



Unfair Terms in Consumer Contracts:

Advice to the Department for Business, Innovation and Skills



**The Law Commission
and
The Scottish Law Commission**

**UNFAIR TERMS IN CONSUMER CONTRACTS:
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and Skills**

March 2013

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The terms of this Advice were agreed on 22 February 2013.

THE LAW COMMISSION
AND
THE SCOTTISH LAW COMMISSION

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CONTENTS

	Page
TABLE OF ABBREVIATIONS	iv
SUMMARY	vi
PART 1: Introduction	1
PART 2: The exemption: the need for reform	8
PART 3: The exemption: a new approach based on transparency and prominence	16
PART 4: Defining “transparent”, “prominent” and “price”	37
PART 5: The grey list	52
PART 6: Copy out, the fairness test and the consequences of non-transparency	74
PART 7: Other issues	86
PART 8: List of recommendations	106
APPENDIX A: Alphabetical list of respondents	110
APPENDIX B: Respondents by category	113
APPENDIX C: Unfair Terms Directive	116

TABLE OF ABBREVIATIONS

ABI	Association of British Insurers
BBA	British Bankers' Association
BIS	Department for Business, Innovation and Skills
BRC	British Retail Consortium
BSA	Building Societies Association
BVRLA	British Vehicle Rental and Leasing Association
CID	Directive 98/27/EC on injunctions for the protection of consumers' interests; OJ 1998 L 166/51
CJEU	Court of Justice of the European Union
CRD	Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights; OJ 2011 L 304/64
DMA	Direct Marketing Association
EULA	End User Licence Agreement
FLA	Finance & Leasing Association
FSA	Financial Services Authority
Issues Paper	Unfair Terms in Consumer Contracts: a new approach? (July 2012), A Joint Issues Paper by the Law Commission and the Scottish Law Commission
MBG	Mobile Broadband Group
NETSA	North East Trading Standards Association
Ofcom	The Office of Communications
Ofgem	The Gas and Electricity Markets Authority
OFT	Office of Fair Trading
TSI	Trading Standards Institute

TSS	Trading Standards Services
UTCCR	Unfair Terms in Consumer Contracts Regulations 1999; SI 1999 No 2083
UCTA	Unfair Contract Terms Act 1977
UTD	Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts; OJ 1993 L 95

Note: all URLs specified in this document were accessible as of 1 March 2013.

THE LAW COMMISSION
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THE SCOTTISH LAW COMMISSION

**UNFAIR TERMS IN CONSUMER CONTRACTS:
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SUMMARY

- S.1 For many years, the law on unfair contract terms has been criticised for its complexity. It is set out in two separate pieces of legislation:
- (1) The Unfair Contract Terms Act 1977 (UCTA) focuses on exclusion clauses. It applies to a broad range of contracts, including those made between businesses and between businesses and consumers.
 - (2) The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR)¹ implement the Unfair Terms Directive 1993 (UTD).² They apply only to contracts between businesses and consumers, but cover a greater variety of non-negotiated terms. Terms may be challenged not only by consumers but by 12 designated enforcement bodies.
- S.2 In 2005 the Law Commission and Scottish Law Commission published a joint Report on Unfair Terms.³ We recommended a single harmonised regime to replace both UCTA and the UTCCR.
- S.3 In May 2012, the Department for Business, Innovation and Skills (BIS) asked the two Law Commissions to review and update this Report in so far as it affects contracts made between businesses and consumers. We were also asked to consider one particularly controversial area: namely the exemption for main subject matter and price currently set out in Regulation 6(2) of the UTCCR.
- S.4 In July 2012 we published an Issues Paper seeking views and received 58 responses.⁴ The responses showed strong support for reform.

¹ SI 1999 No 2083.

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

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

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

MINIMUM HARMONISATION

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

THE EXEMPTION FOR MAIN SUBJECT MATTER AND PRICE

The current law (Part 2)

- S.6 The UTD exempts certain contract terms from review, provided that they are “in plain intelligible language”. Article 4(2) states that a fairness assessment may not relate to “the definition of the subject matter of the contract” or “the adequacy of the price and remuneration...as against the services or goods supplied in exchange”. These words have been copied out into the implementing regulations and are now in Regulation 6(2) of the UTCCR.
- S.7 The exemption has proved particularly difficult to interpret. It has generated complex litigation, culminating in the 2009 Supreme Court decision, *Office of Fair Trading v Abbey National plc*.⁵ This was a test case against seven banks and a building society. The issue was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms.
- S.8 The High Court and Court of Appeal found that the terms were not exempt, because they were not part of the essential bargain between the parties, and a typical consumer would not recognise the charges as part of the price. By contrast, the Supreme Court said that overdraft charges were exempt. It rejected the idea that price terms could be divided into those which formed the essential bargain and those which were ancillary. It said that the price should be determined “objectively”, rather than from the viewpoint of a typical consumer. The judgment has proved difficult to interpret, with regulators and businesses expressing different views.

The case for reform (Part 2)

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

It is virtually impossible for consumers to apply the rules confidently.
[Which?]

Any law that is so complex and could lead to such great delays through judicial interpretation does not meet a fitness for purpose test for consumer protection legislation. [Trading Standards Institute]

The Supreme Court decision has led us to be very cautious in our assessment of unfair terms [Civil Aviation Authority]

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

⁵ [2009] UKSC 6, [2010] 1 AC 696.

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

- S.11 We think that the words of the judgment may be lulling some businesses into a false sense of security. There are other ways to interpret the judgment – and it could be overturned by the Court of Justice of the European Union (CJEU). The German Federal Supreme Court takes a different view on the UTD and has reviewed ancillary bank charges for fairness.⁶
- S.12 In a world of price comparison websites, there is increasing pressure on traders to advertise low headline prices, whilst earning their profits through other charges. Given this potential undermining of competition, the law should provide effective tools to prevent abuse.
- S.13 The current uncertainty has the potential to damage businesses as well as consumers. If a business uses an ancillary price term to subsidise a low headline price, the business is put at risk if the term is later found to be unfair. It faces the substantial costs of litigation; the reputational damage to its business; the cost of repaying consumers; and the demise of its business model.
- S.14 We recommend that the exemption for subject matter and price should be reformed. The current law is unacceptably uncertain. It requires significant legal expertise to navigate, and even then the outcome is unpredictable. Both consumers and traders may suffer from this uncertainty.

The need to protect against small print (Part 3)

- S.15 We think that the exemption should distinguish between terms which are subject to competition and those which are buried in “small print”. Where consumers know about the terms proffered by traders, they are able to take them into account in their choices: the law should not seek to protect consumers from the consequences of their own decisions.
- S.16 By contrast, consumers rarely read “small print”. “Small print” is a concept instantly understood by consumers in their daily lives. It is not just about font size. It is also marked by poor layout, densely phrased paragraphs and legal jargon. Often simply labelling a hyper-link as “terms and conditions” is sufficient to ensure that most consumers do not read the document. We think that all small print terms should be assessable for fairness.

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

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

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

- S.18 We now recommend that price or main subject matter terms should be exempt from review only if they are transparent and prominent. Both approaches distinguish between the terms which consumers take into account in their decision to buy the product and those which become lost in small print. The emphasis on prominence, however, offers a practical way of distinguishing between a headline price and other charges. It also emphasises that whether a term is exempt is within the control of the trader.
- S.19 We recommend that:
- (1) “Transparent” should be defined as in plain, intelligible language; readily available; and, if in writing, legible.
 - (2) The test of “prominence” should refer to the “average consumer” test, which is widely used in European consumer law. It refers to a hypothetical consumer who is “reasonably well informed, reasonably observant and circumspect”.⁷ A term would be prominent if it is presented in such a way that the average consumer would be aware of the term. The more unusual or onerous the term, the more prominent it needs to be.
- S.20 All terms of a contract should be transparent. As discussed below, if they are not, enforcement agencies should be able to challenge them. Clearly not all terms can be prominent. Simply because a term is not prominent does not make it unfair; nor does it raise a presumption that it is unfair. It could, however, be assessed for fairness.

Consultees’ views

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

Transparency and prominence would not only ensure fairness but also further promote competition. [Direct Line Group]

Prominence of the price is key to ensure that consumers know what they are getting for their money [MoneySavingExpert.com]

Traders can be expected to welcome the degree of control which they would have over the application of the exemption. [Malcolm Waters QC]

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

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

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

Excluded term or excluded assessment?

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

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

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

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

Suggested redraft

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

No assessment of fairness shall be made-

- (a) of a term which specifies the main subject matter of the contract;
or
- (b) of the amount of the price, as against the goods or services supplied in exchange,

⁸ [2011] EWHC 2946 (QB).

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

provided that the term in question is transparent and prominent.

Guidance

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

THE GREY LIST (PART 5)

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

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

- (1) permitting the trader to claim disproportionately high sums in compensation or for services which have not been supplied, where the consumer has attempted to cancel the contract;
- (2) giving the trader discretion to decide the amount of the price after the consumer has become bound by the contract;¹⁰ and
- (3) giving the trader discretion to decide the subject matter of the contract after the consumer has become bound by it.¹¹

COPY OUT AND THE FAIRNESS TEST (PART 6)

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

THE NEED FOR TRANSPARENCY (PART 6)

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

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

¹¹ See above.

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

OTHER ISSUES (PART 7)

Terms of no effect

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

End user licence agreements and notices

- S.36 Many end user licence agreements do not have the status of contract terms, yet they often contain exclusion clauses. The clauses are usually unenforceable but may still have a damaging effect by discouraging consumers from claiming their rights. As the UTCCR only apply to contract terms, enforcement bodies cannot take action against clauses which do not have contractual status.
- S.37 By contrast, UCTA protects consumers against exclusion clauses, whether they are contract terms or mere notices. We recommend that the new legislation should cover notices which exclude a trader's liability to a consumer. Where they are unfair, enforcement bodies would have powers to bring actions against them.

Terms which reflect existing law

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

Negotiated terms

- S.39 UCTA applies to all consumer contracts, whether or not they are negotiated. By contrast, negotiated terms are exempt under the UTCCR, though negotiated terms are defined narrowly.
- S.40 We recommend that the new legislation should follow UCTA and apply to negotiated terms. This will affect very few cases. As Which? point out, in practice the vast majority of negotiated terms fall within the exemption for main subject matter or price. Where terms about other issues are genuinely negotiated, they are unlikely to be found unfair. On the other hand, the current exemption for negotiated terms in the UTCCR encourages unnecessary argument and litigation. The legislation will be simpler and more easily enforced if the distinction between standard terms and negotiated terms is removed.

The burden of showing that a term is fair

- S.41 The CJEU recognises that few consumers have the legal expertise to prove that a term is unfair. It has therefore stressed that national courts must consider the fairness of terms on their own motion. We recommend that the new legislation should reflect this case law explicitly, so that the courts are aware of their duty.
- S.42 We do not think that it is necessary to make any other statements about the burden of proof. In practice, issues about the burden of proof are unlike to arise.

Definition of a consumer

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

Remaining role of UCTA

- S.44 The new provisions on unfair terms would only affect contracts made between businesses and consumers. UCTA is wider. It applies to contracts made between businesses, between businesses and consumers, employment contracts and even, to some extent, “private contracts” where neither party is a business.
- S.45 We have considered the effect of a reformed UCTA on employment and private contracts as well as businesses dealing as consumers. We think that all references to “dealing as a consumer” should be removed from UCTA. We also invite BIS to consider whether an opportunity can be found to consolidate the law on private sale contracts.

March 2013

PART 1

INTRODUCTION

BACKGROUND

- 1.1 Consumers enter into multiple standard form contracts each year, as a routine part of daily life. Consumer contracts are particularly significant where goods or services are delivered over time. Examples are utilities, mobile phones, financial services and gyms.
- 1.2 Consumers rarely read contracts thoroughly before purchase. Instead, they focus on headline elements such as price.¹ They lack the time to plough their way through small print, and even if they do read it, there is often little they can do to change it. The trader will not agree to remove the term, and the consumer is likely to find that other suppliers' terms are similar.
- 1.3 Parliament stepped in to protect contracting parties against unfair surprises in contracts, by passing the Unfair Contract Terms Act (UCTA) in 1977. UCTA covers a wide range of contracts (including those between businesses) but focuses on exclusion clauses. In 1993, UCTA was supplemented by a European Directive, the Unfair Terms Directive (UTD), which provided additional protection for consumers.² The UTD is currently implemented through the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).³
- 1.4 Unfair terms legislation continues to be important to consumers. In the current economic climate, where the popularity of price comparison websites is rising, there is pressure on traders to compete on low headline prices, whilst earning their profits through hidden terms. Hidden terms make it difficult to compare traders' deals as consumers do not know at the outset what the true price is.

THE LAW COMMISSIONS' 2005 REPORT

- 1.5 In 2001, the Law Commission and Scottish Law Commission were asked to review the law of unfair terms. In 2002, we published a Consultation Paper which explained the problems caused by the existence of two separate legal regimes:

The two regimes have different scopes of application; to some extent they overlap; and they have different effects. In addition, they use different concepts and terminology. The resulting complexities and inconsistency have been severely criticised.⁴

¹ OFT1312 (February 2011): *Consumer Contracts Market Study*, available at http://www.offt.gov.uk/shared_offt/market-studies/consumercontracts/oft1312.pdf, p 17.

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

³ SI 1999 No 2083.

⁴ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, Executive Summary, para S.8.

- 1.6 In 2005 we published our final Report together with a draft Bill.⁵ The Bill covered all unfair terms protections – for businesses as well as consumers – and sought to bring all unfair terms legislation together in one place. It recommended a harmonised regime, by (for example) removing differences in the fairness test between UCTA and the UTCCR. The Report was accepted in principle by the Government but not implemented at the time.

UPDATING THE 2005 REPORT

- 1.7 In May 2012, the Department for Business, Innovation and Skills (BIS) asked us to review and update our 2005 Report with respect to consumer contracts. BIS were consulting on a package of measures to clarify consumer law, to be introduced by both primary and secondary legislation. This provided an opportunity to clarify the law on unfair terms as it affects consumers.
- 1.8 BIS also asked us to consider one particularly controversial area: namely the exemption set out in Regulation 6(2) of the UTCCR, which provides that terms cannot be assessed for fairness if they relate to the “main subject matter of the contract” or “the adequacy of the price or remuneration as against the goods or services supplied in exchange”. Regulation 6(2) essentially copies out the Directive. It reflects the words of article 4(2) of the UTD, which was something of a last minute compromise added into the Directive at a late stage in the negotiations.
- 1.9 The exemption for main subject matter and price has proved particularly difficult to interpret. It has generated complex litigation, particularly over bank charges, culminating in the 2009 Supreme Court decision in *Office of Fair Trading v Abbey National plc*.⁶

OUR TERMS OF REFERENCE

- 1.10 In May 2012, Norman Lamb MP, Parliamentary Under-Secretary of State for Employment Relations, Consumer and Postal Affairs asked the Law Commission and Scottish Law Commission:
- (1) to review and update the recommendations made by the two Law Commissions in their 2005 Report on Unfair Terms in Contracts in so far as they affect contracts made between businesses and consumers;
 - (2) in particular to examine article 4(2) of the UTD 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;

⁵ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199.

⁶ [2009] UKSC 6, [2010] 1 AC 696.

- (b) the desirability of a single consumer regime to incorporate both the UTCCR and UCTA, without reducing the existing level of consumer protection; and
- (c) the need for clarity.

1.11 This project operates under several constraints. The UTD is “a minimum harmonisation measure”, which means that Member States may give consumers more protection than the Directive specifies, but they may not give consumers less. Any proposal for reform must not “undercut” the UTD. Furthermore, in combining the UTCCR and UCTA into a single regime we have been asked to “round up” rather than “round down”. That said, we do not wish to gold plate the Directive to the extent that it imposes significant costs on traders.

THE 2012 ISSUES PAPER

1.12 In July 2012 we published an Issues Paper which set out the law in detail and asked for views on reform.⁷ We covered two main issues:

- (1) The exemption for main subject matter and price, as set out in article 4(2) of the UTD and Regulation 6(2) of the UTCCR.
- (2) Combining the two separate unfair terms regimes (UCTA and the UTCCR) affecting consumers.

1.13 We concluded that the exemption for subject matter and price was unacceptably uncertain. We thought that price and main subject matter terms should be excluded from review, but only if they are transparent and prominent. We also listed the main recommendations we made in our 2005 Report and asked whether any updating was required.

RESPONSES TO THE ISSUES PAPER

1.14 We received 58 written responses. We also met a range of consumer groups, business groups and regulators during the consultation period.

1.15 Table 1 shows the categories of those who submitted responses. Most of these consultees were not individuals, but organisations representing many stakeholders. For example, the British Retail Consortium represents retailers across the UK; the Building Societies Association represents all 47 UK building societies; the British Bankers’ Association represents High Street banks; and Which? represents over one million members.

⁷ Unfair Terms in Consumer Contracts: a new approach? (July 2012), A Joint Issues Paper by the Law Commission and the Scottish Law Commission.

Table 1: Respondents to the Issues Paper by category

Type of respondent	Number of responses
Academics	12
Individual businesses and trade bodies	20
Consumer organisations	3
Members of the judiciary and the legal profession	11
Members of the public	2
Public bodies	10
Total	58

1.16 We would like to thank all those who have devoted their time and resources in submitting written responses and meeting with us to discuss their views. We understand that the consultation came at an extremely busy time, when BIS was consulting on other changes to consumer law. We are grateful for the high level of interest shown in this subject. Respondents are listed in Appendices A and B to this Paper.

UNFAIR TERMS LAW: A BRIEF OVERVIEW

1.17 Here we provide a short summary of unfair terms legislation. For further details, readers are referred to the Issues Paper.⁸

The Unfair Contract Terms Act 1977

1.18 UCTA applies to a broad range of contracts, but a narrow range of terms. It is not just a consumer measure but also includes contracts between two businesses, employment contracts and even, to a limited extent, “private” contracts where neither party is a business. There are, however, some important exemptions from UCTA, including insurance contracts and land contracts.⁹

⁸ Issues Paper, Part 2. See also Part 5 for recent cases on the exemption.

⁹ See Sch 1, para 1(a) and 1(b) for England, Wales and Northern Ireland. For Scotland, see s 15(3)(a)(i) and s 15(2)(e).

- 1.19 The Act focuses on exclusion clauses. It covers terms or notices which purport to exclude or restrict liability for: causing death or personal injury;¹⁰ other loss or damage caused by breach of a duty of care;¹¹ breaches of certain terms implied by law;¹² and breach of contract generally.¹³ UCTA 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.
- 1.20 UCTA renders some terms of no effect. For example, a term in a consumer contract is automatically void if it purports to exclude the trader's liability for causing death or personal injury. Other terms are only effective if they are fair and reasonable. For example, if a term purports to entitle the trader to render a contractual performance which is substantially different from that which the consumer reasonably expected, it is valid only if it is fair and reasonable.¹⁴

The Unfair Terms in Consumer Contracts Regulations 1999

- 1.21 The UTCCR stay close to the words of the UTD, effectively copying it out. The courts must interpret the Regulations in the light of the wording and purpose of the UTD.¹⁵
- 1.22 The Regulations only apply to consumer contracts, but they apply to all consumer contracts. There are no exemptions for insurance or land contracts. Furthermore, the UTCCR apply to all non-negotiated terms, unless the term is specifically exempt. Unlike UCTA, the UTCCR may be enforced by public bodies as well as individual consumers. They permit the Office of Fair Trading and a list of 11 "qualifying bodies" to go to court to prevent unfair terms from being used.
- 1.23 The UTCCR subject consumer contracts to two requirements: they should be written in "plain, intelligible language";¹⁶ and they should be "fair".¹⁷ We look at each below.

Plain, intelligible language

- 1.24 The "plain, intelligible language" concept applies in three ways:
- (1) If the meaning of a term is in doubt a court will follow the interpretation most favourable to the consumer.¹⁸

¹⁰ Defined in s 14 (England, Wales and Northern Ireland) and s 25(1) (Scotland).

¹¹ For Scotland, s 16 refers to "breach of duty". For the rest of the UK, s 2 refers to "negligence".

¹² 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.

¹³ See s 3 (England, Wales and Northern Ireland) and s 17 (Scotland).

¹⁴ See s 11 (England, Wales and Northern Ireland) and s 24 (Scotland) and Sch 2 for the reasonableness test.

¹⁵ Case 14/83 *Von Colson and Kavann v Land Nordrhein-Westfalen* [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].

¹⁶ UTD, art 5; UTCCR, Reg 7(1).

¹⁷ UTD, arts 3 and 6; UTCCR, Regs 5 and 8.

- (2) Enforcement bodies may exercise powers to remove terms which are not in plain, intelligible language.¹⁹
- (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”.

Exemptions

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

- (1) negotiated terms;
- (2) terms that reflect the existing law;
- (3) the main subject matter or price.

1.26 Regulation 5(1) of the UTCCR sets out the basic test of unfairness, using the words of the Directive:²⁰

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.

1.27 This must be judged at the time the contract was concluded, looking at “all the circumstances attending the conclusion of the contract”.²¹

The “grey list”

1.28 In Schedule 2, the UTCCR contain an “indicative and non-exhaustive” list of terms which may be regarded as unfair. This is copied from the UTD.²² It covers 17 commonly encountered terms, including penalty clauses and price escalation clauses. The Schedule also includes a list of exceptions to the grey list, mainly for financial services contracts.

1.29 The grey list is not definitive. A term may be fair even if it is on the grey list, and it may be unfair even if it is not. In practice, however, the grey list has been an important guide to understanding the purpose of the Directive. As we discuss in Part 5, we do not think that a term which is on the grey list can also be exempt from review under Regulation 6(2).

¹⁸ UTD art 5; UTCCR, Reg 7(2).

¹⁹ For further discussion, see paras 6.47 to 6.64.

²⁰ UTD, article 3(1).

²¹ UTCCR, Reg 6(1). This follows the wording of UTD, art 4(1).

²² UTCCR, Reg 5(5), Sch 2, para 1.

THE STRUCTURE OF THIS ADVICE

- 1.30 In line with our terms of reference, this paper seeks to advise BIS on how best to implement the exemption for main subject matter and price, as set out in article 4(2) of the UTD. It also updates the recommendations we made in our 2005 Report on Unfair Terms in Contracts, in so far as they affect contracts made between businesses and consumers.
- 1.31 This document is divided into seven further parts:
- (1) **Parts 2 to 4** deal with the exemption for main subject matter and price:
 - (a) **Part 2** examines the need for reform.
 - (b) **Part 3** outlines a new approach to defining the exemption for main subject matter and price, so that a term would only be exempt if it was transparent and prominent.
 - (c) **Part 4** looks in more detail at how “transparent”, “prominent” and “price” would be defined. It also recommends guidance on the meaning of transparent and prominent.
 - (2) **Part 5** looks at the grey list. We propose to clarify that a term on the grey list may be assessed for fairness, whether or not the term would otherwise fall within the exemption. We also recommend limited additions to the list to cover early termination clauses and discretionary terms.
 - (3) **Part 6** considers copy out, the fairness test and the effect of including terms which are not transparent.
 - (4) **Part 7** considers other changes to unfair terms legislation.
 - (5) **Part 8** lists our recommendations.
- 1.32 There are also three Appendices:
- (1) **Appendix A** is an alphabetical list of the consultees who responded to our Issues Paper.
 - (2) **Appendix B** lists the respondents by category.
 - (3) **Appendix C** contains the Unfair Terms Directive.

PART 2

THE EXEMPTION: THE NEED FOR REFORM

THE EXEMPTION

- 2.1 The exemption for main subject matter and price is currently set out in Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), which states:

In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-

- (1) to the definition of the main subject matter of the contract, or
- (2) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

- 2.2 This reflects the exclusion set out in article 4(2) of the Unfair Terms Directive (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.

- 2.3 Article 4(2) was inserted into the text at a late stage in the negotiations. Originally, the European Commission had sought to subject every term in a consumer contract to a standard of fairness, whether or not it was individually negotiated.¹ However, two influential German academics, Professors Brandner and Ulmer, argued that in a free market, “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”:

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.²

- 2.4 The exemption has generated considerable litigation. In the Issues Paper we concluded that its scope was fundamentally uncertain and proposed that the exemption should be rewritten.

¹ See M 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.

² E Brandner and P 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.

THE BANK CHARGES LITIGATION

- 2.5 The scope of the exemption came to prominence during the bank charges litigation, culminating in the 2009 Supreme Court decision, *Office of Fair Trading v Abbey National plc*.³
- 2.6 This was a test case brought by the Office of Fair Trading (OFT) against seven banks and one building society. The issue before the court was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms within the meaning of Regulation 6(2). The High Court and Court of Appeal found that the terms were not exempt, because they were not part of the essential bargain between the parties, and a typical consumer would not recognise the charges as part of the price. Conversely, the Supreme Court rejected the idea that price terms could be divided into those which formed the essential bargain and those which were ancillary. It said that the price should be determined “objectively”, rather than from the viewpoint of a typical consumer. The overdraft charges, therefore, fell within the exemption and could not be assessed for fairness.

WHAT THE ISSUES PAPER SAID ABOUT THE NEED FOR REFORM

Uncertainty in the law

- 2.7 In the Issues Paper, we reviewed the law in some detail, taking account of the purpose of the Directive, UK litigation, decisions of the Court of Justice of the European Union (CJEU) and the approach of other Member States.⁴
- 2.8 We concluded that the Supreme Court decision can be interpreted in several ways, and the courts could use it to justify a variety of approaches:
- (1) Some judicial statements in the case say that price terms in plain, intelligible language are exempt from review – and suggest that any term requiring the consumer to pay money may constitute the price if it forms part of the trader’s revenue stream.
 - (2) Other statements suggest that not all payments constitute the “price or remuneration” of goods or services supplied in exchange. In particular, terms on the grey list, including default payments and price escalation charges are not exempt from review.
 - (3) Some statements say that even price terms can be challenged as unfair, provided the challenge is on grounds which do not relate to the appropriateness of their amount.
- 2.9 These various statements are not easy to reconcile, which allows for differing interpretations of the decision. This can be seen in subsequent decisions and in the various ways the case has been interpreted by enforcement bodies and business groups.

³ [2009] UKSC 6, [2010] 1 AC 696.

⁴ For a full legal review, see Parts 4 to 7 of the Issues Paper.

- 2.10 Furthermore, academics have suggested that the Supreme Court decision may be overturned by the CJEU. The exemption has been approached differently in other Member States. For example, the German Federal Supreme Court (*Bundesgerichtshof*) has consistently assessed ancillary bank charges for fairness.⁵ We commented that this may be “a background factor influencing the approach of the CJEU in a future case”.⁶
- 2.11 The Supreme Court itself, aware of the significance and controversy of the decision, explicitly invited Parliament to legislate on the issue. Lord Walker, for example, stated: “Ministers and Parliament may wish to consider the matter further”.⁷

Problems in practice

- 2.12 Our preliminary discussions with stakeholders revealed a concern about the complexity of the law.⁸ This was said to cause real problems in practice. The law requires significant legal expertise to navigate, and even then the outcome is unpredictable. This disadvantages smaller traders and individual consumers who do not have access to sophisticated legal resources and do not want to take the risk of litigation.
- 2.13 We thought that larger traders may also suffer from the current uncertainty. The CJEU may take a narrower approach to interpreting the exemption than the Supreme Court. If this were to happen, traders who have built their business model on a wide interpretation of exempt terms may be faced with expensive litigation and not be able to enforce terms in their contracts.
- 2.14 Consumer groups told us that the bank charges case has rendered the law so unclear that it is difficult to advise consumers. Furthermore, it was suggested that enforcement bodies have to dedicate significant legal resources to interpret the law. Consequently, some Trading Standards Services and consumer advisers have become wary of using the UTCCR, which could undermine consumer protection.

