

5.69 In 2010, the OFT noted that there had been "significant improvements in unarranged overdraft" charges. Many banks had revised their charging structures. As a result, the average unpaid item charge fell from £34 in 2007 to £14 in March 2010.[90]

5.70 The Government has also taken a direct interest in the issue. In the Coalition Agreement of May 2010, the Government stated:

> We will introduce stronger consumer protections, including measures to end unfair bank and financial transaction charges.[91]

5.71 Subsequently, the Government launched its Consumer Credit and Personal Insolvency Review, and published its Formal Response on Consumer Credit in November 2011.[92] The Government noted that significant changes had been agreed between the banks and the OFT. It also announced a package of "additional commitments" that will apply to all full-facility current accounts of the major banks, covering 85% of consumers. These mean that consumers will:

(1) have the option to receive a text or email alert from their bank when their balance falls below a certain level;

(2) be made aware of a "grace period" within which they can credit funds to their accounts and avoid a charge; and

(3) benefit from a small "buffer zone", so that substantial charges are not incurred for very small unarranged overdrafts.

5.72 The banks committed to offer the text alerts by March 2012 and to deliver the other two commitments by March 2013.[93]

5.73 The issue of how current accounts should be charged for remains controversial. On 24 May 2012, Andrew Bailey, a director of the Bank of England, described free banking as "a dangerous myth", which "may require intervention in the public interest".[94] This raises issues which go far beyond the scope of this paper.

[90] OFT press release 26/10, *Significant improvements in unarranged overdrafts build on progress in PCA market* (16 March 2010), available at http://www.oft.gov.uk/news-and-updates/press/2010/26-10.

[91] *The Coalition: our programme for government* (May 2010), available at http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition_programme_for_government.pdf, p 13.

[92] BIS, *Consumer Credit and Personal Insolvency Review: Formal Response on Consumer Credit* (November 2011), available at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/c/11-1341-consumer-credit-and-insolvency-response-on-credit.pdf.

[93] Above, p 8, para 7.

[94] Andrew Bailey, *The future of UK banking – challenges ahead for promoting a stable sector* (24 May 2012), available at http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech574.pdf.

ASHBOURNE

5.74 In *Office of Fair Trading v Ashbourne Management Services*, the High Court considered the application of the UTCCR to various gym membership contracts.[95] This followed the Supreme Court ruling and was the first case to follow the Supreme Court's approach.

5.75 The OFT originally launched its case against Ashbourne Management Services in response to a large number of complaints from consumers who had entered into lengthy gym membership contracts which they were unable to cancel.[96] These included terms which:

(1) required consumers to pay in full for the remainder of the minimum contract period if they cancelled their membership during the period;

(2) tied consumers in for more than 12 months; or

(3) allowed the gym to terminate the agreement and claim all membership fees payable for the entire minimum period for a minor breach by the gym member.

5.76 The OFT contended that these terms were assessable for fairness under the UTCCR. They submitted that the main subject matter of the contract was the right to use the gym and the period of time for which that right was conferred was an ancillary or subsidiary provision.[97]

5.77 Ashbourne Management Services, which provided the standard form membership contracts, rejected this contention. They argued that the terms imposing minimum membership periods fell within the exclusion in Regulation 6(2)(a): it was "quite literally a defining feature of the obligation assumed by the gym club".[98]

5.78 Mr Justice Kitchin looked in detail at the Supreme Court judgment, though there is some confusion in how he applied it to the facts. He dismissed the OFT's contention that the term providing for a minimum period was a subsidiary provision, finding that the main subject matter of each of the contracts was the permission to use and access the gym's facilities for a certain period.[99] Similarly to the Supreme Court, he commented that there was a danger in using the expressions "core" and "ancillary" as shorthand for the words of Regulation 6(2). He did, however, explain that he considered the relevant clause to be a core term.[100]

[95] [2011] EWHC 1237 (Ch), [2011] ECC 31.

[96] OFT press release 92/11, *OFT secures High Court order to stop unfair gym contract terms* (19 August 2011), available at: http://www.oft.gov.uk/news-and-updates/press/2011/92-11.

[97] [2011] EWHC 1237 (Ch), [2011 ECC 31] at [142].

[98] Above at [143].

[99] Above at [152].

[100] Above at [152].

5.79 Despite this, the judge did not consider an assessment of fairness to be precluded by Regulation 6(2). He applied the "excluded assessment" construction to the subject matter exclusion, finding that "regulation 6(2)(a) only precludes the assessment of the fairness of a term by reference to the definition of the main subject matter of the contract".[101]

5.80 After concluding that the term was unfair within the meaning of the UTCCR, Mr Justice Kitchin asked whether his assessment of fairness was excluded by Regulation 6(2)(a):

> This brings me to the final part of the analysis, namely whether this assessment of fairness relates to the definition of the main subject matter of the agreements. In my judgment it does not. The assessment does not relate to the meaning or description of the length of the minimum period, the facilities to which the member gains access or the monthly subscription which he has to pay; nor does it relate to the adequacy of the price as against the facilities provided. Instead it relates to the obligation upon members to pay monthly subscriptions for the minimum period when they have overestimated the use they will make of their memberships and failed to appreciate that unforeseen circumstances may make their continued use of a gym impractical or their memberships unaffordable. Put another way, it relates to the consequences to members of early termination in light of the minimum membership period. Accordingly I believe the assessment is not precluded by regulation 6(2).[102]

5.81 This reasoning is difficult to understand. It is possible to apply an "excluded assessment" construction to a price term because the Regulation states that the assessment must not relate to the "adequacy" of the price as against the goods or services supplied in exchange. There are no equivalent words to qualify the main subject matter of the contract, except "the definition". It is difficult to see how a term could or could not be assessed for its "definitional" quality.

5.82 This reasoning illustrates the difficulties with the Supreme Court's test. Where a court considers the term to be unfair, the court will strain the characterisation of the type of assessment undertaken to allow it to intervene.

5.83 Mr Justice Kitchin ruled that several terms in Ashbourne's standard membership contracts were unfair under the UTCCR and therefore unenforceable. This decision has significance for the gym industry as a whole. In January 2012, the OFT began investigating several other companies which operate gyms or fitness clubs or which provide management services to gyms.[103] This investigation is ongoing.

[101] Above at [153].

[102] Above at [175].

[103] OFT, *Investigation into health and fitness clubs*, available at: http://www.oft.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-current/health-contracts/.

CONCLUSION

5.84 It is not easy to summarise the state of the law following *Abbey National*. There were several strands in the Supreme Court decision:[104]

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

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

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

5.85 These various statements are not always easy to reconcile, which allows for differing interpretations of the decision. We illustrate this uncertainty below.

An example: a re-written commission clause

5.86 In *Foxtons,* the commission charges could be assessed for fairness because they were not in "plain, intelligible language". As we saw, Mr Justice Mann found that some of the phrases used (such as "associated or connected") were unacceptably vague. This, however, returns to the problem identified by Lord Denning in 1983:

> When the courts said to the big concern, "You must put it in clear words", the big concern had no hesitation in doing so. It knew well that the little man would never read the exemption clauses or understand them.[105]

5.87 It would be relatively easy for an estate agent to re-write the substance of the commission clauses in clearer language. Would this make the clauses exempt from review? We are unable to provide a definitive answer to this question.

5.88 If the court thought that the term was unfair, there are arguments which it could use to hold that the term was not exempt. As we have seen, the "excluded assessment" construction allows a judge some leeway. A judge could hold that the term was unfair, not because of the amount of the price, but for some other reason. In reality, however, we do not think it possible to divorce the unfairness and the amount in this way. A court would only use this approach if it thought that the term was unfair, and that initial reaction is bound to be influenced by the amount paid. It is artificial to think that any court could shut its eyes to the disproportion between the size of the commissions and the lack of any real service supplied in exchange.

[104] [2009] UKSC 6, [2010] 1 AC 696.

[105] *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284 at 297. This is discussed in paras 3.5 to 3.13 of this Issues Paper.

5.89 Alternatively, a court may decide that the commissions were exempt and should not be assessed at all. This, we think, would remove much of the efficacy of the UTCCR. It would return to the pre-1995 days when consumers could be taken by surprise by extremely high charges tucked away in clause 5.1 of the small print. We do not think that is right.

Two limbs

5.90 The Supreme Court held that the words of Regulation 6(2) should be taken at face value, but this is not a simple exercise. The Regulation has two limbs, one relating to the main subject matter and the other to the price, but they are not dealt with in the same way.

5.91 Regulation 6(2)(a) refers to "the definition of the main subject matter", implying that the subject matter of a contract can be divided into "main" and "incidental" terms. We do not think that the word "definition" adds much in this context. Instead, the words appear to impose an "excluded term" construction. If a term relates to the main subject matter it is excluded. If it relates to a secondary or incidental subject matter it is included. The Supreme Court has provided little guidance as to how to distinguish between main subject matter and incidental subject matter. The Supreme Court thought that this was a difficult distinction to make and could be impossible in some contracts. For example, a supply of services could be composite such as a week's stay in a hotel offering a wide variety of services.[106]

5.92 By contrast, the words of Regulation 6(2)(b) do not distinguish between main and incidental prices. Price terms may be assessed for fairness, but not if that assessment relates to their "adequacy … as against the goods or services supplied in exchange". The Regulation does not exclude the term as such but it restricts the way in which the term may be assessed. "Adequacy" is an odd term to use in this context, as in most cases consumers will complain that the price is too high, rather than inadequate. We think it just means "amount". The court may assess a price term but may not look at its amount.

5.93 Thus on a literal interpretation, Regulation 6(2) excludes some terms ("main subject matter") and some forms of assessment ("adequacy of the price"). This is an overly complex approach, which we do not think courts will find easy to follow. As we saw, in *Ashbourne* the judge applied the excluded assessment construction to both limbs.

[106] [2009] UKSC 6, [2010] 1 AC 696 at [40].

The actual consumer, the average consumer or a reasonable bystander?

5.94 When a court applies the fairness test, it is required to consider "all the circumstances attending the conclusion of the contract".[107] In an individual challenge, this would include the consumer's individual circumstances. For example, if a salesperson presented a consumer with a document to sign without explaining its contents, it would be relevant that the individual consumer was visually impaired. In *Foxtons,* the Court of Appeal explained that in collective challenges, this type of evidence is unlikely to be available. The court may reach a general conclusion, even if it has to dispense with evidence about all the individual circumstances.

5.95 The Supreme Court held that the test of whether a term is exempt is different. The issue of whether a term is or is not the price does not depend on how actual consumers would have understood it. A term remains an exempt price term even if the actual consumer was illiterate and unable to read it. We think this is right. Traders need certainty. Where traders sell to a mass market it is inevitable that some of their customers will be non-English speakers, illiterate or visually impaired.

5.96 Even if the Supreme Court was right to reject an "actual consumer" test, however, we think that it went too far when it also dismissed the "average consumer" test. As we discuss in Part 7, the "average consumer" is widely used in European case law, and applies to a hypothetical consumer who is "reasonably well-informed, reasonably observant and circumspect".[108] It is a useful and reasonably certain test, which does not depend on evidence about the understanding of actual consumers. We return to this issue in Part 8.

[107] UTD, art 4.

[108] See paras 7.42 to 7.49.

PART 6
REACTIONS TO THE BANK CHARGES LITIGATION

6.1 Reactions to the Supreme Court's decision in *Office of Fair Trading v Abbey National plc*[1] were both strong and predictable. The banks supported the decision. Barclays welcomed the ruling "confirming that unarranged overdraft charges are an important part of the price for the package of account services provided to customers".[2] Clydesdale Bank said that "this decision now brings clarity for all parties".[3]

6.2 By contrast, consumer groups were strongly critical. *This is Money* described the decision as "a shock announcement".[4] The Consumer Panel said that they were "disappointed".[5] *Which?* was optimistic that some consumers may still be able to pursue their claims against banks that had charged them for unauthorised overdrafts but were "concerned" that the ruling "could drive people into the arms of unscrupulous claims handlers".[6] Consumer Focus described the Government's proposals for voluntary action to address some of the concerns raised as "disappointing": they were "tinkering around the edges when substantive reforms are needed".[7]

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

2 Barclays Press Release, *Barclays comments on the bank appeal victory on unauthorised overdraft charges in the Supreme Court* (25 November 2009 11:45), available athttp://www.newsroom.barclays.com/Press-releases/Supreme-Court-ruling-unauthorised-overdraft-charges-681.aspx.

3 Clydesdale Bank Press Release, *OFT Court Case Ruling*, available at http://www.cbonline.co.uk/media/news-releases/2009/oft-court-case-ruling.

4 This is Money, *Bank charges: End in sight for heavy unauthorised overdraft fees* (22 November 2011), available at http://www.thisismoney.co.uk/money/saving/article-2064652/Bank-charges-End-sight-heavy-unauthorised-overdraft-fees.html.

5 The Consumer Panel, *Action to make bank charges fair despite technical Court Judgment* (25 November 2009), available at http://www.myintroducer.com/view.asp?ID=2292.

6 Which?, *Bank charges update: All is not lost* (26 November 2009), available at http://www.which.co.uk/news/2009/11/bank-charges-update-all-is-not-lost-189580.

7 Mike O'Connor, Chief Executive of Consumer Focus, quoted in This is Money, *Bank charges: End in sight for heavy unauthorised overdraft fees* (22 November 2011), available at http://www.thisismoney.co.uk/money/saving/article-2064652/Bank-charges-End-sight-heavy-unauthorised-overdraft-fees.html.

6.3 In this Part we try to look beyond the headlines to consider the more detailed reactions. We start by looking at the academic and other comment. We then summarise the responses to the Department for Business, Innovation and Skills' (BIS) Call for Evidence in 2010.[8] At first sight, the responses appeared split: business respondents were opposed to any change, while consumer groups and enforcement bodies argued that ancillary charges should be assessable for fairness. We think, however, that there may be more common ground than first appears. Many businesses stressed their commitment to transparent pricing, and agreed that hidden charges should not be exempt from an assessment for fairness.

6.4 In the next section, we consider how the main enforcement bodies have reacted to the decision. As we shall see, Ofcom, the Office of Fair Trading (OFT), and the Financial Services Authority (FSA) have interpreted the exemption in a relatively narrow way.

COMMENT ON THE SUPREME COURT DECISION

6.5 Several commentators acknowledged that the Supreme Court was faced with a difficult decision. As Phillip Morgan noted:

> The Supreme Court was in a very difficult position. If the OFT had been successful, the Banks would be facing an Armageddon claim … This could expose the Banks to vast claims covering the time period from the introduction of such charges. Following the demise of Equitable Life, the Supreme Court must be well aware that one appellate decision can be the death blow to a financial institution. Given the economic climate and the state support for the banking sector, the taxpayer would be left to pick up the bill. One cannot but wonder if this is the hidden theme behind the judgment.[9]

6.6 There was concern that the alternative outcome would have marked "the beginning of the end for free banking for the more wealthy".[10] As we have seen, three quarters of all current account customers did not incur unauthorised overdrafts and benefited from the high charges paid by those who did. Ending this cross subsidy would have been politically unpopular.

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

[9] Phillip Morgan, "Bank charges and the Unfair Terms in Consumer Contracts Regulations 1999: the end of the road for consumers?" [2010] *Lloyd's Maritime and Commercial Law Quarterly* 208, p 214.

[10] Fiona Blakeborough, "Bashing the banks?" (2008) *Law Society Gazette* 20. See also Freya Law, "Don't bank on it" (2009) 159, *New Law Journal* 1730.

Support for the decision

6.7 There was some support for the decision. Anu Arora concluded that "the Supreme Court decision is based on the correct interpretation of legal principles, banking law, contract law and consumer protection".[11] She argued that the modern personal current account offers "a complete package of services" in return for "a packaged payment structure". In these circumstances it is not possible to divide the contract into core and ancillary terms, and the law should not concern itself with policing the adequacy of the consideration.

6.8 John Jarvis QC made a similar point when he commented on the High Court decision, before the appeals had been heard. For package products, it is not possible to consider one part of the bargain without assessing the whole bargain. and the UTCCR are not designed to protect consumers from bad bargains.[12]

Criticisms of the decision

6.9 On the other hand, most academic commentators were highly critical of the decision, and where it leaves the law. Mindy Chen-Wishart described the decision as "a bitter blow" to consumers.[13] David Cabrelli and Rebecca Zahn thought the decision "against all expectations".[14] Paul Davies hoped that the decision would prompt legislative intervention. He thought that "a helpful first step would be to adopt the Law Commission's Report [of 2005]".[15] Phillip Morgan commented that the decision "has significantly limited the scope of the protection provided for consumers". He thought that "Macdonald's statement that the [Unfair Terms in Consumer Contracts Regulations (UTTCR)] 'are possibly the single most significant piece of legislation in the field of contract law' may need to be revised".[16]

6.10 Four main arguments were made against the Supreme Court's reasoning: the Court focused too much on the money the banks made from the charges; the Court had failed to take a purposive approach; it should have referred the issue to the Court of Justice of the European Union (CJEU); and the Court had failed to protect consumers against unfair surprise. Below we look briefly at each criticism.

