



**The Law Commission  
and  
The Scottish Law Commission**  
(LAW COM No 292)  
(SCOT LAW COM No 199)

**UNFAIR TERMS IN CONTRACTS**

**Report on a reference under section 3(1)(e) of the Law  
Commissions Act 1965**

*Presented to the Parliament of the United Kingdom by the Secretary of State  
for Constitutional Affairs and Lord Chancellor by Command of Her Majesty  
Laid before the Scottish Parliament by the Scottish Ministers  
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The Law Commission and the Scottish Law Commission were set up by the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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The terms of this report were agreed on 31 December 2004.

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<sup>1</sup> Appointed 11 January 2005. When the terms of this report were agreed on 31 December 2004, the Honourable Mr Justice Wilkie was a Law Commissioner.

**THE LAW COMMISSION**  
**THE SCOTTISH LAW COMMISSION**  
**UNFAIR TERMS IN CONTRACTS**  
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## ABBREVIATIONS USED IN THIS REPORT

CBI	Confederation of British Industry
Chitty	<i>Chitty on Contracts</i> (29th ed 2004)
CISG	United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)
COMBAR	Commercial Bar Association
Consultation Paper	The Law Commissions' 2002 Joint Consultation Paper, Unfair Terms in Contracts (Law Commission Consultation Paper No 166, Scottish Law Commission Discussion Paper No 119)
Directive	Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, 1993 OJ L 95
DTI	Department of Trade and Industry
ECJ	European Court of Justice
First Report	The Law Commissions' 1969 Report: Exemption Clauses in Contracts, First Report: Amendments to the Sale of Goods Act 1893 (Law Com No 24; Scot Law Com No 12)
FSA	Financial Services Authority
Indicative List	Indicative and non-exhaustive list of terms which may be regarded as unfair, contained in the Annex to the Directive and in the UTCCR Schedule 2
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OFTEL	Office of Telecommunications (now subsumed by OFCOM, the Office of Communications, pursuant to the Communications Act 2003)
Rome Convention	The EC Convention on the Law Applicable to Contractual Obligations (Rome, 1980)
SCGD	Directive 99/44/EC of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, 1999 OJ L 171 12-16
Second Report	The Law Commissions' 1975 Report: Exemption Clauses: Second Report (Law Com No 69; Scot Law Com No 39)

SMEs	Small and Medium-Sized Enterprises
SPVs	Special Purpose Vehicles
SSGCR	Sale and Supply of Goods to Consumers Regulations 2002, SI 2002 No 3045
UCTA	Unfair Contract Terms Act 1977
ULIS	Uniform Law on International Sales (The Hague, 1964)
UTCCR	Unfair Terms in Consumer Contracts Regulations 1999, SI 1999 No 2083

# THE LAW COMMISSION AND THE SCOTTISH LAW COMMISSION

Report on a reference to the Law Commissions under section 3(1)(e) of the Law Commissions Act 1965

## UNFAIR TERMS IN CONTRACTS

*To the Right Honourable the Lord Falconer of Thoroton, Secretary of State for Constitutional Affairs and Lord Chancellor,  
and the Scottish Ministers*

### PART 1 BACKGROUND

#### INTRODUCTION

- 1.1 This joint Report is concerned with unfair terms in contracts. As the law currently stands there are two major pieces of legislation dealing with unfair contract terms: the Unfair Contract Terms Act 1977 (“UCTA”)<sup>1</sup> and the Unfair Terms in Consumer Contracts Regulations 1999 (“the UTCCR”).<sup>2</sup> The former focuses primarily on exemption clauses; it applies to contracts between businesses and consumers, between one business and another and, to a limited extent, even to “private” contracts where neither party is acting in the course of a business. The majority of terms purporting to exclude or restrict liability<sup>3</sup> are likely to be subject to it.<sup>4</sup> The latter establish controls over a broad range of contract terms<sup>5</sup> but apply only to consumer contracts.<sup>6</sup>

<sup>1</sup> UCTA contains separate provisions for England and Wales and Northern Ireland on the one hand and Scotland on the other. Part I of UCTA applies to England and Wales and Northern Ireland. (For brevity, in this paper we use “England” to include all three territories.) Part II applies to Scotland. Part III contains provisions which apply in all the jurisdictions. In this Report, the relevant Scottish provisions of UCTA are cited in square brackets after the parallel provision for the remainder of the UK.

<sup>2</sup> SI 1999 No 2083, as amended by the Unfair Terms in Consumer Contracts (Amendment) Regulations 2001, SI 2001 No 1186 (on this amendment see para 3.144 below). The UTCCR apply to the whole of the UK.

<sup>3</sup> For more detail, see Consultation Paper, para 3.12. UCTA also applies to indemnity clauses in consumer contracts.

<sup>4</sup> UCTA also applies to notices that purport to exclude or restrict liability in tort [delict] for negligence [breach of duty]. See further below, para 6.28 – 6.35.

<sup>5</sup> Excluding only the definition of the subject matter of the contract and the contract price.

<sup>6</sup> In the Consultation Paper, we also noted the impact of Council Directive 99/44/EC of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees (“SCGD”). The SCGD was implemented by the Sale and Supply of Goods to Consumers Regulations 2002 (“SSGCR”), SI 2002 No 3045, which came into effect on 31 March 2003. The impact of the Regulations on this project is relatively modest. Nevertheless it has been