CONSULTEES' VIEWS

- 2.15 In the Issues Paper, we asked whether consultees agreed that the current law on which terms should be exempt from the assessment of fairness under the Unfair Terms Directive is unduly uncertain and should be reformed.⁹ We also welcomed evidence of the effect of the *Abbey National* decision on the respondent's organisation, business or consumer experience.¹⁰

⁵ See Issues Paper, paras 7.56 to 7.86.

⁶ Issues Paper, para 7.61.

⁷ [2009] UKSC 6, [2010] 1 AC 696 at [52] by Lord Walker.

⁸ For example, between January to May 2012, we met with Which?, the Financial Services Authority, the OFT, Citizens Advice, Ofcom and the British Bankers' Association. We also had discussions with the Institute of Consumer Affairs and trading standards officers.

⁹ Issues Paper, para 8.14.

¹⁰ Issues Paper, para 8.15.

- 2.16 The responses showed strong support for reform. As we discuss below, most organisations supported reform. They thought that the law was extremely uncertain, and that this led to problems in practice.

Is the law unduly uncertain?

- 2.17 A large majority of respondents agreed that the law was unduly uncertain. Support came from different categories of respondents. All consumer groups agreed with the need for reform, as did the majority of businesses and business groups, public bodies, judges and lawyers.

- 2.18 Most respondents commented on the uncertainty emanating from the Supreme Court judgment in *Abbey National*. They thought that this caused problems for traders, regulators and consumers alike. The Direct Marketing Association put the issue succinctly:

The effect of case law, in particular the Supreme Court decision in *Abbey National*, has led to different views as to which terms could be subject to an unfairness test.

- 2.19 The Association of Her Majesty's District Judges expressed a similar view:

The decision in Office of Fair Trading and *Abbey National* litigation has not brought certainty. The Court of Appeal and Supreme Court interpreted price in two very different ways, indicating that different views exist as to interpretation, and even if there is now binding authority from the Supreme Court that still has to be applied to different situations, Europe may eventually have an input as well.

- 2.20 The Bar Council submitted that the vastly different approaches taken by the courts in *Abbey National* make it "difficult to predict with any confidence what view will be taken as to the scope of the exemption".

- 2.21 Which? confirmed that it fully supported our review on the basis that "it is virtually impossible for a consumer to apply the rules confidently", due to the complexity of the arguments in the bank charges case. Which? went on to point out that courts have subsequently struggled to apply the judgment, and the Supreme Court itself indicated that the law on the exemption should be reviewed.

- 2.22 MoneySavingExpert.com argued that following the Supreme Court judgment the law is unsatisfactory:

We are currently in the No Man's Land of fairness. Clarity is important and it is the one thing we don't have right now... The subsequent result from the Supreme Court means the law did not provide the desire for certainty that all parties need, as it can continue to be interpreted in several ways.

- 2.23 Deborah Parry pointed out that the lack of clarity has a negative impact on enforcement:

The current position is not clear which is unsatisfactory for both businesses and consumers. Advisers and enforcers cannot easily assess what the current position is which weakens the effectiveness of the Regulations.

- 2.24 Only a few consultees thought that the law on the exemption was sufficiently certain. For example, HSBC was in the small minority of those who thought that the Supreme Court judgment had clarified the law:

The UTCCR framework is broadly clear and has been tested through case law, in particular, the *OFT v Abbey National plc* Supreme Court 2009 decision. This has provided clarity to consumers and firms about which terms can be assessed for fairness. The Supreme Court's decision was clear that, in relation to price terms, 'any monetary price or remuneration payable under the contract would naturally fall within the language' of Regulation 6(2)(b).

Should the UTCCR be reformed?

- 2.25 Again, respondents strongly supported reform of the UTCCR. There was a broad spread of support across businesses, business groups, consumer groups, and the judiciary. Agreement was on the ground that there was a need to provide greater clarity and certainty. Only two respondents disagreed, on the basis that the UTCCR are already "fit for purpose" and offered sufficient consumer protection; there was also a concern that the cost of compliance might outweigh any benefit.

- 2.26 Reflecting the majority view, Ofcom wrote:

We agree that the UTCCRs would benefit from reform. Simplifying and clarifying the law should provide greater certainty for both businesses and consumers, help to ensure that consumers are adequately protected and empowered, and benefit fair dealing businesses.

- 2.27 By contrast, the Financial Services Authority (FSA) queried whether reform would be beneficial, given that care would be needed to ensure that any amendments provided an equivalent level of protection. The Law Society, while agreeing with reform, also expressed caution:

Any reform has to be undertaken carefully, in order to make sure the original provisions of the Directive are given effect and EU law is not breached. The existence of the latter will risk time consuming litigation in the CJEU.

The effect of the Supreme Court decision in *Abbey National*

- 2.28 Predictably, banks tended to view the Supreme Court decision in a positive light. By contrast, consumer groups and representatives pointed to the negative impact of the decision. Public bodies tended to confirm that the decision has caused enforcers to take a more cautious approach, which has led to under-enforcement. The judiciary and lawyers thought that the decision has increased the complexity of the law.

The effect on businesses

- 2.29 On behalf of the banks, the British Bankers' Association (BBA) responded that the Supreme Court decision has provided "confirmation for our members (and the public) that unarranged overdraft charges are an important part of current account services and the amount of those charges is not assessable for fairness when expressed in plain, intelligible language".
- 2.30 In addition, the BBA and HSBC thought that the decision had generated a helpful debate, stimulating positive changes in the financial services market, as the banks have worked with the OFT to raise consumers' awareness and understanding of current account charges.

The effect on consumers and enforcement agencies

- 2.31 The Trading Standards Institute (TSI) submitted that the complexity of the issues involved, and the costs of litigation have led to ancillary and contingent charges not being challenged. It responded that from an "enforcement viewpoint, any law that is so complex and could lead to such great delays through judicial interpretation does not meet a fitness for purpose test for consumer protection legislation".
- 2.32 TSI added that the judgment was "unhelpful but has also highlighted a significant area of consumer concern and the unsuitability of present law to adequately deal with it".
- 2.33 The OFT concurred, concluding that the judgment has made it more difficult to provide clear guidance to traders, and it has had a "chilling effect on enforcement of the UTCCR":

We consider that the Supreme Court Judgment was narrow in scope, which should limit its precedent effect. However, the limits to its implications were not clearly indicated...

- 2.34 The Civil Aviation Authority commented that:

The Supreme Court decision has led us to be very cautious in our assessment of unfair terms and whether enforcement action would be possible in some cases. We have received requests from enforcement bodies in other Member States asking us to take action on terms that they considered unfair. However, we have been concerned that in the UK the legal precedent would not support us taking action... We are aware that some other European enforcement bodies take a different and more interventionist approach based on the approach set out in their national law.

- 2.35 Ofcom pointed out that its enforcement action demonstrates that there is "misunderstanding and confusion in the law" among traders. The FSA said that the UTCCR may not be the most appropriate tool for dealing with unfair charges in financial services: instead it could use its rule-making power to address problems.

The effect on the legal profession

- 2.36 The Bar Council considered that in terms of “the impact on the provision of proper legal advice, the *Abbey National* decision has complicated the position”.
- 2.37 Similarly, Tods Murray LLP commented:

We are aware that many law firms were, prior to *OFT v Abbey National plc*, and still are unwilling to express a definitive view on whether a particular contractual term would be assessable for fairness under the UTCCR or whether such a term, if assessable, would be held to be unfair.

CONCLUSION

- 2.38 There is widespread agreement that the scope of the exemption in Regulation 6(2) is uncertain. We think that all parties suffer through this uncertainty. It increases legal costs for all concerned. It also discourages regulators from bringing action against any terms relating to price.
- 2.39 There are particular problems where traders use hidden price terms, which undermine the competitiveness of the market. It is too easy for traders to gain market share by offering low headline prices, and then adding hidden extras. This causes detriment to consumers and disadvantages honest traders who are upfront about their charges.
- 2.40 The current state of the law also poses risks for traders using hidden price terms. We can understand why HSBC has formed the view that, following the Supreme Court's decision, “any monetary price or remuneration payable under the contract” would naturally fall within the exemption. We think, however, that the words of the Supreme Court may be lulling businesses into a false sense of security. As we explored in the Issues Paper, there are several other interpretations of the judgment – and it is quite possible that the judgment may be overturned by the CJEU. In particular, the CJEU may be influenced by the very different interpretation taken by the German Federal Supreme Court.¹¹
- 2.41 A business would be ill-advised to build its business model on the basis that plainly expressed price terms are automatically exempt, no matter how hidden they might be. If a business does use a hidden price term to subsidise a low headline price, the business is put at risk if the term is later found to be unfair. It faces the substantial costs of litigation; the reputational damage to its business; and the cost of repaying consumers for up to six years in England and Wales and five years in Scotland.¹² The amount could be substantial. In the bank charges litigation, the banks had raised £2.56 billion from unauthorised overdraft charges in 2006 alone.

¹¹ See Issues Paper, paras 7.56 to 7.86.

¹² These are the lengths of the limitation period (England and Wales) and prescriptive period (Scotland) respectively.

- 2.42 We have reached the conclusion that the exemption for main subject matter and price set out in Regulation 6(2) of the UTCCR should be reformed. We have been encouraged by the overwhelming support for reform from stakeholders. We have received consistent feedback throughout this project that those involved in this area of law welcome this review, and agree that there is a need for clarification and simplification, for the benefit of traders and consumers alike.
- 2.43 **Recommendation 1: The exemption for main subject matter and price set out in Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 should be reformed.**

PART 3

THE EXEMPTION: A NEW APPROACH BASED ON TRANSPARENCY AND PROMINENCE

- 3.1 In the Issues Paper we proposed that price and main subject matter terms should only be exempt if they were transparent and prominent. By transparent we meant that a term must be in plain, intelligible language; legible and readily available. By prominent we meant that the term was presented in such a way that a reasonably circumspect consumer would be aware of it.
- 3.2 In this Part we consider our overall policy approach. We analyse the responses on this issue, looking first at what consultees said about the exemption for price and then at what they said about the exemption for main subject matter. We found a good level of support for confining the exemption to terms which are transparent and prominent, and we recommend that the legislation is rewritten along these lines.
- 3.3 We then discuss whether the exemption should cover all aspects of a term (the excluded term construction) or should only relate to the way in which the term is assessed (the excluded assessment construction). Contrary to the view taken in the Issues Paper, we have concluded that the price term exemption should not relate to the whole term, but only to one aspect of a price term - namely the amount. In order to implement the Unfair Terms Directive (UTD) fully, it is necessary to state that it is only the assessment of the amount which is excluded.
- 3.4 By contrast, we think that the exemption for main subject matter should include all aspects of the main subject matter, provided that the term is transparent and prominent.
- 3.5 In Part 4, we look in more detail at the definition of “transparent”, “prominent” and “price”, and recommend statutory guidance.
- 3.6 In Part 5, we consider the grey list. We think that all grey list terms should be assessable for fairness and recommend some additions to the list.

THE ISSUES PAPER PROPOSALS

Is the exemption needed at all?

- 3.7 The UTD is a minimum harmonisation measure, which means that the United Kingdom may provide more protection to consumers than is required by the Directive, but may not provide less protection.
- 3.8 One possibility would be to omit the exemption altogether and make all terms of consumer contracts reviewable for fairness. In 2000, the European Commission observed that many countries had not introduced the exemption, including Denmark, Greece, Finland, Portugal and Spain. The Commission commented that:

The courts of these Member States have not taken it upon themselves to revise prices or to meddle with the main subject matter of contracts in a massive or indiscriminate way, as has been feared by the proponents of certain doctrines and in certain professional circles.¹

- 3.9 Despite this experience, however, we accepted the principle put forward by Professors Brandner and Ulmer that the relationship between the price and the goods or services should be determined by “the mechanisms of the market” rather than the courts.² We thought that businesses needed the reassurance that if a term was subject to competition, it would not need to be justified before a court. We therefore proposed that the exemption should be retained, but rewritten.

The problems of small print

- 3.10 In view of the uncertainty surrounding the way the exemption is currently drafted, the Issues Paper looked again at the purpose underlying the Directive.
- 3.11 We argued that one rationale of the exemption is to distinguish between terms which are subject to competition and those which are buried in “small print”. Where consumers know about the terms proffered by traders, they are able to take them into account in their choices: in other words, the traders’ terms are subject to competition. If the information is available, the law should not seek to protect consumers from the consequences of their own decisions.
- 3.12 By contrast, consumers rarely read “small print”. “Small print” is a concept instantly understood by consumers in their daily lives, though it is difficult to pin down in legal terms. It is not just about font size. It is also marked by poor layout, many and densely phrased paragraphs, legal jargon, and inadequate signposting around the text. Often simply labelling a hyperlink as “terms and conditions” is sufficient to ensure that most consumers do not read the document.

Transparency and prominence

- 3.13 Our 2005 draft Bill included a clause to state that the price exemption did not include payments which would be “incidental or ancillary to the main purpose of the contract”. In *Abbey National*,³ the Supreme Court rejected this approach, on the ground that in many contracts it was impossible to distinguish between main and ancillary charges. Some business groups also considered these words to be too uncertain.

¹ Report from the Commission on the implementation of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, COM(2000) 248 final, p 15.

² E Brandner and P 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. See also para 2.3 above.

³ [2009] UKSC 6, [2010] 1 AC 696.

- 3.14 In the Issues Paper we responded to these concerns by shifting the focus from whether a term is incidental or ancillary to whether a term is *transparent and prominent*. We argued that if a term is transparent and prominent, it will be subject to competitive pressures, and should not be assessed for fairness.
- 3.15 By “transparent” we meant that the term should be in plain, intelligible language; legible and readily available to the consumer. By “prominent” we meant that the term should be presented in such a way that a “reasonably well informed, reasonably observant and circumspect” consumer would be aware of it.
- 3.16 We explained that a test which focused on whether a term is transparent and prominent would often produce much the same effect as a test which focused on whether it is ancillary or incidental. Both approaches seek to distinguish between terms which consumers take into account in their decision to buy the product and those which become lost in small print. The emphasis on prominence, however, offers a practical way of distinguishing between a headline price and 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.
- 3.17 We thought that all terms in a consumer contract should be transparent. In a lengthy contract, not all terms can be prominent, but terms which an observant and circumspect consumer is unlikely to read should not contain unfair surprises. They should therefore be reviewable for fairness. By contrast, where a trader ensures that a price or main subject matter term is sufficiently transparent and prominent, we thought that the term should be exempt from review. The trader should not have to justify the fairness of the term to a regulator or court.

PRICE TERMS: TRANSPARENCY AND PROMINENCE

- 3.18 In the Issues Paper, we asked whether consultees agreed that a price term should be excluded from review, but only if it is transparent and prominent.⁴ More than half of the respondents who answered this question agreed. Support came from all categories of consultees: businesses and business groups; consumer groups; public bodies; academics; and the judiciary and lawyers.
- 3.19 Only two consultees disagreed with the proposed concepts of transparency and prominence in their entirety and wished to preserve the current position. These were HSBC and the British Vehicle Rental and Leasing Association (BVRLA).
- 3.20 That said, several businesses and business groups had concerns about how the tests would work in practice, and thought that they would need to be clarified (for example, British Bankers’ Association (BBA), Lloyds Banking Group, Finance & Leasing Association (FLA), Sky, Mobile Broadband Group and Three). The Association of British Insurers (ABI) accepted that exempt terms should be transparent but not that they should be prominent.

⁴ Issues Paper, para 8.67(1).

- 3.21 By contrast, several regulators and consumer groups thought that the exemption should be narrower. They thought it should take into account other factors, such as whether the term was actually subject to competitive pressures. It was suggested that remote contingent charges should not be exempt even if they were made prominent in the documentation.
- 3.22 Two respondents (Office of Fair Trading (OFT) and Professor MacLeod) thought that the exemption should be removed altogether.

Agreement

- 3.23 Those that supported our proposal did so because they thought it would help consumers to make informed choices and promote competition.
- 3.24 For example, Direct Line Group wrote that transparency and prominence would “draw the consumer’s/customer’s attention more towards the cost of service/goods for the duration of the contract rather than just the ‘headline’ cost.” It added that “transparency and prominence would not only ensure fairness but also further promote competition”.
- 3.25 The Direct Marketing Association (DMA) agreed, commenting that the proposal “fits in with the Unfair Terms Directive”. It added that if a term is transparent and prominent, then “a consumer can not argue that the price is unfair as the law is not there to protect them from a bad bargain”.
- 3.26 The Law Society thought it “vital that price terms are transparent and prominent”, and continued:

We believe that it is unfair for consumers not to be presented with a price that is transparent and prominent.

Transparency and openness is important for a well functioning system of contract law. This is particularly true in relation to consumer contracts given their fixed and non-negotiable nature.

- 3.27 MoneySavingExpert.com thought that “prominence of the price is key to ensure consumers know what they are getting for their money”.
- 3.28 Malcolm Waters QC noted that “traders can be expected to welcome the degree of control which they would have over the application of the exemption”.

Disagreement

- 3.29 HSBC and the BVRLA disagreed with our proposal in its entirety. They submitted that it would be problematic in practice, leading to increased uncertainty. Referring to the proposed prominence test, HSBC argued strongly:

We believe that this will ultimately overturn key tenets of the 2009 Supreme Court judgement by forcing firms to decide which price terms form part of the “essential bargain” of a contract in order to qualify under the exemption, when the Supreme Court made clear that there was no distinction to be made between whether a price term is “essential” or “ancillary” under the UTD.

3.30 HSBC went on to conclude that consumers would ultimately have less choice:

The overall effect of the uncertainty created by this change will be a restriction of innovation and therefore consumer choice. If it is unclear to firms whether their price terms will be covered by the exemption, they will inevitably focus their efforts on providing products in the limited number of formats that will be guaranteed to meet the 'prominent' requirement of the exemption.

3.31 The BVRLA responded that the words "transparent" and "prominent" were too subjective, and that traders would find it difficult to ensure that all their pricing terms were prominent.

Business groups' concerns

3.32 Some businesses and business groups had concerns about the practical application of the tests, and requested additional clarification and guidance with regard to the prominence and transparency requirements. For example, the Building Societies Association agreed with the proposal but noted that:

there is often regulatory pressure to include an increasingly large amount of text and additional material, such as health warnings, in 'prominent' positions.

3.33 On behalf of the banks, the BBA wrote:

The BBA believes that further thought needs to be given to how "transparent" and "prominent" should be defined in order to meet the intention of the Unfair Terms Directive and to provide additional clarity, rather than ambiguity, to the current legislation. If such clarity and suitability can be applied to these terms then limiting exclusion of price terms at point of sale from review on this basis could be appropriate.

3.34 The BBA and other business groups also pointed out that consideration ought to be given to the question of how requirements for transparency and prominence will fit with existing financial services regulations covering the provision of contractual information at the point of sale. Lloyds Banking Group endorsed the BBA's view and emphasised that any reform should work "effectively with the high level of regulation" that already exists.

3.35 Sky also sought further clarification:

Sky has some concerns around the practical implications of the Law Commission's proposals that contract provisions must be 'transparent' and 'prominent' in order to fall within the exemption...

Although the most popular call charges may be brought prominently to the customer's attention, it would be unpractical in any sales process to bring all the possible call charges to the customer's attention as the document setting these out runs to several pages and includes details of many call charges which customers may never make, e.g. charges for calls to certain international countries.

- 3.36 The ABI could see the rationale for transparency, but thought that the prominence test was impractical and unrealistic:

We think that the requirement of “prominence” is unrealistic, and contradicts the regulatory requirements placed on firms to only provide key information to consumers to help avoid information overload and consumer disengagement... By definition, not all of the information provided to a consumer can be prominent. Instead, we believe the “readily available” test is a better one for the Law Commissions to recommend.

- 3.37 The Mobile Broadband Group (MBG) commented on the practical limitations of the prominence requirement:

Some businesses – and communications service providers (CSP) are a good example – have some practical limitations on making every aspect of their pricing “prominent” purely because of the sheer volume of information. [...]

In summary, the MBG agrees that all pricing must on all occasions be transparent but we believe, for quite practical reasons, it is not possible for pricing that forms part of the essential bargain to be prominent on all occasions.

- 3.38 The FLA warned that any ambiguity in the test would be exploited by claims management companies:

If the proposals are implemented, it is essential that they are underpinned by clear supporting guidance so that there is no room for ambiguity which could be seized upon by Claims Management Companies intent on “gaming” the system.

Concerns from regulators, consumer groups and academics

- 3.39 On the other hand, some regulators, consumer groups (for example, OFT and Which?) and academics agreed that transparency and prominence were key, but thought that our proposals should have gone further to take account of other elements of consumer behaviour.
- 3.40 The OFT responded that it “would broadly support the proposals on transparency and prominence to the extent that they are a potential improvement to the status quo”. However, it added that: “prominence and transparency alone are not always sufficient”.
- 3.41 The OFT explained that its first preference is for the removal of the exemption. Its second preference is for price terms to be exempted only “where consumers are sensitive to their consequences” to reflect an understanding of behavioural economics:

the proposed legislation needs to include a criterion or criteria reflecting a rationale derived from the Directive and informed by an understanding of behavioural economics as to why some prominent price terms fall within the “main price” exemption and others do not (including grey list terms). To overcome these difficulties, the exemption must be drafted to put beyond doubt that enforcers and the courts need to consider not only whether it is theoretically possible for consumers to assess the risk, but whether they can realistically be expected actually so to do. [...]

The ultimate aim of the enquiry is to determine whether the term is subject to market forces rather than focusing on whether the “average” or “typical” consumer was aware of the term. [...]

We suggest one way forward here (preferably in addition to a price exemption that takes into account sensitivity) would be the inclusion in the grey list of a term which would indicate in the proposed legislation that disproportionate and remote future contingent charges payable when the consumer is not in breach 'may be unfair' – and thus clarify that they are fully assessable for fairness.⁵

3.42 Which?, recognising the importance of transparency and prominence, proposed a test incorporating those concepts and behavioural economics. It proposed a test whereby a price would be exempt only if:

(i) the circumstances in which that price may be levied will definitely arise during the course of the contract; or

(ii) it is the only price that could be payable by the consumer under the contract

providing that price is one

- on which the business typically competes ie the headline/advertised/shop window price (as judged on the basis of the business' marketing strategy and commercial practices); or
- that is otherwise transparent and prominently provided in good time to consumers prior to conclusion of the contract.⁶

3.43 Citizens Advice also thought that transparency and prominence were not enough to ensure effective competition. It emphasised:

the need for additional measures to review terms on which there is not effective competition as a price term could meet the definition of transparent and prominent yet come as a surprise to consumers when it is triggered.

⁵ Reference omitted.

⁶ Emphasis in original.

- 3.44 Similarly, the Financial Services Authority (FSA) thought that transparency and prominence are insufficient to ensure fair outcomes. It was concerned that “an approach that focuses on transparency and prominence may encourage suppliers to produce a long and detailed list of every cost and charge applicable under the contract, making them as transparent and prominent as possible, with the intention of making such terms excluded from an assessment for fairness”. It noted that this might have a possible negative impact on consumers who have particular problems with assimilating information.
- 3.45 Ofcom agreed that, at the very least, price terms should only be exempt from review if they are transparent and prominent. However, Ofcom suggested that additional requirements should be necessary for the exemption to apply, as transparency and prominence alone might not be sufficient:

In entering contracts, the average consumer is likely only to have a limited number of matters at the forefront of their mind. This is so no matter how many terms are presented to them transparently and prominently. Indeed, the more terms so presented, the less transparent and prominent each becomes.

The UTCCRs are not, in any event, concerned solely with unfair surprise. They are also concerned, in order to protect consumers and fair dealing businesses alike, with unfair imbalances of power between consumers and traders that are unlikely adequately to be resolved by transparency and prominence alone. These include terms that seek to exploit inequalities between traders and consumers in matters such as knowledge, need and/or bargaining power, no matter how transparent and prominent those terms are.

Discussion: transparent and prominent price terms

- 3.46 The responses we received show a divergence of views on this issue. Some businesses argue that all price terms should be exempt from review. Meanwhile consumer groups and regulators were concerned that consumers may ignore charges which may arise on some future contingent event, even if those charges are reasonably prominent in the documentation.
- 3.47 Nevertheless, most consultees accepted that confining the price exemption to terms which were transparent and prominent represented a reasonable and practical solution to the difficulties encountered in the bank charges litigation and other cases.

The concerns of business groups

- 3.48 We accept the argument put forward by business groups that for some services it may not be possible for the trader to make all charges prominent. There is often too much information for consumers to take in, which is why we need unfair terms legislation. Businesses may well include charges which are not prominent, and which are therefore assessable for fairness. Simply because a term is not prominent does not make it unfair; nor does it even raise a presumption that it may be unfair.

- 3.49 To take the example given by Sky, a long list of call charges to international countries at the back of the contract will be fair unless there is some breach of good faith, or a significant imbalance in the parties' rights and obligations. A court is highly unlikely to intervene unless the charge is unusual or particularly onerous in a way which an average consumer would not expect. We think, however, that if a business wishes an unusual or onerous charge to be exempt from review, it should make it prominent.
- 3.50 We also acknowledge the concern that businesses should have clarity about what they need to do to bring charges to the attention of consumers. It is also important that the practicalities of making price charges prominent should fit in with other regulations, particularly for financial services. As we explore in Part 4, we recommend that guidance on transparency and prominence should be available to assist businesses. Businesses should have the reassurance of knowing that if they have complied with a regulator's guidance, the regulator will not take action against them.

Behavioural biases

- 3.51 Many regulators and consumer groups thought that the emphasis on what an average consumer knows does not take sufficient account of behavioural biases.
- 3.52 In the Issues Paper we explained that unfair terms legislation assumes that consumers are rational but too busy to read the many complex standard terms presented to them. The problem is therefore one of information asymmetry. Classic economic theory assumes that when consumers are presented with the right information in a way they can understand, they make good decisions.
- 3.53 Recent economic literature, however, suggests that consumers are only rational up to a point.⁷ Consumers approach products with several behavioural biases: they are more concerned with present costs than future costs; they do not pay attention to things that are unlikely to happen; and they are often over-confident. For example, people think that they will go to the gym more often than they do, and that they will become overdrawn less often than actually occurs.⁸ Several regulators thought that our test should draw more directly on this literature to allow all terms which are not subject to competition in fact to be assessed, even if a hypothetical "average consumer" would be aware of them.

⁷ The literature is summarised in a report for the OFT: S Huck, J Zhou and C Duke, *Consumer Behavioural Biases in Competition* (OFT1324) (May 2011). See also the discussion in Part 3 of the Issues Paper.

⁸ See Issues Paper, paras 3.27 to 3.28.