[11] Anu Arora "Unfair Contract Terms and Unauthorised Bank Charges: A Banking Lawyer's Perspective (2012) 1 *Journal of Business Law* 44.

[12] J Jarvis QC, "How fair are bank charges?" (2008) 6 *Journal of International Banking and Financial Law* 282.

[13] Mindy Chen-Wishart, "Transparency and Fairness in Bank Charges" (2010) 126 *Law Quarterly Review* 157, p 157.

[14] David Cabrelli and Rebecca Zahn, "Challenging Unfair Terms: Some Recent Developments" 2010 *Juridical Review* 115, p 134.

[15] Paul Davies, "Bank Charges in the Supreme Court" (2010) 69(1) *Cambridge Law Journal* 21, p 23. See also Andrew Head, "Watch this Space" (2009) 159 *New Law Journal* 1715.

[16] Phillip Morgan, "Bank charges and the Unfair Terms in Consumer Contracts Regulations 1999: the end of the road for consumers?" [2010] *Lloyd's Maritime and Commercial Law Quarterly* 208, p 208 quoting Elizabeth Macdonald, "Scope and Fairness of the Unfair Terms in Consumer Contracts Regulations: *Director General of Fair Trading v First National Bank*" (2002) 65(5) *Modern Law Review* 763.

Too much focus on the banks' revenue stream

6.11 First, criticisms were levied at the attempt to assess a price term "objectively", by looking at how the banks made their money. Simon Whittaker pointed out that the Supreme Court came "very close to saying that the fact that the banks make a good deal of money out of the charges generated by the relevant terms means that they provide for part of the price or remuneration for the package of services".[17]

6.12 Phillip Morgan was also highly critical of the Lords' reasoning in this respect:

> It is submitted that this is to look at the question incorrectly: focusing on the revenue stream is irrelevant. If a lender derives its greatest profit from a contingency interest rate of which few customers are aware and the provision for which is buried in small print, it would be odd if this were seen as part of the essential bargain on the grounds of it constituting a significant source of revenue stream.[18]

Insufficient attention to the purpose of the Directive

6.13 The second criticism is that the court took an English, literal approach to the construction of the UTD, rather than looking at its purpose. Phillip Morgan commented that the Court's approach was:

> distinctly English as opposed to European, in that it is not broad and purposive. This result significantly limits the protection provided to consumers, particularly when dealing with financial products.[19]

6.14 Paul Davies described the reasoning as "a more literal approach to the interpretation of the Regulations than is perhaps desirable".[20] He added that the lower courts adopted a more purposive approach, bearing in mind that the aim of the UTD was to ensure adequate consumer protection. Mel Kenny described the Supreme Court's decision as "traditional and formalistic", compared to the more "Europeanized approach" taken in *First National*.[21]

6.15 Mindy Chen-Wishart added that the Supreme Court should have started with the purpose of the Unfair Terms Directive (UTD):

[17] Simon Whittaker, "Unfair Contract Terms, Unfair Prices and Bank Charges" (2011) 74(1) *Modern Law Review* 106 at pp 115-116.

[18] Phillip Morgan, "Bank charges and the Unfair Terms in Consumer Contracts Regulations 1999: the end of the road for consumers?" [2010] *Lloyd's Maritime and Commercial Law Quarterly* 208, p 212.

[19] Above, p 214.

[20] Paul Davies, "Bank Charges in the Supreme Court" (2010) 69(1) *Cambridge Law Journal* 21, p 22.

[21] Mel Kenny "Orchestrating Sub-prime Consumer Protection in Retail Banking: *Abbey National* in the Context of Europeanized Private Law" *European Review of Private Law* (2011) 43, p 57.

> Article 189 of the EC Treaty obliges national courts to interpret any national legislation implementing a directive in such a way as to achieve its purpose. Since the relevant Directive is aimed at consumer protection, this should determine the perspective from which the proper qualification of the exempted terms should be assessed.[22]

Failure to refer the case to the Court of Justice

6.16 Many academics criticised the Supreme Court's decision not to refer the interpretation of article 4(2) to the CJEU. For example, Paul Davies described the decision not to refer as "dubious".[23] Mel Kenny said that the judgment "dramatically recasts" the doctrine of when references should be made.[24]

6.17 Michael Schilling described the Supreme Court's failure to refer the matter to the CJEU as a missed opportunity. Given the different views expressed by the High Court and Court of Appeal, he was not convinced that the issue was clear (or *acte clair*). He concluded:

> In the end, these somewhat shaky legal arguments only appear as an attempt to legitimise the Supreme Court's true reason for not making a reference: to avoid further delay in resolving the matter.[25]

Need to guard against unfair surprise

6.18 Lastly, it was suggested that by refusing to consider the core bargain from the point of view of a reasonable consumer, the Supreme Court had failed to safeguard consumers against unfair surprise. Mindy Chen-Wishart argued that "consumers are likely to appreciate the core … and logically more transparent terms of the contracts they enter" and so "these are the terms that reg.6(2) justifiably exempts from review, in the name of consumer choice".[26]

6.19 Paul Davies put the point in the following terms:

[22] Mindy Chen-Wishart, "Transparency and Fairness in Bank Charges" (2010) 126 *Law Quarterly Review* 157, pp 161-162.

[23] Paul Davies, "Bank Charges in the Supreme Court" (2010) 69(1) *Cambridge Law Journal* 21, p 23.

[24] Mel Kenny, "Orchestrating Sub-prime Consumer Protection in Retail Banking: *Abbey National* in the Context of Europeanized Private Law" *European Review of Private Law* (2011) 43, p 55.

[25] Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons' rationale", (2011) *International & Comparative Law Quarterly* 933, p 963.

[26] Mindy Chen-Wishart, "Transparency and Fairness in Bank Charges" (2010) 126 *Law Quarterly Review* 157, p 161.

> A pertinent principle … latent in the judgments of the lower courts, is that of "unfair surprise": if a reasonable consumer would be surprised by any term, then the assessment of the fairness of that term should not be excluded by regulation 6. A reasonable consumer may well be flabbergasted to be charged £40 for being overdrawn by £1 for only a day; the vast majority of customers do not consider insufficient funds charges to be an essential element of the contract they enter into with the bank. Sheltering such terms from a test of fairness does little to further the goal of consumer protection.[27]

6.20 Simon Whittaker favoured an approach "which adopts the viewpoint of the average consumer as to the price because this is likely to form the basis of that consumer's genuine choice".[28] This would tie the test to a more general EU understanding of a "consumer", as shown in the wider case law of the CJEU.[29]

RESPONSES TO THE BIS CALL FOR EVIDENCE

6.21 In 2010, BIS published a Call for Evidence, asking whether ancillary, contingent and non-transparent charges should be reviewed for fairness.[30] Responses were split. Consumer groups and enforcement bodies supported change while business groups opposed it.

6.22 On the one hand, Citizens Advice stated:

> We support BIS's intention that contingent, ancillary and non-transparent charges should be unambiguously assessable for fairness under the Consumer Rights Directive. We find that these sorts of charges are a significant source of consumer detriment reflecting the way that markets can fail to ensure fair outcomes for consumers and more vulnerable consumers in particular.[31]

[27] Paul Davies, "Bank Charges in the Supreme Court" (2010) 69(1) *Cambridge Law Journal* 21, p 22.

[28] Simon Whittaker, "Unfair Contract Terms, Unfair Prices and Bank Charges" (2011) 74(1) *Modern Law Review* 106, p 113.

[29] Above, p 115.

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

[31] Citizens Advice Bureau, *Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness: Citizens Advice response to the Department for Business, Innovation and Skills* (August 2010), p 2.

6.23 Conversely, the Confederation of British Industry (CBI) commented that "there does not seem to be any reason why ancillary or contingent prices should be any less subject to competition than other charges".[32] They thought that including contingent or ancillary prices would mean using unfair contract terms legislation as a price control mechanism.[33] Further, the CBI felt that an assessment from the consumer's perspective would "result in inconsistency and uncertainty".[34]

6.24 Other business groups also expressed strong opposition to removing ancillary or contingent charges from the exemption. Vodafone thought that regulation should not impede the way in which businesses were entitled to charge consumers. They expressed particular concern that controls on early termination charges might deprive consumers of the benefit from subsidised handsets.[35] Virgin Media felt that the Government's concerns about contingent and ancillary charges were "a generalisation" which "does not reflect the individual competitive nature of many markets".[36] They rejected a test based on the consumer's perception of the essential bargain as "likely to lead to considerable uncertainty".[37]

SUPPORT FOR TRANSPARENCY

6.25 Although businesses expressed concern about assessing ancillary charges for fairness, there was widespread support for the idea that charges should be transparent. The CBI said that "transparency is the key". They stated:

> Transparency, which is at the heart of the UCCT Directive and which will be reinforced in the Consumer Rights Directive, is the most effective and proportionate way to ensure that consumers can make informed choices.

6.26 The CBI considered that "the focus should be on ensuring transparency so that consumers can make an informed decision about the charges they are prepared to accept". In their view, transparency "should be the driver of competition".

6.27 Virgin Media agreed that "transparency is fundamental to fairness". They felt that transparency is sufficient to ensure consumer protection, stating:

[32] CBI, *Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness: CBI Response* (August 2010), p 3.

[33] Above, p 1.

[34] Above, p 4.

[35] Vodafone, *BIS call for evidence* (August 2010).

[36] Virgin Media, *Virgin Media Response to Call for Evidence – Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness* (August 2010), p 2.

[37] Above, p 1.

> This is part of the wider requirement of putting the consumer into a position where he can make an informed choice. Virgin Media agrees with the view of the OFT that the purpose of the two exemptions in Regulation 6(2) is to allow freedom of contract to prevail in relation to terms that are central to the bargain between consumer and supplier … Given that this Regulation already requires such terms to be transparent and intelligible to the consumer, we believe that consumers are adequately protected. Provided that such core terms are presented in such a way as to ensure that they are, or at least are capable of being, at the forefront of the consumer's mind in deciding whether to enter into the contract, we believe that consumers should be given the freedom (as well as the responsibility) to decide whether to accept and agree to such contract terms.

6.28 Vodafone also supported "the need for the consumer to be properly informed of charges that they may incur and for any terms and conditions to be set fairly". They also said that they "would welcome clarification in relation to the scope of the price exemption provisions in the UTCCRs".

6.29 Similarly, regulators support transparency as a tool for consumer protection. In 2011 the OFT published a study of consumer contracts, drawing on the fields of economics and psychology to identify the potential for consumer harm.[38] This study also stressed the importance of transparency in contract terms:

> For consumers to be able to assess a deal they must be aware of the key elements – the main proposition. Consumers will be aware of those aspects that are explicitly brought to their attention or sought out – we refer to these as 'upfront terms'.[39]

6.30 The study notes that traders can ensure that terms are "upfront" in the way they present them to consumers:

> Where small print terms may worsen the deal compared to consumer expectations, traders could consider bringing these terms clearly to consumers' attention upfront. By making these terms genuinely transparent, such that consumers understand and assess them as part of the deal, the trader can ensure that the term does not come as a surprise.[40]

[38] OFT1312,(February 2011): *Consumer Contracts Market Study*, available at http://www.oft.gov.uk/shared_oft/market-studies/consumercontracts/oft1312.pdf. This study is not an interpretation of the legislation and should not be read as guidance: see p 6, footnote 1. Instead it aims to "set out a systematic approach for assessing the overall effects of consumer contract terms".

[39] Above, p 67.

[40] Above, p 69.

HOW HAVE ENFORCEMENT BODIES INTERPRETED THE JUDGMENT?

6.31 Although much of the academic comment suggests that the Supreme Court decision is a major re-interpretation of the law, enforcement bodies have interpreted it narrowly, and have suggested that it has limited application. Generally, it appears that many of the unfair terms cases that enforcers deal with fall outside the scope of the judgment, because they involve terms falling under the Schedule 2 grey list, or terms which are not in plain and intelligible language. Below we consider how Ofcom, the OFT, the FSA and local Trading Standards Services (TSS) have responded.

Ofcom guidance

6.32 In 2008, Ofcom issued Guidance on unfair contract terms in telephone and other communication services contracts.[41] The Guidance focused on additional charges for bill payment and itemised billing, default and early termination charges, minimum contract periods and minimum notice periods.

6.33 In 2010, following the Supreme Court judgment, Ofcom updated this Guidance.[42] Ofcom's view was that the judgment had only a limited impact on the matters covered by its Guidance.[43]

6.34 The Guidance starts by citing Lord Walker's view that the exemption reflects the "*quid pro quo*" of the contract.[44] Ofcom concede that the payments for fringe services or optional extras may be part of the price,[45] which means they will not consider the amount of non-direct debit charges and itemised and paper billing charges, provided they are clear and transparent.[46]

6.35 Ofcom argue strongly, however, that early termination charges and default charges are not within the exemption. On early termination charges they comment:

[41] The Guidance followed consultation: see Ofcom, *Ofcom review of additional charges, including non-direct debit charges and early termination charges* (February 2008), available at: http://stakeholders.ofcom.org.uk/binaries/consultations/addcharges/summary/addcharges.pdf.

[42] Ofcom, *Ofcom Statement on Additional Charges (Updated Guidance)* (November 2010), available at: http://stakeholders.ofcom.org.uk/binaries/consultations/addcharges/statement/Ofcom_statement.pdf.

[43] Above, para 5.

[44] "*Quid pro quo*" is a Latin tag meaning "this for that".

[45] Ofcom, *Ofcom Statement on Additional Charges (Updated Guidance)* (November 2010), available at: http://stakeholders.ofcom.org.uk/binaries/consultations/addcharges/statement/Ofcom_statement.pdf, para 24, quoting Lord Phillips at [78].

[46] Above, para 35.

> An early termination charge is not part of the exempt *quid pro quo*. There is a, usually monthly, retail price that falls within that. By contrast an early termination charge is a separate, ancillary payment, payable if the consumer does not meet an obligation to continue a contract for a fixed period.[47]

6.36 Ofcom explain that an early termination charge is not paid in exchange for a package of goods and services under the contract: "the opposite applies: it applies when good and services stop being supplied".[48] Assessing early termination clauses does not ask the value for money question. It only asks whether the compensation payable when a contract ends is excessive.[49]

6.37 As far as default payments are concerned, Ofcom comment that "the position is clearer still".[50] In support, they cite statements from the Supreme Court that not every money term is a price term, as can be shown by the decision in *First National Bank*.[51] The Supreme Court also mentioned that terms on the grey list might be unfair, and Ofcom highlight para 1(e) which applies to terms:

> requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation.

6.38 Ofcom state that this applies not only to default charges as such but also to "quasi-default charges" that have that effect. As Lord Walker put it, "traders ought not to be able to outflank consumers by 'drafting themselves' into a position where they can take advantage of a default provision".[52]

6.39 In correspondence Ofcom told us that it had considered carefully how the judgment affected unfair charges. It had reached the view that "the Supreme Court's approach to the exemption was not substantially different in principle to that which Ofcom took in its Guidance".

OFT

6.40 The OFT have not yet amended their Unfair Contract Terms Guidance of September 2008[53] to reflect the judgment. Nor have they issued any other guidance on their interpretation of the judgment, and how they will enforce the UTCCR in light of it.

[47] Above, para 37.

[48] Above, para 38.

[49] Above, paras 39 and 40.

[50] Above, para 44.

[51] Above, para 28, citing statements by Lord Walker at [43], and Lord Mance at [101] and [103].

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

[53] OFT 311 (September 2008): *Unfair contract terms guidance: Guidance for the Unfair Terms in Consumer Contracts Regulations 1999*, available at http://www.oft.gov.uk/shared_oft/reports/unfair_contract_terms/oft311.pdf.

6.41 However, when we met the OFT at the outset of this project, they indicated that they considered the judgment should be interpreted narrowly. This view is reflected in the OFT's Consumer Contracts Study of February 2011.[54] Whilst this document is not guidance and should not be interpreted as such, it states:

> Ultimately it is for the courts to decide whether a term is assessable for fairness, but the OFT believes the exclusion from assessment needs to be as narrow as is compatible with the requirements of the underlying Directive – and in our view, it should only apply to terms concerning the main value-for-money proposition as it is in fact understood by both parties including the consumer. Consequently, we believe that many terms imposing charges should be assessable, including any such charges shown to be outside of ordinary consumers' consideration whether because they are payable on a remote contingency or for other reasons.[55]

6.42 We understand that the OFT continue to look at price terms, under the UTCCR, which they consider fall outside the exemption. It appears, however, that this is an intricate assessment exercise done on a case by case basis. In particular, it is often difficult to make the distinction between those charges which fall within the exemption and those which fall within the Schedule 2 grey list.

6.43 In addition, the OFT accept that the UTCCR may not protect vulnerable consumers against exploitation. Here, other legislation, such as the Consumer Protection from Unfair Trading Regulations,[56] is relevant:

> Broadly speaking the UTCCRs offer good protection from unclear contract terms and from nasty surprises in small print … It is less clear how far the UTCCRs cover unfair terms hidden, as it were, in plain view or concerns we might have about exploitation of vulnerable consumers … - other law … is likely to be relevant here.[57]

[54] Office of Fair Trading, *Consumer Contracts Market Study* (February 2011) available at http://www.oft.gov.uk/shared_oft/market-studies/consumercontracts/oft1312.pdf. This study is not an interpretation of the legislation and should not be read as guidance: see p 6, footnote 1. Instead it aims to "set out a systematic approach for assessing the overall effects of consumer contract terms".