- 1.2 When UCTA applies, it may have the effect that the exclusion or restriction of liability is automatically ineffective; or it may have the effect of invalidating the term unless it is shown to be fair or reasonable. Although the statutory definition of the terms caught by UCTA is wide, it does not apply to all types of term that are potentially unfair. In general, it catches only terms that exclude or restrict one party's obligations or liability. Terms that increase the obligations or liability of the other party are outside UCTA.<sup>7</sup>
- 1.3 If the term is in a consumer contract it will normally be subject to the UTCCR which implement Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts ("the Directive").<sup>8</sup> The UTCCR can apply to almost any type of term<sup>9</sup> that was not individually negotiated and will invalidate the term if it is unfair.
- 1.4 While the two regimes have separate scopes of application, to some extent they overlap. They also employ different concepts and terminology. The co-existence of two overlapping schemes gives rise to complexity and inconsistency that has been subject to severe criticism.<sup>10</sup> There is considerable concern that, at a time when much is being done to make justice more accessible, the nature and scope of the combined protection afforded to consumers by these laws are wholly obscure to the inexpert reader. In this Report, our first task is to consider how to replace these two pieces of legislation with a single unified Act that will set out the law on unfair contract terms in a clear and accessible way.
- 1.5 Many people think that the protection afforded by the current regimes is too narrow. While some provisions protect businesses, many protect only consumers. Businesses, and in particular small businesses, are frequently faced with terms that are widely regarded as unfair but have no means of challenging them. This prompted complaints to the DTI who asked us to examine the issue. Accordingly, in this Report we look, secondly, at whether protections similar to those afforded by the UTCCR should be extended to businesses and, if so, what kinds of businesses should benefit from this increased protection.

## **TERMS OF REFERENCE**

- 1.6 In January 2001 the Law Commission and the Scottish Law Commission<sup>11</sup> received from the Parliamentary Under Secretary of State for Consumers and Corporate Affairs a joint reference in the following terms:

necessary for us to take into account the requirements of the Directive in relation to several issues discussed in this Report. Throughout this Report we refer to the SCGD and the SSGCR where necessary to explain the background to some of our recommendations.

<sup>7</sup> There is one exception: indemnity clauses in consumer contracts are caught by s 4 [s 18].

<sup>8</sup> 21 April 1993.

<sup>9</sup> There are certain exclusions: in particular, the definition of the main subject matter of the contract is not subject to review, nor is the adequacy of the price. These are commonly referred to as "core" terms. See below, para 3.56.

<sup>10</sup> See Consultation Paper, para 2.22.

<sup>11</sup> The Scottish Law Commission also received a parallel reference from the Scottish Ministers.

... to consider the desirability and feasibility of:

- (1) Replacing the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999 with a unified regime which would be consistent with Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts;
- (2) Extending the scope of the Unfair Terms in Consumer Contracts Regulations (or the equivalent in any legislation recommended to replace those Regulations in accordance with (1) above) to protect businesses, in particular small enterprises; and
- (3) Making any replacement legislation clearer and more accessible to the reader, so far as is possible without making the law significantly less certain, by using language which is non-technical with simple sentences, by setting out the law in a simple structure following a clear logic and by using presentation which is easy to follow.

## **CONSULTATION PAPER AND RESPONSES**

- 1.7 The joint Consultation Paper was published on 7 August 2002 and both Law Commissions received a substantial response. In all, 97 organisations and individuals provided comments.<sup>12</sup> These proved extremely helpful. We would like to thank all those who expended their valuable time and resources in responding to the Consultation Paper. Below we give a brief summary of reactions to our provisional proposals concerning each of the three terms of reference.

### **Consumer contracts**

- 1.8 The Consultation Paper recommended a unified regime for consumers. Fulfilling the first of our terms of reference has been primarily an exercise in simplification. Our proposals stipulated that in the consolidation process there should be no reduction in consumer rights. Nor did we propose any substantial extension of consumer protection.
- 1.9 In order to simplify and unify the two very distinct regimes, on individual issues we have had to adopt the approach taken by either one regime or the other. Thus, for example, the UTCCR apply only to terms that are not “individually negotiated”; UCTA applies to exclusion clauses in consumer contracts whether the clause was negotiated or not. We proposed that the unified regime should include both individually negotiated and non-negotiated terms.<sup>13</sup> Similarly, the burden of showing that a term is fair and reasonable under UCTA is on the business; under the UTCCR the burden of showing that a term is unfair is on the consumer. We proposed that under the unified regime the burden should be on the business. A substantial majority of respondents supported both proposals.

<sup>12</sup> A list of the respondents can be found at Appendix E.

<sup>13</sup> It would continue to exclude review of “core” terms such as the price and the subject matter of the contract.

The net result of our work is that there would be a small increase in the protection provided for consumer contracts.<sup>14</sup>

### **Business to business contracts**

- 1.10 Our business to business proposals were that protections similar to those afforded to consumers by the UTCCR should be extended to all business contracts. The Consultation Paper concluded that, although there were situations where consumer and business contracts justified different treatment, “in general terms it is not desirable for the two sets of rules to differ without good reason”.<sup>15</sup>
- 1.11 Although there was some justification for offering small businesses greater protection than larger businesses, nevertheless we considered that it was preferable to treat all businesses alike.<sup>16</sup> We therefore proposed that the provisions of the UTCCR should be extended to cover all businesses.
- 1.12 These proposals received a mixed response. What was evident, however, was resistance to interference with contracts between businesses in general but widespread support for greater protection for small businesses.
- 1.13 We have been persuaded that the regime governing contracts between larger businesses should be left substantially as it stands, preserving the existing position under UCTA. In light of the support for small business protection, we raised several options for a small business regime, culminating in a seminar held in conjunction with the Society for Advanced Legal Studies in July 2003. These discussions confirmed that there is widespread (though not universal<sup>17</sup>) support for a specific regime for small businesses; and that the preferred route is to open to review all contract terms with the exception of those that are “core” terms or which were individually negotiated. We therefore recommend a separate scheme to protect small businesses which will apply to non-negotiated, “non-core” terms.<sup>18</sup>

### **Making the new legislation “clearer and more accessible to the reader”**

- 1.14 UCTA is a complex statute. As we know from our own experience, it is difficult to understand fully without very careful reading. Given the complexity of its subject matter, UCTA is structured in a way that is very economical, but that structure is not easy to grasp. Frequently, a single provision will apply to a number of different types of contract and to a variety of different situations: this makes it difficult to see the effect of the statute, particularly for a reader without legal training.

<sup>14</sup> The more significant is a lessening of the burden of proof on the consumer seeking to argue that a term is unfair: see below, paras 2.12 – 2.13 and 3.124 – 3.130.