3.54 It has been pointed out that many of these behavioural biases are irrational but predictable.⁹ It is therefore possible to foresee how they will be exploited by traders. Many of the most common forms of exploitation are reflected in Schedule 2 paragraph 1 of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), which is an “indicative and non-exhaustive” list of terms which may be unfair (referred to as “the grey list”). For example:

- (1) Sub-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, this 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.
- (2) Sub-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.

3.55 The Directive therefore represents a compromise between classical and behavioural economic approaches. The exemption in article 4(2) seeks to exempt terms which consumers know about, while some paragraphs of the grey list protect consumers against common terms which are known to exploit their behavioural biases.

3.56 Our recommendations seek to preserve this compromise. In general, we think that the courts should not assess the price or main subject matter where the terms were made clear to consumers before they entered into the contract. On the other hand, the legislation is right to recognise well-known ways in which consumers’ biases can be exploited.

3.57 In Part 5 we argue that any term on the grey list does not fall within the exemption. We recommend that this should be made explicit in the legislation. We also propose some limited expansion of the grey list to cover terms known to cause particular problems, such as early termination clauses and terms granting traders unilateral discretion.

3.58 We think that the test of prominence and transparency, when coupled with the extensions to the grey list,¹⁰ will enable the courts to assess the fairness of terms which are not subject to market pressure. It will, however, provide traders with some certainty that if the term is not a grey list term, and if it is made transparent and prominent, they will not be required to justify it to a court or a regulator.

⁹ D Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (2008). For further literature on this issue see D Kahneman, *Thinking Fast and Slow* (2011); and R Thaler and C Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (2008).

¹⁰ See Part 5.

- 3.59 **Recommendation 2: The price exemption should be reformulated, to apply only to terms which are transparent and prominent.**

MAIN SUBJECT MATTER TERMS: TRANSPARENCY AND PROMINENCE

- 3.60 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”. In the Issues Paper, we explained that we proposed to replace the reasonable expectation test with one based on transparency and prominence.
- 3.61 We did not think that this was a substantive difference. A reasonable consumer’s expectations are formed by the deal that is presented – that is by prominent terms.¹¹ Business groups, however, were concerned that the 2005 test was too vague. We thought that the point would be clearer if one focuses on how the deal was presented rather than on what a reasonable consumer may have expected. Thus, we proposed that terms relating to the main subject matter of the contract should be exempt if they are transparent and prominent, rather than transparent and “reasonably expected”.
- 3.62 We asked whether consultees agreed 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.¹²

Strong support for the proposal

- 3.63 Approximately three-quarters of respondents agreed with this proposal. There was strong support from all the categories of respondents. Although respondents raised similar arguments and considerations as they did for price terms, the issue proved less controversial.
- 3.64 The Faculty of Advocates reflected the majority view:

We welcome the transparent and prominent test as a significant improvement on the “reasonable expectations” test, being as it is more robustly objective and, we would hope, more productive of certainty in its application.

- 3.65 North East Trading Standards Association argued that “if the term is prominent and transparent then the consumer will have the effective means to determine whether it is of concern” and that “negates the need for it to be the subject of potential review”.
- 3.66 The DMA concurred:

¹¹ In *Zockoll Group Ltd v Mercury Communications Ltd (No 2)* [1999] EMLR 385, p 395, 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.

¹² Issues Paper, para 8.81.

If the term is transparent and prominent then the consumer will know exactly what they are agreeing to buy and therefore the issue of unfairness becomes irrelevant.

- 3.67 The Bar Council thought that prominence was the right test, as prominent terms were subject to competition:

We have always taken the view that a business would struggle to argue that a term relates to the main subject matter of the contract unless it is at least prominent within the contractual terms. The key issue here is informed consumer choice – consumers need to know the important aspects of the goods or services they intend to purchase in order to compare them properly to competitor products. Given that the principal justification for the exclusion of such terms from the assessment of fairness is that consumers are sufficiently protected by competition in the market, we consider that transparency and prominence are the appropriate tests.

- 3.68 The Law Society considered the proposal to be “consistent with the principles of freedom of contract and party autonomy”.

- 3.69 The BBA also agreed to the proposed test in principle.

Objections to the proposal

- 3.70 The ABI, FSA and OFT were amongst the minority that disagreed with the proposal.

- 3.71 The ABI strongly objected, on the ground that the test for prominence is not practical in the insurance market. The ABI explained:

Ensuring prominence of the main subject matter of an insurance contract is difficult and not always desirable from a consumer perspective.

It added that “the test of prominence would quickly become one of ‘relative prominence’”.

- 3.72 The OFT also expressed strong objection, on the ground that the UTD cannot be understood to envisage that compliance with transparency and prominence requirements alone can transform a “collateral term” into a principal or main obligation. It concluded that only subject matter terms that are genuinely subject to “consumer sensitivity” and therefore competition should be exempt from the fairness test. The OFT emphasised that:

Under the current proposals, consumers and businesses must not be misled into understanding that just because the documentation prominently highlights terms and defines them as the main subject matter of the contract, it necessarily follows that such terms fall within Article 4(2) of the Directive and are exempt from a full review.

- 3.73 The FSA put a similar argument, stating:

We disagree with the presumption that transparency and prominence are sufficient to ensure fair outcomes.

- 3.74 Citizens Advice agreed that prominence and transparency were important, but thought that terms should be reviewed where there is a lack of competitive pressure.

Discussion

- 3.75 We are encouraged by the support shown for this proposal. In reply to the OFT, FSA and Citizens Advice, it is important to stress that not all prominent and transparent terms will be exempt from review. Transparent and prominent non-price terms will only be exempt if they also form the “main subject matter” of the contract.
- 3.76 In the Issues Paper we considered whether it would be possible to omit the word “main” from any new legislation.¹³ We noted the concern expressed by the Supreme Court in *Abbey National*,¹⁴ that it is difficult to divide the subject matter of a contract into “main” and “incidental” terms. We also expressed the view that prominent terms will usually be main terms.
- 3.77 We concluded, however, that it is important to retain the concept of “main subject matter”. If we were to omit the word “main”, the UK may be in breach of its minimum harmonisation requirements. Former Advocate General Trstenjak has characterised the “price” and “main subject matter” as factual circumstances which fall to a national court to decide.¹⁵ UK courts must be given the power to look at the facts and make a decision on this issue. Thus to fall within this exemption a term must pass three tests. The court must ask - Is it the main subject matter? Is it transparent? Is it prominent? We think that this goes a long way to meet the concerns of regulators and consumer groups.
- 3.78 We accept the ABI’s argument that not all terms in an insurance contract can be prominent. The problem, however, is that non-prominent terms are not subject to competitive pressures and should therefore be subject to a fairness assessment.
- 3.79 **Recommendation 3: The main subject matter exemption should be reformulated to apply only to terms which are transparent and prominent.**

PRICE TERMS: EXCLUDED TERM OR EXCLUDED ASSESSMENT?

The Issues Paper proposal

- 3.80 In the Issues Paper our proposal focused on the nature of the term. We thought that a price term should be excluded from the fairness review if it was transparent and prominent.

¹³ Issues Paper, paras 8.75 to 8.78.

¹⁴ [2009] UKSC 6, [2010] 1 AC 696.

¹⁵ Opinion of Advocate General Trstenjak, Case C-484/08 [2010] ECR I-04785 at [70].

- 3.81 The words of the Directive are slightly different. They do not refer to the nature of the term, but to the nature of the assessment. Article 4(2) states that an “assessment of the unfair nature of the terms” shall not relate 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”.
- 3.82 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.
- 3.83 A similar approach has been taken in European case law. In *Caja de Ahorros*,¹⁶ the Advocate General explained that “it is only the assessment of the terms that is limited”, not the term itself. 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”.¹⁷
- 3.84 Furthermore, the European Commission report on the implementation of the UTD appears to suggest that the excluded assessment approach is the correct approach:
- Terms concerning the price do indeed fall within the remit of the Directive, since the exclusion concerns the adequacy of the price and remuneration as against the services or goods supplied in exchange and nothing else. The terms laying down the manner of calculation and the procedures for altering the price remain entirely subject to the Directive.¹⁸
- 3.85 If one takes an excluded assessment approach, it is open to a court to consider aspects of a price term which do not relate to the adequacy of the price. The court would be entitled to consider the fairness of other aspects, such as timing of payment, method of payment or the procedures for altering the price. In *Foxtons v O’Reardon*,¹⁹ for example, the court applied the excluded assessment approach to state that a commission payable to Foxtons under a sole agency agreement could be challenged on the basis of its timing, but not the amount. In this case the commission payable to the real estate agent became payable on exchange of contracts for sale rather than on completion of the transaction.²⁰
- 3.86 In the Issues Paper we favoured the excluded term approach. We thought that it was simpler. We pointed out that it could be difficult to distinguish between the amount of the price and other aspects of a price term, and artificial to look at some aspects of price without considering the amount.

¹⁶ 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.

¹⁷ Opinion of Advocate General Trstenjak Case C-484/08 [2010] ECR I-04785 at [65].

¹⁸ Report from the Commission on the implementation of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, COM(2000) 248 final, p 15.

¹⁹ [2011] EWHC 2946 (QB).

²⁰ The court did not consider this to be unfair and in any event it decided that the term was exempt as a result of the operation of the first limb of the exemption (Regulation 6(2)(a)).

- 3.87 We noted, however, that there was an argument that the excluded term approach was not compatible with European law. As we have seen, the UTD is a minimum harmonisation measure. Member States may give more protection to consumers, but they may not give less. Applied literally, the Directive appears to say that the court must be entitled to assess any aspect of the term apart from “the adequacy of the price or remuneration, as against the services or goods supplied in exchange”. If this is the right way to read the Directive, then it is not open to Member States to widen the exemption to all aspects of a price term, even if the term is transparent or prominent.
- 3.88 We therefore asked consultees whether, in order to implement the Unfair Terms Directive fully, it was 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”.²¹

Consultation responses

- 3.89 The responses to this difficult question were evenly split. Generally, consumer organisations and public bodies favoured the excluded assessment approach, while businesses favoured the excluded term approach. Members of the judiciary, legal profession and academics were divided.

Support for the excluded term approach

- 3.90 Those supporting the excluded term approach agreed that it was simpler. For example, the Bar Council said:

We prefer the simplicity of the proposed approach, i.e. that price terms are not assessable for fairness at all, rather than the current "excluded analysis" approach. The latter tends in our view to involve rather complex mental gymnastics, and the potential unfairness of other aspects of terms which relate to price is properly addressed by the proposed requirements as to transparency and prominence.

- 3.91 The DMA also favoured simplicity:

Although it is arguable that you can separate the adequacy of the price from other aspects of the price, this is a highly academic view and if adopted would complicate the test as set out. This would confuse both traders and consumers as they would not see the very narrow distinction between adequacy and other aspects affecting price.

- 3.92 Professor Simon Whittaker also favoured the excluded term approach, but admitted that the question of correct implementation is not free from doubt.

- 3.93 The BBA did not agree that transparent and prominent price terms may be assessed for matters other than the adequacy of the price. It said that it would oppose such a proposal.

²¹ Issues Paper, para 8.69.

Support for the excluded assessment approach

- 3.94 Several respondents highlighted the risk that any approach which excluded the whole term might fail to implement the Directive properly. For example, Professor Christian Twigg-Flesner wrote:

I am not persuaded that the blanket exclusion of price terms is the best way forward... This might create a wider exemption than permitted by the Unfair Contract Terms Directive. This is a minimum harmonisation measure, but an exclusion from the unfairness test under national law which is broader than that envisaged in the Directive would mean that national law would fall below the minimum level of consumer protection required.

- 3.95 Professor Hugh Collins concurred, commenting: “As long as the question is not ‘Did the consumer pay too much?’, other questions of fairness may occasionally arise”. Similar views were expressed by Royal Institution of Chartered Surveyors and the Association of Her Majesty’s District Judges.

- 3.96 Malcolm Waters QC pointed out that in the *Abbey National* litigation, the banks accepted the excluded assessment approach.

By the time the *Abbey National* case reached the Supreme Court, the banks had accepted that the “excluded assessment approach” was correct; that is to say, they had accepted that, if regulation 6(2)(b) applied to the terms imposing the charges, the effect would not be to render the terms absolutely exempt from any fairness assessment, but merely to exclude any challenge to their fairness based on the “adequacy” of the charges.

- 3.97 He went on to highlight the risk of under-implementation:

The Issues Paper accordingly recommends that a term which qualifies for the exemption should be wholly excluded from any assessment for fairness. There is considerable practical merit in this proposal. However, the Commissions’ support for the “excluded terms approach” involves a departure from the more literal meaning of article 4(2). As the Commissions recognise, this creates a risk that the ECJ might regard the reformulated exemption as going further than is permitted under article 4(2), so making it incompatible with the Directive.

- 3.98 The OFT also favoured the “excluded assessment” approach describing it as “necessary”.

Discussion

The need to ensure minimum harmonisation

- 3.99 Our terms of reference specifically require us to ensure that the UK meets its minimum harmonisation obligations. The UK may narrow the price exemption, but is not entitled to expand it.

- 3.100 After considering the responses carefully, we have been persuaded that in order to implement the Directive fully, it is necessary to take the excluded assessment approach to price. Thus the new legislation should use a simplified version of the words of article 4(2) by stating that if a price term is transparent and prominent, the court may not assess the amount of the price as against the services or goods supplied in exchange.
- 3.101 In practice, we do not think that this will make much difference to the decisions which courts reach. If a price term is transparent and prominent, a court would be unlikely to find that any aspect of the term is unfair.
- 3.102 Furthermore, many transparent and prominent price terms will form the main subject matter of the contract. As we discuss below, the excluded assessment approach does not apply to the exclusion for main subject matter. We recommend that all transparent and prominent terms which form the main subject matter should be excluded from review; and price terms may also be the main subject matter. For example, in a monthly phone contract, the obligation to pay monthly may be excluded from review – not because the assessment relates to the amount of the price, but because the obligation forms the main subject matter of the contract.²²
- 3.103 We understand the concerns of some business groups that the excluded assessment approach is less clear cut than the excluded term approach. We would point out, however, that in the *Abbey National* litigation the banks accepted that this was the correct interpretation of the Directive. The alternative excluded term approach carries a risk that UK legislation may be found to be incompatible with European law, which introduces its own uncertainty.

“Adequacy” or “amount”?

- 3.104 It seems odd that the Directive should refer to the “adequacy” of the price. In most consumer contracts, the consumer pays the price – and in these circumstances, no consumer would argue that the price is too low (or “inadequate”). A consumer’s objection will usually be that the price is too high. As the late Lord Rodger of Earlsferry noted in *Director General of Fair Trading v First National Bank*, the language used is “somewhat strange”.²³ The Supreme Court referred to “the appropriateness” of the price.²⁴
- 3.105 We have considered different language versions of the Directive to gain a better understanding of what is meant by “adequacy”.

²² See also *Foxtons v O’Reardon* [2011] EWHC 2946 (QB) discussed at para 3.85 for another example of a price term which was deemed to form the main subject matter of a contract and was thus exempted from assessment of fairness.

²³ [2001] UKHL 52, [2002] 1 AC 481 at [64].

²⁴ Above.

- 3.106 Analysis revealed that most versions follow the English version and use an equivalent of the word adequacy. However, there are some exceptions. For example, both the Polish and Swedish versions use the word “relationship” (“*relacja*” and “*förhållandet*” respectively). The Danish version phrases it as “correlation” between price and goods or between services and payment for them (“*overensstemmelsen mellem pris og varer eller mellem tjenesteydelser og betalingen herfor*”).
- 3.107 The use of these different formulations shows that there is no particular importance to the word “adequacy”. We think that it is simpler to refer instead to “the amount” of the price.
- 3.108 We discuss the definition of “price” in Part 4 and conclude that price means a monetary obligation. It must therefore be quantifiable. We do not think the reference to “remuneration” adds anything in this context and we recommend that it is removed.²⁵
- 3.109 **Recommendation 4. Provided that a price term is transparent and prominent, the court may not assess the amount of the price as against the services or goods supplied in exchange.**

THE MAIN SUBJECT MATTER: AN EXCLUDED TERM CONSTRUCTION

- 3.110 As currently drafted, Regulation 6(2) of the UTCCR states that the assessment of fairness of a term shall not relate to “the definition” of the main subject matter of the contract. This follows the words of article 4(2) of the UTD, which states that “assessment of the unfair nature of the terms” shall not relate to “the definition of the main subject matter of the contract”.
- 3.111 There are two ways of interpreting this provision. The first is to apply an excluded term construction. In other words, any transparent and prominent term which specifies the main subject matter of the contract is wholly excluded from review. The court may not assess the fairness of any aspect of such a term.
- 3.112 The other approach would be to treat main subject matter terms in the same way as price terms and to apply an excluded assessment construction. On this basis, the court could look at any aspect of the main subject matter except the way that it had been defined. For example, in a contract for gym membership, the court could consider the fairness of any aspect of the main subject matter, except the way that “gym” or “membership” had been defined.

²⁵ Paras 4.49 to 4.66.

- 3.113 We have concluded that, unlike the exemption for price, the exemption for main subject matter applies to the whole term – not just to the way the term has been defined. We say this for two reasons. First, on the policy level, it makes little sense to separate the fairness of the definition from the fairness of other aspects of the main subject matter. In the Issues Paper we thought that this distinction was particularly confusing. It encouraged the courts to assess main subject matter terms on the ground that the unfair aspect did not relate to “the definition of the term” but to some other unfair feature.²⁶ An excluded assessment approach appears to undermine the purpose of the exemption, as consumers will know more about the overall nature of the subject matter than about the details of how terms have been defined.
- 3.114 Secondly, we do not think that the inclusion of the word “definition” in article 4(2) should be accorded any particular weight. To explore this issue further, we analysed the words of the Directive in 18 different languages. This analysis strongly suggests that the reference to “definition” is not a key aspect of the Directive. The German version of the Directive omits the word “definition” altogether. Other language versions contain a word that comes closer to being synonymous with “description” or “determination” rather than “definition”. Examples are “*beskrivningen*” and “*bepaling*” in Swedish and Dutch respectively.
- 3.115 The original proposal for the Consumer Rights Directive, which covered unfair terms, also omitted a reference to “definition” when dealing with the exemption for the main subject matter of the contract. It appears that the word “definition” was simply considered unimportant, rather than there being a substantive policy reason for this change. This provides further support for the argument that the word “definition” is not a key aspect of the exemption. The exemption for main subject matter relates to all aspects of main subject matter terms, not just the way that those terms have been defined.
- 3.116 We have concluded that the UTD deals with main subject matter and price terms in different ways. Whereas the exclusion relating to price only applies to the adequacy or amount of the price, the exclusion for main subject matter applies to all aspects of the main subject matter.
- 3.117 We think that the reference to “definition” within Regulation 6(2)(a) is confusing. If taken literally, it seems to suggest that a court can assess main subject matter terms for aspects of fairness that do not relate to their definitional qualities. We think this method of interpreting the Directive is mistaken. The word definition in this context merely refers to a term which describes or determines the main subject matter. We recommend following the German language version of the Directive, by omitting the word “definition” altogether.
- 3.118 We appreciate, however, that an exemption for any terms *which relate* to the main subject matter of the contract could be interpreted very widely. Despite the fact that this phrase is used in the UTD, we think that it would be better to express it as terms which “specify” or “embody” the main subject matter of the contract.

²⁶ See in particular the discussion of *OFT v Ashbourne Management Services* [2011] EWHC 1237 (Ch), at paras 5.74 to 5.83 of the Issues Paper.

- 3.119 **Recommendation 5. The exemption for main subject matter should apply to any term which specifies the main subject matter, and not simply to the way that the main subject matter has been defined.**

CONCLUSION

- 3.120 As presently drafted, Regulation 6(2) states:

In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-

- (1) to the definition of the main subject matter of the contract, or
- (2) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

- 3.121 Although the wording will be a matter for Parliamentary Counsel, we recommend that the exemption should be redrafted along the following lines:

No assessment of fairness shall be made-

- (1) of a term which specifies the main subject matter of the contract;
or
- (2) of the amount of the price, as against the goods or services supplied in exchange,

provided that the term in question is transparent and prominent.

- 3.122 In the next Part (Part 4), we define “transparent”, “prominent” and “price”, and recommend guidance on the meaning of “transparent” and “prominent”.

- 3.123 Schedule 2 of the UTCCR lists various terms which may be unfair, often referred to as “the grey list”. Part 5 discusses the grey list. We recommend that all grey list terms should be assessable for fairness: that is, they would not fall within the Regulation 6(2) exemption. We also recommend some extensions to the list.

- 3.124 The flowchart below (figure 1) explains how the exemption will operate under our recommendations.

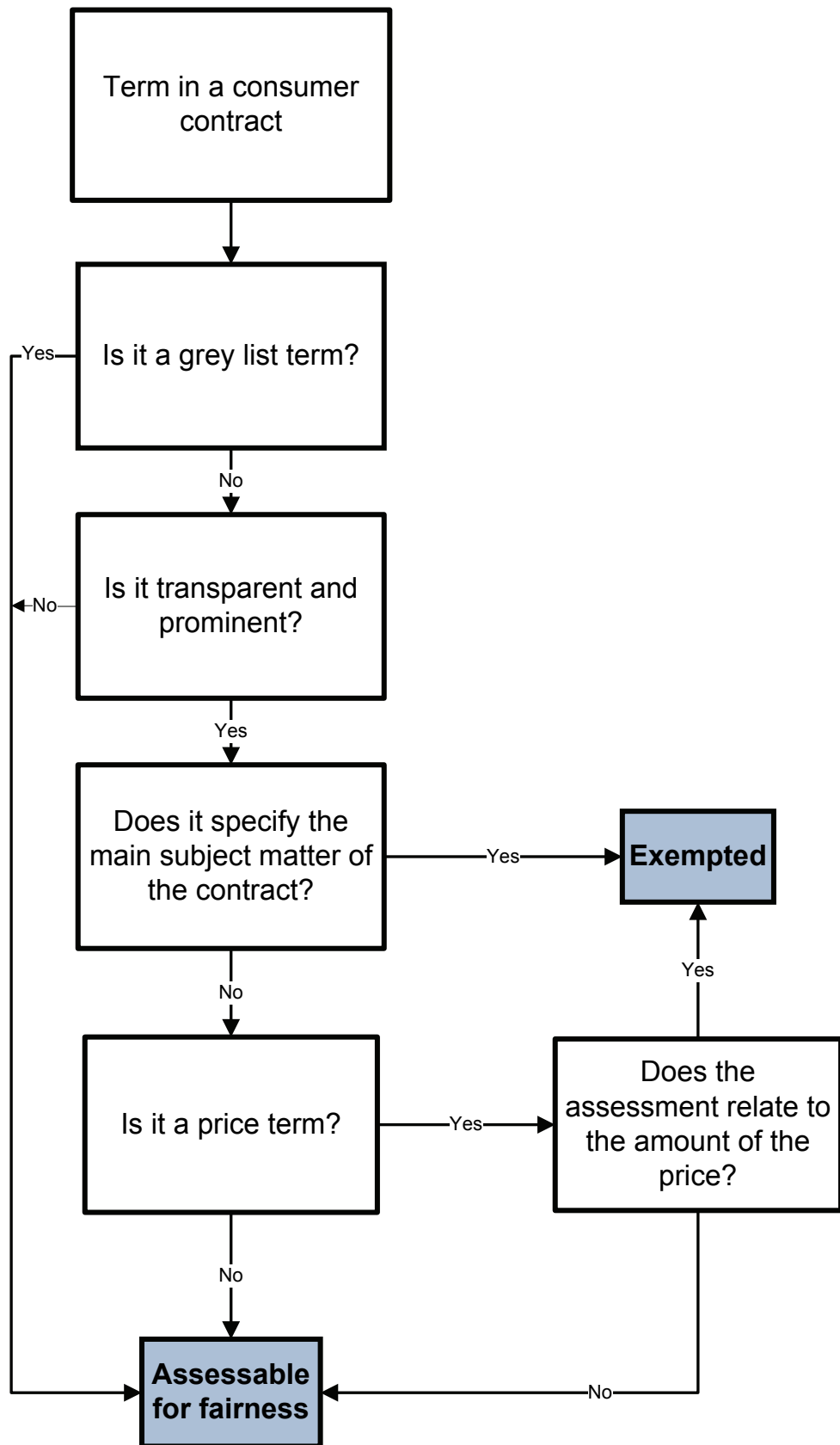


Figure 1: The operation of the exemption under our recommendations.

PART 4

DEFINING “TRANSPARENT”, “PROMINENT” AND “PRICE”

- 4.1 In this Part we look in more detail at the definition of “transparent”, “prominent” and “price”. Finally, we consider the role of guidance.

THE DEFINITION OF “TRANSPARENT”

The Issues Paper proposal

- 4.2 The Unfair Terms Directive (UTD) requires that where written terms are offered to the consumer, “these terms must always be drafted in plain, intelligible language”.¹ Recital 20 explains this and goes slightly further by stating that “the consumer should actually be given an opportunity to examine all the terms”.
- 4.3 In 2005 we thought that Recital 20 would only be satisfied if the term was legible and readily available to the consumer.² An early example of a case where terms were not available is *Thompson v LM&S Railway*.³ There 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 where terms were in writing, they should be available free of charge at the point of sale. Therefore, clause 14(3) of the 2005 draft Bill spelt out that terms should also be legible, presented clearly and readily available to the consumer.
- 4.4 In the Issues Paper we argued that all written terms of a consumer contract should be transparent. We said that this must mean more than that the language would be intelligible if the words were reproduced in another document. The term must also be legible and readily available.
- 4.5 Given that this transparency requirement applies to all terms, even unimportant terms, we kept it simple. We asked whether consultees agreed that *transparent* should be defined as:
- (1) in plain, intelligible language;
 - (2) legible; and
 - (3) readily available to the consumer.⁴

¹ Art 5.

² Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, Appendix A, Explanatory notes, para 13.

³ [1930] 1 KB 41.

⁴ Issues Paper, para 8.67(3).

Support for our proposed transparency definition

4.6 Almost three-quarters of the respondents agreed with the proposed definition of transparent. Strong support for the proposal came from the Association of Her Majesty's District Judges, which commented: "This must be the case as anything less than that defeats the object as consumers would simply never consider the terms". Also in agreement, the Faculty of Advocates stated that these "features appear to us to be the essential component elements of transparency in this context".

4.7 Malcolm Waters QC concluded that the definition was sufficiently clear:

There may be room for argument in individual cases about whether a term satisfies the Law Commissions' proposed tests of transparency and prominence; but the tests are conceptually clear and would have the advantage of being readily applicable to both limbs of the exemption.

4.8 The Bar Council and the Law Society agreed with the proposal, but suggested that consideration ought to be given to requiring the term to be "easily legible."

4.9 The Law Society concluded: "The proposed definition of transparent appears to be neutral and universal and is thus likely to be insulated from the danger of becoming outdated through technological and other developments."

Disagreement

4.10 HSBC was among the small number that strongly objected to the proposal, arguing that "more clarity is required to define what 'legible' and 'readily available to the consumer' mean in practice". It gave an example:

in a situation where a consumer has purchased a product over the phone, it is not clear if it would be considered "readily available" to provide the full Terms and Conditions of the product in an email after the phone conversation has finished. We would welcome further clarity on this.