[55] Above, para 6.13.

[56] Discussed in Part 3.

[57] OFT1312 (February 2011): *Consumer Contracts Market Study*, available at http://www.oft.gov.uk/shared_oft/market-studies/consumercontracts/oft1312.pdf, para 6.17.

FSA

6.44 In January 2012, the FSA also published Guidance on Improving Standards in Consumer Contracts. It highlights types of contract terms which the FSA commonly find to be of concern under the UTCCR.[58] These include terms which give the firm the right to vary unilaterally the contract, terminate the contract or use discretion in exercising its powers. The Guidance does not, however, attempt to interpret the exemption in the light of the Supreme Court judgment. It merely notes that the exemption exists, and quotes Regulation 6(2).[59]

6.45 There is a particular issue about how far exclusions in insurance contracts define the main subject matter of the contract, so we were interested to see how the FSA approached the issue. Below we provide a brief outline of the issue, and give examples of the FSA approach drawn from its recent decisions.

Insurance and the definition of the main subject matter

6.46 In 2007 we published a Consultation Paper on insurance contract law which discussed the effect of the UTCCR on consumer insurance contracts in some detail.[60] We noted that the insurance industry opposed the idea that definitions of risk and exclusions should be subject to review for fairness, and was very concerned at the possible impact of the UTD. To assuage its fears, the UTD included the following words in Recital 19:

> 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 … . 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.

6.47 This raises the issue of how far exclusion clauses in an insurance contract should be taken to be "the definition of the main subject matter". A major insurance text considers that the exemption extends to terms which describe the perils insured against and specify the measure of indemnity afforded by the cover, but not to procedural requirements to give notice of claims.[61]

[58] FSA finalised Guidance, *Unfair Contract Terms: Improving Standards in Consumer Contracts* (January 2012), available at: http://www.fsa.gov.uk/static/pubs/guidance/fg12_02.pdf.

[59] Above, para 2.3.

[60] Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (2007) Law Commission Consultation Paper No 182; Scottish Law Commission Discussion Paper No 134, paras 2.72 to 2.107.

[61] J Birds and N Legh-Jones, *MacGillivray on Insurance Law* (11th ed 2008) paras 10-020 to 10-021, p 244.

6.48 The case of *Bankers Insurance Co v South* lends some support to this view.[62] A holiday-maker had taken out a travel insurance policy which excluded "compensation or other costs arising from accidents involving … possession of any … motorised waterborne craft". Following a jet ski accident, the victim argued that the term was unfair. Mr Justice Buckley held that, as the term was in plain intelligible language, it fell within the Regulation 6(2) exemption.[63] In any event he could see nothing unfair in the term.[64]

Examples of recent decisions

6.49 We have therefore looked at some of the FSA's decisions to see how the FSA approaches this issue in practice. One case involved a clause in a home buildings insurance policy, which included damage caused by "subsidence and heave" but then excluded damage caused by "settlement, shrinkage or expansion".[65] None of these terms were defined. The FSA conceded that the term *may* relate to the definition of the main subject matter, citing Recital 19. It then pointed out that Recital 19 only applied to terms which *clearly* define the risk. Here the effect of the term was not clear. Nor was the term in plain, intelligible language.

6.50 The FSA took a similar view on a term about pet insurance.[66] The term stated that the insurer would not pay for treatment which it did not consider "reasonable or necessary", giving the insurer wide discretion over whether to pay a claim. Again, the FSA stated that the term may relate to the definition of the main subject matter, but it was not in plain, intelligible language. The terms "reasonable and necessary" were vague and potentially subjective concepts.

6.51 These decisions suggest that the crucial issue is whether a consumer would be able to understand the effect of a term. If the term is vague or difficult to apply, the FSA will consider that it is not in plain, intelligible language. This takes a purposive approach to the issue. At one level, a term which says "we will only pay your claim if we think it is reasonable" uses plain language, but it is not intelligible because it fails to tell the consumer which claims would be paid.

Local Trading Standards Services

6.52 TSS are also enforcement bodies under the UTCCR. In initial discussions, it was suggested that the judgment had made some TSS wary of enforcing the UTCCR, because it had caused confusion. TSS have generally had their budgets cut, and they do not have access to additional legal resources, so they are reluctant to become embroiled in the intricate arguments that arose in the bank charges litigation.

62 [2003] EWHC 380 (QB), [2004] Lloyd's Rep IR 1.

63 Above at [24].

64 Above at [24].

65 Legal and General Insurance Ltd undertaking in relation to its Home Insurance Essentials policy (14 December 2011), available at http://www.fsa.gov.uk/pubs/other/lg-insurance-undertaking.pdf.

66 RBS Insurance firms undertaking in relation to Direct Line and all other pet insurance policies, (25 November 2011), available at http://www.fsa.gov.uk/pubs/other/rbs_insurance_undertaking.pdf.

6.53 TSS receive a large number of complaints about standard form contracts. They must decide how best to use resources, including which arguments to pursue in their negotiations with traders. Generally, they will opt for the best arguments to achieve the quickest results. Following the judgment, the UTCCR are perceived by many as problematic and, therefore, not the best tool for prompt resolution.

6.54 Stakeholders also suggested that it was even more difficult for those advising individual consumers whether to challenge a term in a contract which appeared to be unfair; consumer advisers often avoid the UTCCR altogether. In Part 8 we invite evidence on this issue.

CONCLUSION

6.55 In Part 5 we concluded that, following the Supreme Court judgment in *Abbey National,* Regulation 6(2) could be interpreted in different ways. The enforcement bodies have tended to interpret it narrowly. It has been suggested that the exemption should be confined to the main value-for-money proposition as understood by both parties, including the consumer. This, however, is not the only way the judgment could be interpreted. The issue is subject to considerable uncertainty.

6.56 We think that this uncertainty is undesirable. It is to the advantage of well resourced, large organisations which can pay for sophisticated legal advice to interpret the law. It is to the disadvantage of smaller traders or individual consumers who would not be prepared to take the risk of litigation. It may also discourage TSS from taking enforcement action.

6.57 In Part 8 we make proposals to bring greater certainty to this area, and to give enforcement bodies a firmer foundation to their work.

PART 7
THE EUROPEAN CASE LAW

7.1 The Unfair Terms Directive (UTD) is a European measure, which must be interpreted in line with the decisions of the Court of Justice of the European Union (CJEU). In this Part we start by looking at how the UTD has been interpreted by the CJEU.

7.2 We then consider the concept of "the average consumer" as used more widely in EU law. As we explain below, the CJEU has set a robust standard, describing the average consumer as someone who is "reasonably well informed, reasonably observant and circumspect".

7.3 The CJEU does not decide issues in isolation, but is influenced by developments in the Member States. It is therefore useful to see how other Member States have interpreted the UTD. We summarise some of the main developments here and give more details in Appendix A.

EUROPEAN COURT GUIDANCE ON THE UTD

The importance of European Court case law

7.4 Jurisdiction over the UTD is split between national courts and the CJEU. It is for the CJEU to interpret the UTD and for national courts to apply it to the specific facts of individual cases.[1] The UTD is a minimum harmonisation measure, which means that the implementing legislation of Member States cannot fall below the standard of consumer protection enshrined by the UTD, though it can be higher.

7.5 As the UK has "copied out" the terms of the UTD, the courts must interpret the words of the Regulation in line with CJEU guidance on the interpretation of the UTD. If the UK were to introduce legislation in a different form, the legislation would also need to be interpreted in line with the Directive – and if it were incompatible with the minimum standard of protection laid down in the Directive, the European Commission could bring action to demand compliance. As Advocate General Trstenjak commented, "any limitation of the scope of the Directive … as a result of incorrect implementation implies a failure to come up to the minimum standard of protection laid down by Community law".[2]

7.6 Yet the interpretation of the UTD is far from clear. Member States continue to raise new queries about it, although the UTD was enacted nearly 20 years ago. Advocate General Trstenjak recently noted that the CJEU still receives a "large number" of references for a preliminary ruling on its interpretation.[3]

1 Joined Cases 28/62 to 30/62 *Da Costa en Schaake NV v Nederlandse Belastingadministratie* [1963] ECR 31 and Case C-366/96 *Cordelle* [1998] ECR I-583 at [9].

2 Opinion of Advocate General Trstenjak Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785 at [80].

3 Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [1].

Rulings on only a few areas

7.7 In a few discrete areas, the CJEU has provided definitive rulings. For example, for the purpose of the UTD a "consumer" must be a natural person.[4] Further, a national court is obliged to raise the unfairness of a term of its own motion whether or not a consumer has raised the issue.[5] This is because it is necessary:

> for ensuring that the consumer enjoys effective protection, in view in particular of the real risk that he is unaware of his rights or encounters difficulties in enforcing them.[6]

Where the court considers such a term to be unfair it must not apply it, except if the consumer opposes that non-application.[7]

7.8 There are many areas, however, where the CJEU has yet to give a definitive ruling. In particular, there is relatively little guidance on the exemption in article 4(2). The Advocate General has characterised the "price" and "main subject matter" as "two factual situations" which are matters for the national courts.[8]

7.9 Nevertheless, the CJEU has repeatedly commented on the purpose of the UTD and has set out principles which should guide national implementation. Three key ideas emerge from the judgments of the CJEU:

(1) The purpose of the UTD is to correct an imbalance between consumers and traders;

(2) It is essential that national implementing measures are precise and clear; and

(3) Enforcement of the UTD should seek to deter future use of unfair terms.

7.10 We discuss these below.

7.11 We then consider two recent decisions which provide some limited guidance on the interpretation of article 4(2): *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios* (*Caja de Ahorros*)[9] and *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (*Nemzeti*).[10] Advocate General Trstenjak gave opinions in both cases and these are particularly helpful.

[4] Joined cases C541/99 and C-542/99 *Cape Snc v Idealservice Srl* [2001] ECR I-9049 at [16].

[5] Joined cases C-240/98 to C-244/98 *Océano Grupo Editorial SA v Quintero* [2000] ECR I-04941.

[6] Case C-473/00 *Cofidis v Fredout* [2002] ECR I-10875 at [33] and joined cases C-240/98 to C-244/98 *Océano Grupo Editorial SA* at [26].

[7] Case C-243/08 *Pannon GSM Zrt v Erzsébet Sustikné Győrfi* [2009] ECR I-04713 at [35].

[8] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [70].

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

[10] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012).

Correcting an imbalance

7.12 The CJEU has stated that the UTD is aimed at correcting an imbalance between the bargaining positions of the trader and consumer. In this respect the UTD is not a one-sided consumer protection measure, but furthers its common market origins in establishing equality between consumers and traders. In an oft quoted passage the CJEU stated:

> The system of protection laid down by the Directive is based on the notion that the imbalance between the consumer and the seller or supplier may only be corrected by positive action unconnected with the actual parties to the contract.[11]

7.13 This recognises that traders can take advantage of their stronger bargaining position by using unfair terms in standard-form contracts which consumers cannot influence:

> The system of protection introduced by the Directive is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge. This leads to the consumer agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of those terms.[12]

7.14 However, the UTD is not designed to protect consumers from entering into disadvantageous contracts. In *Caja de Ahorros*, Advocate General Trstenjak described the purpose in the following terms:

> Directive 93/13 does not go so far as to put an end altogether to the parties' freedom to arrange their own affairs … The consumer is not to be protected generally against entering into a disadvantageous transaction. Rather, he is deemed to be adequately protected, with regard to the main subject-matter, through competition.[13]

7.15 The idea that the purpose of the UTD is to restore balance between consumers and traders to promote competition continues to guide the CJEU's interpretation of the UTD. In *Nemzeti*,[14] Advocate General Trstenjak stated that the collective enforcement procedures create "a just balancing of the interest of consumers and undertakings" and also "ensure fair competition".[15]

[11] Joined cases C-240/98 to C-244/98 *Océano Grupo Editorial SA Quintero* [2000] ECR I-04941 at [27].

[12] Above at [25].

[13] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [40].

[14] Case C-472/10 (26 April 2012).

[15] Opinion of Advocate General Trstenjak Case C-472/10 (6 December 2011) at [41].

7.16 The limits of the UTD's consumer protection purpose can be seen in the CJEU's ruling in *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira*.[16] Here the Spanish court had been asked to enforce a final arbitration award granted in favour of a mobile phone provider (Asturcom) against a consumer who had not paid instalments due under her mobile phone contract. Despite having notice of the arbitration proceedings the consumer did not appear and did not contest the matter in any way. The Spanish court considered the arbitration clause in the mobile phone contract unfair, because the costs incurred by the consumer in travelling the long way to the arbitration tribunal were likely to be greater than the amount in dispute.[17] However, the Spanish court had no power to apply the UTD provisions because the final arbitration award had the force of *res judicata*.[18] Accordingly the Spanish court sought guidance from the CJEU.

7.17 The CJEU characterised the essential question as "whether the need to replace the formal balance … requires the court or tribunal responsible for enforcement to ensure that the consumer is afforded absolute protection".[19] The court ruled that it did not. The CJEU said that the need to comply with Community law:

> cannot be stretched so far as to mean that … a national court is required not only to compensate for a procedural omission on the part of a consumer who is unaware of his rights … but also to make up fully for the total inertia on the part of the consumer.[20]

The need for clarity

7.18 The CJEU has often commented on the need for national implementing measures to be clear and certain. This is because the UTD envisages consumers taking action to enforce their rights and so individuals should be able to understand and apply the law themselves. As the court said in *Commission v Netherlands*:

> Regard must be had to the Court's consistent concern to ensure that the existing national legislation leaves no doubt as to the effects of the directive upon the legal position of individuals.[21]

7.19 In *Commission v Sweden*, the court said that it is not merely important but essential for national implementing measures to be sufficiently precise and clear:

[16] Case C-40/08 [2009] ECR I-09579.

[17] Above at [25].

[18] Latin for "a matter already judged". It means that a matter which has been finally decided between two parties cannot be re-opened.

[19] Case C-40/08 [2009] ECR I-09579 at [34].

[20] Above at [47].

[21] Case C-144/19 [2001] ECR I-3541 at [17]. See also the Opinion of Advocate General Tizzano C-144/19 [2001] ECR I-3541 at [36].

> According to settled case-law, it is essential that the legal situation resulting from national implementing measures be sufficiently precise and clear and that individuals be made fully aware of their rights so that, where appropriate, they may rely on them before the national courts.[22]

Deterrence

7.20 Finally, the CJEU has emphasised that the enforcement of the UTD should occur in a manner which deters and dissuades the further use of unfair terms. This means that group enforcement actions can be brought before an unfair term is actually used. In *Commission v Italy,*[23] the Court stated:

> The deterrent nature and dissuasive purpose of the measures to be adopted, together with their independence from any particular dispute mean, as the Court held, that such actions may be brought even though the terms which it is sought to have prohibited have not been used in specific contracts, but have only been recommended by suppliers and sellers or their associations.[24]

The article 4(2) exemption

7.21 There is very little CJEU guidance on the correct interpretation of the article 4(2) exemption. To date, no decision has dealt directly with the types of terms which fall within its scope. Instead, Advocate General Trstenjak has characterised the "price" and "main subject matter" as factual circumstances which fall to a national court to decide.[25]

Caja de Ahorros

7.22 *Caja de Ahorros* was a reference from a Spanish court concerning a term in a home loan contract which rounded up a variable interest rate to the nearest quarter of a percent.[26]

7.23 The Spanish legislation omits any provision based on article 4(2) in its legislation implementing the UTD. Accordingly, the CJEU was asked to consider whether this was compatible with the UTD. The Court found it was compatible because by not including article 4(2) the Spanish government was adopting more "stringent provisions compatible with the Treaty in the area covered by this Directive" within the meaning of article 8 of the UTD.

[22] Case C-478/99 [2002] ECR I-4147 at [18].

[23] Case C-372/99 [2002] ECR I-819.

[24] Above at [15].

[25] Opinion of Advocate General Trstenjak Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785 at [70].

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

7.24 Advocate General Trstenjak noted that article 4(2) was added as a result of an amendment by the Council during the legislative process[27] and that it corresponded to legal provisions which were in force within the legal systems of certain Member States, such as Germany.[28]

7.25 The Advocate General considered the literature on the purpose of the exemption. She stated:

> In the unanimous view of legal theorists the intention of the legislature in including Article 4(2) is to restrict judicial review as to whether the terms of consumer contracts are unfair in the interest of the parties' freedom to arrange their own affairs and in the interest of a functioning market based on competition in respect of price and efficiency.[29]

7.26 She explained the market-based rationale further:

> According to the fundamental principles of a liberal economic order, the parties to a contract have decided of their own free will on the thing or service promised and the consideration, for the exchange of which the contract is concluded. That is in conformity with the laws of the market and of competition, which are partly set aside in the case where there are tests or assessments for fairness or equivalence, with the result that any kind of systematic market conduct planned by reference to those laws would be excluded.[30]

7.27 Finally, she summarised the purpose of the article 4(2) exemption in the following terms:

> It may be inferred from Article 4(2) of Directive 93/13 that the Community legislature intended the main obligations under the contract and the adequacy of the price/quality ratio to be left in principle to agreement by the parties and to market supply at the time. In a certain way, Article 4(2) reflects the tension between the parties' freedom to arrange their own affairs and the need for statutory intervention in favour of consumer protection.[31]

[27] Opinion of Advocate General Trstenjak Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785 at [61].