<sup>15</sup> See Consultation Paper, para 5.21.

<sup>16</sup> *Ibid*, para 5.1.

<sup>17</sup> See below, para 2.33.

<sup>18</sup> See paras 2.30 – 2.43 and Part 5, below.

- 1.15 For the most part the UTCCR are in a much simpler style. In this they reflect the Directive that they implement and which they follow very closely. However, parts of the UTCCR have implications that are not obvious to the reader. The “indicative and non-exhaustive list of the terms which may be regarded as unfair” contained in Schedule 2 (the “Indicative List”) uses terminology that is alien to English and Scots readers, lawyers and non-lawyers alike.
- 1.16 Clarity and accessibility in legislation, particularly consumer legislation, is a key objective underpinning this project. In order to provide consultees with a sample of our approach to clear and accessible drafting, we took the step, unusual for the Law Commissions, of including in our Consultation Paper draft clauses prepared by Parliamentary Counsel.<sup>19</sup> They form the basis of the Draft Bill now included in this Report.
- 1.17 All those respondents who addressed the issue were in favour of our proposals to simplify the language in the way we stated in the Consultation Paper.
- 1.18 The legislation should be accessible to non-lawyers though we are also conscious that simplicity of language should not compromise legal certainty. Many respondents suggested that as much as possible of the content of the legislation should be contained in the body of the Draft Bill so that it was not necessary to search the text and then pursue endless cross-references to schedules. We agree. There was also support for the use of examples within the legislation. Nevertheless, we have been persuaded that it would be more appropriate for examples to be in the Explanatory Notes which accompany the Draft Bill rather than in the Draft Bill itself.<sup>20</sup>

### **SCOTLAND: LEGISLATIVE COMPETENCE**

- 1.19 In looking ahead to the implementation of our recommendations, we realise that, as far as the Scottish Executive is concerned, this will stimulate a debate as to legislative competence. It appears to us that our recommendations encompass both reserved and devolved matters, although there may be doubt as to the exact division of competence. It may be that some provisions<sup>21</sup> apply equally to reserved and devolved matters.
- 1.20 The provisions relating to the regulation of consumer contracts<sup>22</sup> appear to us to be reserved to the competence of the Westminster Parliament in terms of section C7 of Part II of Schedule 5 to the Scotland Act 1998. On the other hand, the provisions regulating business contracts<sup>23</sup> and those regulating private contracts<sup>24</sup>

<sup>19</sup> See Consultation Paper, Appendix B.

<sup>20</sup> See below, para 3.117. See further Explanatory Notes to clause 30 and Sch 2.

<sup>21</sup> For example, the “fair and reasonable” test (clause 14) and the Indicative List (Sch 2).

<sup>22</sup> Part 2 and related provisions.

<sup>23</sup> Clauses 9 – 11 and related provisions.

<sup>24</sup> Clause 13.

appear to us to be devolved to the Scottish Parliament as relating to Scots private law.<sup>25</sup>

- 1.21 In relation to the provisions on business liability for negligence,<sup>26</sup> we consider that the main thrust of this Part of the Draft Bill relates to the Scots private law of obligations and is therefore devolved. However, some doubt may arise in relation to clause 2(1) which provides an exemption from clause 1 for employees excluding or restricting liability for negligence to an employer. If this were to be construed as a provision regulating what an employee may do by contractual arrangement with his employer, it may be seen as relating to the reserved area of employment rights and duties in section H1 of Part II of Schedule 5 to the 1998 Act.
- 1.22 In relation to clause 12 (employment contracts) we consider that it could be argued that the purpose of this provision is concerned with the regulation of employment rights and duties. If so, this would fall within the reservation of section H1 of Part II of Schedule 5 to the 1998 Act.
- 1.23 We would also point out that there are certain consequential amendments<sup>27</sup> and repeals<sup>28</sup> of Scottish statutory provisions.

## **ACKNOWLEDGEMENTS**

### **The DTI Report by Dr Simon Whittaker**

- 1.24 An initial research project on the first two parts of the project was carried out for the Department of Trade and Industry by Dr Simon Whittaker of St John's College, Oxford. Dr Whittaker's report demonstrated that while consolidation was feasible, it would not be straightforward. It highlighted a number of issues that would need detailed consideration. The matter was then referred to the Law Commissions. The Consultation Paper drew on Dr Whittaker's report and we would like to acknowledge the considerable help that we derived from it.

### **Further assistance**

- 1.25 We are also extremely grateful to the many people who commented on our proposals and discussed possible solutions with us. We are unable to name all the individuals who helped us, but particular thanks must go to Professor Michael Bridge of University College London; Professor Nick Gaskell of Southampton University; Professor Stephen Weatherill of Oxford University and Kate Gibbons of Clifford Chance.

<sup>25</sup> We do not consider that the business contract provisions or the provisions on business liability for negligence come within the ambit of section C1 of Part II of Schedule 5 to the 1998 Act which is concerned with the creation, operation, regulation and dissolution of business associations.

<sup>26</sup> Part 1.

<sup>27</sup> Sch 5.

<sup>28</sup> Sch 6.

- 1.26 We would also like to acknowledge the help that has been given to us by many organisations and public bodies. These include: the Enterprise Team at the Treasury, the FSA, the Insolvency Service, the OFT, the Financial Markets Law Committee, OFGEM, OFTEL, Fujitsu Services and the Society of Advanced Legal Studies.

### **THE STRUCTURE OF THE REPORT**

- 1.27 In Part 2 of this Report we provide an overview of our recommendations and describe the general scope of each part of the project in greater detail. In Part 3 we set out our recommendations for a unified regime to apply to consumer contracts. In Part 4 we explain our recommendations for business contracts in general and in Part 5 we consider extending the wider controls of the UTCCR to contracts with small businesses. Some particular issues, including employment contracts, private sales and non-contractual notices, are addressed in Part 6. In Part 7 we discuss international contracts and choice of law. Finally, Part 8 sets out a full list of recommendations.
- 1.28 The Draft Bill itself, along with its Explanatory Notes, forms Appendix A. To help the reader, the text of UCTA is reproduced in Appendix B,<sup>29</sup> that of the UTCCR in Appendix C, and the Directive in Appendix D. We conclude, in Appendix E, with a list of those who responded to our provisional proposals.