Concerns

4.11 The Finance & Leasing Association (FLA) and the British Bankers' Association (BBA) were concerned that our proposals might "gold plate" the Unfair Terms Directive, by imposing further regulation in the financial services industry which might conflict with existing rules. As the BBA put it:

The UTCCR currently mirrors the Unfair Terms Directive in excluding price terms from review only if they are expressed in *plain intelligible language*. The Law Commission proposes to add two further provisos to what constitutes transparency and this may raise the potential of gold-plating of the relevant Directive requirement.⁵

⁵ Emphasis in original.

- 4.12 The FLA said that it was not opposed to “the intention underlying the proposed definition of ‘transparent’”. However, “the additional elements of the definition could have the effect of generating petty wrangling from those that would seek to exploit the legislation”.

“Legible”

- 4.13 The FLA was concerned that terms would have to be “legible”:

In our view, legibility is a subjective issue. The meaning of it in this context and in relation to this legislation would need to be carefully defined to prevent spurious complaints from Claims Management Companies about the size of the printed text of the agreement or the colour of the ink used.

“Readily available”

- 4.14 The BBA thought that the concept of legibility was uncontroversial. It did, however, raise concerns about the “readily available” requirement, and suggested alternative terms which exist under current regulations:

Although the BBA agrees that price terms should be readily available to a consumer we do have concerns about “transparency” being defined to include that the term is “readily available”. The term “readily available” is not used widely in existing financial services regulation and particularly not with regard to the provision of information to consumers. Alternative, suitable terms are however used, for instance within the Payment Services Regulations and the FSA BCOBS rules, referring to “making information available” and “providing information”. We would therefore question whether a new term “readily available” helps to clarify the regulations or serves to create an additional uncertainty.

- 4.15 Sky expressed concerns about the practical effect of requiring price terms to be readily available:

particularly where a customer is purchasing a “package” or “bundle” of services, or is purchasing a primary service but may at a later date add other services which are priced separately but which also form part of the same contracts, or where prices change regularly.

Discussion

- 4.16 We have considered the definition of “transparent” in detail following the consultation responses.
- 4.17 We do not think that our definition “gold plates” the Directive. The articles of the Directive must be interpreted in line with the recitals, and Recital 20 is clear that “the consumer should actually be given an opportunity to examine all the terms”. We think that this principle is already part of the Directive and should appear on the face of the legislation.

Legibility

- 4.18 We accept that the requirement of legibility can only apply if the term is in writing. We think this should be specified in the legislation.
- 4.19 We note the suggestion from the Bar Council and the Law Society that the requirement should be changed to “easily legible”. The FLA pointed out, however, that legibility is subjective: it expressed concern that too high a test could be exploited by claims management companies. We wish to keep this requirement simple, and think that it would be sufficient to state that if a term is in writing it must be legible. By this we mean legible to most consumers of the product.

Readily available

- 4.20 We have been asked to explain the concept of “readily available”. We think that it is implicit within the Directive that terms should be available to consumers before they become bound by the contract. Furthermore, the terms should be provided free of charge, without requiring the consumer to travel or to incur other costs: hence the reference to “readily available” rather than just “available”.
- 4.21 It is, however, a relatively low test. The intention is that consumers should have the opportunity to examine the terms – not necessarily that most consumers will examine them. The issue of how far an average consumer would actually be aware of the term goes to “prominence” rather than “availability”, which we consider below.

The fit with FSA rules

- 4.22 The BBA asked how the requirement for terms to be “readily available” ties in with Financial Services Authority requirements. It drew our attention to the requirement in BCOBS 4.1.1 that a bank must make available appropriate information to retail customers:
- (1) in good time;
 - (2) in an appropriate medium;
 - (3) in easily understandable language and in a clear and comprehensible form.⁶
- 4.23 This is a very similar concept to “transparent”. If the information met this test, we think that it would also meet our test of transparency. The guidance in BCOBS 4.1.2 is, however, more detailed. It specifies, for example, that the terms and conditions must be on paper or in another durable medium. Our test is less prescriptive: it would be possible for a purely oral price term to meet our test if the consumer was told about it before becoming bound. Given that unfair terms legislation applies to all consumer contracts across the board, we would not wish to be as prescriptive as the FSA rules.

⁶ BCOBS stands for “Banking: Conduct of Business sourcebook” and is part of the Financial Services Authority rule book.

Telephone contracts

4.24 HSBC asked whether terms would be considered “readily available” if a consumer purchased a product over the phone, and was then sent the full Terms and Conditions in an email after the phone conversation has finished. We think this must depend on what was said during the phone call, and when the consumer became bound by the contract.⁷ We have identified four scenarios:

- (1) *The consumer is told about the term during the phone conversation.* In this case, the term is available to the consumer as they have been told about it. If the term is in plain intelligible language and sufficiently prominent, it would be exempt from review.
- (2) *The consumer is not told about the term during the phone call, but may cancel the order after receiving the email.* In this case, we think that the terms are available to the consumer before they are bound by the contract. The term meets the criterion of availability. Whether the term is prominent is a different question.
- (3) *The consumer is told that the sale is “subject to our standard terms and conditions” but becomes bound by the terms without having an opportunity to examine them.* In this case, the terms might be incorporated within the contract by strict application of contract law, but they must be fair. It would be incompatible with the Directive to state that such terms were exempt from review, given the explicit statement in Recital 20 that the consumer must be given an opportunity to examine all the terms.
- (4) *No mention is made of the terms during the phone call. The consumer is bound by the contract before receiving the email and has no opportunity to cancel or withdraw thereafter.* In this case, it is highly doubtful that the terms and conditions are part of the contract at all. A court may well find that the terms have no effect as they have not been incorporated into the contract.

Conclusion

4.25 We have reached the conclusion that price terms should only be exempt from review if they are transparent. By this we mean that they must be in plain, intelligible language, legible (if in writing) and readily available.

4.26 **Recommendation 6. To be “transparent” a term must be**

- (1) in plain, intelligible language;**
- (2) readily available to the consumer;**

⁷ The Consumer Protection (Distance Selling) Regulations 2000 (SI 2000 No 2334) might also be of relevance here. Regs 11 and 12 give the consumers a period of seven working days to cancel a contract (or three months plus seven working days where the supplier has not complied with the information requirements in Reg 8). This will be extended to 14 days once the Consumer Rights Directive (Directive 2011/83/EU) is transposed into UK law.

(3) and, if in writing, it must be legible.

THE DEFINITION OF “PROMINENT”

The Issues Paper proposal

- 4.27 In the Issues Paper we argued that a term should only be exempt from review if it is prominent. By this we meant 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.
- 4.28 European law relies on the concept of “the average consumer”. This hypothetical person is “reasonably well informed, reasonably observant and circumspect”,⁸ but their “level of attention is likely to vary according to the category of goods and services in question”.⁹ In the Issues Paper, we asked whether it would be helpful to adopt this test. We suggested that a term should be considered prominent if it was presented in a way that the average consumer would be aware of the term.¹⁰
- 4.29 We said 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. In a general challenge, the court would 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 document, though this may also be important.
- 4.30 In the Issues Paper we commented that 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. The leading case is *Interfoto*,¹¹ which approved an earlier statement from Lord Denning that some clauses “would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient” to bind the other party.¹² The question before the court in that case was whether a term was sufficiently brought to the defendants’ attention to make it part of the contract. The wider principle at stake, however, is the same – whether the term is fairly brought to the other party’s attention.

⁸ 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.

⁹ 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].

¹⁰ Issues Paper, para 8.68(1).

¹¹ *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433, [1988] 2 WLR 615. It was applied in Scotland in *Montgomery Litho Ltd v Maxwell* 2000 SC 56.

¹² The quote comes from *J. Spurling v Bradshaw* [1956] 1 WLR 461 at p 466.

Support for our proposed definition of “prominent”

4.31 Almost two-thirds of respondents agreed that a term should be considered prominent if it was presented in a way that the average consumer would be aware of the term. All categories of respondents were well represented.

4.32 Reflecting the majority view, the Judges of the Court of Session considered this to be “a familiar and suitable objective test, and a fairly robust standard”. Similarly, the North East Trading Standards Association noted:

The “average consumer” test is a default in much EU related legislation. If the changes are meant to make the regulations both more transparent and also simpler to enforce central to this should be that they mirror other legislation within the same context.

4.33 Deborah Parry considered that the “‘average consumer test’ may sometimes be slightly more ‘generous’ to businesses than a reasonable person test, but this ... is an acceptable price of standardisation”.

4.34 The Association of Her Majesty’s District Judges concurred, concluding “if the consumer then does not consider it further they have no basis for any subsequent challenge”.

Concerns about the proposed definition of “prominent”

4.35 Most of those who opposed the test were worried about the concept rather than the definition we had used. As we have seen, some business groups such as the ABI thought that it was unrealistic to make all price information prominent. By contrast, regulators and consumer groups thought that prominence may not be sufficient to ensure consumers took note of the term.

4.36 That said, some business groups agreed with the principle of prominence, but expressed concern about how it would operate in practice. The BBA agreed that “prominence” is beneficial in exploring fairness, but feared it has “its own complexities due to the subjective nature by which it must be assessed”. They thought that it might lead to:

a paradox whereby the more that one seeks to create prominence by emboldening and highlighting information the less prominent that information becomes in comparison to the highlighted information with which it sits.

4.37 The Nationwide Building Society also agreed with the proposal in principle, but it was concerned about the suggestion that the use of hyperlinks could prevent terms from being considered prominent:

Within our internet bank and website hyperlinks are used primarily to improve the customer experience as we find that click through terms and conditions are less frustrating for the customer than reams of text appearing every time a page is opened.

4.38 The FLA had no objections to the “average consumer” test, but still thought that the proposal failed to define the term “prominent” adequately.

- 4.39 Meanwhile the Office of Fair Trading (OFT) welcomed “recognition of the fact that the consumer’s perspective should figure in determining the scope of the exemption”. It thought, however, that the proposed definition “fails to adequately take into account whether consumers do factor the term into their decision to enter the contract”. It objected to the introduction of the “average consumer” concept to the UTCCR, arguing that unfair terms legislation should also protect “vulnerable” consumers. It commented:

in the UCT Directive the fairness test requires that “all the circumstances attending the conclusion of the contract” (Article 4(1) of the Directive) are taken into account and, more generally, the requirement of good faith supports our [the OFT’s] objection to the view that vulnerable consumers are not intended to enjoy special protection.

The OFT thought that it would be an “anomaly” for the average consumer standard “to be recognised as being applicable to just one aspect of the legislation”.

- 4.40 The OFT also expressed concern that, in some cases, consumers may fail to take account of a term even if it is reasonably prominent. As we discuss in Part 5, in discussions it gave an example from *OFT v Foxtons*,¹³ in which a consumer who planned to let their property would be required to pay a substantial commission to Foxtons if they later sold the property. The OFT thought that when terms covered remote contingencies such as this, consumers would not engage with them, even where prominent.

Discussion

- 4.41 There was a good level of support for our test of prominence. It is right that the issue of prominence should be assessed from the point of view of a consumer, but we think that the standard should be objective and reasonably high. The concept of a “reasonably well informed, observant and circumspect” consumer is well-established in European law, and we think that it can be useful in this context.
- 4.42 The legislation needs to use a general test that can be applied across all sectors. We understand businesses’ desire for more detail, but think that this is best addressed through guidance.
- 4.43 The OFT feared that the “average consumer” would spread across different tests in unfair terms litigation, so as to prevent the court from looking at all the circumstances of the case. We stress that under our recommendations the fairness test will continue to operate in the same way and “all the circumstances attending to the conclusion of the contract” will still have to be taken into account by the courts. If a consumer’s vulnerability is a relevant circumstance, then the court must take it into account.

¹³ [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

- 4.44 The average consumer standard we recommend is to be applied to the prominence test for the purposes of establishing whether or not a term can be exempt. We do not believe that this particular test should be subjective, or else it would be too difficult to apply in practice.
- 4.45 After considering the OFT's concerns, we think it would be useful to state in the legislation that the more unusual or onerous the term, the more prominent it needs to be. This clarifies that there is an element of relativity to the definition of "prominent". Some terms may need to be more prominent than others. As we have seen, this is not a novel concept; it reflects Lord Denning's "red hand rule" as endorsed in *Interfoto*.¹⁴
- 4.46 **Recommendation 7. To be "prominent" a term must be presented in such a way that the average consumer would be aware of the term. The more unusual or onerous the term, the more prominent it needs to be.**

THE RELATIONSHIP BETWEEN TRANSPARENCY AND PROMINENCE

- 4.47 There is considerable overlap between the concepts of transparency and prominence. Although transparent terms will not always be prominent, prominent terms will usually be available and legible. Even prominent terms, however, may not necessarily be in plain and intelligible language, and we need to preserve this important element of the UTD. We think that a term should only be exempt when both tests are satisfied.
- 4.48 The difference between the two concepts is that while all terms should be transparent, not all terms need to be prominent. As we explore in Part 6,¹⁵ we think that all terms in a consumer contract should be transparent. Regulators should have power to ensure that terms are rewritten in plain intelligible language or produced in a more legible and available form if they are not. Unlike the transparency requirement, however, the issue of prominence is only relevant to the exemption.

¹⁴ *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433. [1988] 2 WLR 615.

¹⁵ Paras 6.47 to 6.64.

THE DEFINITION OF “PRICE”

The Issues Paper proposal

- 4.49 In the Issues Paper we explained that in English and Scots law, price is defined as “money consideration”.¹⁶ 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.¹⁷ 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. A price term, however, must be expressed in terms of money.
- 4.50 Article 4(2) refers to “price and remuneration”. “Remuneration” has no particular legal meaning, and we doubted that it extended more widely than price.
- 4.51 We argued that the article 4(2) exemption should not apply to terms which were not expressed in money. An example of a non-money term would be the term in the Facebook t&cs which grants Facebook a worldwide licence to use any photographs which the consumer posts.¹⁸ Although in common speech this might be considered “the price” which the consumer pays for joining Facebook, we do not think that this corresponds to the legal meaning of either price or remuneration. Terms which impose non-money obligations on consumers can be particularly problematic and we did not think that they should fall within the price exemption.
- 4.52 In some cases, where the consumer is selling goods to a trader, the “price” may be paid by the trader. We thought that article 4(2) was intended to apply to money paid by the trader in these circumstances.
- 4.53 We concluded that where the consumer buys goods or services, a price term means an obligation on the consumer to pay money; and where the consumer sells or supplies goods or services, it means an obligation on the trader to pay money. We asked whether consultees agreed.¹⁹

Support for our proposed definition of “price”

- 4.54 Two-thirds of respondents agreed with our proposal. Agreement was spread broadly across the groups. As the Building Societies Association (BSA) wrote, it seemed to be “sufficiently clear to be effective in practice”. The Bar Council thought that the proposal appeared “uncontroversial”.

¹⁶ Sale of Goods Act 1979, s 2(1).

¹⁷ 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.

¹⁸ The June 2012 version of Facebook contract includes the following term: For content that is covered by intellectual property rights, like photos and videos (IP content), you specifically give us the following permission, subject to your privacy and application settings: you grant us a non-exclusive, transferable, sub-licensable, royalty-free, worldwide license to use any IP content that you post on or in connection with Facebook (IP License). This IP License ends when you delete your IP content or your account unless your content has been shared with others, and they have not deleted it. See <http://www.facebook.com/legal/terms>.

Other comments about our proposed definition of “price”

- 4.55 Some respondents pointed out that our proposal was badly worded. For example, Morton Fraser LLP was hesitant about using the word “buys” as it could be “unduly restrictive”. They pointed out that when a consumer opens a bank account, they are not “buying” a bank account. In a similar vein, the Direct Marketing Association was unsure whether the definition would cover transactions such as hire purchase or conditional sales. Deborah Parry queried how it would operate for transactions where only part of the consideration is money consideration, such as part-exchange deals, or where vouchers or coupons are used.
- 4.56 Several businesses found our proposed definition confusing and raised questions about what it meant. For example, AVIVA and the BBA queried whether the definition would include contingent charges that might become payable during the life of a contract.
- 4.57 The BSA queried whether the definition included the rate of interest payable, valuation fees, and legal expenses. Similarly Nationwide Building Society requested further guidance “about how price terms such as default or arrears charges ... would be considered in relation to this definition”.
- 4.58 Tods Murray LLP explained that there are two separate features in the definitions of price under the 1979 Sale of Goods Act and the Draft Common Frame of Reference: (i) that it is an obligation to pay money for a product or service and (ii) that the obligation is undertaken in consideration of or in exchange for the product or service. It submitted that our proposed definition did not take sufficient account of the second feature. It suggested that the proposed definition should be “amended so that only those obligations to pay money which are undertaken in consideration of or in exchange for the product or service fall within its scope”.
- 4.59 Concurring with Tods Murray LLP, Ofcom also emphasised that price should be limited to any obligation to pay in exchange for goods and services.
- 4.60 The OFT objected to the proposal on the ground that it was too wide. It thought that only “main price” was intended to fall within the exemption:

The starting point of looking at the average consumer's awareness of any monetary payment obligation fails to make any distinction between those payment terms, which the consumer typically factors into his decision to enter the contract (“main price” terms) and those payment terms he may be aware of but which are inherently likely to play no part in his decision to enter the contract.

¹⁹ Issues Paper, para 8.67(2).

The proposed definition could lead to the price exemption being interpreted as including any payment under the contract provided it is transparent and prominent. This would obviously include default payments, early termination charges and increased payments arising from unfair variation clauses on the grey list, as well as areas not specifically covered by the grey list.²⁰

Discussion

- 4.61 As we discussed earlier,²¹ our proposals do not distinguish between main price and ancillary price. In *Abbey National*,²² the Supreme Court rejected this approach, on the ground that it was often impossible to make such a distinction. Price is therefore intended to be a broad concept which includes ancillary and contingent charges. We agree with the OFT that some terms, such as early termination charges, may be particularly problematic, which is why they are dealt with by our recommendation to extend the grey list, as discussed in Part 5.
- 4.62 As we discussed in Part 3, we recommend that the price exemption would apply not to the whole term but to an assessment of the amount of the price as against the services or goods supplied in exchange. Given this approach, relatively little turns on the definition of “price” as such. We do not think that it is necessary to include our original definition within the legislation. We accept that the Issues Paper formulation was imprecise when it referred to a consumer “buying” goods or services, and we do not propose to proceed with it.
- 4.63 The only significant aspect of the definition of price is that it refers to “money consideration”. This definition is already included in section 2(1) of the Sale of Goods Act 1979, and we think that the same definition should apply to price in this context.
- 4.64 As we explained in the Issues Paper, we do not think that the reference to “remuneration” adds anything and we think it could cause confusion. It is unlikely that remuneration includes non-monetary obligations (such as terms requiring consumers to grant traders intellectual property rights). Even if such terms are included with the definition of remuneration, however, we do not think that it is right in policy terms for them to be exempted. Non-monetary obligations on the consumer which do not form the main subject matter are unlikely to be subject to competition. We therefore recommend that the word “remuneration” should be omitted from the new legislation.
- 4.65 **Recommendation 8. Price should be defined as “money consideration”, in line with the definition currently found within section 2(1) of the Sale of Goods Act 1979.**
- 4.66 **Recommendation 9. The reference to “remuneration” within article 4(2) of the Unfair Terms Directive should be omitted from the new legislation.**

²⁰ Emphasis omitted.

²¹ Paras 3.13 to 3.59.

²² [2009] UKSC 6, [2010] 1 AC 696.

NEED FOR GUIDANCE

The Issues Paper proposal

- 4.67 In the Issues Paper we asked whether the court should have regard to statutory guidance when deciding whether a term is transparent and prominent.²³
- 4.68 We noted that 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).²⁴ This does not, however, prohibit the provision of guidance by bodies such as the OFT and the Financial Conduct Authority. Nor did we suggest 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.

Consultees strongly supported guidance

- 4.69 Almost three-quarters of respondents agreed that guidance would be helpful. Businesses, business groups, consumer organisations, members of the judiciary, lawyers, and public bodies were all strongly in favour.
- 4.70 The Faculty of Advocates summarised the views of many by saying that “the key aims of clarity and certainty will be better served if such guidance is made available”.
- 4.71 Ofcom welcomed the proposal, stating: “Any steps that can be taken to help bring the legislative language to life and make it easier to understand would be welcome”.
- 4.72 The BBA agreed with the proposal, subject to the proviso that “guidance is not intentionally or inadvertently used to gold plate the Unfair Terms Directive or to make or allow retrospective application of the revised regulations”. The BBA further commented that:

there should be one set of statutory guidance for financial services. This should be produced by the FSA/FCA and should take account of all relevant existing financial services legislation and regulation. Guidance should be subject to appropriate public consultation and cost/benefit analysis before it is released and it should have a suitably long ‘shelf-life’ to give firms and consumers confidence in the standards which apply, whilst being future-proofed to apply to new practices.

- 4.73 Other business groups, such as the ABI, shared the BBA’s concern that guidance should not result in an additional layer of regulation.

²³ Issues Paper, para 8.68(2).

²⁴ Directive 2011/83/EU of 25 October 2011, OJ 2011 L 304/64. The CRD requires price terms to be clear and comprehensible (arts 5(1) and 6(1)). As the CRD is a maximum harmonisation measure (art 4), the UK is not able to impose any additional formal requirements about the way information is presented for distance or off-premises contracts (art 6). Financial services, however, are excluded from the provisions of the CRD (art 3(3)(d)).

Disagreement

4.74 The Association of Her Majesty's District Judges considered that guidance was not necessary. Paul Davies was not convinced that statutory guidance would be helpful, adding "it should be very broad, and take into account the distinct possibility that the CJEU may issue its own guidance".

4.75 HSBC objected more strongly to statutory guidance:

this would allow the enforcement authorities which produce the statutory guidance to gold-plate the Unfair Terms Directive. In our view, the courts are the proper agents to interpret the law.

Other comments

4.76 The Bar Council responded that it would prefer that terms were clearly defined in statute, rather than relying on statutory guidance. It added that if there is to be guidance, the status of such guidance needs to be made clear in the enabling provision to avoid uncertainty about the extent to which it is binding.

4.77 The OFT reserved judgement, on the basis that it required further information on, for example, the mechanism for preparing guidance and its enforceability. In principle, however, it favoured some flexibility in the legislation to avoid the need to use primary legislation to correct problems in achieving of the purposes of the Directive.

Discussion

4.78 There was strong support for guidance. We think that it would give businesses greater clarity over how to make terms transparent and prominent and how this ties with other sector-specific regulation. This will inform businesses about the regulators' approach to enforcement and provide some reassurance on the question of compliance. Guidance should not, however, prevent other parties from bringing proceedings alleging unfairness of a term.

4.79 Unfair terms legislation is one-size-fits-all. It affects a wide range of consumer contracts. That includes contracts in complex sectors, many of which are highly regulated (such as banking, insurance, utilities or telecommunications). We believe that it would be helpful for businesses operating in these sectors to have sector-specific guidance on the meaning of transparent and prominent and how these tests overlap with other legislative requirements.

4.80 Any guidance produced by regulators would not be intended to supplement the law or constrain the courts in any way, but only to assist businesses in understanding the tests in the specific context in which they operate. The guidance we recommend would not be binding on the court or amount to a code of practice leading to specific outcomes. Thus, there would be no potential for gold plating the Directive. The courts should, however, be able to have regard to guidance as opinion evidence if they consider it helpful.

4.81 **Recommendation 10: The Department for Business, Innovation and Skills should hold discussions with the Office of Fair Trading and other regulators about the mechanics of preparing guidance. Subject to these discussions, it should ensure that in deciding whether a term is transparent or prominent, the courts may have regard to guidance.**

PART 5

THE GREY LIST

INTRODUCTION

- 5.1 Article 3(3) of the Unfair Terms Directive (UTD) states that “the Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair”. The Annex is not a black list: in some circumstances the listed terms may well be fair. However, a suggestion of unfairness hangs over the listed terms. For this reason, the Annex is usually referred to as “the grey list”.
- 5.2 This Annex is reproduced word for word in Schedule 2 of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR). Paragraph 1 sets out a list of 17 terms which may be regarded as unfair, while paragraph 2 makes some exceptions to the list, mainly for financial services contracts.
- 5.3 In the Issues Paper we noted that since the bank charges litigation, the grey list had assumed greater prominence. Enforcement bodies have argued that terms on the grey list, or terms which resemble terms on the grey list must be assessable for fairness and therefore cannot fall within the exemption for price or main subject matter. Here we start by examining this argument. We agree that on a correct reading of the Directive, it appears that a grey list term cannot also be an exempt term. However, the issue is not beyond all doubt. We think it would be helpful for the new legislation to state explicitly that grey list terms are assessable for fairness, and that the exemption should be read subject to this provision.
- 5.4 Next we look at whether the Annex should be copied out from the Directive or rewritten in clearer terms. In 2005 we recommended a rewritten grey list. Following consultation, however, we have been persuaded that rewriting the grey list merely to make it clearer carries too many risks. We think that the list should be copied out from the Directive subject to only limited changes and additions.
- 5.5 The main change would be to make the terminology consistent with the terminology to be used in the new consumer legislation. In particular, the grey list refers to “a seller or supplier”. For consistency and simplicity this phrase should now be replaced by “trader”.
- 5.6 We then discuss possible additions to the grey list. We conclude that the grey list already adequately deals with price escalation charges and default charges. We recommend, however, adding new provisions to deal with early termination charges and terms which grant traders discretion over the price and subject matter.
- 5.7 Finally, we consider a specific proposal from the OFT that a new provision should be added to cover disproportionate and remote contingent charges.

SHOULD ALL GREY LIST TERMS BE ASSESSABLE FOR FAIRNESS?

- 5.8 On a literal construction of the Directive, it is possible that some terms on the grey list are also price terms within the meaning of article 4(2). At least four terms on the list relate to obligations on the consumer to pay money. These are terms which have the object or effect of:

- (1) Permitting 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;¹
 - (2) Requiring a consumer “who fails to fulfil his obligation to pay a disproportionately high sum in compensation”;²
 - (3) Permitting the trader to retain sums paid for services not yet supplied where the trader dissolves the contract;³ or
 - (4) Providing for the price of goods to be determined at the time of delivery or allowing the trader to increase the price without in both cases giving the consumer the corresponding right to cancel the contract.⁴
- 5.9 Furthermore, in some circumstances it may be possible for a listed term to form the main subject matter of the contract.
- 5.10 This raises the question of whether grey list terms may fall within the exemption and therefore be excluded from the fairness assessment. In the Issues Paper we argued that, under European law, terms on the grey list must be assessable for fairness. The Court of Justice of the European Union has already held that price escalation clauses cannot be within the exemption: in *Nemzeti*, it stated specifically that the “exclusion cannot apply to a term relating to a mechanism for amending the prices of the services provided to the customer”.⁵ We thought that the same argument applied to other grey list terms.
- 5.11 This point also appeared to be recognised in *Abbey National*.⁶ Here, 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.
- 5.12 We asked two questions on this issue: first whether consultees agreed that the price exemption should not apply to terms on the grey list;⁷ and then whether consultees agreed that a term on the grey list does not relate to the main subject matter of the contract.⁸ Below we consider the responses to each question in turn.