[28] Above at [64].

[29] Above at [62].

[30] Above at [63].

[31] Above at [64].

7.28 The finding that the omission of article 4(2) fell within article 8 of the UTD rested on a complicated assessment of what "the area covered by this Directive" meant. If article 4(2) set the scope of the UTD as a whole then its omission would not be "in the area covered" by the Directive. The CJEU, however, supported the Advocate General's finding that article 4(2) did not set the scope of the UTD in its entirety but described a particular type of assessment that was excluded from review. This meant that terms which define the "main subject matter" and "price" of the contract are not excluded from the scope of the Directive as a whole, but are exempt from a particular type of assessment. Therefore, Spain was entitled to extend protection under the UTD to terms excluded by the Directive (namely the "main subject matter" and "price"). [32]

7.29 The Advocate General stated "it must be observed that it is only the assessment of the terms that is limited" because the 19th recital "proves that the Community legislature evidently proceeded on the assumption that even contractual terms relating to the main subject-matter or the price/quality ratio may sometimes certainly be unfair".[33] This issue was raised by the UK Supreme Court in *Office of Fair Trading v Abbey National plc* as one which was likely to be of great practical importance[34] because it means that, for example, if a price term is in plain, intelligible language and falls within the exemption it can nevertheless be assessed so long as the assessment does not relate to its adequacy.

7.30 That said, the Court did not comment on whether the term which triggered the reference to the CJEU – a term in a home loan contract which rounded up a variable interest rate to the nearest quarter of a percent – itself fell within the scope of article 4(2). The Advocate General characterised it as a factual assessment of the contract which fell within the jurisdiction of the national court.

Nemzeti

7.31 *Nemzeti* establishes that a price escalation clause in a telephone contract could be assessed for fairness under the UTD.

7.32 In this case the Hungarian court sought guidance on the effectiveness of a term in a telecommunications provider's standard contract. The term gave the provider the right to charge customers additional costs for using a money order to pay their bills, without the method of calculation being laid down in the contracts. The Hungarian national consumer protection authority received a large number of complaints about the term and challenged its fairness. The Hungarian court sought clarification from the CJEU on whether a term which was found to be unfair was:

(1) void against all future customers with the particular firm before the court; and

(2) whether this type of term was automatically unfair.

[32] Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785 at [43].

[33] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [65].

[34] [2009] UKSC 6, [2010] 1 AC 696 at [29] by Lord Walker.

7.33 In answer to the first question, the CJEU said that Hungary had a degree of discretion in how to structure its enforcement procedures[35] because, in the words of the Advocate General, the UTD "carries out only a partial and minimum harmonisation of national legislation concerning unfair terms".[36] Accordingly, the CJEU considered the Hungarian provisions which declared the term void against all future customers with the firm before the court as compatible with the UTD – particularly because of the deterrent effect of such a sanction.[37]

7.34 However, in answer to the second question, the CJEU said that this type of term was not automatically unfair. The court is required to determine whether:

> in light of all the terms appearing in the [contract] … and in the light of the national legislation setting out rights and obligations which could supplement those provided by the [contract] at issue, the reasons for, or the method of, the amendment of the fees connected with the service to be provided are set out in plain, intelligible language and, as the case may be, whether consumers have a right to terminate the contract.[38]

As the Advocate General stated, "an independent and detailed assessment is necessary to determine whether the contract term in question is unfair".[39]

7.35 The Opinion of Advocate General Trstenjak, which the CJEU essentially followed, gave some useful guidance on the interpretation of the article 4(2) exemption. She clearly stated that not all price terms fall within its scope:

> The fact that the defendant in the main proceedings charged its customers for the cost of money orders could, at first sight, lead one to assume that the practice in question affects only the price, one of the essential obligations of the contract, which under Article 4(2) of Directive 93/13 can be subject to substantive assessment only if the term is not expressed in plain intelligible language. However, this would be to overlook the fact that the dispute hinges less on the amount of the cost itself than on the entitlement of the defendant in the main proceedings unilaterally to amend the contract terms for particular services. The question raised is thus more complex than it initially appears. In reality, it is necessary to assess, on the basis of

[35] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [35].

[36] Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [44].

[37] Above at [57] to [58]; Case C-472/10 of 26 April 2012 at [37] and [39] where the Court endorsed the Advocate General's reasoning.

[38] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [31].

[39] Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [81].

> Directive 93/13, a particular method of contract amendment which may significantly prejudice the consumer.[40]

7.36 The CJEU agreed stating that the "exclusion cannot apply to a term relating to a mechanism for amending the prices of the services provided to the customer".[41]

7.37 As an aid to interpretation the Advocate General looked to the grey list as illustrative of the scope of the exemption:

> The fact that Article 3(1) in conjunction with point 1(j) of the annex lists a similar situation should be seen as an indication that the intention of the legislature was to subject the method of unilaterally amending contracts to closer scrutiny on the basis of Directive 93/13.[42]

7.38 She also suggested that this purposive approach should be adopted when interpreting the "plain and intelligible language" element to the exemption. Accordingly, the test of whether a term is in plain intelligible language should not be set too low so that it curtails the scope of the exemption:

> Against this background, the requirements for the term to be clear and intelligible, which determine whether a substantive assessment may be carried out and compliance with which must be ascertained according to the case-law of the competent national court, should not be set too low.[43]

7.39 Finally, in assessing whether a term is transparent, the Advocate General suggested that the term "must be plain and intelligible to the consumer".[44] The CJEU put this point in the following terms:

> In the assessment of the 'unfair' nature of a term … the possibility for the consumer to foresee, on the basis of clear, intelligible criteria, the amendments, by a seller or supplier of the [contract] with regard to the fees connected to the service to be provided is of fundamental importance.[45]

[40] Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [79].

[41] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [23].

[42] Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [79].

[43] Above at [79].

[44] Above at [87].

[45] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [28].

Romanian decision

7.40 At the time of writing we are aware of a Romanian referral to the CJEU on the interpretation of the article 4(2) exemption - *SC Volksbank România SA v Câmpan*.[46] The Romanian court has sought guidance on whether either the concept of "main subject matter" or "price" in article 4(2) can be interpreted as including a "risk commission" in a mortgage contract, calculated at 0.22% of the total credit balance and payable monthly. There is great scope for this reference to clarify the matter. Equally, however, the CJEU may adopt the deferential approach expressed by Advocate General Trstenjak in *Caja de Ahorros* by stating that the "price" and "main subject matter" are factual circumstances which fall to a national court to decide.[47]

Conclusion

7.41 Whilst the CJEU has not provided a ruling which directly addresses the difficulties encountered by the UK Supreme Court in *Abbey National,* we are able to derive some important guidance on how the UTD should be implemented. In particular, the UK should bear in mind the re-balancing purpose of the UTD, the strong CJEU statements about the need for implementing measures to be precise and clear and for enforcement to have sufficient strength to deter and dissuade the future use of unfair terms. It is also clear that the article 4(2) exemption does not apply to price escalation terms.

CASE LAW ON THE "AVERAGE CONSUMER"

7.42 So far, we have only considered case law on the UTD itself. Here we discuss another concept which is widely used in EU consumer protection law: the "average consumer". The UTD does not explicitly refer to the average consumer but, as we saw in Part 5, it has been suggested that the average consumer test is a helpful way of understanding the level of protection which the UTD is intended to provide.

7.43 The CJEU has set a robust standard, describing the average consumer as someone "reasonably well informed, reasonably observant and circumspect".[48] It is an objective test, which is not based on the understanding or expectations of a particular consumer.

[46] Case C-571/11 *SC Volksbank România SA v Andreia Câmpan and Ioan Dan Câmpan* (14 November 2011).

[47] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [70].

[48] Consumer Protection from Unfair Trading Regulations 2008 (SI 2008 No 1277), Reg 2(2), mirroring the CJEU's approach in Case C-210/96 *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung* [1998] ECR I-4657.

7.44 The leading case on the average consumer is *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung,*[49] which was about egg labelling. Under the relevant regulations, statements on egg boxes must not be likely to mislead the purchaser.[50] These eggs were described as "six-grain – 10 Fresh eggs". The German authorities objected on the basis that the pack was likely to mislead consumers since the "six grains" only made up 60% of the chickens' food mix.

7.45 The German court took the view that the provision could be interpreted in two ways:

(1) that the misleading nature of the statements should be assessed by a survey of the actual expectations, or on the basis of an expert's report; or

(2) that the statement should be assessed in light of an objective notion of a purchaser, irrespective of the actual expectations of consumers.

7.46 The CJEU ruled that the correct approach was to consider the "presumed expectations of an average consumer who is reasonably well informed and reasonably observant and circumspect",[51] without ordering an expert's report or a consumer poll.[52]

7.47 The CJEU applied this test in *Gottfried Linhart and Hans Biffl,*[53] where a product was described as "dermatologically tested". The court found that an average consumer would take this to mean no more than it had been tested and found not to be harmful to the skin. An average consumer would not be misled into thinking that the product had been shown to be beneficial to skin.[54]

7.48 Similarly, in *Verein gegen Unwesen in Handel and Gewerbe Köln eV v Mars GmbH*, the CJEU held that a flash on a chocolate bar wrapper advertising it to be 10% larger was not misleading just because the advertisement itself was larger than 10%.[55] Reasonably circumspect consumers would be aware of this.

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

[50] Council Regulation (EEC) No 1907/90, Art 10(2)(e) states that statements designed to promote sales were permitted, "provided that such statements and the manner in which they are made are not likely to mislead the purchaser".

[51] Case C-210/96 *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung* [1998] ECR I-4657 at [31].

[52] This approach was approved and applied by the CJEU in Case C-220/98 *Estée Lauder Cosmetics GmbH & Co OHG v Lancaster Group GmbH* [2000] ECR I-117.

[53] Case C-99/01 *Criminal Proceedings against Gottfried Linhart and Hans Bifll* [2002] ECR I-9375 at [31].

[54] Case C-99/01 *Criminal Proceedings against Gottfried Linhart and Hans Bifll* [2002] ECR I-9375 at [32].

[55] Case C-470/93 *Verein gegen Unwesen in Handel and Gewerbe Köln eV v Mars GmbH* [1995] ECR I-1923.

7.49 The European Commission's Guidance has emphasised that the average consumer is "a critical person, conscious and circumspect in his or her market behaviour".[56] However, "the average consumer's level of attention is likely to vary according to the category of goods and services in question".[57] We do not think that the average consumer can be expected to read every term in a standard contract presented to them.

Vulnerable consumers

7.50 As we saw in Part 3, the Unfair Commercial Practices Directive (UCPD) relaxes the average consumer test in certain circumstances. It protects vulnerable consumers where:

(1) the commercial practice was "directed to a particular group" of consumers; or

(2) a "clearly identifiable group of consumers is particularly vulnerable … because of their mental or physical infirmity, age or credulity" and a trader could be reasonably expected to foresee this.

7.51 This recognises that certain groups of consumers will be particularly susceptible to unfair practices. Although such practices may reach the majority of consumers, for example through spam emails, they are designed to exploit weaknesses in specific groups. However, not all weaknesses count, and the modified test only applies if the consumer's added vulnerability arises from infirmity, age,[58] or "credulity".

[56] European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009) 1666, p 25.

[57] See Joined Cases T-183/02 and T184/02 *El Corte Inglés v Office for Harmonisation in the Internal Market (Trade Marks and Designs)* [2004] ECR II-00965 at [68].

[58] Particularly the elderly, children and teenagers, see European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009) 1666, pp 29 to 30.

7.52 The list of just three factors has been criticised as arbitrary.[59] Whereas vulnerability due to infirmity or age is relatively straightforward, vulnerability due to "credulity" is more difficult to pin down.[60] The European Commission's Guidance states that "credulity" covers groups of consumers "who may more readily believe specific claims … because of particular circumstances".[61]

7.53 In our Report on misleading and aggressive practices, we commented that if viewed analytically, the vulnerable consumer test seems strange.[62] Many practices will have a disproportionate effect on credulous consumers, and it is not clear when one should look at "the average consumer" and when at "the average credulous consumer".[63] The test seems to work best if applied in a broad way, focusing on a fair outcome. If a practice is clearly fraudulent and exploitative, but an averagely critical consumer would not be taken in, then it may be right to look at the practice from the point of view of the average credulous consumer.

7.54 It is important to note that the "vulnerable consumer" test is confined to the UCPD, and is not replicated in other consumer protection measures. We do not think that it is relevant to an interpretation of the UTD.

LESSONS FROM IMPLEMENTATION IN OTHER COUNTRIES

7.55 In Appendix A we look at how other jurisdictions have dealt with this issue. Here we summarise the main conclusions of this research.

Germany

7.56 Professor Hein Kötz has highlighted the "striking discrepancy between the decision of the Supreme Court and German case law on the issue in question".[64] Many German cases have assessed the fairness of bank charges, but it has been against a different factual and legal background.

[59] J Stuyck, E Terryn and T Van Dyck, "Confidence through fairness? The new Directive on unfair business to consumer commercial practices in the internal market" (2006) 43(1) *Common Market Law Review* 107, 121 to 122. Cathcart and Williams point out that the test overlooks economic vulnerability due to economic factors such as low income or degree of financial pressure: C Cathcart and J Williams, "The highly detailed general principles of the Consumer Protection from Unfair Trading Regulations 2008" (2009) 77 *Scottish Law Gazette* 24, p 28.

[60] It has been suggested that some groups such as tourists or asylum seekers may be "prone to credulity" because of their language skills, but it is hard to identify a group by virtue of their naivety: see C Twigg-Flesner, D Parry, G Howells & A Nordhausen, *An analysis of the application and scope of the unfair commercial practices directive*, a report for the Department of Trade and Industry (18 May 2005), available at http://www.bis.gov.uk/files/file32095.pdf, para 2.65.

[61] European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009) 1666, p 30.

[62] Consumer Redress for Misleading and Aggressive Practices (2012) Law Com No 332; Scot Law Com No 226, para 2.34.

[63] The Oxford English Dictionary defines "credulous" as "ready or disposed to believe".

[64] Hein Kötz, "Schranken der Inhaltskontrolle bei den Allgemeinen Geschäftsbedingungen der Banken: Entscheidung des britischen Supreme Court vom 25. November 2009", (2012) 20 *Zeitschrift für Europäisches Privatrecht* 332, pp 344 to 346.

7.57 In Germany, the banking system is structured differently to the UK, as account holders are typically charged a general current account fee. This general fee has not been assessed for fairness.

7.58 On the other hand, ancillary terms have been assessed. As we explain in Appendix A, the German Federal Supreme Court (*Bundesgerichtshof – BGH*) has consistently held that the standard terms of banks may be assessed for fairness if they provide for specific fees to be charged on top of the general current account fees. Thus the Court assessed the fairness of fees charged to a customer who wished to withdraw cash at the counter rather than from an ATM[65] or who was notified by the bank that his account has been seized by his creditors[66] or who was overdrawn.[67] In one 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. Again this was held to be unfair.[68]

7.59 It is difficult, however, to model our recommendations on Germany, as the German legal position is not directly comparable. The article 4(2) exemption is familiar to the German legal system. Indeed, it was inserted late in the legislative process following the submission of two German academics.[69] That said, it has been incorporated into the law in a uniquely German way.

7.60 The current German price/subject matter exemption[70] stems from § 8 Unfair Terms Act 1976 (AGBG) which predates the UTD. The German system subjects all standard terms that deviate from, or add to, default rules to an assessment of fairness.[71] Since there is no default rule about the price or subject matter of a contract, a contract cannot deviate from it and hence such a term is not assessable. In contrast, the German system does provide default rules for ancillary price terms and as such, they are assessable for fairness. This method of regulation is so foreign to the common law system that it is difficult to see how a similar implementation of the UTD could be replicated in the UK.

7.61 The German experience is interesting, however, because it demonstrates the widely different approaches taken to the UTD exemption. The CJEU would also

[65] BGH 30 November 1993, BGHZ 124, 254, NJW 1994, 318.

[66] BGH 19 October 1999, NJW 2000, 651.

[67] BGH 13 February 2001, BGHZ 146, 377, NJW 2001, 1419.

[68] 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 edn, 2010), pp 818-20.

[69] The article 4(2) exemption was inserted by the European Council who favourably promulgated a submission by Professors Brandner and Ulmer (Professor Brandner and Professor Ulmer, "The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission" (1991) 28 *Common Market Law Review* 647).

[70] § 307(3) German Civil Code.

[71] German law provides a multitude of default contractual rules which define the parties' rights and obligations in the absence of agreement. 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.

be aware of the approach taken by the German Federal Supreme Court (*Bundesgerichtshof* - BGH) in cases involving ancillary bank charges. These cases may therefore be a background factor influencing the approach of the CJEU in a future case.