<sup>29</sup> This includes s 21(3A) which, although in force, does not appear in a number of the published versions of UCTA.

## **PART 2**

# **AN OVERVIEW OF OUR RECOMMENDATIONS**

2.1 In this Part we provide an overview of our recommendations. Detailed consideration of the issues is to be found in the Parts that follow.

### **A UNIFIED REGIME FOR CONSUMERS (PART 3)**

#### **Background**

2.2 For consumer contracts, the key objective of our project was to design a single, unified legislative regime that preserved the consumer protections currently afforded by both UCTA and the UTCCR.

2.3 In developing our recommendations we were aware of the constraints imposed on us by the UK's obligation to implement the Directive in full. Equally, as we stated in the Consultation Paper,<sup>1</sup> we were keen that consumers should not be deprived of any of the protections afforded by UCTA.<sup>2</sup>

2.4 At present, unfair terms in consumer contracts are governed by both UCTA and the UTCCR.<sup>3</sup> The existence of this dual regime has caused considerable confusion and uncertainty because:

- (1) the statutory controls over unfair terms are split between two pieces of legislation and must be located in each text;
- (2) the UTCCR and UCTA contain inconsistent and overlapping provisions;
- (3) the scope of application of each piece of legislation is different;
- (4) UCTA and the UTCCR use different language and terminology;
- (5) UCTA is drafted in a very dense and highly technical style; and
- (6) the UTCCR are a fairly literal version of the text of the Directive whose language and, in some instances, concepts are not always easily understood by UK lawyers.

<sup>1</sup> Paras 4.22 – 4.29.

<sup>2</sup> We did propose that UCTA, s 5 [s 19] should not be replicated. This was because it provides no additional practical protection for the consumer. See Consultation Paper, paras 4.27 and 4.205 – 4.207.

<sup>3</sup> The history of UCTA, the Directive and the UTCCR (both the 1994 and 1999 versions which implement the 1993 Directive) is set out in the Consultation Paper, paras 2.10 – 2.16.

### **The principal differences between UCTA and the UTCCR**

2.5 The differences between UCTA and the UTCCR are multiple and were discussed in some detail in the Consultation Paper.<sup>4</sup> A summary of the respective schemes will make the principal differences apparent.

2.6 UCTA:

- (1) applies only to exclusion and limitation of liability clauses and indemnity clauses;
- (2) makes certain exclusions or restrictions of no effect at all;
- (3) subjects others to a reasonableness test;
- (4) contains guidelines for the application of the reasonableness test;
- (5) puts the burden of proving that a term within its scope is reasonable on the party seeking to rely on the clause;
- (6) often applies whether the terms were negotiated or were in a “standard form”;
- (7) does not apply to certain types of contract even when they are consumer contracts;
- (8) has effect only between the immediate parties;
- (9) has separate provisions for Scotland; and
- (10) applies to terms and notices excluding certain liabilities in tort [delict<sup>5</sup>].

UCTA also applies to contracts between businesses and certain “private” contracts for the sale of goods where neither of the two parties is a business.

2.7 In contrast, the UTCCR:

- (1) apply to any kind of term other than the definition of the main subject matter of the contract and the adequacy of the price;
- (2) do not make any particular type of term of no effect at all;
- (3) subject the terms to a fairness test;
- (4) do not contain detailed guidelines as to how that test should be applied, but contain a so-called “grey” list of terms which “may be regarded” as unfair;

<sup>4</sup> In Part III.

<sup>5</sup> Tort is an English concept. Here, and in the discussion that follows, we refer to the Scottish equivalent, delict, in square brackets.

- (5) leave the burden of establishing that the clause is unfair on the consumer;
- (6) apply only to “non-negotiated” terms;
- (7) apply to consumer contracts of all kinds;
- (8) are not only effective between the parties but empower various bodies to take action to prevent the use of unfair terms; and
- (9) apply to the UK as a whole.

They do not apply to business or private contracts.

### **Our consultation proposals**

2.8 The most important of our provisional proposals for creating a unified regime of controls over consumer contracts were as follows:

- (1) there should be unified legislation for the whole of the UK;
- (2) (with some minor exceptions) there should be no reduction of consumer protection;
- (3) those terms that are of no effect under UCTA should remain of no effect;
- (4) other terms (including terms that were individually negotiated) should be required to satisfy a “fair and reasonable” test;
- (5) as far as possible, the new regime should be clearer and more accessible to the reader; and
- (6) where possible, important requirements of the unfair terms legislation that are not immediately obvious from the existing legislation should be made explicit. In particular, the exemptions for the main definition of the subject matter of the contract and for the “adequacy of the price” should be clarified. The new legislation should also emphasise the vital importance, in determining whether a term is fair, of plain intelligible language and transparency in general.

### **The response to our Consultation Paper**

2.9 Overall the responses to our consultation proposals on consumer contracts were positive. We asked consultees to comment generally on the practical and economic impact that our proposals would have for consumers and businesses. Of the responses we received, just under half were wholly positive. A similar number thought that our proposals would bring benefits, particularly to consumers, but expressed some concern about possible increased costs for businesses. Only a handful made no positive comment.

## **Our recommendations**

- 2.10 The Commissions' policy for consumer contracts remains very similar to that set out in the Consultation Paper.<sup>6</sup> In broad terms, we recommend legislating to allow a consumer to challenge any kind of term that is not a "core" term, whether or not the term was negotiated. The details of these recommendations are discussed in Part 3. Here we mention two points on which the Consultation Paper did not make firm proposals but rather specifically invited views.
- 2.11 The discussion that follows refers to various sections in UCTA. Where the relevant sections differ between England and Scotland, we give the English version first, followed by the Scottish provision in square brackets.