¹ UTCCR, Sch 2, para 1(d).

² UTCCR, Sch 2, para 1(e).

³ UTCCR, Sch 2, para 1(f).

⁴ UTCCR, Sch 2, para 1(l).

⁵ Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012) at [23].

⁶ [2009] UKSC 6, [2010] 1 AC 696.

⁷ Issues Paper, para 8.67(4).

⁸ Issues Paper, para 8.82.

The price exemption should not apply to grey list terms

- 5.13 Nearly two-thirds of respondents agreed that the price exemption should not apply to terms on the grey list. All categories of respondents were well represented within that group. Generally, they thought that the proposal would provide greater clarity.

Support for the proposal

- 5.14 Which? strongly agreed that the exemption from review should not apply to grey list terms:

Which? agrees that the price exemption should not apply to the terms set out in the grey list and believe a clear statement to this effect should be included in the new legislation. To find otherwise would seem to undermine the purpose of the UTCCRs and particularly the legislative process that clearly intended the grey list clauses to be assessable. We recommend that such a statement should be by reference to the grey list as a whole, rather than listing individual terms. It should also be made clear that, just because a certain price term does not appear in the grey list, it does not mean that term falls within the price exemption.

- 5.15 The Association of British Insurers (ABI) also thought that “it would be helpful for there to be clarity on this matter”.

Disagreement

- 5.16 The Office of Fair Trading (OFT) thought that the clarification we proposed was unnecessary, and could have an unduly limiting effect:

There is a problem with explicitly stating that any grey list terms are excluded from the effect of the price or main subject matter exemption. This could be taken to mean that only terms, which precisely correspond with terms in the grey list fall outside the exemption. However, given the explicitly illustrative and non exhaustive nature of the grey list this cannot be the case. [...]

In any event, we think that such clarification is unnecessary, particularly if further terms are added to the list. It is obviously right and well-recognised judicially - expressly by the Supreme Court - that terms on the grey list are assessable for fairness.⁹

- 5.17 By contrast, the Finance & Leasing Association (FLA) denied that grey list terms could be assessed for fairness:

We do not agree that a blanket exclusion from the exemption should apply to the grey list. We do not consider that this is in line with the aims of the Directive and, in our view, appears to be in conflict with the Supreme Court’s decision in the Abbey National case.

⁹ Reference omitted.

The subject matter exemption should not apply to grey list terms

5.18 In the Issues Paper we asked whether consultees agree that a term does not relate to the main subject matter of the contract if it is included in the grey list.¹⁰

5.19 Consultees strongly agreed with the effect and purpose of this proposal - that a term should be assessable for fairness if it is included on the grey list. On the other hand, several consultees (including the Faculty of Advocates, Tods Murray LLP, the British Bankers' Association (BBA), and the Direct Marketing Association (DMA)), pointed out that certain terms on the grey list could relate to the main subject matter of the contract. As the Faculty of Advocates put it:

We agree with the effect of this proposal, which is that such terms should always be subject to review. However, we suggest that it would be better expressed as such rather than as what may be considered in some cases an artificial rule that such terms do not relate to the main subject-matter of the contract. The reality in an individual case may well be that a term on the grey list does relate to the main subject-matter of the contract and it may be expressed transparently and prominently but it should nevertheless be subject to review.

5.20 The BBA had a similar view:

The BBA agrees that the terms included in the grey list should be assessable for fairness. However, this does not mean that a term on the grey list cannot relate to the main subject matter of the contract, it means... that the exemption applying to the main subject matter can not apply.

5.21 By contrast, the OFT expressed caution against clarifying that the exemption does not apply to grey list terms because it could encourage a narrow and literal approach to interpreting the grey list. It might also lead to the conclusion that the exemption applies to any term not on the grey list.

Discussion

5.22 We think that the legislation should specifically state that terms on the grey list are always assessable for fairness. We agree with the OFT that this is probably already the law, but we think it would be helpful to state so specifically. The FLA response shows that the issue is not beyond all possible doubt.

5.23 We accept the point made by the Faculty of Advocates, the BBA and others that our original proposal concerning main subject matter terms was poorly expressed. The important issue is not whether grey list terms are the main subject matter of the contract, but whether they should be assessable for fairness. This objective is achieved by specifying that all grey list terms may be assessed for fairness, and that the exemption currently set out in Regulation 6(2) must be read subject to this provision.

¹⁰ Issues Paper, para 8.82.

5.24 We do not think that such a statement would expand the exemption in the way that the OFT fears. As we have explained, terms are only exempt if they are transparent and prominent. Even then, to be exempt the term must specify the main subject matter or the assessment must be of the amount of the price.

5.25 **Recommendation 11: The legislation should specifically state that terms on the grey list are assessable for fairness. The price/main subject matter exemption should be read subject to this provision.**

The grey list exceptions

5.26 We have also been asked to confirm the status of the exceptions to the grey list, which are set out in paragraph 2 of Schedule 2. We think that the correct interpretation of the current legislation is that terms listed as exceptions to the grey list are also reviewable for fairness, unless they are exempt by other provisions of the UTCCR, such as the exemption in Regulation 6(2). Below, we include a flowchart (Figure 2) explaining the operation of Schedule 2.

5.27 One example of an exception under paragraph 2 would be a price indexation clause,¹¹ where the method by which the price varies is explicitly described.¹² The fact that price indexation clauses are listed in paragraph 2 of Schedule 2 means that they are not treated in the same way as other price escalation clauses listed in paragraph 1. Under our recommended scheme, a price indexation clause would be treated in the same way as other price terms. If a price indexation clause is transparent and prominent, the fairness assessment may not relate to the amount of the price. If, however, the price indexation clause is not transparent or prominent, the court may assess every aspect of it for fairness.

5.28 Given the possible confusion on this issue, we think that it should be clarified in the new legislation. The legislation should confirm that paragraph 2 terms are assessable for fairness unless they are exempted under another provision of the legislation.

5.29 **Recommendation 12: The legislation should state that terms in paragraph 2 of the grey list are assessable for fairness, unless they are exempted by other provisions of the legislation.**

¹¹ A price indexation clause links the price to an external index such as exchange rate or rate of inflation. An example would be linking the price to one of the Bank of England's interest rates.

¹² See UTCCR, Sch 2, para 2(d).

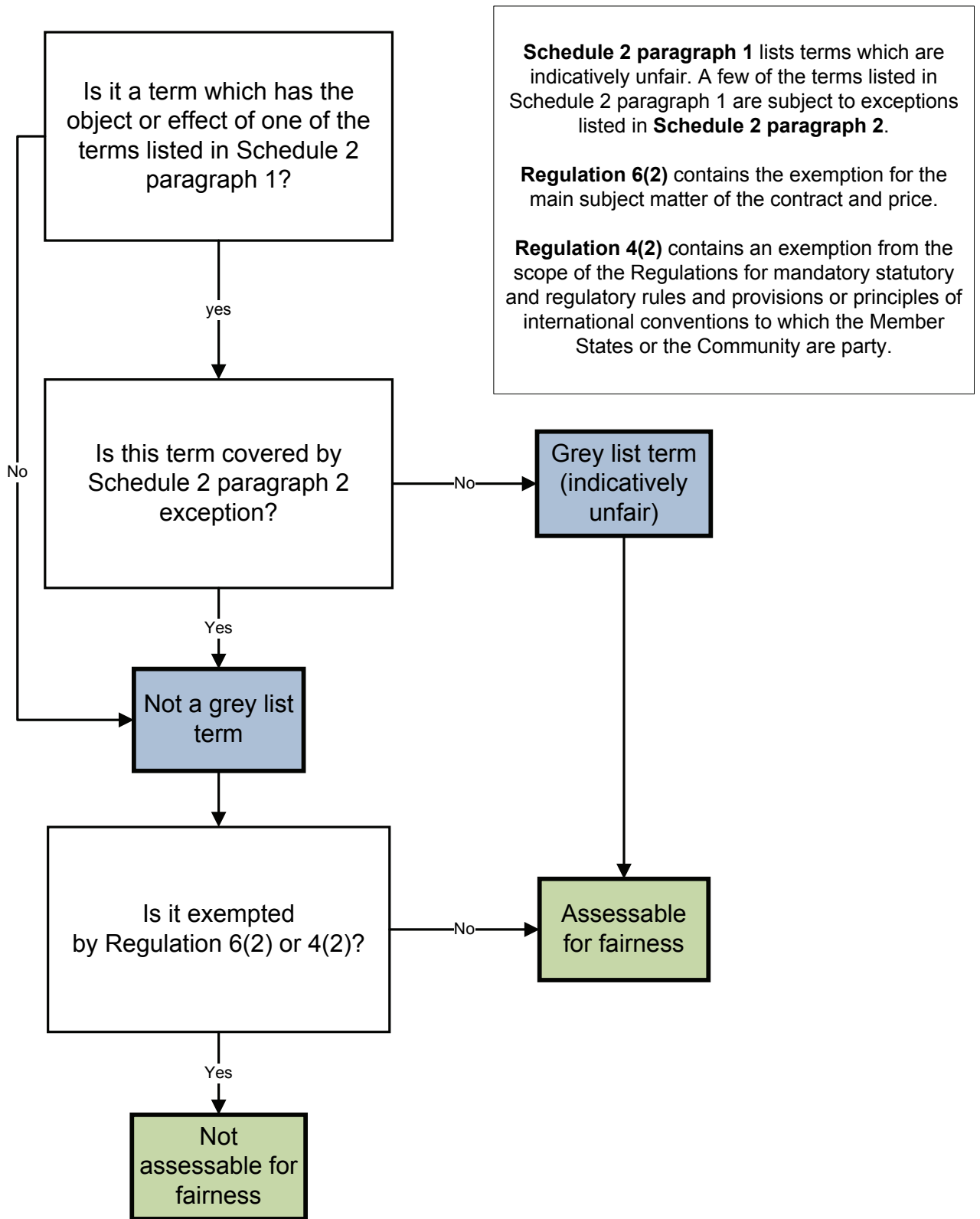


Figure 2: Flowchart explaining the operation of Schedule 2.

REWRITE OR COPY OUT?

- 5.30 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.¹³ The objective was to make the new legislation clearer and more accessible. In response to our 2002 Consultation Paper,¹⁴ most consultees agreed that it would be useful to reformulate the grey list in terms that would be more comprehensible. As a result, we attempted to rewrite the grey list. Our reformulated list was included in the draft Bill that accompanied the 2005 Report.
- 5.31 In the Issues Paper we asked consultees whether they agreed that the indicative list should be reformulated in the way set out in Appendix B (containing the list from the draft Bill) or whether it should be left in its original form.¹⁵

Consultation responses

- 5.32 The responses to the consultation question were split. Just below half of the respondents agreed with the proposal. Some of those who disagreed opposed the proposal in general terms, while others pointed to the shortcomings of the rewritten grey list in Appendix B.
- 5.33 Support for the proposal was based on the conviction that the reformulated list is clearer and “easier to understand and apply”. The DMA thought that the new list is:

more likely to be understood by UK consumers and traders, especially SMEs. It may be that larger traders have been dealing with the European Directives for many years and may state that they are familiar with the language used, but for many smaller businesses, especially new or recently new ones, being able to understand the laws without resort to costly legal advice would be invaluable.

- 5.34 The Building Societies Association was more cautious:

Some re-writing for the sake of clarity could be helpful, but firms, regulators and consumer bodies have got used to the “grey list” over the years and a fundamental re-write could lead to unforeseen consequences.

- 5.35 Several consultees expressly disagreed with the rewritten list, arguing that it was less clear. The BBA thought that it introduced “additional ambiguity and complexity”. Some of the respondents noted various discrepancies between the Annex to the Directive and the rewritten list. The FLA submitted that in some cases “changes have resulted in the meaning of elements of the list having been changed completely”.

¹³ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.116.

¹⁴ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No 166; Scottish Law Commission Discussion Paper No 119, para 4.121.

¹⁵ Issues Paper, para 9.53.

5.36 The British Retail Consortium argued that the list “should be reproduced in its original form to avoid confusion in cross border sales and because it has not given rise to any real problems”.

5.37 The regulators also tended to favour retaining the current list. Ofcom agreed there might be benefits, but also highlighted the risks:

We agree that there would be benefits from re-writing the Grey List in clear language, using terminology familiar in the UK... However... it also has the potential risk of creating inconsistency with the Directive and uncertainty in the legal interpretation of the new UK law. That is, the UK law would have to be interpreted in light of the Directive. That may be less straightforward where the two differ.

5.38 The OFT preferred to maintain the current grey list, but wished to add to it:

In short, while we are fully aware of the effort made to achieve an improvement on current provision, we do not favour the replacement of UTCCRs Schedule 2 by the re-written list at Appendix B, either as it stands, or indeed in an amended form. We would prefer a less drastic approach to dealing with the shortcomings in Schedule 2.

We suggest that one way forward here is to keep the existing “copy out list” but to expand its scope as indicated above, solely or mainly by adding new terms to the list.

5.39 Finally, Which? was “not convinced there is a need to wholly re-write the grey list”, concluding that it is largely effective as copied from the UTD.

Discussion

5.40 We have been persuaded by the strong arguments put against rewriting the list simply for the sake of clarity. The meaning of the grey list has become much better known and understood in the eight years which have passed since the 2005 Report.. In particular, OFT Guidance¹⁶ has done a great deal to explain how the grey list applies to various types of contract term.

5.41 Reformulating the grey list carries a risk of wrongly implementing the Directive. There is also the problem of losing the precedent value of cases which have been decided since the UTCCR came into force. We are concerned that the experience of using the list will be lost if the list is reformulated. Further, a reformulation could add another layer of complexity, since the rewritten grey list would need to be interpreted in light of the Directive in any event.

5.42 We have concluded that it is best to leave the list in its original form. The benefits of rewriting it have not been made out, while the risks are clear. We are persuaded by the arguments put by the OFT that the way forward is to keep the existing “copy out list” but to expand its scope by adding new terms.

¹⁶ OFT311 (September 2008): *Unfair contract terms guidance: Guidance for the Unfair Terms in Consumer Contracts Regulations 1999*, available at http://oft.gov.uk/shared_oft/reports/unfair_contract_terms/oft311.pdf.

- 5.43 **Recommendation 13: The indicative list of terms that might be unfair should be copied out from the Unfair Terms Directive, subject to the specific changes and additions discussed below.**

Terminology

- 5.44 It is important that the new legislation uses consistent terms. The original grey list refers to a “seller or supplier”. We understand that the new Consumer Bill of Rights will use the term “trader” instead. If so, we think that for the sake of consistency, the term “seller or supplier” should be replaced with “trader”.
- 5.45 There may be other defined terms used in the grey list. The Consumer Bill of Rights might treat digital content as a category separate from goods and services, in which case the grey list will need to be amended to match those changes. The exact nature of these changes, however, will be a matter for Parliamentary Counsel in due course.
- 5.46 **Recommendation 14: The use of defined terms in the grey list should be consistent with other consumer legislation.**

ADDING NEW TERMS

- 5.47 In the Issues Paper we suggested some extension to the grey list. When we proposed that the exemption should not apply to terms on the grey list we added that this “should include price escalation clauses; early termination charges and default charges”.¹⁷ We expressed the view that price escalation clauses and default charges were already covered by the grey list, but we thought there should be some extensions to the list to cover early termination charges.
- 5.48 We also asked questions about terms which give the trader discretion to decide the price¹⁸ or the main subject matter¹⁹ after the consumer has become bound by the contract.
- 5.49 Most respondents agreed that price escalation clauses, early termination charges and default charges should be covered, though they did so in fairly general terms. Relatively few respondents grappled with the detail of the grey list to consider how far these clauses were already covered by the grey list, or exactly how the grey list should be expanded. As discussed below, we received more detailed comments on discretionary terms.

Views on price escalation, early termination and default charges clauses

- 5.50 A majority thought that the grey list should include these types of term. The Royal Institution of Chartered Surveyors commented that the proposal “seems sensible and although the examples given above are not in themselves unfair, these areas are potentially some of the ones that might be open to causing most mischief”.
- 5.51 Direct Line Group made a similar comment:

¹⁷ Issues Paper, para 8.67(4).

¹⁸ Issues Paper, para 8.68(3).

¹⁹ Issues Paper, para 8.83.

It is often these particular terms that create the fundamental unfairness in terms of price and are “buried” in amongst other information under the terms and conditions wording.

5.52 The BBA believed that “it is important that the legislation and statutory guidance are clear about what is and isn’t considered to constitute a term included in the grey list”. On the other hand, they specifically stipulated that “this clarification must include confirmation that default charges continue to be defined only as penalties for breach of contract”.

5.53 The Mobile Broadband Group urged caution:

We also note that it is sometimes suggested that there is a presumption that a term on the grey list is unfair, but that this is not formally part of the UTD or UTCCR. Nevertheless, it seems to the MBG, that inclusion does informally carry the implication that the mere existence of such clauses are inherently unfair, when in fact they can be a very necessary mechanism for balancing the interests of consumers and traders.

5.54 The FLA disagreed with the proposal altogether:

We do not agree that the additional terms listed in the consultation should be added to the grey list. In our view, adding these terms would result in duplication.

5.55 We think we have authority to recommend some limited additions to the list. We discuss the detail of these provisions below. As we explain, we have concluded that the grey list already deals adequately with price escalation clauses and default charges. We see a need, however, for additions to deal with early termination charges and clauses which grant the trader discretion to decide the price or subject matter of the contract. We also discuss a proposal from the OFT that the list should include disproportionate and remote future contingent charges.

PRICE ESCALATION CLAUSES

The current grey list terms

5.56 Price escalation clauses are dealt with under paragraph 1(l). This covers terms which permit the trader to increase the price without giving the consumer the right to cancel the contract:

providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract is concluded.

5.57 Paragraph 1(j) is also relevant:

enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract.

5.58 Paragraph 1(j) would apply even where the consumer does have a right to cancel if there is no valid reason for the increase.

Exceptions for some financial services contracts

5.59 Both subparagraphs (j) and (l) are subject to some exceptions listed in paragraph 2. Paragraph 2(b) states that:

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

5.60 Paragraph 2(c) relates to both subparagraphs (j) and (l) and states that they do not apply to:

- transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;

- contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency.

5.61 Also, paragraph 2(d) is of relevance here:

Subparagraph (l) is without hindrance to price-indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

Discussion

5.62 We think that the grey list already covers the specific problems caused by price escalation clauses. We have concluded that there is no need to add to the grey list to cover these sort of terms. It is true that the paragraph 2 exceptions add some complexity to the issue, but it represents a carefully negotiated compromise which we have no wish to disturb.

5.63 **Recommendation 15: Price escalation clauses are already covered by the grey list. There is no need for additions to the list to deal with this issue.**

DEFAULT CHARGES

5.64 Default charges are covered by paragraph 1(e). This covers terms which have the object or effect of:

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

5.65 In the Issues Paper we argued that terms may also be assessed for fairness if they have the same effect as a default charge. This is because Schedule 2 covers not only the terms listed but also terms which have “the object or effect” of the terms listed. As Lord Walker put it in *Abbey National*, “traders ought not to be able to outflank consumers by ‘drafting themselves’ into a position where they can take advantage of a default provision”.²⁰ We also noted the Ofcom guidance that both default charges and “quasi-default charges” are clearly assessable for fairness.²¹

5.66 It is true that in *Abbey National*, the OFT failed to establish that overdraft charges had the same object or effect as default charges. The court found that the charges in question were contingent charges rather than default charges, which was a matter of fact for the court. It is clear that the exact nature of any term is very dependent on the facts. We do not think that it is possible to give the courts clearer guidance on this issue without taking many contingent charges outside the scope of the exemption. The BBA stated its clear opposition to any such change.

5.67 We have concluded that the grey list adequately deals with default charges and does not require any additions in that respect.

5.68 **Recommendation 16: Default charges are already covered by the grey list. There is no need for additions to the list to deal with this issue.**

EARLY TERMINATION CHARGES

5.69 There has been much public disquiet over contract terms which tie consumers into contracts for unusually long periods, or demand excessive penalties if consumers cancel early. Such terms often exploit consumers’ behavioural biases. As discussed earlier, consumers tend to focus on their present needs, and underestimate the likelihood that circumstances will change in the future. Furthermore, excessively long contracts are inherently anti-competitive, as consumers are prevented from switching to new suppliers. 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.²²

What we said in the Issues Paper

5.70 In the Issues Paper we noted Ofcom’s strong view that early termination charges are not within the exemption. Ofcom’s guidance states that:

²⁰ [2009] UKSC 6, [2010] 1 AC 696 at [43].

²¹ *Ofcom statement on Additional Charges (Updated Guidance)* (November 2010), para 44, available at: http://stakeholders.ofcom.org.uk/binaries/consultations/addcharges/statement/Ofcom_statement.pdf.

²² [2011] EWHC 1237 (Ch), [2011] ECC 31.

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.²³

5.71 Ofcom explained that an early termination charge is not paid in exchange for a package of goods and services under the contract: “the opposite applies: it is paid when goods and services stop being supplied”.²⁴ 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.²⁵

5.72 That said, the issue is not as clear cut as it should be. The grey list only partially covers early termination clauses. Paragraph 1(d) covers sums that have already been paid, but not sums which are still due. It covers terms which have the object or effect of:

permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract.

5.73 In the Issues Paper we saw no reason to distinguish between a term which allows the trader to retain money paid upfront and a term which requires the consumer to continue monthly payments. We thought that 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.

5.74 This is not to suggest that all early termination charges are necessarily unfair. 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. 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. We thought that early termination charges were sufficiently problematic to be assessable for fairness.

Consultees' views

5.75 We received only a few comments on this important issue. Sky pointed out that some sector specific legislation sets a maximum length of contracts. For example, the Universal Services Directive establishes a maximum period of 24 months for communication services. They queried how this would interact with the proposed addition to the grey list.

²³ *Ofcom statement on Additional Charges (Updated Guidance)* (November 2010), para 37 (emphasis omitted), available at: http://stakeholders.ofcom.org.uk/binaries/consultations/addcharges/statement/Ofcom_statement.pdf.

²⁴ Above, para 38.

²⁵ Above, paras 39 and 40.

- 5.76 Ofcom expressed concern about a suggestion that an early termination clause could only be reviewable for fairness if the period it covers is unreasonably long. They thought that it would be inconsistent with the requirements of the Directive.
- 5.77 We were also alerted to a recent case decided by Ayr sheriff court, in which a couple booked a wedding at the Lodge on Loch Lomond. When they cancelled the event 10 weeks before the appointed day, the couple were asked to pay 75% of the anticipated costs of the entire wedding. The court found that this was unfair and ruled that the couple should not be required to pay the £2,011 asked of them.²⁶ It is not clear from the newspaper report we have seen how this decision was reconciled with the words of Regulation 6(2).
- 5.78 The decision is interesting because it highlights that problems over cancellation charges are not always associated with unreasonably long contracts, but may apply to a wide range of contracts.

Discussion

- 5.79 We have been persuaded by the comments we received from Sky and Ofcom that we should not include provisions about unreasonably long contract terms themselves. The mischief is not the length of the contract itself but the imposition of unreasonably high charges when consumers attempt to cancel.
- 5.80 The problem is that paragraph 1(d) is overly narrow in only covering the trader's right to retain sums already paid by the consumer, and not covering terms which permit traders to claim payments from the consumer following cancellation. It covers sums that have already been paid, but not sums which are still due.
- 5.81 We think that a new paragraph should be added to the grey list to deal with disproportionately high cost cancellation clauses. It should cover terms which have the object or effect of permitting the trader to claim disproportionately high sums in compensation or for services which have not been supplied, where the consumer has attempted to cancel the contract.
- 5.82 **Recommendation 17: A new paragraph should be added to the indicative list to cover terms which have the object or effect of permitting the trader to claim disproportionately high sums in compensation or for services which have not been supplied, where the consumer has attempted to cancel the contract.**

THE TRADER'S DISCRETION TO DECIDE THE PRICE

- 5.83 In the Issues Paper we asked whether it would be helpful to explain 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.²⁷

²⁶ Herald Scotland, "Couple win hotel court battle over cancelled big day", 4 December 2012. <http://www.heraldscotland.com/news/home-news/couple-win-hotel-court-battle-over-cancelled-big-day.19555192>.

²⁷ Issues Paper, para 8.68(3).

5.84 Paragraph 1(l) covers some terms which give the trader discretion over price. It has two limbs:

- (1) As we have seen, it covers terms which allow a seller or supplier to increase their price without giving the consumer the right to cancel the contract (price escalation clauses). This, however, only covers increases to a specified price and would not apply where the price was fully within the trader's discretion from the start of the contact.
- (2) It also covers terms "providing for the price of goods to be determined at the time of delivery". This includes discretionary price setting for goods but does not grant equivalent protection to consumers of services.

5.85 We noted a French case about a private detective's expenses.²⁸ 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.

5.86 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.²⁹ 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.

5.87 The issue is also subject to the Consumer Rights Directive (CRD), which must be implemented into UK law by December 2013.³⁰ 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".³¹ We did not think, however, that the CRD removes all the potential problems in this area as there is some uncertainty whether the plumbing firm from our example, for instance, has provided the consumer with information about how the price is to be calculated.

²⁸ Issues Paper, para 7.65.

²⁹ 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.

³⁰ Implementing measures are to be adopted and published by 13 December 2013. They are to be applied from 13 June 2014.

³¹ For distance and off-premises contracts, see art 6(e). For other contracts, see art 5(c).

5.88 In the Issues Paper we thought it may be helpful to deal with discretionary price terms explicitly in any new legislation on unfair terms. This raises the question of whether we should add another paragraph to the grey list to cover terms which give the trader discretion to decide the amount of the price after the consumer has become bound by the contract.

Consultees supported the proposal

5.89 More than two-thirds of respondents agreed with this proposal. No consultees disagreed with the entirety of the proposal.

5.90 The Faculty of Advocates thought it was “a fundamental matter which requires specific treatment”.

5.91 North East Trading Standards Association accepted that “not all terms of this nature would necessarily be unfair”, but thought that “to exclude them from a fairness test would lead to an undermining of the regulations and regulatory framework”.

5.92 The Bar Council added that it needs to be “made clear that it is not the Court’s duty to assess the fairness of the price which is ultimately set by such a clause; rather, it is the fairness of the mechanism for setting that price”.

5.93 The BBA gave the proposal qualified support:

in financial services there are some products for which it is not possible to determine the price when the contract is signed (e.g. a forward foreign exchange contract). We therefore believe that such products should be exempt from the grey list and/or additional clarity provided that reference within the contract to the relevant mechanism by which the price will be set is sufficient to qualify the term as suitably transparent and prominent.

5.94 The OFT considered that “such terms are currently fully assessable for fairness but would welcome clarification on this point in the proposed legislation”. It thought this was best dealt with by adding a further term to the grey list. It added that:

any purely discretionary right to set a price after the consumer has become bound to pay is objectionable. Such a term is likely to have the same effect as a price variation clause. Indeed, we consider that there would be good arguments that such terms are already covered, on an appropriately purposive interpretation of paragraph 1(I) of the grey list.

Other comments

5.95 Professor Duncan Sheehan did not think that “all uncertainty can be banned” and referred to the plumber scenario presented in the Issues Paper:³²

³² Issues Paper, para 8.54.