Spain

7.62 The Spanish legislation omits the article 4(2) exemption in its entirety. This has generated great debate and is criticised by many Spanish academics and practitioners.[72] They advocate that Spanish law should be read as if the exemption was enacted, despite the legislature's decision not to implement article 4(2). It is suggested that excluding the price and main subject matter from review better reflects the liberal approach of the Spanish Constitution to free commerce.

7.63 Despite such disquiet, the CJEU recently confirmed in *Caja de Ahorros*[73] that Spain was entitled to omit article 4(2) from its legislation. Member States may go beyond the minimum harmonisation requirements of the UTD by adopting more stringent provisions to protect consumers.[74] The Spanish Supreme Court has subsequently cited this decision as support for the assessment of unfair terms, whether or not they would constitute part of the "essential bargain". However, no trend towards widespread price intervention can yet be clearly discerned.

France

7.64 The French legislation "copies out" the text of the article 4(2) exemption for consumer contracts.[75] Interestingly, however, the exemption is not included in recent legislation which extends the UTD fairness test to business contracts.

7.65 There has been relatively little discussion of the significance of the exemption in the French courts. The only case we have found was before the Court of Appeal of Toulouse, which considered the application of the exemption to a contract for private detective services.[76] A wife engaged a detective to watch her husband to discover whether he was being unfaithful. She then refused to pay the detective's final invoice, arguing that the contract term determining the price was unclear and unfair. This was because she was not able to ascertain the final price she would be charged, in particular in relation to the detective's expenses. The court did not agree. They found that the terms in question were drafted in a clear and legible way, which was easily understandable. Therefore the term was exempt from an assessment of fairness.

[72] 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*).

[73] Case 484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* of 3 June 2010.

[74] Above at [32].

[75] Article L 132-1 *Code de la consommation Loi* no 95-96 of 1 February 1995.

[76] Court of Appeal Toulouse 25 September 2007 Case number 06/02410 available at http://www.legifrance.gouv.fr/.

7.66 As we saw in Part 6, UK enforcement bodies have taken action against terms which give the trader excessive discretion to determine what is provided and charged.[77] In the Toulouse case, however, the expenses were not wholly within the detective's discretion. Given the uncertain elements in the calculation of the detective's expenses, the amount of the detective's remuneration could be assessed by the court.[78] Thus, the court had power to prevent excessive charging without relying on unfair terms legislation.

Australia

7.67 Australia has recently chosen to implement unfair terms legislation based on the UTD. In 2010, the Australian Commonwealth Parliament enacted a comprehensive Australian Consumer Law (ACL), which has been replicated in the laws of each of the States and Territories.[79] Part 2-3 of the ACL regulates unfair terms in standard form consumer contracts,[80] and is modelled on the UTD.[81] Previously only the State of Victoria had chosen to model unfair terms legislation on the UTD.[82]

7.68 Rather than copying out the language of the UTD, the Commonwealth Government has sought to clarify the law, and in particular, the transparency requirement and exemption. This provides a useful interpretation of the UTD requirements, which mirrors some of the conclusions we reached in 2005.

7.69 Under the ACL:

> A term is transparent if it is:
>
> (a) expressed in reasonably plain language;
>
> (b) legible;
>
> (c) presented clearly; and

[77] See, the discussion of pet insurance at para 6.50.

[78] 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.

[79] This is contained in schedule 2 of the Competition and Consumer Act 2010 (Cth). The States and Territories have agreed to introduce legislation mirroring the ACL as part of their respective laws.

[80] 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).

[81] See Sirko Harder, Problems in interpreting the unfair contract terms provisions of the Australian Consumer Law, (2011) 34 *Australian Bar Review* 306, p 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).

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

(d) readily available to any party affected by the term.[83]

7.70 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.[84]

7.71 The "upfront price" is defined further:

> The *upfront price* payable under a standard form 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.[85]

7.72 The Australian interpretation of the rationale for the exemption and their application of it by segregating out price terms which are "upfront" lend 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. As the explanatory memorandum states:

> 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.[86]

[83] 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 (2002) Unfair Terms in Contracts, Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, p 97.

[84] 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.

[85] ACL, s 26(2).

[86] Explanatory Memorandum, para 5.64.

Further, the Australian test links the exemption to the idea of transparency. The explanatory memorandum provides that in determining whether a future price forms the upfront price "a key consideration … may be the transparency of the disclosure of such payment, or the basis on which such payments may be determined, at or before the time the contract is made".[87] This ensures that the upfront price term is regulated by competition whilst other monetary terms can be assessed against a standard of fairness.

CONCLUSION

7.73 As we have seen, the interpretation of EU law is a matter for the CJEU and the application of that law is for individual Member States. Whilst the Supreme Court decision is currently the binding statement on the Unfair Terms in Consumer Contracts Regulations, a decision from the CJEU on the interpretation of the UTD may alter fundamentally the way in which the UTD should be applied.

7.74 Should the CJEU directly consider the interpretation of article 4(2), its interpretation may be shaped by the way in which other Member States have implemented the UTD. We have not been able to discern a common trend among Member States on how the UTD has been implemented and applied. Some Member States (such as France) have copied out article 4(2), some (such as Spain) have omitted it, while Germany has integrated the test within its own legal system in a unique way. Meanwhile the CJEU has stressed that it is important for the implementation to be precise and clear. We think that this is more important than following the words of the UTD.

7.75 At present, we think that the scope of the exemption is unacceptably uncertain. Therefore, in Part 8 we propose a new test for exempt terms. To ensure the UK's implementation of the UTD is certain enough to withstand any decisions from the CJEU, our proposals afford a slightly higher level of consumer protection than the UTD by narrowing the scope of the exemption. Following the CJEU decision in *Caja de Ahorros*[88] this would be consistent with EU law.

[87] Explanatory Memorandum, para 5.67.

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

PART 8
PROPOSALS FOR REFORM

A NEW APPROACH

8.1 In view of the deadlock among stakeholders over the interpretation of the exemption, we have taken a fresh look at which terms should be exempt from review.

8.2 Our preliminary meetings with stakeholders[1] revealed a strong common desire for certainty, and a shared recognition that consumers should be told about how much they were paying and what they were getting for their money. Our proposals therefore focus on whether a term is transparent and prominent to be exempt from review.

8.3 We think this is in line with the purpose and aims of the Unfair Terms Directive (UTD). If a term is transparent and prominent, a consumer should be aware of it, which means that it will form part of the "essential bargain". By contrast, other terms are not subject to the same competitive pressures, and should be assessed for fairness.

8.4 We think that under the current law, the exemption from the fairness assessment set out in Regulation 6(2) does not apply to price escalation clauses, early termination charges and default charges. This follows from the decisions in *First National Bank*,[2] *Ashbourne*[3] and *Nemzeti*,[4] and from the statements in *Office of Fair Trading v Abbey National plc*[5] concerning the grey list. In the interests of certainty, we think that it would be helpful if the legislation stated in clear terms that the exemption does not apply to these terms. This does not mean that such terms are always unfair. Many are perfectly fair, but we think that a court should be able to assess them taking into account the amount of the charge and what the trader provides in return.

CONSTRAINTS

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

(1) The law should be compatible with European law. As the UTD is a minimum harmonisation measure, the UK may not provide a lower standard of consumer protection. The law may be a higher standard and still be in line with European law.

1 During January to May 2012, we met with Which?, the Financial Services Authority, the Office of Fair Trading, Ofcom, Citizens Advice, and the British Bankers' Association.

2 [2001] UKHL 52, [2002] 1 AC 481.

3 [2011] EWHC 1237 (Ch), [2011] ECC 31.

4 Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [23]. See the discussion in Part 7.

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

(2) Although our proposals may go beyond what is strictly required by the UTD, we should not gold-plate the Directive to the extent that it imposes significant costs on traders.[6]

(3) The law should be compatible with Schedule 2 of the Unfair Terms in Consumer Contracts Regulations(UTCCR). Schedule 2 is an indicative and non-exhaustive list of terms which may be regarded as unfair. We think the intention of the UTD is that the exemption should not apply to these terms.

(4) The law should preserve consumer rights under the Unfair Contract Terms Act 1977 (UCTA). Under section 3 (in England and Wales) and section 17 (in Scotland), where one party deals as a consumer, the other party may not exclude liability for breach of contract or claim to be entitled to render a contractual performance substantially different from that which was reasonably expected.

(5) The Court of Justice of the European Union (CJEU) has stressed that implementing legislation must be "precise and clear".[7] All parties asked for more certainty over the meaning of the exemption, though that certainty is not always easy to deliver.

SMALL PRINT

8.6 As we have seen, the purpose of unfair terms legislation is to distinguish between terms which a reasonably circumspect consumer should know about and those buried in "small print".

8.7 The concept of "small print" is instantly understood by consumers in their daily lives. People know it when they see it, though it is difficult to pin down in legal terms. It is not just a question of font size, though several of the end user licence agreements discussed in Appendix C were in 6 point font or less. The concept includes some or all of the following:

(1) Poor layout;

(2) Faint colours, such as grey text;

(3) Generous sprinklings of legal jargon;

(4) Long sentences;

(5) Dense paragraphs;

(6) Inadequate signposting or headings;

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

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

(7) Little attempt to distinguish between important and unimportant terms. For example, in *Office of Fair Trading v Foxtons Ltd*,[8] the judge found that a major price term was tucked away in clause 5.1 under a heading "Sales Provisions".

(8) Labelling the material "terms" or "terms and conditions". These words are signals to consumers not to read the document.

8.8 This material is easily distinguishable from marketing material, which traders go to considerable lengths to make attractive and readable.

8.9 Small print may not be avoidable. Consumers will need access to the legal terms and conditions when a dispute arises, even if they do not read the terms before entering the contract. In complex deals, not all the information can be prominent – and some events are so unlikely that they are not worth worrying about in advance.

8.10 The problem is that small print can be used to conceal nasty surprises. As Mr Justice Mann put it in *Foxtons*, they permit "ambush" or "time-bombs",[9] and because consumers so rarely read small print, those surprises are not subject to competitive pressure. The purpose of the UTD is to ensure that the terms in small print may be reviewed for fairness. The UK must ensure that that purpose is fulfilled.

THE CASE FOR REFORM

8.11 We think the current law on which terms are exempt from review under the UTCCR is unacceptably uncertain. This advantages well resourced, large organisations which can pay for sophisticated legal advice. It disadvantages smaller traders and individual consumers.

8.12 In response to the Department for Business, Innovation and Skills (BIS) Call for Evidence, some business groups expressed the view that the current law is relatively certain, and that change might result in "inconsistency and uncertainty".[10] We think that the current law may lull traders into a false sense of security. Businesses which rely on unexpected charges, default charges or early termination fees for their revenue stream are taking a risk if they think that such terms would be exempt from review. A subsequent UK court may well interpret the Supreme Court decision in *Abbey National*[11] in a way which allows these terms to be assessed for fairness. Furthermore, a decision from the CJEU could fundamentally alter the law in this area.

[8] [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

[9] Above at [98].

[10] See para 6.23 of this Issues Paper.

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

8.13 To ensure the UK's implementation of the UTD is certain enough to withstand any decisions from the CJEU, our proposals afford a slightly higher level of consumer protection than the UTD by narrowing the scope of the exemption. Following the CJEU decision in *Caja de Ahorros*[12] this would be consistent with EU law. We think there is a strong case for legislative change to bring greater certainty to the law.

8.14 **Do consultees agree that:**

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

(2) The UTCCR should be reformed?

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

PRICE TERMS

8.16 We think that a price term can be excluded from review, but only if it is transparent and prominent. Below we set out what we mean by "price", "transparent" and "prominent". We explain why we prefer this approach to one based on whether a price term is "main" or "incidental or ancillary".

8.17 We then discuss the grey list, and explain why we think that the exemption does not apply to price escalation clauses, early termination charges and default charges. We propose that this point should be clarified in any new legislation. We also ask whether, as a general principle, terms should be reviewed for fairness if they grant the trader discretion to determine the amount of the price after the consumer is committed to the contract.

Price

8.18 In English and Scots law, price has been defined as "money consideration".[13] This is also the approach taken in the Draft Common Frame of Reference, which defines price as the "monetary obligation" in exchange for what is being supplied or provided.[14] The price may include a variety of payment methods (such as cash or cheque) and may be paid through a third party, as where a consumer tenders a credit card, and the finance company pays on the consumer's behalf.

8.19 Article 4(2) refers to "price and remuneration". "Remuneration" has no particular legal meaning, and it is not clear whether it extends more widely than price. We think not. Obligations on a consumer which are not expressed as money may be particularly problematic, and we do not think there is any reason to extend the meaning of the price exemption beyond obligations to pay money.

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

[13] Section 2(1) Sale of Goods Act 1979.

[14] C Von Bar and E Clive (ed), *Principles, Definitions & Model Rules of European Private Law, Draft Common Frame of Reference (DCFR),* Vol 1 (Full edition, 2010), p 77.

8.20 In some cases, where the consumer is selling goods to a trader, the "price" may be paid by the trader. We think that article 4(2) is intended to apply in these circumstances. Take an example where a consumer sells a valuable gold ring for a pittance to a trader because the consumer does not realise its true value. The words of article 4(2) against looking at the "adequacy of the price" appear to fit to this situation. In fact the word "adequacy" fits more comfortably here than in the more usual case where the consumer pays an excessive price.

8.21 Therefore, we think that in most contracts the phrase "price or remuneration" is intended to apply to monetary obligations on the consumer. In contracts where the consumer sells or supplies goods or services to the trader, the exemption applies to monetary obligations on the trader.

Transparent

8.22 In 2005, we explained that the "plain intelligible language" requirement of the UTD is probably not satisfied if the term is in print that is difficult to read, the layout of the contractual document is difficult to follow or if the terms are not readily accessible.[15] Therefore, clause 14(3) of the 2005 draft Bill spells out that the term should also be legible, presented clearly and readily available to the consumer.

8.23 The explanatory notes to the draft Bill use *Thompson v LM&S Railway*[16] as an example of a situation where the terms were not readily available. In that case, the ticket referred the customer to the railway's standard terms and conditions in a separate document which the customer had to buy for 6d at another railway station. We thought that terms should be available free of charge at the point of sale.

8.24 We think that these basic transparency requirements should apply to all terms. Article 5 states that where terms are in writing "these terms must always be in plain, intelligible language". This must mean more than the language would be intelligible if the words were reproduced in another document. The words must also be legible and available. Given that this transparency requirement applies to all terms, even unimportant terms, we have kept it simple. Below we ask whether terms should be in plain, intelligible language, legible and readily available to the consumer.

Prominent

8.25 Transparency is important, but we do not think it is enough by itself to exempt a price term from review. A company may produce well written, well laid out terms, readily available online if the consumer clicks the link at the bottom of the page marked "terms and conditions". This document, however, may still retain the essential characteristic of "small print", which is that most consumers would not read it.

[15] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, Appendix A, Explanatory notes, para 13.

[16] [1930] 1 KB 41.

8.26 We think that a term should only be exempt from review if it is prominent. By this we mean that it is presented during the sales process in such a way that a reasonable consumer would be aware of the term even if they did not read the full contractual document. Our intention is that the consumer should be aware of the "essential bargain". In other words they should know what they have to pay and what they will receive in return.

8.27 The more unusual or onerous the term, the more prominent it needs to be. This is in line with the policy behind the general common law rule that a party should take steps to bring particularly unusual or onerous terms to the other party's attention.[17] In business to business contracts, such a rule would only apply where a contract was not signed. In business to consumer contracts we think it should apply even if the contract is signed, given how readily consumers agree to terms they have not read. The Office of Fair Trading (OFT) market study on consumer contracts notes a recent YouGov survey which found that most consumers do not read contracts thoroughly before signing them.[18]

8.28 Whether or not a term is prominent has to be judged against a standard of some sort. The essential question is: prominent to whom? In our view the appropriate standard should be objective rather than subjective. The individual consumer would be an inappropriate standard to use as it would provide a very uncertain test. One possible objective standard used elsewhere is "the average consumer", which we discuss below.

Presented in a way that the average consumer would be aware of the term

8.29 The test we have in mind is based on the concept of the average consumer, as developed in European case law. As discussed in Part 7, this hypothetical person is "reasonably well informed, reasonably observant and circumspect",[19] but their "level of attention is likely to vary according to the category of goods and services in question".[20] Even circumspect consumers do not spend their lives scrutinising every term of every product they buy – or they would not have enough time left over for work, family and enjoying the purchases they have made.

8.30 We suggest that the test should be whether the term was presented in such a way that the average consumer would be aware of it. This means that in an individual challenge the court should consider evidence of how the term was actually presented, including the material the consumer was sent, and what the salesperson said.

[17] See *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433; *Shepherd Homes Ltd v Encia Remediation Ltd* [2007] EWHC 70. *Interfoto* was applied in Scotland in *Montgomery Litho Ltd v Maxwell* 2000 SC 56.