### ***The burden of showing that a term is fair and reasonable***

- 2.12 In the Consultation Paper we invited views about where the burden of showing that a term is reasonable should fall in a case involving an individual consumer (as opposed to a case brought by a qualifying body under the preventive powers).<sup>7</sup> The draft clauses included in the Consultation Paper (referred to below as the "Consultation Draft") offered alternative drafts to show different possibilities.<sup>8</sup> The first followed UCTA (section 11(5) [section 24(4)]), rather than the UTCCR,<sup>9</sup> in providing that it is for the party claiming that a term is fair and reasonable to prove that it is the case.<sup>10</sup> The second made the burden differ according to whether or not the term was contained in our replacement for the Indicative List.<sup>11</sup> If the term was on the list, the burden would fall on the party claiming that it was fair and reasonable; if it did not, the burden would be placed on the party claiming that a term was not fair and reasonable.<sup>12</sup> Consultees were evenly divided as to which version they preferred. When we considered the issue in greater depth, it became clear that the second approach was unsuitable for two reasons. First, allowing the inclusion of a term on the Indicative List to reverse the burden of proof would be circular, since some terms are on the list only if they are disproportionate or unreasonable. Second, we were persuaded that a business is almost always in a stronger position than a consumer when contracting. It was therefore agreed that the business should bear the burden in all cases involving individual consumers.
- 2.13 There was some concern that a business should not have to justify every term of the contract without the issue having been raised by the consumer in relation to a

<sup>6</sup> We do, however, recommend substantive changes to our consultation proposals in the area of evasion by choice of law, which are discussed in Part 7.

<sup>7</sup> Paras 4.146 – 4.150.

<sup>8</sup> Consultation Draft, clause 13.

<sup>9</sup> The UTCCR make no provision for this burden and therefore it may be taken to fall on the party seeking to show that the clause is unfair, according to the normal course of proceedings.

<sup>10</sup> Consultation Draft, clause 13(2), first version.

<sup>11</sup> Our replacement for the Indicative List included the exemption and restriction of liability clauses currently caught by UCTA.

<sup>12</sup> See Consultation Draft, clause 13(2) – (3), second version.

specific term. To address this concern, the final Draft Bill provides that the business only has to prove that the term or notice was fair and reasonable once the issue has been raised.<sup>13</sup>

### ***Employment contracts***

- 2.14 In the Consultation Paper we noted not only that some courts have treated the employee as a consumer but also that employment contracts share some features with business contracts.<sup>14</sup> We asked whether employment contracts should be included in our regime as business contracts, consumer contracts or in a category of their own. Over the course of the project we consulted a number of specialists in the field of employment law. We were persuaded that there are already sufficient controls over employment contracts in general. There is therefore no need to extend to employees the proposed consumer protections. However, it is important that exclusions and limitations of liability in written standard terms of employment should be subject to controls. Following that consultation process, we decided to treat employment contracts as a separate category. The practical effect of our recommendations is that where the employment is on the employer's standard terms, a term that purports to exclude or restrict the employer's liability or to allow the employer to render a performance substantially different from that reasonably expected will be subject to the "fair and reasonable" test.<sup>15</sup>

### ***Choice of law and international contracts***

- 2.15 UCTA has three provisions dealing with international contracts and choice of law issues: sections 26, 27(1) and 27(2). The UTCCR have one provision which is closely based on Article 6(2) of the Directive. Regulation 9 provides that the UTCCR shall apply notwithstanding any term that applies the law of a non-Member State provided the contract has a close connection with the territory of the Member States.
- 2.16 We took a close look at these provisions to see whether they should be replicated or substituted in the new legislation. The question whether and how to replace section 27(2), which provides rules to prevent evasion of UCTA's controls by means of a choice of foreign law, gave rise to some difficulty in relation to consumer contracts.
- 2.17 In the Consultation Paper, we suggested that it would be possible to rely on the independent operation of certain provisions of the Rome Convention. We thought they would ensure the application of our consumer protections in all the situations contemplated by Article 6(2) of the Directive, irrespective of the choice of law of a

<sup>13</sup> See Draft Bill, clause 16, and below, paras 3.124 – 3.130. In the context of enforcement proceedings and the exercise of preventive powers the burden of proof remains on the OFT, or other regulator, seeking to prove that a term in a consumer contract is not fair and reasonable.

<sup>14</sup> See Consultation Paper, paras 4.80 – 4.81.

<sup>15</sup> This is the effect of UCTA, s 3 [s 17] when the standard terms of employment are treated as written standard terms of business.

non-Member State. But we eventually decided that the Rome Convention would not achieve this objective independently. Instead it would be necessary to include express provisions in the new legislation nullifying attempts to evade its consumer protections by means of a choice of foreign law.

- 2.18 We looked at the possibility of incorporating provisions replicating Article 6(2) of the Directive, with any necessary modifications. However, UK law gives consumers stronger protection than is required by the Directive which they would not necessarily have under the law of another Member State. We were persuaded that a clause enforcing UK mandatory provisions in a wide range of circumstances would afford broader protection to UK consumers than a clause replicating the exact wording of Article 6(2) (as Regulation 9 of the UTCCR does). This is because a choice of another Member State's law might give UK consumers less protection than they would enjoy under UK law, but the wording of Article 6(2) would not operate to apply the more favourable protection of UK law to that contract. We therefore recommend that the Draft Bill's mandatory provisions should apply whenever the consumer is living in the UK and takes the necessary steps to conclude the contract there.
- 2.19 We considered drafting a provision that would apply the protective regime of the new legislation to *all* contracts that could be said to have a close connection to the territory of the Member States. Nevertheless, we decided against this course on the grounds that it would be inappropriate to apply UK law to contracts with a more substantial connection to another Member State. In these circumstances the other State's own Directive-compliant regime would normally apply to protect the consumer by virtue of the existing rules of private international law. Therefore, in cases not covered by our core choice of law provisions for UK consumers, we recommend that the law of another Member State should apply if it would do so in the course of the application of the ordinary rules of private international law.
- 2.20 In any remaining cases closely connected to the Member States as a whole, we recommend that the new legislation should apply by default so as to comply with the requirements of the Directive. We also consider that the Draft Bill should expressly include a presumption that contracts for goods and services exported to territories outside the Member States should not be regarded as closely connected to the Member States.
- 2.21 We did not experience the same problems in deciding whether or not to reproduce the effect of UCTA section 26 for consumer contracts. Section 26 exempts cross-border contracts for the sale or supply of goods. There is no similar exemption in the Directive or in the UTCCR. Accordingly, if it is to comply with the Directive, the new legislation cannot have a blanket exemption for international contracts. Therefore we recommend that the effect of section 26 on consumer contracts is not reproduced in the new legislation.
- 2.22 A secondary effect of this approach will be to implement fully the SCGD for the first time. The SCGD provides no exemption for international contracts. However, the SSGCR implementing the SCGD leave exclusions of the seller's obligations to be regulated by UCTA, without apparently noticing that UCTA does not apply to international sales contracts.