It is just as unfair to force a plumber to do much more work than might initially have been thought for limited money as to allow him to gouge the consumer by spending longer than anticipated to ramp up the bill.

5.96 The Mobile Broadband Group's comment was sector specific.³³

Many CSPs and other businesses rely on long term contracts with their customers. Although they do endeavour to calculate how any likely changes will affect them, this is far from an exact science and outside the control of any business. We recognise that such changes are not unpopular with consumers, but this unpopularity is, in itself, a check against businesses implementing such price rises lightly, because businesses, especially mobile network operators, rely on retaining as many customers as possible.

Discussion

5.97 We agree with the OFT that the sort of terms we have in mind are very close to those listed in paragraph 1(l). It is possible that on a purposive interpretation of paragraph 1(l) they are already covered. Nevertheless, we think it would be helpful to add a new, slightly wider, paragraph to the grey list to include terms which have the object or effect of giving the trader discretion to decide the amount of the price after the consumer has become bound by the contract. There is considerable support for such a change.

5.98 Professor Duncan Sheehan commented on the possible unfairness to the plumber in our example. There could be no objection to a plumbing firm which charged for the number of hours which are reasonably required, as a court would then have jurisdiction to determine what amounted to a reasonable number of hours. The problem here is that the plumbing firm has attempted to give itself total discretion to determine the number of hours.

5.99 It is worth pointing out that in this example, the trader is not left entirely without a remedy, even if the term is later found to be unfair. If the price term is later held not to bind the consumer because it is unfair, we think that the contract would fall within section 15 of the Supply of Goods and Services Act 1982. As no price has been agreed, the court would have the right to determine a "reasonable charge" for the service provided. Equally, in Scotland, if the court found that following the unfairness of the term, the contract was not capable of continuing in existence, the plumber would have a *quantum meruit*³⁴ claim for a reasonable amount to cover the service rendered.

³³ Ofcom has recently issued a consultation addressing this issue: *Price rises in fixed term contracts: Options to address consumer harm*, available at <http://stakeholders.ofcom.org.uk/binaries/consultations/gc9/summary/condoc.pdf>.

³⁴ Entitlement to *quantum meruit* (in the sense of "as much as the work is worth") arises where there is a contract for services but no agreement on the amount of remuneration. Where a custom can be established, the customary rate shall be applied to determine the amount of remuneration. Otherwise, the court will decide on a reasonable remuneration. See W McBryde, *The Law of Contract in Scotland* (3rd ed 2007), para 9-45.

5.100 We note the BBA's concern that this should not include forward foreign exchange contracts and other financial products where the price is liable to fluctuate in accordance with financial market rates. These contracts are already exempt from paragraphs 1(j) and 1(l) of Schedule 2. As discussed above, they are covered by the specific exceptions in paragraph 2.³⁵ We recommend that the paragraph 2 exceptions would also apply to the new provision.

5.101 **Recommendation 18: A new paragraph should be added to the indicative list, to cover terms which have the object or effect of giving the trader discretion to decide the amount of the price after the consumer has become bound by the contract. This should be subject to the exceptions currently listed in Schedule 2 paragraph 2 of the Unfair Terms in Consumer Contracts Regulations 1999.**

THE TRADER'S DISCRETION TO DECIDE THE SUBJECT MATTER

5.102 Similar issues arise with the subject matter of the contract, where a term provides that the trader can unilaterally decide what goods or services they will provide under the contract after the consumer has become bound by the contract.

5.103 In the Issues Paper we gave an example of enforcement action by the Financial Services Authority (FSA) in respect of pet insurance.³⁶ 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. 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.

5.104 We think that it is right that terms which grant traders this sort of discretion should be reviewable for fairness. We expressed concern, however, that under the current law the issue was not beyond all doubt. It could be argued that a term which says "we will only pay your claim if we think it is reasonable" uses plain intelligible language, even if it fails to tell the consumer which claims would be paid.

5.105 In the Issues Paper, we asked 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.³⁷

Strong support for the proposal

5.106 The overwhelming majority of respondents agreed with this question for the benefit of clarity; only two disagreed.

³⁵ Paras 5.59 to 5.61.

³⁶ 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. This is discussed in the Issues Paper at paras 6.49 to 6.51.

³⁷ Issues Paper, para 8.83.

5.107 The Trading Standards Institute agreed with the proposal, pointing out that a term giving the trader unilateral discretion might undermine the consumer's ability to negotiate over the subject matter. Deborah Parry concurred: "The more explanation provided of what is and is not excluded the better."

5.108 Direct Line Group replied:

We agree and welcome such proposals as this would be in line with other similar unfair terms e.g. a supplier's discretion as to when to deliver or cancel a contract.

5.109 HSBC agreed with the proposal, as did the BBA. The BBA's agreement was subject to any conflict with existing financial services regulation.

5.110 The OFT supported the proposal, and suggested that it should be added to the grey list:

We strongly support the proposal that the future legislation should leave no doubt that a term which purports to give the trader discretion to decide the subject matter after the consumer has become bound by the contract is fully assessable for fairness... We suggest that a term is added to the grey list addressing this type of potential unfairness.

5.111 Sky expressed concern about how the proposal would apply in practice, and sought clarification, giving the example of a "veggie box" delivery:

There are a number of scenarios where the exact subject matter of a contract may vary during the course of a contract term. For example, it is common for the contents of fruit and vegetable boxes delivered to consumers' homes, not be determined until the day before or even the day of delivery. This is explained clearly to the customers who purchase these boxes at an agreed price and often specific parameters are agreed such as the number of pieces of fruit or vegetables which will be supplied, or specific exclusions such as potatoes.

Discussion

5.112 There is clear support for this addition. We think that it would be useful to add a paragraph to the indicative list to cover terms which give the trader discretion to decide the subject matter of the contract after the consumer has become bound by it.

5.113 The new paragraph would be very similar to paragraph 1(k), which covers terms enabling the trader to alter unilaterally without a valid reason any characteristic of the product or service to be provided. Paragraph 1(k), however, only covers alterations, while the new paragraph would cover discretionary terms which were present in the contract from the start. It would, for example, deal with terms in consumer insurance contracts which give the insurer wide discretion whether to pay claims.

- 5.114 We do not think that the addition would cover the example given by Sky, in which a trader contracts to supply “a variety of seasonal vegetables”, and where the subject matter is defined by clear parameters. On the other hand, an additional term which permitted *any* vegetables to be supplied might be reviewable, especially where the consumer was sent nothing but potatoes.
- 5.115 Again we note the BBA’s concerns that this should not interfere with financial products where the amount of foreign exchange supplied or the number of shares which the consumer receives fluctuates in accordance with financial market rates. We do not think that these contracts would be caught by the provision, but for the avoidance of doubt we recommend that the new paragraph should be subject to the Schedule 2 paragraph 2 exceptions.
- 5.116 **Recommendation 19: A new paragraph should be added to the indicative list, to cover terms which have the object or effect of giving the trader discretion to decide the subject matter of the contract after the consumer has become bound by it. This should be subject to the exceptions currently listed in Schedule 2 paragraph 2 of the Unfair Terms in Consumer Contracts Regulations 1999.**

DISPROPORTIONATE AND REMOTE CONTINGENT CHARGES

The OFT’s views

- 5.117 In response to our consultation, the OFT argued strongly for another addition to the grey list:

We suggest one way forward here (preferably in addition to a price exemption that takes into account sensitivity) would be the inclusion in the grey list of a term which would indicate in the proposed legislation that disproportionate and remote future contingent charges payable when the consumer is not in breach 'may be unfair' – and thus clarify that they are fully assessable for fairness.³⁸

- 5.118 In correspondence with us, the OFT gave the example of the sales commission term in *Office of Fair Trading v Foxtons Ltd.*³⁹ This term required landlords letting their property to pay Foxtons a percentage of the purchase price if the landlord sold the property to a tenant introduced by Foxtons, even if Foxtons did not assist with the sale.

³⁸ Reference omitted.

³⁹ [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

5.119 The Court found that this term was not in plain intelligible language and that it was unfair. 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.⁴⁰ 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”.⁴¹ 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”.⁴²

5.120 Clearly, this clause was not prominent, and following our recommendations it would be assessable for fairness. The OFT expressed concern, however, that even if such a term was prominent, few consumers would engage with its implications. As the OFT explain:

The typical consumer landlord seeking to *let* a property will by definition have at that point no intention of *selling* it – as such he will most likely brush off any attempt to get him to think about a piece of technical small print that has no relevance to him, and in any case will not see it as reason to walk away from the contract.⁴³

5.121 The OFT argued that where terms relate to extremely remote contingencies, consumers do not engage with them, or take them into account in their decision-making, even if the terms are reasonably prominent.

Discussion

5.122 In Part 4 we explained that to be “prominent”, a term must be presented in such a way that the average consumer would be aware of the term. Furthermore, the more unusual or onerous the term, the more prominent it needs to be. Thus to be exempt from review, such a sales commission term would need to be made very prominent indeed. We think that it is unlikely that any trader would wish to draw attention to such an obviously unfair term. Even if individual consumers did not necessarily engage with such a term, it would be likely to cause bad publicity for the trader.

5.123 We think that it would be difficult to draft a paragraph along the lines that the OFT suggests which did not open all contingent charges to review, however prominently they had been presented to the consumer. It would always be open to a consumer to argue that an overdraft charge, for example, was a disproportionate and remote future contingent charge, on the ground that when they opened the account they did not intend to go overdrawn.

5.124 Having considered the issue carefully, we have reached the conclusion that making an exception for disproportionate and remote contingent charges would introduce too much uncertainty into the recommended scheme.

⁴⁰ Above at [103].

⁴¹ Above at [104].

⁴² Above at [105].

⁴³ Email sent on 13 November 2013 (emphasis in original).

5.125 **Recommendation 20: A new paragraph should not be added to the indicative list to cover disproportionate and remote contingent charges.**

PART 6

COPY OUT, THE FAIRNESS TEST AND THE CONSEQUENCES OF NON-TRANSPARENCY

INTRODUCTION

- 6.1 Our 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. Our aim was to simplify and clarify the law without reducing the current level of consumer protection. We did not simply “copy out” the Unfair Terms Directive (UTD). Instead we sought to rewrite the UTD in words which would be more familiar to a UK audience.
- 6.2 When we consulted on these issues in 2002, a majority of consultees supported our proposals. In our 2012 Issues Paper, we summarised the proposals and asked whether consultees still agreed with them.
- 6.3 In this Part, 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 look at consultees’ views on our proposals to rewrite the fairness test. These questions proved particularly controversial. We have been persuaded by the strong arguments put to us to change our 2005 recommendations.
- 6.4 Finally, we discuss the requirement in Article 5 of the UTD that written terms must always be in plain, intelligible language. We think that this effectively requires terms not only to be in plain, intelligible language but also legible and available. As we discuss, the UTD does not specify the consequence if a term is not transparent. We do not think that non-transparent terms are automatically unfair, but we think that enforcement bodies should be able to use their powers under Part 8 of the Enterprise Act 2002 to remove them.

COPY OUT OR REWRITE?

- 6.5 In 2005 we argued that the UTD should be rewritten in a clear way, using terminology familiar to a UK audience. Thus the draft Bill which accompanied our Report made many changes to the words of the Directive, in an attempt to make it easier to understand.
- 6.6 In the Issues Paper we asked if this was the right approach. We asked whether consultees agreed that the UTD should not be “copied out” into the law of the UK, but should be rewritten in a clearer, more accessible way.¹

¹ Issues Paper, para 9.11.

- 6.7 We noted that the Court of Justice of the European Union has emphasised that national measures to implement the UTD must be clear and certain.² On the other hand, Government guidance on transposition requires the copying out of Directives, unless the alternative is preferable.³

Consultees' views

- 6.8 Most consultees favoured rewriting the UTD in theory, on the basis that it is desirable for the law to be written in a way that is understandable. Professor Hans Micklitz, Citizens Advice and Deborah Parry pointed out that a certain amount of rewriting would be necessary because we propose to combine UCTA provisions with the UTD provisions.
- 6.9 That said, many of those who agreed with rewriting the UTD urged caution. Several consultees highlighted the risk that a rewrite might cause additional confusion or could prevent the UTD from being implemented properly.
- 6.10 Meanwhile, a significant minority of consultees preferred copy out, including leading business groups, the main regulators and Which?. Consultees argued that lawyers and regulators are now more familiar with the UTD, so the arguments supporting a rewrite no longer apply.

Those in favour of a rewrite

- 6.11 The Direct Marketing Association thought that consumers and small and medium sized traders without access to legal advice would benefit from the use of simpler language in legislation. It expressed a common view:

As with many European Directives, the Unfair Terms Directive is drafted in a way unfamiliar to UK consumers and traders, especially SMEs. It would seem sensible to take the opportunity to implement the Directive into UK law so that consumers and traders better understand their respective rights and responsibilities, being careful to ensure that the spirit of the Directive is maintained.

- 6.12 The Law Society and North East Trading Standards Association also supported a rewrite.

Those that gave qualified support

- 6.13 A significant proportion of those in favour of a rewrite gave qualified support or urged caution. For instance, Professor Hans Micklitz commented:

² Case C-236/95 *Commission of the European Communities v Hellenic Republic* [1996] ECR I-04459 at [13]; and case C-478/99 *Commission of the European Communities v Kingdom of Sweden* [2002] ECR I-04147 at [18].

³ Department for Business, Innovation and Skills, *Transposition Guidance: How to implement European Directives effectively* (July 2011) part 1, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70010/Implementing_EU_Directives_into_UK_law_July_2011.pdf.

If the two acts are merged, a re-writing will be necessary. However, the limits under EU law have to be observed. Key terms like good faith cannot be eliminated in the rewritten version.

6.14 The Law Society of Scotland responded:

Yes, we agree. However, any rewritten form should not depart too far from the terms of the Directive and must be capable of being interpreted in a way consistent with the terms and objectives of the Directive.

6.15 Professor Christian Twigg-Flesner summed up a commonly held view about the challenge of the drafting exercise:

In general terms, I would encourage an approach that does not simply copy-out the text of a directive, particularly when some of the provisions are quite dense. This will require some careful drafting, however, to ensure that the substance of the directive is reflected in national law.

However, I would urge some caution when it comes to central terms... Sometimes, it might be better to adopt EU terminology, especially where this introduces new concepts, or, in the case of a recasting of existing legislation, where there is a body of relevant case-law on the interpretation of certain key phrases.

Those favouring copy out

6.16 A significant minority of consultees expressed strong objections to a rewrite. They thought that the position had changed since 2005, as consultees are now more familiar with the concepts in the UTD.

6.17 Malcolm Waters QC put the arguments in favour of copy out:

there is now a fairly substantial body of case law in which the meaning of the legislation has been considered by the UK courts and extensive guidance has been issued by the OFT and other bodies with responsibility for enforcement of the UTCCR, such as the FSA.

Moreover, to the extent that the language of the Directive remains unfamiliar to UK lawyers, it could be argued that its “foreignness” is a salutary reminder that some of the key concepts employed in the Directive have no direct counterpart in UK law.

6.18 The Bar Council emphasised the limitations of a rewrite, arguing that the new words would still need to be interpreted in line with the Directive:

We agree that clarity and accessibility are important factors... but the fact remains that the UTD remains the source of the provisions and as such will have to be considered when constructing the new provisions, at least insofar as the issue of whether the new provisions satisfy the minimum harmonisation requirements is concerned.

- 6.19 The Association of British Insurers also argued against attempting to rewrite the UTD as “both regulators and firms are familiar with the language and requirements of the UTCCR”. HSBC thought that rewriting the legislation could give rise to “new uncertainties or unintended consequences”.
- 6.20 The British Retail Consortium (BRC) and Sky were concerned about the effect of different wording on cross-border transactions. The BRC thought that “a re-write using UK terminology could undermine attempts to enhance the value of the single market for consumers”.
- 6.21 From a consumer perspective, Which? also expressed concern about rewriting the UTD:

While we recognise new legislation using simplified language may be of benefit to individual consumers, there are benefits to closely matching the language used in the Unfair Terms Directive as, for example, it would help promote the direct application of past decisions under the existing UTCCRs as well as decisions based on the Unfair Terms Directive in other Member States.

- 6.22 The regulators also tended to favour a copy-out approach. The Office of Fair Trading (OFT) wrote:

We do not think anything of substance (including, in particular, the objective of protecting consumers) should be sacrificed, or even put at significant risk, for the sake of using simple language. Consumers will not in practice commonly refer directly to statutory provisions for guidance, and if they do so are unlikely readily to comprehend any form of words that implements the Directive satisfactorily for legal purposes. Accordingly, it would be pointless and harmful to attempt to make the objective of enabling them to read and understand the legislation directly into an overriding objective.

- 6.23 Similarly, the Financial Services Authority (FSA) could not see the benefit of a rewrite:

There do not appear to be any significant benefits to rewriting the Unfair Terms Directive to make it clearer and more accessible. In our view, much of the current UTCCR is written in a way that is relatively easy to understand, so whilst there may be arguments for clarifying aspects of the UTCCR, a complete rewrite does not seem necessary.

- 6.24 In common with the OFT, the FSA emphasised that: “If a decision is taken to rewrite the UTD, we consider that any draft Bill or Regulations produced as part of such a process should be separately consulted on.”

Discussion

- 6.25 We have been persuaded by the strong arguments put to us that we should not rewrite the Directive simply to make it more accessible to a UK audience. We agree with Professor Twigg-Flesner that it is often better to adopt EU terminology, where this introduces new concepts, or where there is a body of relevant case law on the interpretation of certain key phrases.

- 6.26 The UTD is now almost 20 years old, and has been interpreted by a substantial body of case law, both in the UK and in Europe. It has also been the subject of extensive guidance from the OFT and other regulators. We do not wish to disturb this existing understanding unless there is a good reason to do so. We also accept that the wording of the legislation will need to be interpreted in the light of the Directive in any event. We note, too, that Government guidance on transposition requires copying out of Directives, unless the alternative is preferable.
- 6.27 In several instances, there are good reasons to make changes to the text of the Directive. We have already discussed the need to reform the exemption for price and subject matter currently in Regulation 6(2) of the UTCCR. Some changes are needed to incorporate the consumer provisions of UCTA within the same legislation. Furthermore, in Parts 4 and 7 we conclude that there are important elements in the recitals which need to be reflected in the text of the legislation.⁴ We accept, however, that unless there is a specific reason to make a change, the new legislation should reflect the words of the UTD.
- 6.28 **Recommendation 21: The Unfair Terms Directive should be copied out into the law of the UK, subject to the specific recommendations we make.**

THE FAIRNESS TEST

- 6.29 Regulation 5(1) of the UTCCR sets out the basic test of unfairness, using the words of article 3(1) of the UTD:

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.

- 6.30 This must be judged at the time the contract was concluded. Regulation 6(1) follows the words of article 4(1) by stating:

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.

⁴ In particular, the words in Recital 13 discussed at paras 7.39 to 7.51 and the words of Recital 20, discussed at paras 4.2 to 4.5 and 6.50.

- 6.31 This contrasts with the test in UCTA, which requires that a term is “fair and reasonable” having “regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made”.⁵ UCTA lists various factors to which the court should have regard, including the strength of the relative bargaining positions of the parties⁶ and whether the party seeking to restrict liability could obtain insurance.⁷
- 6.32 In 2002, we noted that there had been considerable debate about the interpretation of the fairness test.⁸ We discussed the fairness test in detail and concluded that there was no substantive difference between tests in UCTA and the UTCCR. 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.
- 6.33 We thought that the reference to “good faith” may be confusing to a UK audience and that it would be better to ask whether the term is “fair and reasonable”.⁹ Clause 14 of the draft Bill set out the details of the test. Clause 14(1) said:
- Whether a contract term is fair and reasonable is to be determined by taking into account—
- (a) the extent to which the term is transparent, and
- (b) the substance and effect of the term, and all the circumstances existing at the time it was agreed.
- 6.34 Clause 14(4) then listed ten factors to which the court should have regard. This included factors listed in UCTA (such as the strength of the parties’ bargaining position) but was more extensive.

Consultees’ views

- 6.35 In the Issues Paper, we asked whether consultees agreed that the fairness test should be rewritten in line with clause 14(1) of the draft Bill.¹⁰ Although a majority of respondents supported the new test, strong arguments were put against it.

⁵ See s 11(1) for England and Wales and s 24(1) for Scotland.

⁶ UCTA Sch 2, para (a). In theory, Sch 2 only applies to terms in non-consumer contracts which exclude implied terms in the sale or supply of goods (under ss 6(3), 7(3), 20 and 21) but the 2002 Consultation Paper noted that the factors had been applied more widely (para 3.72).

⁷ See s 11(4) in England and Wales and s 24(3) in Scotland.

⁸ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No166; Scottish Law Commission Discussion Paper No 119, para 3.57.

⁹ Clause 4(1) of the draft Bill.

¹⁰ Issues Paper, para 9.50.

- 6.36 Those consultees that welcomed the proposal thought it offered increased clarity. For example, the Law Society thought that the “unfairness test in UCTA and in the UTCCRs appears, to all intents and purposes, to be the same”. However, several respondents disagreed that the tests had the same meaning. Malcolm Waters QC commented:

It is by no means clear that the Directive’s twin concepts of “significant imbalance” and “good faith” have the same meaning as the “fair and reasonable” test proposed by the Law Commissions...

- 6.37 Similarly, the Bar Council was unsure “to what extent there is a requirement to look beyond the concept of fairness” in the new test. Sky thought that the proposed test “represents a considerable and disproportionate change” which would have an “onerous impact on consumers”.

- 6.38 Professor Christian Twigg-Flesner noted that the position has changed since 2005 and the same arguments do not apply:

Although both proposals made a lot of sense in 2005, we have since seen a significant body of domestic case law emerge, which shows that the courts are able to handle the current test as well as might be expected. So I am now less persuaded of the need for re-wording; indeed, I think the case for retaining the language has become stronger now.

- 6.39 The OFT saw possible advantages and disadvantages of the new test, before concluding that it would prefer the unfairness test to stay as it is, unless all the various risks could be satisfactorily addressed.

- 6.40 Meanwhile the FSA thought that the proposed test would lead to uncertainty about whether existing terms drafted with the old test in mind are fair under the new test. The FSA warned that:

the benefit of consistency with other European markets and the relevance of judgments from European courts could be lost, as could the precedent value of existing materials relating to the UTCCR.

The FSA said that the new test “may also raise the question of whether the Directive had been properly implemented”.

- 6.41 Few consultees commented on the list of factors we proposed for courts to take into account. However, the list proved unpopular with those that did, such as the OFT, FSA and Sky. As the OFT commented:

In our view the factors in Clause 14(4) of the 2005 Bill, if taken forward, need reconsidering. We do not think that they are all consistent with the Directive’s intention... Furthermore, we consider it very odd that there is no specific mention in the list of the concept of good faith.

Discussion

Keeping the words of articles 3(1) and 4(1)

- 6.42 As we have seen, Regulations 5(1) and 6(1) of the UTCCR currently reflect articles 3(1) and 4(1) of the UTD. We accept the arguments put to us in favour of retaining these words. The test is now more familiar to a UK audience, and has acquired a significant body of domestic and European case law to interpret it. It no longer appears to give rise to much confusion. We have been persuaded that the benefits of changing the formulation do not outweigh the risks of introducing new uncertainties. We also agree that if we are to keep the current UTD test, it would be inappropriate to add further factors to it.
- 6.43 The new legislation will incorporate the consumer protection provisions of UCTA. This means that business-to-consumer provisions which are currently subject to the “fair and reasonable” test in UCTA will be removed from UCTA and subsumed within the fairness test in the new unfair terms legislation. There are three sorts of terms in consumer contracts which must be fair and reasonable under UCTA to be enforceable. These are terms which:
- (1) exclude or restrict liability for negligence or breach of duty (section 2(2) in England and Wales or section 16(1)(b) in Scotland);
 - (2) exclude or restrict liability for breach of contract, or which allow a trader to render a contractual performance substantially different from that which was reasonably expected (section 3 in England and Wales or section 17(1) in Scotland);¹¹ or
 - (3) require a consumer to indemnify another person for liability for negligence or breach of contract (section 4 in England and Wales or section 18(1) in Scotland).
- 6.44 We have therefore considered the effect of subjecting these terms to the UTD test rather than the fair and reasonable test in UCTA. In particular, would the removal of the UCTA factors reduce consumer protection? We think not. As we argued in 2005, the two tests are very similar, if not identical. Furthermore, terms which inappropriately exclude or limit the consumer’s legal rights are included in the grey list.¹² Although in formal terms, there is no presumption that exclusion clauses are unfair, in practice the courts would require strong justifications for them, and this is true under both formulations of the test.

¹¹ These sections also cover terms which allow a trader to render no contractual performance at all. Note too that exclusion or restriction clauses are defined widely to include clauses which make enforcement subject to onerous conditions or which restrict rules of evidence or procedure: s 13 in England and Wales and s 25(3) in Scotland.

¹² UTCCR, Sch 2, para 1(b).

- 6.45 We have concluded that the UTD test should replace the “fair and reasonable” test in UCTA as far as consumer contracts are concerned. This would allow for greater simplicity in the law, without limiting the protection that is currently offered. We discuss the remaining role of UCTA in Part 7.¹³
- 6.46 **Recommendation 22: The fairness test set out in articles 3(1) and 4(1) of the Unfair terms Directive should be replicated in the new legislation. It should not be supplemented by a list of factors.**

THE REQUIREMENT THAT ALL TERMS SHOULD BE TRANSPARENT

Article 5

- 6.47 Article 5 of the UTD requires that all written terms are in plain, intelligible language. It states:

In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language.

- 6.48 The article goes on to say that in an individual challenge by a consumer, “where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail”.

- 6.49 Article 5 has been implemented in Regulation 7 in the following terms:

(1) A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language.

(2) If there is doubt about the meaning of a written term, the interpretation which is most favourable to the consumer shall prevail but this rule shall not apply in proceedings brought under regulation 12 [by enforcement bodies].

- 6.50 In our 2005 Report we argued that there was more to article 5 than simply the language used. We thought that the words of article 5 must be read subject to Recital 20, which states that not only should contracts be drafted in plain, intelligible language, but that “the consumer should actually be given an opportunity to examine all the terms”. It follows that terms should not only use the right language but should also be legible and available. Terms cannot be acceptable under the UTD if they are too small to read. We therefore developed the concept of “transparency”, discussed in detail in Part 4.

The consequences of failing to make terms transparent

- 6.51 This leads to difficult questions about the consequences of failing to make written terms transparent.

¹³ Paras 7.110 to 7.131.