[18] OFT1312(February 2011): *Consumer Contracts Market Study*, available at http://www.oft.gov.uk/shared_oft/market-studies/consumercontracts/oft1312.pdf, p 27

[19] Reg 2(2) Consumer Protection from Unfair Trading Regulations 2008 (SI 2008 No 1277), mirroring the European Court of Justice's approach in Case C-210/96 *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung* [1998] ECR I-4657.

[20] See Joined Cases T-183/02 and T184/02 *El Corte Inglés v Office for Harmonisation in the Internal Market (Trade Marks and Designs)* [2004] ECR II-00965 at [68].

8.31 In a general challenge, the court will need to look at the firm's general business practices. This might include evidence about the advertising material used, the structure of the firm's website, any key fact documents or information leaflets provided and the instructions given to sales staff. Often it will involve more than just looking at the structure of the written contract documents themselves, though the nature of the written contract may also be important. In some cases contract documents are divided into "key information" sections, brought to the consumer's attention, and "small print", which is not. Where this is the case, the court may well conclude that the "key information" is prominent, while price terms in the small print may be assessed for fairness.

8.32 Once the court has determined how the clause has been presented, we think the test should be objective: would an average consumer be aware of the term? This test assumes that the consumer is "reasonably well informed, reasonably observant and circumspect". For example, the court should look at the standard of a UK consumer without learning difficulties, who is literate and speaks English. In any mass market product, some consumers will be vulnerable, but we do not think that unfair terms legislation was intended to protect vulnerable consumers from bad bargains. Other laws protect that group of consumers.

8.33 We ask whether the test should be that a term is prominent if it was presented in such a way that the average consumer would be aware of it.

Guidelines

8.34 We think it would be helpful if there were statutory guidelines on the meaning of both "transparent" and "prominent".

8.35 Some stakeholders have expressed the view that a "key facts" document might be beneficial, to set out the price and the main subject matter in a transparent way. For distance and off-premises contracts, Member States cannot introduce specific requirements for how information is presented, as this would be inconsistent with the Consumer Rights Directive (CRD).[21]

8.36 This does not, however, prohibit the provision of guidelines by bodies such as the OFT and the Financial Conduct Authority (which will replace the Financial Services Authority). We are not suggesting that terms which do not comply with the guidance would be void or unfair – simply that they would be reviewable for fairness, like most terms in consumer contracts.

8.37 We therefore ask consultees whether the court should have regard to statutory guidance when deciding whether a term is transparent and prominent.

[21] The CRD requires price terms to be clear and comprehensible. As the CRD is a maximum harmonisation measure, the UK is not able to impose any additional formal requirements about the way information is presented for distance or off-premises contracts. Financial services, however, are excluded from the provisions of the CRD.

Incidental and ancillary terms

8.38 The 2005 draft Bill included a clause to state that the price exemption did not include payments which would be "incidental or ancillary to the main purpose of the contract". Relying on the decision in *Director General of Fair Trading v First National Bank*,[22] we explained that this was the existing law. We said that we were only making explicit a point which was "currently implicit within the UTCCR".[23] This, however, is not consistent with the view of the law as set out by the Supreme Court in *Abbey National*.

8.39 Several stakeholders have argued that the Supreme Court decision should be overturned through legislation, so that a price term cannot be exempt from review if it is incidental, ancillary or contingent. We do not propose this approach for the reasons given below.

8.40 We think that contingent fees should be within the exemption, provided they are transparent and prominent. Many prices are contingent, such as where estate agents charge only if the house is sold, or solicitors charge only if the case is won. These are still part of the essential bargain and subject to competition.

8.41 The problem with stating that incidental or ancillary charges should be reviewed for fairness is that those words are inherently uncertain. As we saw, the Supreme Court and many business groups were particularly concerned about the uncertainties of defining an ancillary charge. In 2002, we explained that the definition depended on how the deal was presented to the consumer: if the price was sufficiently prominent it would be part of the main bargain. We think it is more helpful to focus on whether the charge is prominent, rather than on whether it is "ancillary". We do not think there is a substantive difference between these two approaches. The emphasis on prominence, however, is more certain and offers a practical way of distinguishing between a headline price and what are commonly thought of as incidental and ancillary terms. It also emphasises that whether a term is exempt is within the control of the trader. A trader may ensure that a price term is exempt from review by making it prominent.

8.42 For these reasons we propose that the test should be based on whether a term is transparent and prominent, rather than on whether it is incidental, ancillary or contingent.

The grey list

8.43 Schedule 2 of the UTCCR lists various terms which may be unfair, often referred to as "the grey list". As we saw in Part 5, the Supreme Court held that the terms listed in Schedule 2 may be assessed for fairness, either because they are not price terms or because they contain elements of unfairness which do not relate to the amount. The terms referred to are those which:

[22] [2001] UKHL 52, [2002] 1 AC 481.

[23] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, Appendix A, Explanatory notes, para 16.

(1) Permit the trader to retain sums paid by the consumer when the consumer "decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount" from the trader when the trader cancels the contract;[24]

(2) Require a consumer "who fails to fulfil his obligation to pay a disproportionately high sum in compensation";[25]

(3) Permit the trader to retain sums paid for services not yet supplied where the trader dissolves the contract;[26] and

(4) Allow the trader to increase the price without in both cases giving the consumer the corresponding right to cancel the contract.[27]

8.44 The schedule is not always easy to interpret. In our 2005 Report we proposed to re-write it in clearer and wider terms. For example, with reference to Schedule 1 (d), we thought it was artificial to link the trader's right to keep the consumer's deposit to the provision of "an equivalent amount of compensation" by the trader. Instead we thought that a term might be unfair if it entitled a trader, when a consumer cancels a contract, to keep sums paid in respect of services which the trader has yet to supply.[28]

8.45 Since the Supreme Court decision, the grey list has assumed much greater prominence than it had before. Ofcom and other enforcement bodies have argued strongly that any term on the grey list, or which resembles a term on the grey list, cannot be within the exemption set out in Regulation 6(2). They are particularly concerned about price escalation clauses, early termination charges and default charges.[29]

8.46 We agree that a price escalation clause cannot be within the exemption. The CJEU has been explicit on this point. In *Nemzeti*, it stated that the "exclusion cannot apply to a term relating to a mechanism for amending the prices of the services provided to the customer".[30] We think that it is important to recognise this explicitly in the legislation.

8.47 Given the importance of clarity in this area, we also think that it would be helpful to state that the exemption cannot apply to early termination charges and default charges. As we saw in Part 6, Ofcom has particular concerns about these terms. There is a strong argument that they may be reviewed for fairness under the current law, but we think it would be helpful to put the issue beyond doubt.

[24] UTCCR, Sch 2, 1(d).

[25] UTCCR, Sch 2, 1(e).

[26] UTCCR, Sch 2, 1(f).

[27] UTCCR, Sch 2 1(l).

[28] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, Appendix A, draft Bill, sch 2, para 7.

[29] See discussion in Part 6.

[30] Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [23]. See the discussion in Part 7.

8.48 "Default charges" are charges which apply where consumers have breached their obligations. We think that default charges may be reviewed for fairness, for two reasons. First, it is consistent with the House of Lords' decision in *Director General of Fair Trading v First National Bank*.[31] Secondly, paragraph 1(e) of the grey list covers terms which require a consumer "who fails to fulfil his obligation to pay a disproportionately high sum in compensation".

8.49 We also think that terms may be assessed for fairness if they have the same effect as a default charge. As Lord Walker put it, "traders ought not to be able to outflank consumers by 'drafting themselves' into a position where they can take advantage of a default provision".[32]

8.50 Finally, particular concerns have been expressed about terms which tie consumers into contracts for unreasonably long periods, or which impose excessive costs on consumers who terminate early. The UTD aimed to promote competition, and these terms are fundamentally anti-competitive as they prevent consumers from switching to other suppliers. As we saw in Part 5, in *Office of Fair Trading v Ashbourne Management Services*, the High Court found that a term which tied consumers to a gym membership contract for more than 12 months was unfair.[33]

8.51 As discussed above, the grey list includes some terms which impose early termination charges but not others. We cannot see any reason to say that a term which allows the trader to retain money paid up-front may be assessed for fairness, but a term which requires the consumer to continue monthly payments following cancellation may not be assessed. We think it would be helpful to say explicitly that a term may be assessed for fairness if it commits the consumer to pay for services for an unreasonably long time; or if, once the consumer has attempted to cancel the contract, it permits a trader to retain or claim payments for services which have not been supplied.

8.52 This is not to suggest that all price escalation clauses, default charges or early termination charges are unfair. Many are fair. In order to decide whether they are fair, however, it is necessary to consider the amount of the charge in relation to the goods or services supplied. An early termination charge in a mobile phone contract, for example, might be quite fair if it simply recouped the cost of the handset supplied.

8.53 As we discuss in Part 9, in 2005 we recommended that the grey list should be re-written in clearer terms, and our 2005 draft is set out in Appendix B. We now think that it should also be expanded slightly to include terms which commit the consumer to pay for services for an unreasonably long time; or, once the consumer has attempted to cancel the contract, permit a trader to retain or claim payments for services which have not been supplied. We also think that the legislation should state explicitly that terms on the grey list do not fall within the exemption.

[31] *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481.

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

[33] [2011] EWHC 1237 (Ch), [2011] ECC 31.

Terms which give the trader discretion over price

8.54 One particular problem addressed in the grey list is terms which grant the trader discretion to determine the amount of the price after consumers have committed themselves to the contract. Price escalation clauses are one example of this, but there are others. In Part 7 we discussed a French case about a private detective's expenses. Could a detective agency include a contract term which allowed it to charge "any expenses which we think are necessary"? Another example would be a plumbing firm which charged £50 an hour for "the number of hours which we deem to be required". A consumer faced with a gushing pipe may agree to such a term, even if it is presented prominently. Should it be open to a court to assess the fairness of the term after the event?

8.55 One argument that has been made is that a discretionary term is not in "plain, intelligible language" because it does not tell consumers how much they must pay. On other hand, the language may be sufficiently plain and intelligible to convey the essential message, which is that the trader may decide how much to charge at a later stage.

8.56 There are other legal provisions which cover uncertain price terms. Under section 15 of the Supply of Goods and Services Act 1982, where no price has been agreed, there is an implied term that the service recipient will pay a "reasonable charge", as determined by a court.[34] Therefore there can be no complaint about a contract term which required a consumer to pay a "reasonable amount", as this would be the default law in any event. The problem, in the examples we have given, is that they oust the jurisdiction of the court to decide what is reasonable and instead permit the trader to charge a potentially unreasonable amount at the trader's discretion.

8.57 The issue is also subject to the Consumer Rights Directive (CRD), which must be implemented into UK law by December 2013. As we discuss in Part 3, the CRD provides that, before entering the contract, the trader must provide the consumer with the listed information in "a clear and comprehensible manner". This includes the total price of the goods or service inclusive of taxes, or where the price "cannot reasonably be calculated in advance, the manner in which the price is to be calculated".[35] We do not think, however, that the CRD removes all the potential problems in this area. First, there is some uncertainty whether the plumbing firm has provided the consumer with information about how the price is to be calculated. Secondly, the Government has yet to decide what the consequences of a breach of the information requirements should be.

8.58 Therefore, we think it may be helpful to deal with discretionary price terms explicitly in any new legislation on unfair terms. We ask whether it would be helpful to state that that the exemption does not apply to any term which purports to give the trader discretion to decide the amount of the price after the consumer has become bound by the contract.

[34] S 15. Note also that special rules apply to solicitors' bills, which allow a court to strike out costs which are unreasonable in amount or which have been unreasonably incurred. S 15 does not apply in Scotland; instead the common law concept of *quantum meruit* applies. See W McBryde, *The Law of Contract in Scotland* (3rd ed 2007), para 9-45.

[35] Directive 2011/83/EU of 25 October 2011, OJ 2011 L 304/64. For distance and off-premises contracts, see art 6(e). For other contracts, see art 5(c).

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

8.59 As we have seen, in *Abbey National*, the Supreme Court held that price terms may be assessed for fairness, provided that the assessment does not relate to the appropriateness of the price in relation to the goods or services supplied in exchange. There are also suggestions to this effect in the European case law.[36]

8.60 In 2005, we excluded terms rather than the assessment of terms. If a term was excluded, the court could not look at it at all. By contrast, if a term was assessed for fairness, we thought it important for the court to look at "the substance and effect of the term, and all the circumstances existing at the time it was agreed". This includes looking at its amount.

8.61 We think that if a term is assessable for fairness, the court should look at all the circumstances, including the amount. When assessing a price escalation clause, for example, a court will inevitably distinguish between a clause which permits only a small increase, and one which permits an increase which was hugely disproportionate to the value of the goods or service supplied. Similarly, in *Office of Fair Trading v Foxtons Ltd*,[37] a major reason why the terms were held to be unfair was that the amounts payable were significant and bore little relationship to the services obtained.[38] It is artificial to think that a court can assess a term for fairness without considering its amount.

8.62 We also think that if a term is transparent and prominent, and not one of the listed terms, it forms part of the essential bargain. Therefore it should not be assessed at all.

8.63 There is an argument that that approach is not compatible with European laws. As we saw in Part 7, in *Caja de Ahorros*,[39] the Advocate General stated "it is only the assessment of the terms that is limited", not the term. She went on to explain that "even contractual terms relating to the main subject-matter or the price/quality ratio may sometimes certainly be unfair".[40]

8.64 We have considered whether the legislation must therefore provide that a prominent price term may be assessed for fairness, provided that the assessment does not relate to the price/quality ratio. An example might be a clear, prominent term in an airline contract that required the consumer to pay in US$. Should it be open to the court to look at the currency requirement, but not look at the amount? We think not. If the term was part of the essential bargain, we think that it should not be assessed at all. If, on the other hand, it is not part of the essential bargain, we think that a court should be entitled to look at all aspects of the term, including whether a discount was provided by paying in US$.

[36] See in particular Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785, discussed in Part 7.

[37] [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

[38] Above at [90].

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

[40] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [65].

8.65 On balance, we think that our proposals meet the minimum standards required by EU law. Terms may be assessed if they are not transparent or prominent, or if they are on the grey list. We also make specific provision for default charges and early termination charges.

8.66 That said, we welcome views on whether, in order to implement the UTD fully, it is necessary to specify that even transparent, prominent price terms may be assessed for matters other than "the adequacy of the price as against the goods or services supplied in exchange".

Questions on price terms

8.67 **Do consultees agree that:**

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

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

(3) Transparent should be defined as:

(a) in plain, intelligible language;

(b) legible;

(c) readily available to the consumer?

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

(a) price escalation clauses;

(b) early termination charges; and

(c) default charges?

8.68 **Would it be helpful to explain that:**

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

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

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

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

MAIN SUBJECT MATTER

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

Reasonable expectations

8.71 The 2005 draft Bill provided that a term should only be exempt if it was transparent and "substantially the same as the definition the consumer reasonably expected". This incorporated the test used in UCTA. For England, Wales and Northern Ireland, section 3(2)(b) of UCTA states that a party cannot by reference to any contract term:

> claim to be entitled to render a contractual performance substantially different from that which was reasonably expected of him … unless that term satisfies the requirement of reasonableness.

In Scotland, the equivalent provision is section 17(1)(b) which talks about rendering "a performance substantially different from that which the consumer or customer reasonably expected from the contract".

8.72 In *Zockoll Group Ltd v Mercury Communications Ltd (No 2)*,[41] Lord Bingham MR pointed out that what was reasonably expected seems to refer to the other party's reasonable expectations derived from all the circumstances, including the way the contract was presented to them.[42] This means that the reasonable expectations test and the prominence test are the same. A reasonable or average consumer's expectations are formed by the deal which is presented – that is by the prominent terms.

8.73 In initial discussions with stakeholders, there was a strong demand for clarity. Business groups in particular were concerned that "reasonable expectations" was a vague test. We think the point is clearer if one focuses on how the deal was presented rather than what a reasonable consumer may have expected. Thus our current proposal is to exempt terms relating to the main subject matter of the contract if they are transparent and prominent, rather than transparent and "reasonably expected". We do not think, however, that there is any real difference between these two concepts.

[41] [1999] EMLR 385, p 395.

[42] *P & O Steam Navigation Co v Youell* [1997] 2 Lloyd's Rep 136, 142, by Potter LJ; *W Photoprint v Forward Trust Group* (1993) 12 Tr LR 146; *Megaphone International Ltd v British Telecommunications plc*, The Independent, 1 March 1989.

The grey list

8.74 Article 3(3) of the UTD states that terms on the grey list "may be regarded as unfair". As we discussed above, we think this means that it must be open to the court to assess them for fairness. We therefore propose to clarify that the exemption for main subject matter does not apply to terms on the grey list. For example, an arbitration clause or exclusion of liability should always be assessable for fairness, however it was presented.

Main and incidental subject matters

8.75 The UTD and the UTCCR both refer to the "main subject matter", which implies that the subject matter of a contract can be divided into "main" and "incidental" terms. In *Abbey National*,[43] the Supreme Court provided relatively little guidance on how this distinction is to be made.

8.76 One guide to whether a term is "main" depends on how it was presented. In our view, prominent terms are likely to be considered to be "main", while small print terms are "incidental". Another guide is whether the term is on the grey list: exclusion clauses and arbitration clauses are not "main".