## **PRESERVING THE EFFECT OF UCTA IN BUSINESS CONTRACTS (PART 4)**

### **Background**

- 2.23 We were asked to consider whether UCTA provided sufficient protection for business contracts. Because UCTA only addresses exclusions and limitations of liability, the primary concern was that other unfair terms escape review. The scope of clauses excluding or limiting liability is widely conceived in UCTA, so that, for example a business which deals on the other party's standard terms can challenge a term apparently allowing that party to render a contractual performance substantially different from that which was reasonably expected.<sup>16</sup> However, this does not permit the business to challenge unfair standard terms which relate to its own performance or obligations.

### **Our proposals**

- 2.24 In the Consultation Paper, we provisionally proposed that the protection against unfair terms in contracts between businesses should be extended to include most of the protections afforded to consumer contracts under the UTCCR. During consultation, we became aware that this proposal was highly controversial. This was principally because of the uncertainty that might result from a wider range of terms in business contracts being subject to review, even if such terms would seldom be held to be unreasonable. Consultees have persuaded us to alter our views. The Commissions do not recommend such expanded protection for businesses in general. However, we do recommend expanded protection for small businesses.

### **Our recommendations**

- 2.25 The broad policy of our recommendations for business contracts in general is to preserve the effect of UCTA.
- 2.26 We recommend a measure of deregulation in respect of the existing law by removing some of the controls that UCTA presently imposes over exclusions and limitations of liability for breach of terms implied by statute. The relevant sections are UCTA section 6(3) [section 20(2)(ii)] and section 7(3) [section 21(3)]. They relate to four terms implied by the Sale of Goods Act 1979 and associated legislation.<sup>17</sup> Briefly, these implied terms require that goods should conform to description or sample and should be of satisfactory quality and fit for the buyer's purpose. UCTA states that in business contracts any term (whether standard or negotiated) which attempts to restrict any of these four implied terms is subject to the reasonableness test. In the Consultation Paper we thought that the controls should only apply to non-negotiated terms as it would be very rare for a negotiated exclusion clause to be considered unfair.<sup>18</sup> The majority of consultees

<sup>16</sup> See UCTA, s 3 [s 17] and Consultation Paper, paras 3.13 – 3.14.

<sup>17</sup> Sale of Goods Act 1979, ss 13,14 & 15. Similar terms are implied into hire-purchase contracts by the Supply of Goods (Implied Terms) Act 1973, ss 9, 10 & 11; into other contracts for the transfer of property in goods by the Supply of Goods and Services Act 1982, ss 3, 4 & 5 [ss 11C, 11D & 11E]; and into contracts for hire by the Supply of Goods and Services Act 1982, ss 8, 9 & 10 [ss 11I, 11J & 11K].

<sup>18</sup> See below, para 4.25 – 4.29 and 4.36 – 4.40.

who examined this question supported our argument. This is now our final recommendation. Any attempt to exclude or restrict liability for breach of the four implied terms of correspondence and quality will only be subject to the fair and reasonable test when the party disadvantaged by the term dealt on the other party's written standard terms of business.

- 2.27 We did not propose to change the existing rule that renders automatically void attempts to exclude liability for breach of the implied term that the seller is entitled to sell the goods. This term is set out in section 12 of the Sale of Goods Act 1979 and associated legislation.<sup>19</sup> In broad terms, it states that the seller has the right to sell, that the goods are free from any undisclosed charge or encumbrance and that the buyer will enjoy quiet possession of the goods. Under UCTA section 6(1) [section 20(1)], the implied term cannot be excluded from contracts of sale or hire purchase. Similarly, UCTA section 7(3A) [section 21(3A)] states that it cannot be excluded from contracts for barter or exchange, or from contracts for work and materials.
- 2.28 We did, however, propose some deregulation in respect of contracts for hire. At present, in contracts for hire, it is possible to exclude terms that the supplier is entitled to hire out the goods provided that the exclusion is reasonable. This is set out in UCTA section 7(4) [section 21(1)(b)].<sup>20</sup> We suggested in the Consultation Paper that any provision replicating this section should apply only to non-negotiated clauses. A small majority of those who responded to the question agreed that restricting these provisions to non-negotiated clauses would either make no practical difference or would have a marginal but desirable effect. This is now our final recommendation. Terms which exclude or restrict liability for breach of the implied undertaking that the supplier is entitled to hire out the goods will only be subject to the fair and reasonable test when the party disadvantaged by the term dealt on the other party's written standard terms of business.
- 2.29 Although the lessening of legislative controls over business contracts is not itself within the terms of reference of this project, we believe this small deregulation is a desirable simplification to the unfair contract regime. It should achieve some reduction in uncertainty while making little difference in substance.

## **EXTENDING THE SCOPE OF PROTECTION FOR SMALL BUSINESSES (PART 5)**

### **Background**

- 2.30 Many of those who supported our Consultation Paper proposals for business contracts referred to the particular problems experienced by small businesses. We were struck by the fact that a number of those who opposed our Consultation Paper proposals for business contracts in general qualified their opposition in respect of small businesses. They noted that small businesses are more

<sup>19</sup> See also Supply of Goods (Implied Terms) Act 1973, s 8 and the Supply of Goods and Services Act 1982, s 2 [s 11B].