- 6.52 In 2005 we did not think that a non-transparent term was automatically unfair. On the other hand, we thought that it was “a vital aspect of fairness”.¹⁴ We thought that it should be possible for a term to be unfair principally or solely because it was not transparent.¹⁵ Therefore, the fairness test set out in the draft Bill required the court to take into account “the extent to which the term is transparent”.
- 6.53 In the Issues Paper we explained that there is another consequence of failing to make terms transparent. Enforcement bodies acting under Part 8 of the Enterprise Act 2002 can exercise their powers to remove terms which breach article 5.
- 6.54 This point is not specified in the UTCCR, but is a consequence of the Consumer Injunctions Directive (CID). The CID requires Member States to introduce mechanisms for proceedings by qualified entities seeking orders requiring the cessation or prohibition of any infringement of any part of the UTD.¹⁶ The CID was implemented by Part 8 of the Enterprise Act 2002, which aims to protect the collective interests of consumers where there is an act or omission contravening a listed directive.¹⁷ The UTD is a listed directive. Given that article 5 is written in mandatory terms (“terms must always be drafted in plain, intelligible language”), it follows that enforcement bodies must be entitled to seek orders requiring the cessation of the use of terms which are not in plain intelligible language.
- 6.55 We think that the CID must also be read subject to Recital 20, which means that terms should be drafted in a way which would give consumers the opportunity to examine all the terms. This means that the enforcement bodies should have power to bring enforcement action against terms which are illegible or unavailable.
- 6.56 In the Issues Paper we noted that this power would be particularly helpful in dealing with terms in end user licence agreements (EULAs). In Appendix C we drew attention to complex and unintelligible terms which confused consumers even if they had no substantive legal effect. We thought that enforcement bodies should have clear powers to remove them.¹⁸

Our current view

Written terms should be transparent

- 6.57 It is clearly important that the new legislation should include a specific reference to article 5. We think that this should require terms to be transparent, rather than simply in plain, intelligible language. The legislation should therefore include a statement along the following lines: “written terms offered to the consumer must be transparent”.

¹⁴ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.98.

¹⁵ Above, para 3.102.

¹⁶ Directive 98/27/EC of 19 May 1998 on injunctions for the protection of consumers’ interests, OJ 1998 L 166/51. This was replaced by the codifying Directive 2009/22/EC of 23 April 2009, OJ 2009 L 110/30: see art 2(1)(a).

¹⁷ Enterprise Act 2002, Part 8, s 212.

¹⁸ Appendix C to the Issues Paper, para C.70.

6.58 We discussed the definition of “transparency” in detail in Part 4. It requires that terms are in plain, intelligible language, readily available to the consumer and legible. These are not onerous requirements. Whilst we fully accept that not all terms can be prominent, we see no reason why all terms should not be transparent. We think that this is already required by the UTD, and that the point should be made clear.

6.59 We have considered whether widening the words of Regulation 7(1) from “plain, intelligible language” to transparency could be seen as a presentational requirement contrary to the Consumer Rights Directive (CRD) which is a maximum harmonisation measure. We think not, because the CRD must be read subject to the UTD. The requirement that consumers “should actually be given an opportunity to examine all the terms” is already part of the UTD, when read alongside Recital 20.

The consequences of terms not being transparent

6.60 We have considered whether the legislation should specify that terms may be unfair principally or solely because they are not transparent. Given the strong arguments put by many consultees in favour of keeping the current fairness test, we have decided not to make this change. We think that the courts will be strongly influenced by the fact that terms are not transparent, but the fairness test must take account of “all the circumstances attending the conclusion of the contract”. We would not wish to suggest that non-transparent terms are almost always unfair.

6.61 On the other hand, we think it important to clarify that enforcement bodies may use their powers under Part 8 of the Enterprise Act 2002 against terms which are not transparent. This enables regulators to work with traders to improve the way that terms are presented, without being drawn into arguments about whether those terms are fair. Our survey of the problems caused by EULAs shows that there are too many incomprehensible, jargon-ridden terms in use, which confuse consumers and discourage them from relying on their legal rights. Enforcement bodies should be able to take steps to remove them without undue legal argument.

6.62 We think that this is already the law: as explained above, it follows from the requirement in the CID that enforcement bodies may seek orders against an infringement of any part of the UTD. Under Part 8 of the Enterprise Act 2002, the powers are available for “an act or omission which harms the collective interests of consumers” and contravenes a directive listed in Schedule 13.¹⁹ Nevertheless, this consequence is by no means clear from a casual reading of the UTCCR. We think that the issue should be clarified.

6.63 **Recommendation 23: Regulation 7(1) of the Unfair Terms in Consumer Contracts Regulations 1999 should be amended to state that written terms offered to the consumer must be transparent.**

¹⁹ Enterprise Act 2002, Part 8, ss 210 and 212.

6.64 **Recommendation 24: The new legislation should clarify that enforcement bodies may use their powers under Part 8 of the Enterprise Act 2002 against written terms which are not transparent.**

PART 7

OTHER ISSUES

- 7.1 In this Part we discuss our remaining recommendations on unfair terms in consumer contracts.

TERMS OF NO EFFECT

- 7.2 Under the Unfair Contract Terms Act 1977 (UCTA) two types of term in consumer contracts are rendered of no effect at all. These are terms which exclude or restrict:

- (1) the implied terms about the title, quality and fitness of goods;¹ or
- (2) business liability for death or personal injury.²

- 7.3 We noted that the Department for Business, Innovation and Skills (BIS) have proposed that the implied terms of title, quality and fitness of goods should become non-excludable statutory guarantees.³ This means that it will no longer be necessary for provisions in unfair terms legislation to prevent their exclusion in consumer contracts. As BIS are already simplifying the law in this respect, we did not discuss the exclusion of the implied terms in the Issues Paper.

- 7.4 We focused on terms relating to death or personal injury. We noted that, under UCTA, terms are of no effect if they purport to exclude or restrict a business's liability to a consumer for death or personal injury resulting from negligence or breach of duty. We asked consultees whether they agreed that these terms should continue to be ineffective.⁴

Consultees' views

- 7.5 Consultees' views have not changed since 2002, when we first posed this question – all respondents who answered the question agreed that these terms should continue to be ineffective. As Deborah Parry put it, removing this protection would be a “retrograde step”.
- 7.6 Under the Unfair Terms in Consumer Contracts Regulations 1999(UTCCR), such terms would almost certainly be unfair under the general fairness test. Which?, however, commented that “not all consumers will realise this and consumer detriment is likely to result” from the lack of a specific provision.

¹ See s 6(1) and (2) in England and Wales and ss 20(1) and (2) in Scotland. These sections prevent the exclusion of the implied terms in s 12 to 15 of the Sale of Goods Act 1979, which relate to title, conformity with description or sample, and the quality and fitness of goods. The sections also prevent the exclusion of the corresponding terms in hire-purchase contracts. Similarly s 7(2) in England and Wales and s 21(1) in Scotland prevent the exclusion of similar implied terms in other contracts under which title to goods passes.

² See s 2(1) in England and Wales and s 16(1)(a) in Scotland.

³ Department for Business, Innovation and Skills, *Enhancing Consumer Confidence by Clarifying Consumer Law* (July 2012), available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31350/12-937-enhancing-consumer-consultation-supply-of-goods-services-digital.pdf at 2.4.

⁴ Issues Paper, para 9.22.

- 7.7 We agree with Which? that it would be insufficient to rely on the fairness test alone. We think that terms which exclude or restrict liability for death or personal injury resulting from negligence or breach of duty should continue to be of no effect.

What would such a provision look like?

- 7.8 An aim of this project is to bring all unfair term provisions affecting business to consumer contracts into one place. We therefore think that this provision should be in the new legislation.
- 7.9 We note that the UTCCR already list one type of term of no effect. Regulation 5(6) states that terms requiring a consumer to bear the burden of proving that a financial supplier failed to comply with its distance marketing obligations shall always be regarded as unfair.⁵ A provision relating to terms restricting or excluding liability for death or personal injury would be similar in nature.
- 7.10 At present, the terms in UCTA dealing with liability for personal injury or death are quite specific. They cover both contract terms and notices, but apply only to business liability resulting from negligence or breach of duty.
- 7.11 The provisions differ between England, Wales and Northern Ireland on the one hand and Scotland on the other. The English, Welsh and Northern Irish provision, section 2(1), refers to terms or notices which exclude or restrict liability for death or personal injury resulting from negligence. Under section 1, this is confined to liability arising from things done by a person in the course of business, or from the occupation of premises for business purposes. Negligence is specifically defined. In broad terms the definition covers liability as arising from:
- (1) a contractual obligation to take reasonable care or exercise reasonable skill in the performance of a contract;
 - (2) the common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty); or
 - (3) from occupier's liability.
- 7.12 By contrast, the Scottish provision, section 16, refers to a term or notice which "purports to exclude or restrict liability for breach of duty arising in the course of any business or from the occupation of any premises used for business purposes". Breach of duty is defined, in section 25(1), as breach of any obligation to take reasonable care or exercise reasonable skill arising from a contract, or from a common law duty, or from section 2(1) of the Occupiers' Liability (Scotland) Act 1960.
- 7.13 In 2005 we rewrote these provisions, to cover the whole of the UK. The relevant clauses are in Part 1 of the draft Bill. Our aim was to bring the provisions together in a clearer way, while keeping the substance of the law.

⁵ This was added by the Financial Services (Distance Marketing) Regulations 2004 Reg 24(3) (SI 2004 No 2095) to implement Directive 2002/65/EC of 23 September 2002 on distance marketing of consumer financial services (OJ 2002 L 271).

- 7.14 We think that the new version of the UTCCR should include a provision based on Part 1 of the draft Bill, with appropriate adaptations.⁶ The effect would be that any term or notice which excludes or restricts a business's liability for death or personal injury resulting from negligence or breach of duty would always be regarded as unfair. The definition of negligence should follow the draft Bill.
- 7.15 The grey list also covers terms which purport to limit liability for death or personal injury. Paragraph 1(a) of Schedule 2 lists terms which have the object or effect of:
- excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier.
- 7.16 This is wider than the provisions in UCTA, as it covers liability resulting from any "act or omission", not just negligence. This would include intentional torts or delicts. It will therefore be necessary to preserve this paragraph, though it will need to be read subject to the new provisions.
- 7.17 **Recommendation 25: The new legislation should replicate the substance of the provisions in the Unfair Contract Terms Act 1977 concerning terms and notices which purport to exclude or restrict a trader's liability for causing death or personal injury resulting from negligence or breach of duty. Such terms should always be regarded as unfair.**

END USER LICENCE AGREEMENTS

- 7.18 In the Issues Paper we included an Appendix on the effect of unfair terms legislation on end user licence agreements (EULAs).⁷ EULAs commonly accompany contracts for software and other digital products. 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.
- 7.19 We explained that terms which simply reproduce existing copyright law cannot be reviewed for fairness under the Unfair Terms Directive (UTD), as they simply reproduce the default law. On the other hand, we thought that other terms could be reviewed, including clauses which purport to exclude the supplier's liability under the law of privacy, negligence or libel.

Just contract terms, or contract terms and notices?

- 7.20 We highlighted a problem. For a term to be reviewable for fairness, it must be part of a contract. 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.

⁶ For example, the new provision need not include clause 1(2) (which relates to business liability for other forms of loss and damage); or clause 2 (which does not relate to business to consumer contracts). It should be noted that clause 2(2) does not apply to Scotland thereby preserving differences (which continue to exist) in the law of occupiers' liability there.

⁷ Issues Paper, Appendix C.

- 7.21 Exclusion clauses in browse wrap licences are almost certainly void. Even if an exclusion clause is unenforceable, however, it may still be damaging, as it may confuse consumers and discourage them from pursuing their legal rights. We thought that it would be helpful if enforcement bodies could take action against unfair exclusion clauses in EULAs without facing a technical and difficult argument about whether the EULA constituted a contract.
- 7.22 UCTA, unlike the UTCCR, is not confined to contract terms. UCTA also covers notices which exclude business liability. In 2005, we recommended that notices which exclude business liability should fall within the scope of the new legislation, and that it should be open to the Office of Fair Trading (OFT) and other enforcement bodies to bring actions against such notices. In Appendix C, we argued that the power to take action against notices would be particularly helpful in dealing with some EULAs.⁸

Consultees' views

- 7.23 We asked whether the UTD applied to end user licence agreements in a satisfactory way. This question received relatively few responses. Most people agreed that the UTD dealt with EULAs satisfactorily. Several respondents suggested that the problems related to lack of enforcement rather than the law.
- 7.24 That said, both Which? and the OFT were concerned that EULAs might escape regulation because traders could argue that EULAs are not contracts. As Which? put it, "companies claim the UTCCRs do not apply to EULAs because they are 'licences'".
- 7.25 The OFT welcomed the power to take action against notices as well as contract terms. The OFT described this as essential "to ensure a high degree of consumer protection". Ofcom also supported such a change.

Discussion

- 7.26 In 2005 we proposed to follow UCTA by including notices which purported to exclude or restrict business liability resulting from negligence.⁹ Having considered the problems which arise over EULAs, we now think that protection should extend more widely than negligence. Many exclusions in EULAs refer to other forms of liability, including liability for defamation or breach of privacy. Some exclusions are written in such vague, general terms that it is difficult to pin-point what liability is intended to be excluded.
- 7.27 We have therefore been persuaded to extend the provisions on notices to include any notice which purports to exclude any legal liability which the trader would have to the consumer in the absence of the notice. We discuss this further below.

⁸ Issues Paper, Appendix C, para C.70.

⁹ See draft Bill, clause 1(2).

NOTICES

- 7.28 As we noted above,¹⁰ UCTA covers contract terms and notices which exclude business liability, while the UTCCR only cover contract terms.
- 7.29 In 2005, we recommended that the preventive powers should apply to UCTA as well as the UTCCR. 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.
- 7.30 In the Issues Paper, we asked consultees whether they agreed that enforcement bodies should be able to bring enforcement action against unfair notices which purport to exclude the business’s liability.¹¹ All respondents who answered this question agreed.
- 7.31 In light of the support for our proposal, we recommend that notices should be included within the new legislation. And, as discussed above, the new legislation should cover any notice which purports to restrict or exclude a legal liability which the trader would otherwise have to the consumer.
- 7.32 This will not be a major change. UCTA already offers protection against notices which purport to exclude or restrict liability for negligence. And in all the cases we have looked at, the purported exclusion was void in any event. The laws of the UK do not permit a business to protect itself against the possibility of legal action simply by putting up a notice, but such notices are routinely used in the online environment.
- 7.33 The main change would be to permit enforcement bodies to take action to remove such notices. It would allow them to bring action against end user licence agreements, for example, without complex legal arguments about whether the licences were or were not contracts.

How would this change be effected?

- 7.34 In the previous section, we concluded that terms excluding business liability for death or personal injury resulting from negligence should be of no effect. The new legislation should therefore state that notices excluding liability for death or personal injury are not binding on the consumer.
- 7.35 Other notices which purport to exclude or restrict the trader’s liability should fall within the general fairness test set out in the UTD. This will involve extending the scope of the UTCCR, as currently set out in Regulation 4. Regulation 4 states:

These Regulations apply to unfair terms in contracts concluded between a seller or a supplier and a consumer.

¹⁰ Para 7.22.

¹¹ Issues Paper, para 9.57.

- 7.36 This will need to be extended to include terms contained within notices of a non-contractual nature which purport to exclude or restrict the trader's legal liability to a consumer.
- 7.37 At present, section 14 (section 25(1) in Scotland) of UCTA defines a "notice" as including an "announcement, whether or not in writing, and any other communication or pretended communication". We think this is a satisfactory definition which could be carried across to the new legislation.
- 7.38 **Recommendation 26: Notices which purport to exclude or restrict a trader's legal liability to a consumer should be brought within the scope of the legislation. This means that:**
- (1) **notices would be assessable for fairness (unless they fall within the provisions relating to liability for personal injury and death outlined above); and**
 - (2) **enforcement bodies would have powers to bring action against notices.**

TERMS WHICH REFLECT THE EXISTING LAW

- 7.39 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 1(2) of the UTD.
- 7.40 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".
- 7.41 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.¹² 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.
- 7.42 In 2005 we recommended that the scope of this exemption should be clarified, so as to include terms which produced substantially the same result as would be produced as a matter of the law if the term were not included, provided that the term was also transparent.¹³

¹² This is discussed further in Appendix C to the Issues Paper.

¹³ Unfair Terms in Consumer Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.72.

Consultees' views

- 7.43 In the Issues Paper we asked consultees whether they agreed that the exclusion of “mandatory statutory or regulatory provisions” in Regulation 4(2) should be rewritten to include terms which reflect the existing law.¹⁴
- 7.44 A strong majority of the respondents who answered this question agreed with our proposal. The Faculty of Advocates were among those who supported “this point being made explicitly in the Regulations for the avoidance of doubt”.
- 7.45 We think that it is important to include this provision on the face of the legislation. As we argued in 2005, we think this exclusion is already part of the UTCCR, as properly interpreted against the UTD and its recitals. The issue, however, is by no means clear from a reading of the UTCCR as presently drafted. Our terms of reference require us to bear in mind the need for clarity, and we think that the legislation would be clearer if it included the explanation given in Recital 13.

How would this change be effected?

- 7.46 As discussed in Part 6, there is a strong desire to keep to the original words of the Directive, unless there is a good reason not to do so.
- 7.47 We think that it is important to include the statement in Recital 13 that “the wording ‘mandatory statutory or regulatory provisions’ in article 1(2) also covers rules which, according to the law, shall apply between the contracting parties provided no other arrangements have been established”. This, we think, is already part of the law.
- 7.48 On the other hand, we think that it is best to keep within the general principle of copy out by staying as close as possible to the relevant words of Recital 13. We think this would be preferable to rewriting the exemption in a different way, as it would, in any event, need to be interpreted against the words of Recital 13.
- 7.49 At present, Regulation 4(2) states:

These Regulations do not apply to contractual terms which reflect–

- (a) mandatory statutory or regulatory provisions (including such provisions under the law of any Member State or in Community legislation having effect in the United Kingdom without further enactment);
 - (b) the provisions or principles of international conventions to which the Member States or the Community are party.
- 7.50 We think this should be expanded to include a third paragraph, which follows the words of Recital 13 by stating:
- (c) rules which, according to the law, shall apply between contracting parties provided that no other arrangements have been established.

¹⁴ Issues Paper, para 9.62.

- 7.51 **Recommendation 27: The exclusion in Regulation 4(2) should specifically include “rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established”.**

NEGOTIATED TERMS

- 7.52 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.
- 7.53 We think that it is important to maintain the UCTA controls on negotiated terms. Our terms of reference specifically ask us to incorporate the two current legal regimes “without reducing the existing level of consumer protection”. The question is whether to maintain a complex distinction between UCTA and the UTCCR in the way that negotiated terms are treated, or whether to remove the exclusion for negotiated terms across both sets of legislation.
- 7.54 When we consulted on this issue in 2002, a large majority of consultees thought that the new legislation should apply to all terms, whether negotiated or not. This would make the legislation simpler, while affecting very few cases.¹⁵ 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.¹⁶ Therefore in 2005 we recommended that the exemption for negotiated terms should be removed.

Consultees’ views

- 7.55 We asked whether consultees still agreed that the new legislation should cover terms in consumer contracts, whether or not they were individually negotiated.¹⁷ The majority of those who answered this question agreed that it should.

Responses in favour of our proposal

- 7.56 Deborah Parry made a strong argument for the inclusion of negotiated terms:

Simplification and standardisation of the combined provisions of the UTD and UCTA should be the key aim. The current restriction to non-individually negotiated terms in the UTCCRs encourages argument and litigation. Businesses have no real need to be concerned about negotiated terms being open to scrutiny as the fairness test is very likely to be satisfied in the vast majority of cases.

¹⁵ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.52.

¹⁶ 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.

¹⁷ Issues Paper, para 9.36.

- 7.57 North East Trading Standards Association thought that “at times it may be unclear whether a term has been individually negotiated or not”. Thus, the “legislation would be clearer and more easily enforced were it to cover all terms in the contract irrespective of whether they are individually negotiated or not”.
- 7.58 The OFT supported the inclusion of negotiated terms and argued that “the effect of the current exemption under the UTCCRs is that traders sometimes see it as a loophole from the law, arguing that terms that have been negotiated when the reality is that they have not”.
- 7.59 Which? put forward three reasons to include negotiated terms:
- The vast majority of (if not all) terms that would be negotiated by the consumer are likely to be “core terms” and/or the “price” and so excluded from an assessment for fairness in any event;
 - It removes any doubt as to whether the UTCCRs apply where a consumer has sought, unsuccessfully, to negotiate terms of a contract;
 - Even though a consumer may seek to negotiate a term it does not mean the end result will be fair. In particular, the information asymmetries referred to above may mean the consumer does not properly appreciate what they are negotiating. In addition, they will probably not realise that by seeking to negotiate the contract, they are losing their protection under the UTCCRs.

Against the inclusion of negotiated terms

- 7.60 HSBC, on the other hand, considered that “this will further upset the careful balance that was written into the UTD and the UTCCR between consumer protection and freedom of contract”.
- 7.61 The British Bankers’ Association (BBA) noted that “courts already have discretion to determine whether a negotiated term was indeed subject to fair negotiation and to act if that was not the case”.
- 7.62 The Finance & Leasing Association thought that the change:
- could undermine and put at risk the freedom of an individual to contract terms that are peculiar to their own circumstances. Requiring that individually negotiated terms should be subject to the fairness and transparency assessment would result in businesses being reluctant to indulge the particular wishes of consumers for fear of reprisals at a later stage.
- 7.63 Paul Davies was against the change on the ground that “in these cases there is no ‘consumer surprise’”. He thought that if “the agreement reached cannot be vitiated for other reasons (such as misrepresentation, duress, undue influence or unconscionability) then perhaps it is fair for the company to be able to rely on the term as it stands”.

Discussion

- 7.64 We accept that our proposal involves an element of rounding up, but we do not think that it unduly restricts freedom of contract. It will affect very few cases. As Which? point out, in practice the vast majority of negotiated terms will fall within the exemption for main subject matter or price, and therefore be excluded from review. And where terms about other issues are genuinely negotiated, they are very unlikely to be found unfair, as the courts are not there to undo bad bargains.
- 7.65 This should not suggest that the extension is unnecessary. The legislation should have the same scope across the board, while not reducing the consumer protection currently offered by UCTA. The reform will also preclude factually difficult arguments over whether a particular term was individually negotiated or not. We agree with Deborah Parry that the current position encourages “argument and litigation” over whether a term was individually negotiated.¹⁸ We think that legislation will be more easily enforced if the distinction between standard terms and negotiated terms is removed.
- 7.66 **Recommendation 28: Any term, with the exception of exempted terms, should be subject to the fairness assessment, whether negotiated or not.**

THE BURDEN OF SHOWING THAT A TERM IS FAIR

- 7.67 Under UCTA the burden of showing that a term is fair lies on the business.¹⁹ By contrast, the UTCCR do not specifically allocate the burden of proof. However, the Court of Justice of the European Union (CJEU) has held that 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.²⁰ Where the court considers such a term to be unfair it must not apply it, except if the consumer opposes the non-application.²¹
- 7.68 The rationale for the duty on the courts to raise the issue of fairness of their own motion was explained by CJEU in *Mostaza Claro* in the following terms:

¹⁸ Reg 5(2) states that a term is not individually negotiated “where it has been drafted in advance” and the consumer has “not been able to influence the substance of the term”. In *UK Housing Alliance Ltd v Francis* [2010] EWCA Civ 117, [2010] 3 All ER 519, the Court of Appeal held that the fact that a consumer had instructed solicitors who had the opportunity to negotiate terms in a leasehold did not mean that the terms were individually negotiated. In this case, the solicitors had not raised objections to the term. Other issues would have arisen if the solicitors had objected, but no changes had been made to the term. It is still ambiguous whether a term would be treated as negotiated if, for example, the consumer took the opportunity to negotiate a term, but was provided with a different concession instead.

¹⁹ See s 11(5) (England, Wales and Northern Ireland) and s 24(4) (Scotland).

²⁰ Case C-243/08 *Pannon GSM Zrt v Erzsébet Sustikné Győrfi* [2009] ECR I-04713; see also Joined cases C-240/98 to C-244/98 *Océano Grupo Editorial SA v Quintero* [2000] ECR I-04941.

²¹ Above at [35].

The nature and importance of the public interest underlying the protection which the Directive confers on consumers justify, moreover, the national court being required to assess of its own motion whether a contractual term is unfair, compensating in this way for the imbalance which exists between the consumer and the seller and supplier.²²

- 7.69 The *Pannon* case makes that obligation subject to an important proviso – it is dependent on the availability of legal and factual elements necessary for that task.²³
- 7.70 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.²⁴ The business will generally have far greater resources than the consumer and is better placed to explain why the term has been included.
- 7.71 Different considerations apply where the claim is brought by an authorised body, which will generally have access to resources to a much greater extent than the typical consumer. In 2005 we recommended that where proceedings are brought by an enforcement body using its preventive powers the burden of proof should be borne by the enforcement body.²⁵

Consultees’ views on the burden where proceedings are brought by individual consumers

- 7.72 In the Issues Paper we began by asking if consultees agreed that, 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.²⁶ A majority of respondents who answered this question agreed with the proposal.

In favour of the proposal

- 7.73 Many respondents (for example, Ofgem) pointed to the “far greater resources” that traders have at their disposal. The Royal Institution of Chartered Surveyors considered it to be an “equality of arms’ point”. The Faculty of Advocates also argued that businesses:

will be better placed than the consumer to explain the rationale behind the term and the facts and circumstances that are said to make it fair.

- 7.74 Professor Christian Twigg-Flesner thought that this represented the current position:

²² Case C-168/05, *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421 at [38].

²³ Case C-243/08 *Pannon GSM Zrt v Erzsébet Sustikné Györfi* [2009] ECR I-04713 at [35].

²⁴ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, para 3.130.

²⁵ Above, para 3.163.

²⁶ Issues Paper, para 9.30(1).

Businesses might be concerned about the additional burden this might put on them, but bearing in mind the clear obligation on a court to raise this issue of its own motion, there is already a *de facto* reversal.

7.75 Deborah Parry made a consistency argument:

The burden currently placed on businesses seeking to enforce a term under s 11 UCTA appears to have been applied in a fair and balanced way in cases coming before the courts. In combining UCTA and UTCCR there should be consistency in approach and where it is a B2C [business-to-consumer] transaction it is most appropriate to place the burden on the business party.

7.76 Which? considered that the burden on the trader should be minimal, because “the trader will (or at least should) have already considered whether terms were fair when the contract was put together”.

7.77 A few respondents agreed but with a reservation. The Association of Her Majesty’s District Judges thought that the “evidential burden should only pass to the business once the consumer has prima facie set out an argument that it is unfair”. Similarly, the Bar Council noted that “it ought not to be sufficient for a consumer merely to complain that a contract, or a term or terms thereof, is unfair without specifying why”.

7.78 The Building Societies Association agreed, with the exception of claims brought by claims management companies.

Against reversed burden of proof

7.79 All of the respondents who disagreed came from the business sector.

7.80 The British Retail Consortium was worried that in “having two different approaches to the burden of proof, an authorised body could effectively require to show a term is fair by using an individual complaint as a front”.

7.81 HSBC opposed on the ground that “it would lead to an increase in the number of vexatious claims, particularly from Claims Management Companies who would seek to exploit this change”. A similar point was made by the BBA, who also pointed to a “corresponding increase in administrative costs”.

7.82 The Association of British Insurers (ABI) wrote:

Placing the burden of proof on a firm to prove their terms are “fair” seems to assume that all firms’ terms are automatically assumed to be “unfair” unless proven otherwise. This should not be the approach we take to markets and firms and it contradicts the logic of the UTCCR, which deals with how to determine and address the minority of contract terms which are *unfair*, and does not require proof that they are fair.²⁷

²⁷ Emphasis in original.