8.77 This leaves open the question of whether we need to retain the word "main" in any new legislation. Would it be sufficient to state that all terms are exempt from review if they are transparent and prominent and do not fall within the grey list? We did consider this option, but we think that we should retain the language used in the UTD.

8.78 If we were to omit the word "main", the UK may be in breach of its minimum harmonisation requirements. A court may find that a term is not "main" if it is analogous to a grey list term, but does not fall within the exact language of the schedule. Moreover, Advocate General Trstenjak has characterised the "price" and "main subject matter" as factual circumstances which fall to a national court to decide.[44] UK courts must be given the power to look at the facts and make a decision on this issue. Therefore, we think that under any new implementation of the UTD, the words of the exemption should continue to refer to the "main subject matter of the contract".

Terms which give the trader discretion over the subject matter

8.79 Earlier we discussed terms which gave the trader discretion to decide the price after the consumer had become bound by the contract. Similar issues arise with the subject matter of the contract. An example is the pet insurance case discussed in Part 6.[45] The term stated that the insurer would not pay for treatment which it did not consider "reasonable or necessary", giving the insurer wide discretion over whether to pay a claim.

[43] [2009] UKSC 6, [2010] 1 AC 696.

[44] Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [70].

[45] RBS Insurance firms undertaking in relation to Direct Line and all other pet insurance policies, (25 November 2011).

8.80 We welcome views on whether it would be helpful to state that the exemption does not apply to any term which purports to give the trader discretion to decide the subject matter after the consumer has become bound by the contract.

Questions on the main subject matter

8.81 **Do consultees agree that a term relating to the main subject matter of the contract should be exempt from review, but only if it is transparent and prominent?**

8.82 **Do consultees agree that a term does not relate to the main subject matter of the contract if it is included in the grey list?**

8.83 **Would it be helpful to state that the exemption does not apply to any term which purports to give the trader discretion to decide the subject matter after the consumer has become bound by the contract?**

WORKED EXAMPLES OF OUR PROVISIONAL PROPOSALS

8.84 To illustrate the effect of our proposals, we think it would be helpful to set out some examples.

Example 1 – Broke Bank plc

A consumer (C) wants to open a current account on-line. C proceeds through five screens, but none of them mention the unauthorised overdraft charges. Screen 6 includes a link at the bottom of the page to "Terms and Conditions".

There is no need to click this link, but if C does click the link, she is taken to another screen listing various documents including "account information". The "account information" screen then lists a variety of links, one of which is "charges". Only if C clicks the "charges" link will she have any idea of what Broke Bank charges for unauthorised overdrafts.

8.85 We do not think that the charges for unauthorised overdrafts are prominent thereby exempting them from an assessment for fairness. This does not mean that the charges are unfair – simply that a court could consider them.

Example 2 – Open Bank plc

By contrast, Open Bank ensures that before opening a current account, customers must pass through a screen which includes a clear table setting out its charges for unauthorised overdrafts.

8.86 In this case we think that the charges are transparent and prominent. A court may not assess them for fairness.

Example 3 – Lightfinger Lender

In the 2002 Consultation Paper we gave an example of a "low cost" four-year loan. One term provides for a low level of interest payable for the first two years, and a higher rate thereafter.[46]

Another term provides that if the borrower defaults within the first two years, the higher rate is payable for the whole of the remaining period. This means that a week's delay in making a single payment might result in a substantial increase to the overall costs.

8.87 In 2002 we said that the first term (a higher rate after two years) was exempt from review provided that it was transparent and part of the deal as presented to the consumer. This remains the case under our present proposals. The test is whether the term is transparent and prominent.

8.88 In 2002 we said that the other term (the default rate) may be challenged. This was no more the price than a price escalation clause. Again, this remains the case under our current proposals. A default clause is excluded from the exemption and may be assessed for fairness.

Example 4 – Fleece U Carpets

A consumer (C) enters into a credit agreement with Fleece U Carpets to buy a carpet, and sets up a standing order to pay the 12 monthly instalments. C did not stop the standing order after the twelfth payment, which resulted in C overpaying by £105.50.

When C asks Fleece U to refund the overpayment, Fleece U point to a term in the small print of the standard terms and conditions:

"Any overpayments made by you shall automatically be credited to a pre-payment account, maintained by us. You can use the funds in this pre-payment account to purchase additional goods from us. Any funds in this prepayment account are strictly non-refundable."

C does not want to buy another carpet.

8.89 In this example, under our provisional proposals, we consider that the term does not fall within the exemption as it is not transparent or prominent. Arguably, it may also be caught by Schedule 2, paragraph 1(d) of the UTCCR, as a term permitting the trader to retain prepayments where the consumer does not want to proceed with the contract.

Example 5 – Flighty Airlines

A consumer (C) decides to book flight tickets using Flighty Airlines' website. The home page quotes a price of £99 per person for a return flight to Madrid.

[46] Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 3.28.

C decides to commence the booking process, and after 20 minutes reaches the fifteenth screen, which is the "booking confirmation page". C is then surprised to find that on this screen the final price is shown as "£198 per person, including airport and baggage check-in fees, and booking fees".

C is unhappy that the price has doubled but as it has taken 20 minutes to reach this stage in the process, C decides to book the flight.

8.90 In this example, we consider that the price (£198) falls within the exemption, as it has been brought to the consumer's attention before the contract is entered into. This contrasts with the example given below.

8.91 The original headline price of £99 appears misleading. This means it could be challenged under the Consumer Protection from Unfair Trading Regulations 2008, as a misleading action or omission.[47] In our 2012 Report on Consumer Redress for Misleading and Aggressive Practices,[48] we consider how far consumers should have a private right of redress for misleading practices.

Example 6 – SoarPrice Airlines

In this example, C is similarly attracted by a home page which quotes a price of £99 for a return flight to Madrid. At the end of the booking process, the final screen confirms that the price is indeed £99, but that "excess baggage fees may apply".

When C reaches the check-in desk with a 20 kilo suitcase, C is informed that the baggage allowance is only 2 kilos. The excess baggage fee for the suitcase is £99. In order to take the suitcase, the consumer must pay this fee immediately. C pays under protest.

8.92 In this case, the charge is not sufficiently transparent or prominent to fall within the exemption. C may start a court action to ask for a refund of the payment, on the ground that the term was unfair.

[47] Consumer Protection from Unfair Trading Regulations 2008 (SI 2008 No 1277), Regs 5, 6.

[48] Consumer Redress for Misleading and Aggressive Practices (2012) Law Com No 332; Scot Law Com No 226.

Example 7 – Mr Dodgy Door Seller

In this example, Boilers-R-Us sells boilers for £300 to C door-to-door. The contract requires C to use Boilers-R-Us for yearly maintenance, which costs £400 a year. Boilers-R-Us sets this out very clearly on the front page of their key facts brochure. It is also written on the first page of the contract next to the price of the boiler unit. Further, Boilers-R-Us requires all of its door-to-door sales persons to clearly explain the £400 maintenance cost to C. However, in one particular sale Mr Dodgy Door Seller does not give Mrs Smith the key facts brochure, he covers over the £400 in the contract when Mrs Smith signs and he does not explain the maintenance requirement.

8.93 In this case, in a group enforcement action, the court would be presented with evidence of the standard practice of Boilers-R-Us. This standard practice would mean that the cost of the yearly maintenance of the boiler would be exempt from review. However, if Mrs Smith were to challenge the fairness of the term, the court would consider the way in which the term was presented to her and consider whether an average consumer would be aware of the term if they did not read the full contract. If the court accepted Mrs Smith's evidence, the term would be reviewable for fairness because Mr Dodgy Door Seller's actions meant that the term was not prominent and an average consumer would not be aware of it.

PART 9
OUR PREVIOUS RECOMMENDATIONS ON OTHER ISSUES

9.1 As we explained in Part 2, the Law Commissions' 2005 Report on Unfair Terms recommended bringing together the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations 1999 (the UTCCR) into a single regime.

9.2 Our aim was to simplify and clarify the law without reducing the current level of consumer protection. Where the two regimes differed we "rounded up" in favour of consumers. Unlike the UTCCR we did not simply "copy out" the Unfair Terms Directive (UTD). Instead we sought to explain the UTD in words which would be more familiar to a UK audience.

9.3 We consulted on these issues in 2002, and received 97 responses. A substantial majority of consultees supported our proposals. In 2005, we made final recommendations, which were accepted in principle by the Government.[1] We are not minded to re-open our 2005 recommendations outside the specific issues raised by the exemption for main subject matter and price. Given the time that has elapsed since our original consultation, however, we think it would be helpful to summarise our recommendations and ask if there are any areas where updating may be required.

9.4 We start with a general question: should the UTD be copied out into legislation or should it be rewritten to make it clearer and easier for a UK audience to understand? We then set out eight recommendations made in our 2005 Report. We ask if these continue to be supported by consultees.

9.5 Finally, we consider two other issues. First, we ask whether the current legislation deals adequately with the problems raised by end user licence agreements. Secondly, we consider the role of UCTA following new legislation to protect consumers.

COPY OUT OR REWRITE?

9.6 In Part 7, we noted that the Court of Justice of the European Union (CJEU) has repeatedly stressed that national measures to implement the UTD must be clear and certain. For example, in *Commission v Greece* the court stated:

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

> It is particularly important, in order to satisfy the requirement of legal certainty, that individuals should have the benefit of a clear and precise legal situation enabling them to ascertain the full extent of their rights and, where appropriate, to rely on them before the national courts.[2]

9.7 In *Commission v Sweden*, the court said that this was not merely important but essential.[3]

9.8 Government guidance on transposition requires the copying out of Directives, unless the alternative is preferable.[4] In 2005 we argued strongly that the UTD should be rewritten in a clear way, using terminology familiar in the UK. The great majority of consultees agreed. If the UTD is to succeed in its purpose it must be sufficiently clear and accessible to be used by ordinary consumers. We think that the current language is too obscure to be accessible.

9.9 Much of the difficulty has focused around the exemption for price and main subject matter set out in article 4(2). In Part 8 we propose to rewrite the exemption in a new way. Our proposals are not intended to be an exact replica of article 4(2). In some ways the new proposals allow for a slightly higher standard of consumer protection.

9.10 Here we ask a more general question about copying out, not just in relation to article 4(2), but in relation to the whole of the UTD. We ask whether consultees agree that the legislation would be more effective if it were re-written in clearer terms, as we tried to do in the draft Bill which accompanied our 2005 Report.

9.11 **Do consultees agree that the Unfair Terms Directive should not be "copied out" into the law of the UK, but should be rewritten in a clearer, more accessible way?**

[2] Case C-236/95 *Commission of the European Communities v Hellenic Republic* [1996] ECR I-04459 at [13].

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

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

THE DEFINITION OF A "CONSUMER"

9.12 UCTA applies a wide definition to the phrase "consumer contract", which can include some contracts made by businesses.[5] In *R & B Customs Brokers Ltd v United Dominions Trust,*[6] the UCTA consumer provisions were applied to a brokerage firm that bought a car. The Court of Appeal held that a firm only contracts "in the course of a business" if the contract is integral to the business or is one which is made regularly.[7]

9.13 The UTCCR use a different definition. Regulation 3 follows the UTD by stating:

> "Consumer" means any natural person who, in contracts covered by these Regulations, is acting for purposes which are outside his trade, business or profession.

9.14 This definition is restricted to "natural persons", so a company cannot rely on it in any circumstances, even if it is acting for purposes outside its business.[8] Furthermore, the UTCCR would not cover a sole trader buying a car for use in a business, even if that use were only incidental to the business.[9] This concept is now used widely in definitions across all EU consumer Directives, and has been considered by the CJEU on several occasions.[10] It has also become the normal definition used in UK consumer legislation.

9.15 In 2005, we recommended following the UTD approach. We proposed to define a consumer as "an individual who enters into the contract wholly or mainly for purposes unrelated to a business".

9.16 In their recent consultation paper, the Department for Business, Innovation and Skills (BIS) propose to follow our recommended approach in all consumer protection legislation. They propose that UK legislation should define a consumer by reference to acting for purposes which are "wholly or mainly" outside their business, trade or profession.[11]

5 For England and Wales, see s 12(1). For Scotland, see s 25(1) in terms of which consumers can clearly include non-natural persons.

6 [1988] 1 WLR 321.

7 See Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, paras 3.81 to 3.88 for a detailed discussion. For a recent development in Scots law, see *MacDonald v Pollock* [2012] CSIH 12, 2012 SLT 462, where Lord Eassie, in delivering the Opinion of the Court, held at [22] that the proper interpretation of this phrase for the purposes of the Sale of Goods Act 1979 (SOGA), s 14 was that given by the Court of Appeal in *Stevenson & Anor v Rogers* [1999] QB 1028 (ie there is no requirement of a degree of regularity of occurrence). Lord Eassie also remarked at [22] that if it were thought that the same phrase in UCTA, s 12 should receive the same interpretation as s 14 of SOGA, "we would be minded to decline to follow *R & B Customs Brokers Co Ltd*, which is a decision by which we are not bound."

8 Joined cases C-541/99 and C-542/99 *Cape Snc v Idealservice Srl* and *Idealservice MN RE Sas v OMAI Srl* [2001] ECR I-09049.

9 See Case C-269/95 *Benincasa v Dentalkit Slr* [1997] ECR I-3767 and Case C-464/01 *Johann Gruber v Bay Wa AG* [2005] ECR I-00439.

10 See above.

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

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

9.18 One further point in relation to the definition of a "consumer" is that, whereas the analogy between a consumer and an employee is not very satisfactory, UCTA is clearly intended to apply to employment contracts.[12] On the other hand, the UTD is meant to exclude employment contracts from the scope of its controls[13] albeit that there is nothing expressly to this effect either in the main text of the Directive or the UTCCR. In order to implement the Directive therefore, we think that, for the avoidance of doubt and given that currently the opposite is true under UCTA, the definition of "consumer" should exclude employees.[14]

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

TERMS OF NO EFFECT

9.20 As we saw in Part 2, under UCTA some terms are not permitted in any circumstances. This includes terms which limit liability for death or personal injury, or which exclude basic undertakings about the quality and fitness of goods. In 2002, we proposed that such terms continue to be ineffective. There was strong support for this proposal and it formed part of our recommendations.[15]

Terms which exclude liability for death or personal injury

9.21 We think that any replacement for UCTA and the UTCCR must include a specific provision to prevent terms which restrict or exclude a business's liability to a consumer for death or personal injury.

9.22 **Do consultees agree that terms which purport to exclude or restrict a business's liability to a consumer for death or personal injury should continue to be ineffective?**

The implied terms of quality and fitness

9.23 It is also important to ensure that contract terms cannot be used to exclude the implied terms of quality and fitness contained in the Sale of Goods Act 1979, the Supply of Goods (Implied Terms) Act 1973 and the Supply of Goods and Services Act 1982.

[12] In England and Wales, the list of contracts to which the Act does not apply makes no mention of employment contracts; see UCTA 1977, Sch 1, para 1. In Scotland, the list of contracts to which the Act is to apply includes "contracts of service or apprenticeship"; see UCTA 1977, s 15(2)(b).

[13] Council Directive 93/13/EEC, recital 10. The exclusion of employment also follows from the Directive's application being to contracts under which property or services are supplied *to* rather than *by* the consumer.

[14] See further paras 9.69 to 9.70 below on the effects of this prospective change in the law.

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

9.24 We note however, that in their recent consultation paper, BIS propose that the implied terms should be re-enacted in a simplified form. At present, the implied terms are set out in the statutes mentioned above, while the provisions which prevent their exclusion are in UCTA. BIS propose that instead the implied terms should become non-excludable statutory guarantees, which means that it will no longer be necessary for provisions in unfair terms legislation to prevent their exclusion in consumer contracts. [16]

9.25 We think this would be a simpler way of addressing the issue. It also means that clause 5 of our draft Bill will no longer be needed.

THE BURDEN OF SHOWING THAT A TERM IS FAIR

9.26 Under UCTA the burden of showing that a term is fair lies on the party claiming that it is fair – that is, the business.[17] By contrast, the UTCCR do not specifically allocate the burden of proof. In 2005, we noted that "it naturally falls on the party alleging that the term is unfair – that is, the consumer".[18]

9.27 This may be an oversimplification. The CJEU held that under the UTCCR a national court is obliged to raise the unfairness of a term of its own motion whether or not a consumer has raised the issue.[19] Where the court considers such a term to be unfair it must not apply it, except if the consumer opposes that non-application.[20]

9.28 In 2005, we recommended that in proceedings brought by individual consumers, where an issue about the term's fairness is raised, the burden of showing that a term is fair should rest with the business.[21] As the business will generally have far greater resources than the consumer, we thought that where the fairness of a term is in issue, it should be required to justify its position.

9.29 The same does not apply where a claim is brought by the Office of Fair Trading (OFT) or another qualifying body under the preventive powers. We pointed out that these bodies have much greater resources than individual consumers. We thought that a reverse burden of proof in preventive proceedings would be unduly restrictive for businesses.[22]

[16] See BIS, *Enhancing Consumer Confidence by Clarifying Consumer Law* (July 2012), This approach was recommended in G Howells and C Twigg-Flesner, *Consolidation and Simplification of UK Consumer Law* (2010), available at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/c/10-1255-consolidation-simplification-uk-consumer-law.