<sup>20</sup> The relevant implied term is to be found in the Supply of Goods and Services Act 1982, s 7 [s 11H].

vulnerable and that additional protection may be appropriate here. Given this common theme in the responses, we decided to re-examine the case for small business protection.

2.31 At the seminar on small business contracts,<sup>21</sup> we proposed extending to small businesses the same protections that we had been asked to consider extending to businesses in general. They are similar to those afforded to consumers under the UTCCR. In other words, the regime would apply a fairness test to all the terms of the contract other than the “core” terms. Examples of potentially unfair clauses against which businesses, unlike consumers, are not currently protected include:

deposits and forfeiture of money paid clauses;

default rates of interest (which are not shown to be penalties);

automatic extension of contract clauses;

price variation clauses;

entire agreement clauses;

arbitration clauses;

indemnity clauses; and

termination clauses.

2.32 Discussion at the seminar and subsequent responses to an informal discussion paper confirmed that, subject to one proviso, there is wide support for protecting small businesses, particularly those that can be considered quasi-consumers because of their vulnerability in the market. The support came from many sectors of industry, law firms, the Financial Markets Law Committee and others. The proviso was that the regime should not apply to small businesses operating in the financial sector, since these are often highly sophisticated, or to businesses closely associated with larger firms or companies. We agree. We also take the view that the protection should not apply to any type of contract that is not currently affected by UCTA so that, for instance, contracts of insurance should not be affected.

2.33 It is true that support was not universal. The CBI maintained that giving additional protection to small businesses would make it riskier to contract with them and consequently would work against their interests. This is an important point. However, it was the firm view of the representatives of small businesses who responded – and in particular the Federation of Small Businesses – that greater protection is very much needed. It appears that small businesses may prefer a reduction in the risks they face even at the possible cost of some loss of business.

<sup>21</sup> See above, para 1.13.

2.34 Consumer contracts are also subject to another layer of control under the UTCCR which has no equivalent under UCTA. The UTCCR give the Office of Fair Trading (“the OFT”) and other authorised bodies the power to prevent the use or recommendation of unfair terms. At the seminar and in subsequent discussion, there was some enthusiasm for similar preventive powers for terms in small business contracts; but it seemed unlikely that any appropriate body would be willing and able to take on the task.

### **Our recommendations**

2.35 We recommend that, with certain exceptions, the protection against unfair terms given to consumers by the UTCCR should be extended to apply to small business contracts. Our detailed recommendations for small business contracts are set out and explained in Part 5 of this Report. The expanded protection which we now recommend is essentially to allow small businesses to challenge any type of standard term<sup>22</sup> that has not been individually negotiated and is not a “core” term.

2.36 After some deliberation, we decided to define a small business in the new legislation by reference to the number of employees and not, for example, to turnover. We believe that this is the criterion which is most likely to be accessible to the other contracting party and is, therefore, most likely to promote certainty and predictability.

2.37 We decided to restrict our expanded protections to those businesses commonly called “micro” businesses.<sup>23</sup> These businesses tend to be the most vulnerable and unsophisticated, with the fewest resources. They are therefore those most in need of protection. Outside this category, we believe that the imperative for protection is not so strong and is generally outweighed by the desirability of maximising commercial freedom of contract. We have therefore adopted a cut-off point of nine employees and the Draft Bill provides accordingly.<sup>24</sup> It also contains a provision exempting from the regime those small businesses that are “associated with” larger businesses, for example, where they belong to the same group of companies. The Draft Bill contains a wide definition of “associated person”<sup>25</sup> in order to exclude not only small businesses which are part of the

<sup>22</sup> See para 5.68, below.

<sup>23</sup> For statistical purposes, the Department of Trade and Industry usually employs the following definitions:

micro firm: 0 – 9 employees

small firm: 0 – 49 employees (includes micro)

medium firm: 50 – 249 employees

large firm: 250 employees and over.

<sup>24</sup> Clause 27.

<sup>25</sup> Clause 28.

same group of companies but also those that are effectively run in accordance with the wishes of more sophisticated commercial entities.<sup>26</sup>

- 2.38 In the course of the project our attention was drawn to the problem of businesses that meet the employee numbers criterion but operate in such a high-value environment that it would not be appropriate for them to be subject to the controls of our proposed regime for small businesses. Specifically, these businesses might be small companies issuing securities, often referred to as special purpose vehicles (“SPVs”). We were told that it is quite common for such companies to have only a handful of employees but to do multi-million pound deals.
- 2.39 It was also pointed out that protections are largely unnecessary in areas where businesses dealing with small businesses are already regulated. In extending protections to small businesses in these situations we run the danger of over-regulating the market. The most obvious situation in which this might occur is that of contracts for the provision of financial services. Most contracts of this kind are already subject to regulation by the Financial Services Authority (FSA).
- 2.40 To make our proposed regime more sensitive to the needs of small businesses, we recommend that, in addition to an exemption for businesses that are associated with larger businesses, there should be two further exemptions. These are:
- (1) a “transaction value limit” according to which contracts with a value greater than £500,000 or that are one of a series of contracts with a total value in excess of £500,000 are excluded from the small business controls;
  - (2) an exemption for financial services contracts.
- 2.41 In Part 5 we consider whether a small business should be able to challenge any “non-core” term that was not individually negotiated (the current criterion of the UTCCR) or only when such a term formed part of the other party’s written standard terms of business. It is proposed to adopt a two limb definition of “non-negotiated” which will ensure that, before it can be challenged, a “non-core” term must (a) have been put forward as one of its written standard terms by the other (usually larger) business; and (b) not have been the subject of individual negotiation. This definition is intended to target standard terms and to leave bespoke contracts unregulated.
- 2.42 These proposed small business provisions are to apply as additional protection in any contract with a small business, whether that business is dealing with a large business or with another small business. In all other respects small businesses are treated the same as larger businesses. This means that small businesses can take advantage of the protections afforded by the preserved UCTA regime that operates in respect of business contracts in general. It also means that, vis-à-vis consumers, small businesses will count simply as businesses and will be subject to the controls set out in our recommendations for consumer contracts.