Consultees' views on the burden where proceedings are brought by enforcement bodies

7.83 In the Issues Paper we asked consultees whether they agreed that in proceedings brought by an authorised body under its preventive powers, the authorised body should be required to show that a term is unfair.²⁸

7.84 All but three respondents agreed. Most respondents argued that authorised bodies have far greater resources. For example the Faculty of Advocates commented that:

The issue of disparity of resources will not arise here, and indeed in many cases the authorised body is likely to have the upper hand in this regard. Further, the commencement of such proceedings by an authorised body ought to follow only when that body has completed an investigation that allows it to set out a positive case of unfairness.

7.85 The Law Society also pointed out that “where the power of the state is concerned, it is an important principle that the state should have to prove liability, with a presumption of innocence”.

7.86 Citizens Advice was the only respondent who expressly disagreed with the proposal. It did “not feel it is unreasonable to expect businesses to be able to justify the fairness of any particular term regardless of whether proceedings are brought by an authorised body or individual consumers”.

7.87 The OFT thought that further consideration should be given to the position of the Trading Standards Services (TSS):

TSS are also enforcers under the Regulations, and it is the intention of forthcoming legislative changes that they should play a substantially larger part in enforcement of unfair terms legislation, albeit the lead in such matters will fall to the CMA. Their resources and access to legal advice are more often than not limited, and likely to remain so, or even become more so in the current economic climate.

7.88 Ofgem suggested “specific research on the extent to which designated enforcers are seeking injunctive relief from the courts and if not, whether reversing the burden of proof might change this”.

Discussion

7.89 The effect of the CJEU case law is that a court must consider the fairness of a term even if the consumer does not mention the point. Furthermore, the court must be entitled to find that a term is unfair even if the consumer does not present any evidence. It is important that any new legislation is consistent with this case law.

²⁸ Issues Paper, para 9.30(2).

- 7.90 We think that it would be helpful to have an express statement in legislation spelling out the effect of the CJEU case law. Although this is already the law, we think that it would be helpful to state it explicitly in order to bring this obligation to the attention of the courts. It should be particularly helpful in raising the awareness of the lower courts that this is in fact an obligation rather than just a power given to the courts.
- 7.91 On further reflection, we do not think that the legislation should include any other statements relating to the burden of proof. To put the burden of proof on the consumer, even if it was just to prove a *prima facie* case, may not fit with the requirements of the EU law. Conversely, we do not want to suggest that all contract terms are assumed to be unfair unless the contrary is shown, though we can see why the ABI and others may have had this impression when we proposed to reverse the burden of proof.
- 7.92 We were impressed by the fact that the UTCCR have been in operation for almost 20 years, but the question of the burden of proof has never caused any major concerns despite the legislation being silent on the issue. In practice, where a business seeks to rely on a contract term, it will need to establish that the term exists, and will usually be required to present a copy of the term to the court. Often this will be the only evidence that is required. The court will then be able to read the term and decide for itself whether the term is fair. Thus, any burden of proof on the business is a light one.
- 7.93 In Part 6 we noted the strong desire to copy out the UTD and its case law, rather than try to rewrite the law in terms more familiar to a UK audience. With this in mind, we think it may be clearer to keep to the words of the *Pannon* judgment, and leave the issue of the burden of proof as it is now. In that case the Court stated that:
- The national court is required to examine, of its own motion, the unfairness of a contractual term where it has available to it the legal and factual elements necessary for that task.
- 7.94 We therefore limit ourselves to recommending that the new legislation should specifically state that in proceedings brought by individual consumers, the court should be required to consider the fairness of a term even if the consumer has not raised the issue of unfairness. This will be sufficient to establish that the consumer does not have to prove the unfairness of a term. Unfair terms legislation is meant to protect unrepresented consumers in low level litigation before the county court or sheriff court, so it is important that the law is accessible. Furthermore, the CJEU has consistently said that national implementing measures must be clear and certain, so that individuals are made fully aware of their rights.²⁹
- 7.95 We do not think any change to the current text of the UTCCR is necessary to deal with the burden of proof in proceedings brought by enforcement bodies.

²⁹ See Issues Paper, paras 7.18 and 7.19. See in particular case C-144/99 *Commission v Netherlands* [2001] ECR I-3541 and case C-478/99 *Commission v Sweden* [2002] ECR I-4147.

- 7.96 **Recommendation 29: The new legislation should state that, in proceedings brought by individual consumers, the court is required to consider the fairness of a term, even if the consumer has not raised the issue, where it has available to it the legal and factual elements necessary for that task.**

THE DEFINITION OF A CONSUMER

- 7.97 In the Issues Paper we explained that UCTA and the UTCCR use different definitions of a consumer.³⁰ UCTA applies wide definitions of “deals as consumer” (in England and Wales) and “consumer contracts” (in Scotland) both of which cover contracts made by businesses if the contract is not integral to the business or made regularly. This means that a business making a one-off transaction, such as buying a photocopier, would be treated as a consumer for the purposes of UCTA.³¹
- 7.98 The UTCCR, on the other hand, uses a narrower definition found in the UTD and other Directives. The definition of a consumer is limited to a “natural person” who is “acting for purposes which are outside his trade, business or profession”.
- 7.99 In 2005, we recommended adopting a slightly wider version of the UTD definition. We defined a consumer as “an individual who enters into the contract wholly or mainly for purposes unrelated to a business”. We have since recommended similar definitions in our reports on misleading and aggressive practices and consumer insurance law.³²
- 7.100 The addition of the words “wholly or mainly” responds to a concern that many consumers occasionally use products such as mobile phones or home computers for work purposes. We thought that a consumer buying a mobile phone mainly for recreational purposes should not be stripped of protection simply because they intended to use the phone for some occasional work calls.
- 7.101 We noted that BIS proposed a similar approach for all consumer protection legislation. In their July 2012 consultation paper, they proposed that UK legislation should define a consumer by reference to acting for purposes which are “wholly or mainly” outside their business, trade or profession.³³

Views and discussion

- 7.102 In the Issues Paper we asked whether consultees agreed 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”.³⁴

³⁰ Paras 9.12 to 9.14.

³¹ See *R & B Customs Brokers Ltd v United Dominions Trust* [1988] 1 WLR 321, [1988] 1 All ER 847.

³² Consumer Redress for Misleading and Aggressive Practices (2012) Law Com 332; Scot Law Com No 226, para 6.21; Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation (2009) Law Com No 319; Scot Law Com No 219, para 5.19.

³³ Department for Business, Innovation and Skills, *Enhancing Consumer Confidence by Clarifying Consumer Law* (July 2012), p 26.

³⁴ Issues Paper, para 9.17.

7.103 A strong majority of the respondents who answered this question agreed with our proposal. Many expressed a need for consistency across all legislation. We think that consistency is key: the legislation on unfair terms should follow the definition of “consumer” used in the new Consumer Bill.

7.104 That said, a few consultees raised issues about the definition of consumer we proposed. The OFT raised particular concerns about exploitative schemes targeted at people who are not in business but who would like to be. They mentioned:

training contracts, contracts for model agency services, “vanity publishing” schemes, advertising aimed at persuading people to invest in consultancy fees about their inventions, and “home-working” schemes, where any money an individual may receive is unlikely to equal the upfront fees charged.

7.105 The OFT thought that these should be regarded as consumer contracts. We agree that this should be the case, since those people are still consumers at the time of entering into a contract and they have “the vulnerabilities characteristic of consumers”.

7.106 The OFT has pointed to section 210(4)(b) of the Enterprise Act 2002, which relates to domestic infringements. It specifically covers contracts where:

the individual receives or seeks to receive the goods or services with a view to carrying on a business but not in the course of a business carried on by him.

7.107 In our Report on Consumer Redress for Misleading and Aggressive Practices we considered the problem of training contracts and concluded that the definition of a consumer we recommended was already wide enough to cover such cases.³⁵ On the other hand, given the many ways in which vulnerable people are exploited by the false promise of “a business, trade or profession” we can see advantages of clarifying the issue in the way the OFT recommends. If so, it would need to be done across all consumer legislation. We therefore refer the matter to BIS for further consideration, rather than make specific recommendations about unfair terms legislation. For present purposes, the most important consideration is that the definition in unfair terms legislation is consistent with that to be used in the forthcoming Consumer Bill.

7.108 **Recommendation 30: The definition of consumer should follow that used in the forthcoming Consumer Bill of Rights.**

7.109 **Recommendation 31: The Department for Business, Innovation and Skills should consider whether to clarify that the definition of a consumer encompasses situations where a natural person seeks to receive goods or services with a view to carrying on a business but not in the course of a current business.**

³⁵ Consumer Redress for Misleading and Aggressive Practices (2012) Law Com 332; Scot Law Com No 226, paras 6.14 to 6.20.

THE REMAINING ROLE OF UCTA

7.110 The new legislation would only affect contracts made between businesses and consumers. UCTA is much wider than this. It also affects business to business contracts, employment contracts and private contracts made between two consumers. This raises the question of what the remaining role of UCTA should be.

Businesses dealing as consumers

7.111 Under our recommendations, UCTA provisions concerning consumers will be removed from the scope of that legislation and consolidated in new consumer legislation. In the preceding section we discussed the discrepancy in definitions of a consumer between UCTA and the UTCCR. The new definition is likely to be narrower than the definition currently used in UCTA, which protects businesses making one-off transactions (such as an insurance broker making a one-off purchase of a car).

7.112 This opens up a question of how the scope of UCTA should be affected. There are two possible options:

- (1) Except from the scope of UCTA only what would be covered by the new legislation; or
- (2) Remove all references to “dealing as a consumer” from UCTA.

7.113 The first option has the advantage of retaining the existing scope of protection. This would mean that businesses making a one-off transaction, and so dealing as consumers, would be protected in the same way as they are now. The second option, on the other hand, is commendable for its clarity and simplicity with negligible loss of protection.

7.114 We have considered what protections might be lost to businesses making one-off purchases if they could not rely on the additional protections provided by “dealing as a consumer”. There are three main differences:

- (1) Under section 3 of UCTA,³⁶ if a term purports to entitle the trader to render a contractual performance which is substantially different from that which the consumer reasonably expected, it is valid only if it is fair and reasonable. This protection applies both to a party who “deals as a consumer” and to a party who deals on the other’s written standard terms of business. Although businesses will no longer be able to rely on this protection in negotiated contracts, it will still be available to them in standard term contracts.

³⁶ S 3 applies in England and Wales; in Scotland, the equivalent provision is s 17.

- (2) Sections 6 and 7 of UCTA impose controls on attempts to exclude the implied terms which, for example, require goods to be of satisfactory quality and fit for purpose.³⁷ Where the party deals as a consumer, the terms may not be excluded at all. For other business contracts, any such exclusion must be fair and reasonable. In a one-off transaction, any exclusion is unlikely to be fair and reasonable, so in practice there is little difference between the two approaches.³⁸
 - (3) Section 4 (section 18 in Scotland) protects those who deal as consumers from being made to indemnify another party for liability for negligence or breach of contract. Any such term must be reasonable. In practice this provision is seldom used.
- 7.115 On balance, we favour the simpler option: we think that references to dealing as a consumer should be removed from UCTA. This carries with it only a negligible loss of protection. The alternative option would lead to a very complicated piece of legislation carrying little benefit for businesses.
- 7.116 **Recommendation 32: Following the new legislation, the Unfair Contract Terms Act 1977 should no longer regulate business to consumer contracts. Nor should it continue to provide additional protection to a business that deals as a consumer.**

Employment contracts under UCTA

- 7.117 At present, employees receive two protections under UCTA:
- (1) Employers can only exclude liability for negligence if it is reasonable;³⁹
 - (2) Employers can only claim to be entitled to render a contractual performance substantially different from that which was reasonably expected if the term is reasonable.⁴⁰
- 7.118 In England and Wales, the second protection is set out in section 3, and applies to employment contracts in two separate ways. First, it applies because employees are considered to be consumers under the wide definition of consumer used in UCTA. Secondly, the protection applies to all standard form contracts, and most employment contracts are written in standard form.

³⁷ 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.

³⁸ There are also protections for consumer goods in s 5 (s 19 in Scotland). In 2005 we concluded that it is not necessary to preserve s 5, since its importance has diminished in practice: see *Unfair Terms in Contracts* (2005) Law Com No 292; Scot Law Com No 199 at para 3.48.

³⁹ See s 2 (England, Wales and Northern Ireland) and s 16 (Scotland).

⁴⁰ See s 3 (England, Wales and Northern Ireland) and s 17 (Scotland).

- 7.119 In Scotland the general UCTA controls are expressly applied to contracts “of service or apprenticeship”,⁴¹ and it has been said judicially that employment contracts will almost always be consumer contracts under the definition in the Act.⁴²
- 7.120 Under the new scheme, employees would no longer be included within the definition of a consumer. This means that employees would continue to receive protection against terms which exclude liability for negligence, or against terms in standard form contracts. On the other hand, they would not receive protection against terms in negotiated contracts which entitle the employer to render a contractual performance substantially different from that which was reasonably expected. Such terms in non-standard form contracts would no longer be required to be reasonable.
- 7.121 When we recommended a similar outcome in 2005,⁴³ it was subject to criticism. In 2008, Professor Douglas Brodie argued that the decline of collective bargaining and the rise of individual employment contracts left more scope for substantively unfair terms in employment contracts.⁴⁴ 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.

Consultees’ views and discussion

- 7.122 In the Issues Paper we asked consultees whether the removal of controls from non-standard form employment contracts would be problematic in practice.
- 7.123 We received very few responses to this consultation question. Half of the respondents saw no practical problems in removing this element of protection from employees. None of the respondents provided any evidence that this protection is important in practice.
- 7.124 Stephen Miller wrote that:

The only part of the contract where this could be said to present a consistent problem in my view would be the use of restrictive clauses or covenants in the non-standard form employment contract; but common law already supplies the necessary "reasonableness" test in circumstances in which contracting out is impossible (on public policy grounds). The legislation on unfair contract terms rarely features in disputes about the enforceability of restrictions.

- 7.125 He also addressed the concerns raised by Professor Brodie:

⁴¹ See s 15(2)(b).

⁴² *Chapman v Aberdeen Construction Group Ltd plc* 1993 SLT 1205, p 1209 (Lord Caplan). For the definition of “consumer contract” see s 25(1).

⁴³ Unfair Terms in Contracts (2005) Law Com No 292; Scot Law Com No 199, paras 6.2 to 6.10.

⁴⁴ D 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; discussed also in the Issues Paper, para 9.70.

With all due respect to Professor Brodie, I also think it is unlikely that a Court or Tribunal in the United Kingdom would uphold an apparently valid attempt to exclude the implied obligation of mutual trust and confidence. I can certainly see as a matter of first principles that any implied term could be supplanted by an express term, it is just that a Court or Tribunal would be expected to disregard such an attempt on public policy grounds there being so much authority to the effect that the implied obligation of mutual trust and confidence is an irreducible term in the employment contract because such contracts govern relationships essentially of a personal nature.

- 7.126 We have concluded that it would not cause practical problems to make this small change to unfair terms legislation as it affects employees. The main problems of unfair terms relate to standard form contracts, which are drafted in advance by the employer. Here controls would remain. We therefore stand by the recommendation we made in 2005 to remove the protection currently granted to employees using non-standard form contracts.
- 7.127 **Recommendation 33: Employees should not be regarded as consumers under the new legislation.**

Private contracts under UCTA

- 7.128 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.⁴⁵ There are also implied terms that goods correspond to their description or sample: under UCTA these can only be excluded if reasonable.⁴⁶ There are no implied terms that goods are of satisfactory quality or fit for their purpose.
- 7.129 In the Issues Paper we expressed concern that, following the consumer reforms, these provisions would be extremely difficult to find. The implied terms themselves would be left behind in the Sale of Goods Act 1979, which would otherwise be an exclusively business to business statute. Meanwhile, the provisions to regulate their exclusion would be left in UCTA, which would also be seen as a business to business statute, rather than a place to find provisions relating to consumer to consumer contracts.
- 7.130 We would urge BIS to consider whether an opportunity can be found to consolidate the law on private sale contracts.
- 7.131 **Recommendation 34: The Department for Business, Innovation and Skills should consider whether an opportunity can be found to consolidate the law on private sale contracts.**

⁴⁵ See s 6(1) (England, Wales and Northern Ireland) and s 20(1) (Scotland).

⁴⁶ See s 6(3) (England, Wales and Northern Ireland) and s 20(2) (Scotland).

PART 8

LIST OF RECOMMENDATIONS

We make the following recommendations:

NEED FOR REFORM

- 8.1 The exemption for main subject matter and price set out in Regulation 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 should be reformed. (Paragraph 2.43)

THE EXEMPTION

- 8.2 The price exemption should be reformulated, to apply only to terms which are transparent and prominent. (Paragraph 3.59)
- 8.3 The main subject matter exemption should be reformulated to apply only to terms which are transparent and prominent. (Paragraph 3.79)
- 8.4 Provided that a price term is transparent and prominent, the court may not assess the amount of the price as against the services or goods supplied in exchange. (Paragraph 3.109)
- 8.5 The exemption for main subject matter should apply to any term which specifies the main subject matter, and not simply to the way that the main subject matter has been defined. (Paragraph 3.119)
- 8.6 To be “transparent” a term must be
- (1) in plain, intelligible language;
 - (2) readily available to the consumer;
 - (3) and, if in writing, it must be legible. (Paragraph 4.26)
- 8.7 To be “prominent” a term must be presented in such a way that the average consumer would be aware of the term. The more unusual or onerous the term, the more prominent it needs to be. (Paragraph 4.46)
- 8.8 Price should be defined as “money consideration”, in line with the definition currently found within section 2(1) of the Sale of Goods Act 1979. (Paragraph 4.65)
- 8.9 The reference to “remuneration” within article 4(2) of the Unfair Terms Directive should be omitted from the new legislation. (Paragraph 4.66)
- 8.10 The Department for Business, Innovation and Skills should hold discussions with the Office of Fair Trading and other regulators about the mechanics of preparing guidance. Subject to these discussions, it should ensure that in deciding whether a term is transparent or prominent, the courts may have regard to guidance. (Paragraph 4.81)

THE GREY LIST

- 8.11 The legislation should specifically state that terms on the grey list are assessable for fairness. The price/main subject matter exemption should be read subject to this provision. (Paragraph 5.25)
- 8.12 The legislation should state that terms in paragraph 2 of the grey list are assessable for fairness, unless they are exempted by other provisions of the legislation. (Paragraph 5.29)
- 8.13 The indicative list of terms that might be unfair should be copied out from the Unfair Terms Directive, subject to the specific changes and additions discussed below. (Paragraph 5.43)
- 8.14 The use of defined terms in the grey list should be consistent with other consumer legislation. (Paragraph 5.46)
- 8.15 Price escalation clauses are already covered by the grey list. There is no need for additions to the list to deal with this issue. (Paragraph 5.63)
- 8.16 Default charges are already covered by the grey list. There is no need for additions to the list to deal with this issue. (Paragraph 5.68)
- 8.17 A new paragraph should be added to the indicative list to cover terms which have the object or effect of permitting the trader to claim disproportionately high sums in compensation or for services which have not been supplied, where the consumer has attempted to cancel the contract. (Paragraph 5.82)
- 8.18 A new paragraph should be added to the indicative list, to cover terms which have the object or effect of giving the trader discretion to decide the amount of the price after the consumer has become bound by the contract. This should be subject to the exceptions currently listed in Schedule 2 paragraph 2 of the Unfair Terms in Consumer Contracts Regulations 1999. (Paragraph 5.101)
- 8.19 A new paragraph should be added to the indicative list, to cover terms which have the object or effect of giving the trader discretion to decide the subject matter of the contract after the consumer has become bound by it. This should be subject to the exceptions currently listed in Schedule 2 paragraph 2 of the Unfair Terms in Consumer Contracts Regulations 1999. (Paragraph 5.116)
- 8.20 A new paragraph should not be added to the indicative list to cover disproportionate and remote contingent charges. (Paragraph 5.125)

COPY OUT AND THE FAIRNESS TEST

- 8.21 The Unfair Terms Directive should be copied out into the law of the UK, subject to the specific recommendations we make. (Paragraph 6.28)
- 8.22 The fairness test set out in articles 3(1) and 4(1) of the Unfair Terms Directive should be replicated in the new legislation. It should not be supplemented by a list of factors. (Paragraph 6.46)

- 8.23 Regulation 7(1) of the Unfair Terms in Consumer Contracts Regulations 1999 should be amended to state that written terms offered to the consumer must be transparent. (Paragraph 6.63)
- 8.24 The new legislation should clarify that enforcement bodies may use their powers under Part 8 of the Enterprise Act 2002 against written terms which are not transparent. (Paragraph 6.64)

OTHER ISSUES

- 8.25 The new legislation should replicate the substance of the provisions in the Unfair Contract Terms Act 1977 concerning terms and notices which purport to exclude or restrict a trader's liability for causing death or personal injury resulting from negligence or breach of duty. Such terms should always be regarded as unfair. (Paragraph 7.17)
- 8.26 Notices which purport to exclude or restrict a trader's legal liability to a consumer should be brought within the scope of the legislation. This means that:
- (1) notices would be assessable for fairness (unless they fall within the provisions relating to liability for personal injury and death outlined above); and
 - (2) enforcement bodies would have powers to bring action against notices. (Paragraph 7.38)
- 8.27 The exclusion in Regulation 4(2) should specifically include "rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established". (Paragraph 7.51)
- 8.28 Any term, with the exception of exempted terms, should be subject to the fairness assessment, whether negotiated or not. (Paragraph 7.66)
- 8.29 The new legislation should state that, in proceedings brought by individual consumers, the court is required to consider the fairness of a term, even if the consumer has not raised the issue, where it has available to it the legal and factual elements necessary for that task. (Paragraph 7.96)
- 8.30 The definition of consumer should follow that used in the forthcoming Consumer Bill of Rights. (Paragraph 7.108)
- 8.31 The Department for Business, Innovation and Skills should consider whether to clarify that the definition of a consumer encompasses situations where a natural person seeks to receive goods or services with a view to carrying on a business but not in the course of a current business. (Paragraph 7.109)
- 8.32 Following the new legislation, the Unfair Contract Terms Act 1977 should no longer regulate business to consumer contracts. Nor should it continue to provide additional protection to a business that deals as a consumer. (Paragraph 7.116)
- 8.33 Employees should not be regarded as consumers under the new legislation. (Paragraph 7.127)

8.34 The Department for Business, Innovation and Skills should consider whether an opportunity can be found to consolidate the law on private sale contracts. (Paragraph 7.131)

APPENDIX A: ALPHABETICAL LIST OF RESPONDENTS

Association of British Insurers

Aviva Plc

Bar Council

Hugh Beale

British Bankers' Association

British Parking Association

British Retail Consortium

British Sky Broadcasting

British Vehicle Rental and Leasing Association

Building Societies Association

Citizens Advice

Civil Aviation Authority

Hugh Collins

Paul Davies

Direct Line Group

Direct Marketing Association

East Sussex Trading Standards

Faculty of Advocates

Finance & Leasing Association

Financial Services Authority

George Gretton

Geraint Howells

HSBC

Judges of the Court of Session

Lloyds Banking Group

Elizabeth Macdonald

R J Mackay
John MacLeod
Hans-W Micklitz
Stephen Miller
Mobile Broadband Group
MoneySavingExpert.com
Morton Fraser LLP
National Caravan Council
Nationwide Building Society
North East Trading Standards Association
Ofcom
Ofgem
Office of Fair Trading
Ombudsman Services
Deborah L Parry
Royal Institution of Chartered Surveyors
Duncan Sheehan
Sheriffs' Association
South Ayrshire Trading Standards Service
The Association of Her Majesty's District Judges
The Law Society
The Law Society of Scotland
The Publishers Association
The Trading Standards Institute
Three
Tods Murray LLP
Christian Twigg-Flesner
Malcolm Waters QC

Which?

Simon Whittaker

Ian Wildgoose

We also received one confidential response.

APPENDIX B: LIST OF RESPONDENTS BY CATEGORY

ACADEMICS

Hugh Beale

Hugh Collins

Paul Davies

George Gretton

Geraint Howells

Elizabeth Macdonald

John MacLeod

Hans-W Micklitz

Deborah L Parry

Duncan Sheehan

Christian Twigg-Flesner

Simon Whittaker

INDIVIDUAL BUSINESSES AND TRADE BODIES

Association of British Insurers

Aviva Plc

British Bankers' Association

British Parking Association

British Retail Consortium

British Sky Broadcasting

British Vehicle Rental and Leasing Association

Building Societies Association

Direct Line Group

Direct Marketing Association

Finance & Leasing Association

HSBC

Lloyds Banking Group
Mobile Broadband Group
National Caravan Council
Nationwide Building Society
Royal Institution of Chartered Surveyors
The Publishers Association
Three

CONSUMER ORGANISATIONS

Citizens Advice
MoneySavingExpert.com
Which?

MEMBERS OF THE JUDICIARY AND THE LEGAL PROFESSION

Bar Council
Faculty of Advocates
Judges of the Court of Session
Stephen Miller
Morton Fraser LLP
Sheriffs' Association
The Association of Her Majesty's District Judges
The Law Society
The Law Society of Scotland
Tods Murray LLP
Malcolm Waters QC

MEMBERS OF THE PUBLIC

R J Mackay
Ian Wildgoose

PUBLIC BODIES

Civil Aviation Authority

East Sussex Trading Standards

Financial Services Authority

North East Trading Standards Association

Ofcom

Ofgem

Office of Fair Trading

Ombudsman Services

South Ayrshire Trading Standards Service

The Trading Standards Institute

CONFIDENTIAL

We also received one confidential response.

APPENDIX C

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

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

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

Having regard to the proposal from the Commission,¹

In cooperation with the European Parliament,²

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

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

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

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

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

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

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

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

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

¹ OJ No C 73, 24.3.1992, p 7.

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

³ OJ No C 159, 17.6.1991, p 34.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

HAS ADOPTED THIS DIRECTIVE:

Article 1

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

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

Article 2

For the purposes of this Directive:

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

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

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

Article 3

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

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

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

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

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

Article 4

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

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

Article 5

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

Article 6

1. Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.

2. Member States shall take the necessary measures to ensure that the consumer does not lose the protection granted by this Directive by virtue of the choice of the law of a non-Member country as the law applicable to the contract if the latter has a close connection with the territory of the Member States.

Article 7

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

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

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

Article 8

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

Article 9

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

Article 10

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

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

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

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

Article 11

This Directive is addressed to the Member States.

Done at Luxembourg, 5 April 1993.

For the Council
The President
N. HELVEG PETERSEN

ANNEX

TERMS REFERRED TO IN ARTICLE 3 (3) 1. Terms which have the object or effect of:

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

(m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;

(n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;

(o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;

(p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;

(q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

2. Scope of subparagraphs (g), (j) and (l)

(a) Subparagraph (g) is without hindrance to terms by which a supplier of financial services reserves the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.

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

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

(c) Subparagraphs (g), (j) and (l) do not apply to:

- transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;

- contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency;

(d) Subparagraph (l) is without hindrance to price-indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.