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

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

[19] Joined cases C-240/98 to C-244/98 *Océano Grupo Editorial SA v Quintero* [2000] ECR I-04941.

[20] Case C-243/08 *Pannon GSM Zrt v Erzsébet Sustikné Győrfi* [2009] ECR I-04713 at [35].

[21] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, paras 3.124 to 130.

[22] Above, para 3.162.

9.30 **Do consultees agree that:**

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

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

NEGOTIATED TERMS

9.31 UCTA applies to all consumer contracts, whether or not they are negotiated. By contrast, negotiated terms are exempt under the UTCCR, though negotiated terms are defined narrowly.[23]

9.32 In 2005, we argued that it was important to maintain the UCTA controls on negotiated terms. A business should not be entitled to exclude its liability for causing death or personal injury in any circumstances, even through a negotiated term. The issue was whether to keep a distinction between UCTA and the UTCCR in this regard, or whether to remove the exclusion for negotiated terms across the board.

9.33 A large majority of consultees agreed that the new legislation should apply to all terms, whether negotiated or not. This would make the legislation simpler, while affecting very few cases.[24] It is rare for a consumer to negotiate about any term except the price or main subject matter. The OFT also gave evidence that some negotiations could be exploitative.[25]

9.34 Some consultees argued that where a consumer had taken advice about a term in a lease or house purchase, and had had the opportunity to negotiate it, the term should not be considered unfair. We agree, but this is dealt with through the assessment for fairness, rather than through an exemption for such terms. The exemption for negotiated terms does not cover such situations. In *UK Housing Alliance Ltd v Francis,*[26] the term was held to be non-negotiated even though the consumer had instructed solicitors who had the opportunity to consider and negotiate the term.[27]

9.35 Overall, we think that the legislation would be simpler if the exclusion of negotiated terms were removed.

9.36 **Do consultees agree that the new legislation should cover terms in consumer contracts, whether or not they are individually negotiated?**

[23] See paras 2.18 to 2.21 of this Issues Paper.

[24] Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.52.

[25] In the Report on Consumer Redress for Misleading and Aggressive Practices, we gave illustrations of aggressive tactics in which doorstep sales people stayed for several hours and wore down the consumer's resistance by offering various "negotiated" advantages: Consumer Redress for Misleading and Aggressive Practices (2012) Law Com No 332; Scot Law Com No 226, para 3.50.

[26] [2010] EWCA Civ 117, [2010] 3 All ER 519.

THE FAIRNESS TEST

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

9.38 In *Director General of Fair Trading v First National Bank plc,*[28] Lord Bingham examined the words of Regulation 5(1) and suggested that they imposed a "double requirement":[29] for a term to be unfair it must be both "contrary to the requirement of good faith" and impose a "significant imbalance" between the parties. He explained that "good faith" looked at procedure while "significant imbalance" looked at substance.

9.39 Lord Bingham described good faith as demanding fair and open dealing:

> Openness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer.[30]

9.40 He then explained that fair dealing requires that a supplier should not take advantage of the consumer's "necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract" or weak bargaining position.

9.41 Meanwhile, Lord Bingham thought that the requirement of significant imbalance focused on the substance of the term:

> The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour. This may be by the granting to the supplier of a beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty. The illustrative terms set out in [the grey list] provide very good examples of terms which may be regarded as unfair.[31]

[27] Above at [19] by Longmore LJ.

[28] [2001] UKHL 52; [2002] 1 AC 481.

[29] Above at [17] by Lord Bingham.

[30] Above at [17] by Lord Bingham.

[31] Above at [17] by Lord Bingham.

9.42 We discussed this in some detail in our 2002 Consultation Paper.[32] Although a court must consider both the substance of the term and the way in which it was presented, we thought that a term could be unfair on its substance alone.[33] This reflects the approach of UCTA whereby a term excluding the trader's liability for death or personal injury is always unfair, however it was presented to the consumer.

9.43 Most of the terms listed in the grey list are potentially unfair in substance, and the list would lose much of its force if the terms were only considered unfair if it could be shown that they were presented in an unfair way. It would be a particular problem in enforcement action where "the precise way in which a clause is presented to a consumer may not be known".[34]

9.44 We also argued that a term may be unfair under the UTCCR purely because it was incorporated into the agreement in an unfair way, even though the term was not necessarily unfair in substance. Again, this follows from the grey list, which includes terms which irrevocably bind the consumer "to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract".[35] This is the case even if the terms would have been regarded as fair if presented correctly. For example, a term requiring the consumer to notify defects within a specified time may be fair, but it would work unfairly if the consumer did not know about it.

9.45 Similarly, in Appendix C we discuss a jurisdiction clause which is almost certainly void.[36] Could it be argued that if a clause is void in substance, it cannot create an imbalance in the rights and obligations of the parties? We think this is too narrow a way of looking at the UTCCR. Terms may cause a significant imbalance if they confuse consumers about their rights and obligations and so dissuade them from relying on their rights.

9.46 In 2002, we concluded that the fairness test in UCTA and the fairness test in the UTCCR were the same. We argued that for both tests, one must look at both procedural and substantive aspects. In most cases, there will be some element of procedural unfairness and some element of substantive unfairness. At the extremes, however, one aspect would suffice. A term may be unfair merely because it was hidden or deliberately confusing. Similarly, a court may find a term on the grey list (such as a term which excludes the consumer's right to take legal action) to be unfair, even if the court has no evidence about how the term was presented to individual consumers.

9.47 We thought that the reference to "good faith" may be confusing to a UK audience and that it would be better to use the phrase "fair and reasonable". Schedule 2 of UCTA gives further guidance on what this means, which is repeated in the recitals to the UTD.

[32] Unfair Terms in Contracts (2002), Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, paras 3.57 to 3.69.

[33] Above, para 3.63.

[34] Above, para 3.63.

[35] Schedule 2, para 1(i).

[36] See paras C.54 to C.56.

9.48 In 2005, we recommended that the test to be applied to a contract term should be whether it was fair and reasonable, looking at: the extent to which it was transparent; the substance and effect of the term; and all the circumstances existing at the time it was agreed.[37] The draft Bill set out a list of factors for the court to take into account.[38]

9.49 In Part 5 we also discuss the difference between assessing the fairness of a term in a case brought by an individual consumer, and assessing fairness when the case is brought by an enforcement body. As the Court of Appeal explained in *Office of Fair Trading v Foxtons*,[39] the two tests do not differ in substance, but in a general challenge it may not be possible for the court to consider all the individual circumstances. Instead, the court is required to assess the position by reference to the typical consumer. We intend to retain this aspect of the law.

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

RE-WRITING THE GREY LIST

9.51 Schedule 2 of the UTCCR sets out an "indicative and non-exhaustive" list of terms which may be regarded as unfair. It is copied from the annex to the UTD.[40] In 2005 we recommended that the indicative list should be reformulated using concepts and language more likely to be understood by readers in the UK.[41] We also thought that the Secretary of State should have a statutory power to add to the list.[42]

9.52 As we saw in Part 8, the grey list has become an important means of understanding the limits of the exemption for terms relating to the main subject matter of the contract or the price. It is now accepted that if a term is of a type listed in Schedule 2 it cannot fall within the exemption. For this reason, in Appendix B, we set out Schedule 2 of the UTCCR and the equivalent schedule in the draft Bill, so that consultees can compare the two.

9.53 **Do consultees agree that the indicative list should be reformulated in the way set out in Appendix B? Alternatively would it be preferable to reproduce the list annexed to the Unfair Terms Directive in its original form?**

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

[38] Above, clause 14(2).

[39] *Office of Fair Trading v Foxtons Ltd* [2009] EWCA Civ 288 at [16].

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

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

[42] Above, para 3.112.

NOTICES

9.54 UCTA covers contract terms and notices which exclude business liability, while the UTCCR only cover contract terms. In 2005, we recommended that the preventive powers should apply to UCTA as well as the UTCCR.

9.55 This means that the OFT and other bodies would be able to take action against notices. For example, the OFT would be able to demand that a sign in a store car-park saying "no liability is accepted for injury" is taken down. Such signs have long been ineffective in legal terms, but organisations continue to use them, presumably in an attempt to discourage people from claiming their rights.

9.56 As we explain in Appendix C, the power to take action against notices would also be helpful in dealing with some "end user licence agreements". The internet includes many sites which state that by downloading material the consumer will be taken to have agreed to the owner's terms and conditions, but there is no box or icon to click. These so called "browse wrap licences" probably do not have the status of contract terms, so the UTCCR would not apply to them. In some cases, however, they may unfairly discourage consumers from bringing an action for breach of a duty of care and we think that it should be possible to take action against such businesses.

9.57 **Do consultees agree that enforcement bodies should be able to bring enforcement action against unfair notices which purport to exclude the business's liability?**

Terms which reflect the existing law

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

9.59 This exemption is wider than the words of article 19(2) would suggest. Recital 13 explains that it includes "rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established". Thus the exemption applies to all terms that reflect default rules, which would apply even if the contract term did not exist.

9.60 In Appendix C we give examples of this sort of term when we discuss terms in end user licence agreements which merely reflect existing copyright law.

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

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

END USER LICENCE AGREEMENTS

9.63 As we explore in Appendix C, contracts for software and other digital products usually involve end user licence agreements (EULAs). These agreements not only include terms about how far the consumer may copy the information, but may also include unfair terms, such as restrictions of liability. EULAs involve a mix of both copyright law and contract law, which means that their interpretation may be legally complex. We discuss some of these complexities in Appendix C.

9.64 Terms which simply reproduce existing copyright law cannot be reviewed for fairness under the UTD as they simply reproduce the default law. As we explain in Appendix C, however, other terms can be reviewed, including clauses which purport to exclude the supplier's liability under the law of privacy, negligence or libel. We think that the way that the UTD applies to EULAs is relatively straightforward and does not require any special adaptation. We ask consultees if they agree.

9.65 **Do consultees agree that the Unfair Terms Directive applies to end user licence agreements in a satisfactory way, and that it does not require any special adaptation?**

THE REMAINING ROLE OF UCTA

9.66 The new legislation would only affect contracts made between businesses and consumers. As we discussed in Part 2, the role of UCTA is much wider than this. It also affects business to business contracts, employment contracts and private contracts made between two consumers.

9.67 The main UCTA protections in business to business contracts are:

(1) Businesses can only exclude liability for negligence if it is reasonable;[43]

(2) In standard form contracts, a business can only claim to be entitled to render a contractual performance substantially different from that which was reasonably expected if the term is reasonable;[44]

(3) The implied terms about quality and fitness for purpose in the sale and supply of goods can only be excluded if it is reasonable.[45]

[43] See s 2 (England, Wales and Northern Ireland) and s 16 (Scotland).

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

[45] See ss 6 & 7 (England, Wales and Northern Ireland) and ss 20 & 21 (Scotland).

9.68 The first two protections also apply to employment contracts. At present, section 3 (in England and Wales) may apply to an employment contract either because the contract is a standard form contract, or because the employee is a "consumer" under the quite wide definition of a consumer in UCTA. In Scotland the general UCTA controls are expressly applied to "contracts of service or apprenticeship",[46] and it has been said judicially that employment contracts will almost always be consumer contracts under the definition in the Act.[47]

9.69 Following our proposal above (para 9.19) that the definition of "consumer" should exclude employees, the effect would be to remove from employees protection which they currently enjoy. There would continue to be controls in place in relation to standard form employment contracts, and for employer liability exclusions/restrictions; there would also continue to be no controls in respect of employee liability exclusions/restrictions, albeit this last would still be achieved by the rather un-transparent route of the current statutory language. But there would be no controls by way of fairness/reasonableness tests in relation to express terms of non-standard form employment contracts.

9.70 Although this is in effect what we recommended in our Report in 2005,[48] albeit in a slightly different form, that approach was subject to criticism. Shortly after publication of our Report, Professor Douglas Brodie argued that the decline of collective bargaining and the rise of the individual employment contract left more scope for substantively unfair terms in employment contracts, where typically the employee's ability to influence the contract terms was limited or non-existent in practical terms. His principal concern was the use of express terms to contract out of the terms which the law (usually the common law) would otherwise imply into employment contracts, such as the obligation of mutual trust and confidence. He drew attention to the existence of legislation in New South Wales explicitly regulating the fairness of individual employment contracts. In the UK, the treatment of the employment contract as a consumer contract under the UCTA provided scope for such an approach and he argued that, accordingly, it should not be abrogated in the way proposed in the 2005 Report.[49] In view of such criticism on grounds which may appear cogent in the light not only of the decline of collective bargaining but also of adverse conditions in the current employment market, we would welcome comments on this prospective change in the law.[50]

9.71 **Do consultees think that the removal of controls in relation to non-standard form employment contracts, resulting from our proposals, would be problematic in practice? If so, please provide evidence**.

[46] See s 15(2)(b).

[47] *Chapman v Aberdeen Construction Group Ltd plc* 1993 SLT 1205, p 1209 (Lord Caplan). For the definition of "consumer contract" see s 25(1).

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

[49] Douglas Brodie, "The employment contract and unfair contracts legislation" (2007) 27(1) *Legal Studies* 95. See also the same author's *The Contract of Employment* (2008), ch 17.

[50] See paras 9.17 and 9.19 above.

9.72 The effect on private (consumer-to-consumer) sales is limited and complex. Under the Sale of Goods Act 1979, in private contracts there is an implied term that the seller is entitled to sell. Under UCTA this may not be excluded.[51] There are also implied terms that goods correspond to their description or sample: under UCTA these can only be excluded if reasonable.[52] There are no implied terms that goods are of satisfactory quality or fit for their purpose.

9.73 We think that UCTA can be left to regulate business to business contracts without adding to the complexity of the current law. We are concerned, however, that following the consumer reforms, the implied terms relevant to private sales will be left behind in some old Acts, and may be difficult to find. We think that an opportunity should be found to consolidate the law in this area.

[51] See s 6(1) (England, Wales and Northern Ireland) and s 20(1) (Scotland).

[52] See s 6(3) (England, Wales and Northern Ireland) and s 20(2) (Scotland).

PART 10
LIST OF CONSULTATION QUESTIONS

10.1 We ask for comments and responses to the following questions:

THE EXEMPTION FOR THE MAIN SUBJECT MATTER AND PRICE

The case for reform

10.2 Do consultees agree that:

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

(2) The UTCCR should be reformed? (8.14)

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

Price terms

10.4 Do consultees agree that:

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

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

(3) Transparent should be defined as:

(a) in plain, intelligible language;

(b) legible;

(c) readily available to the consumer?

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

(a) price escalation clauses;

(b) early termination charges; and

(c) default charges? (8.67)

10.5 Would it be helpful to explain that:

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

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

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

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

Questions on the main subject matter

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

10.8 Do consultees agree that a term does not relate to the main subject matter of the contract if it is included in the grey list? (8.82)

10.9 Would it be helpful to state that the exemption does not apply to any term which purports to give the trader discretion to decide the subject matter after the consumer has become bound by the contract? (8.83)

OTHER ISSUES

Copy out or rewrite?

10.10 Do consultees agree that the Unfair Terms Directive should not be "copied out" into the law of the UK, but should be rewritten in a clearer, more accessible way? (9.11)

The definition of a "consumer"

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

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

Terms of no effect

10.13 Do consultees agree that terms which purport to exclude or restrict a business's liability to a consumer for death or personal injury should continue to be ineffective? (9.22)

The burden of showing that a term is fair

10.14 Do consultees agree that:

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

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

Negotiated terms

10.15 Do consultees agree that the new legislation should cover terms in consumer contracts, whether or not they are individually negotiated? (9.36)

The fairness test

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

Re-writing the grey list

10.17 Do consultees agree that the indicative list should be reformulated in the way set out in Appendix B? Alternatively would it be preferable to reproduce the list annexed to the Unfair Terms Directive in its original form? (9.53)

Notices

10.18 Do consultees agree that enforcement bodies should be able to bring enforcement action against unfair notices which purport to exclude the business's liability? (9.57)

Terms which reflect the existing law

10.19 Do consultees agree that the exclusion of "mandatory statutory or regulatory provisions" in Regulation 4(2) should be rewritten to include terms which reflect the existing law? (9.62)

End user licence agreements

10.20 Do consultees agree that the Unfair Terms Directive applies to end user licence agreements in a satisfactory way, and that it does not require any special adaptation? (9.65)

The remaining role of UCTA

10.21 Do consultees think that the removal of controls in relation to non-standard form employment contracts, resulting from our proposals, would be problematic in practice? If so, please provide evidence. (9.71)

IMPACT ASSESSMENT

10.22 The Impact Assessment is at Appendix E to the Issues Paper, available on our websites at: http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts_htm and http://www.scotlawcom.gov.uk (See News column). It is summarised in Part 4 of the Summary.

10.23 We invite comments on the costs involved in the following:

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

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

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

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

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

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

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

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

10.28 We invite comments on the following tentative estimates:

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

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