<sup>26</sup> See paras 5.45 and 5.52 – 5.54, below.

- 2.43 We think that these recommendations will deal with the types of unfair terms that have caused real problems to many small businesses.

#### **MAKING THE NEW LEGISLATION “CLEARER AND MORE ACCESSIBLE TO THE READER”**

- 2.44 An important aspect of the Law Commissions’ duty is to attempt to make the law more accessible. This means accessible not only to lawyers but to all those affected by it. This is particularly important where the law has an impact on the day-to-day life of individuals or the day-to-day operation of businesses.
- 2.45 In the Consultation Paper we set out as one of our guiding aims the principle that any proposed legislation should be accessible to the business people and consumers affected by it. We considered that, at the very least, the legislation should be capable of being understood by consumer advisers, many of whom are not legally qualified, and any person in business who has some knowledge of contracting.<sup>27</sup>
- 2.46 With this in mind, we decided to depart from our usual practice of appending draft legislation only to the Final Report and we included a draft in the Consultation Paper. This was not a full Bill but consisted of 18 sample clauses. We believed that sample clauses would facilitate consultation on the presentation as well as the substance of our proposals.

#### **The Consultation Draft**

- 2.47 In general, the Consultation Draft was well-received by consultees. The Plain English Campaign, for example, approved of its simplified style. It has therefore been used as the basis for the Draft Bill appended to this Report. That said, the Consultation Draft was far from complete: it dealt only with some parts of consumer contracts. In developing a legislative scheme for contracts across the board, it has been necessary to make significant changes to the Consultation Draft, affecting both substance and presentation. Nevertheless, accessibility, plain language and clear presentation have remained at the heart of the project and we believe that the Draft Bill appended to this Report reflects these. We have made every effort to draft a Bill in plain and intelligible language without detracting from the precision and certainty of its provisions.
- 2.48 In particular, the Draft Bill follows the Consultation Draft in containing separate parts for the particular controls that apply to each type of contract. Part 1 deals with exclusions and restrictions of business liability in negligence which apply to all types of business and consumer contracts, and also to notices in tort [delict]. Part 2 deals with consumer contracts and Part 3 deals successively with business contracts in general, small business contracts, employment contracts and private contracts. Although the Draft Bill has the same number of provisions as the Act and Regulations it replaces, we believe that it is much more accessible to its readers.

<sup>27</sup> See Consultation Paper, para 2.35.

## **Defined terms**

- 2.49 The Draft Bill follows the Consultation Draft in containing a general interpretation provision towards the end of the draft.<sup>28</sup> In the Consultation Paper we suggested that the list of definitions should be placed at the end of the Bill because we think that the practice of starting with definitions can be off-putting to the lay reader.<sup>29</sup>
- 2.50 The interpretation provisions of the Draft Bill<sup>30</sup> have been drafted to refer to all defined terms, wherever the definition is located in the Bill. This provides a single point of reference for any reader wishing to establish the meaning of a term.
- 2.51 The Plain English Campaign suggested that we should highlight in the body of the text words and terms which were later defined. On first consideration, this seemed to be a useful idea. However, we have decided that it is just not practical.<sup>31</sup> It would also be potentially misleading, as non-highlighted terms may be defined elsewhere – for example, by other legislation, the courts or European law.
- 2.52 However, most users of the Bill are in fact unlikely to read the Queen's Printer's copy, but a version in a guide or collection of legislation. There is nothing to prevent the publishers of such a guide or collection arranging for defined words to be highlighted in some way when they appear in the text.

## **The use of examples in legislation**

- 2.53 There is one significant change from the Consultation Draft. The Consultation Draft included examples of the kind of term that amounts to an exclusion or restriction of liability within the meaning of the legislation or that fall within our replacement for the UTCCR's Indicative List of terms that may be regarded as unfair.<sup>32</sup> While many consultees welcomed this, it was put to us that previous experience of using examples in legislation has not always been happy: the examples may quickly become out of date and may turn out to be incorrect. With the development of Explanatory Notes to accompany a Bill, examples in the Act are not necessary. Examples of the type that we included in the Consultation Draft are intended to help the lay reader but, as we have just said, lay readers are likely to refer to guides or collections of legislation which can include relevant extracts from the Explanatory Notes. On reflection, we have concluded that it would be more appropriate for the examples to be in the Explanatory Notes.

<sup>28</sup> Draft Bill, clause 32; Consultation Draft, clause 18.

<sup>29</sup> See Consultation Paper, para 8.21.

<sup>30</sup> Draft Bill, clauses 25 – 32.

<sup>31</sup> This is because: (1) it is not appropriate that the format of Bills should be changed without the express sanction of Parliament; (2) highlighting goes against what the Procedure Committees in Parliament have said about layout; (3) using bold and italic type would interfere with the way in which Parliament currently highlights some provisions in proposed legislation; and (4) highlighting text would further complicate subsequent amendment, and therefore interpretation, of legislation.

<sup>32</sup> UTCCR, Sch 2.

# **PART 3**

## **A UNIFIED REGIME FOR CONSUMER CONTRACTS**

### **BACKGROUND**

- 3.1 The first of our terms of reference was to replace UCTA and the UTCCR with a single unified regime. The proposals put forward in the Consultation Paper<sup>1</sup> received broad support. The vast majority of respondents agreed that a unified regime would reduce uncertainty and confusion. They thought the uniformity offered by a single regime would provide greater clarity for consumers, businesses and enforcement authorities.
- 3.2 Our proposals on clarity and accessibility of the new regime<sup>2</sup> similarly received strong support. Respondents particularly welcomed the clarification of consumer law and mentioned that inconsistencies in the current regime benefit neither consumers nor their suppliers. Further, they criticised the formulaic and legalistic language of the current legislation and noted that it is confusing for consumers to have to search multiple sources to find the true state of the law. We agree with these criticisms. We have endeavoured where practicable to write the Draft Bill in plain language and to place much of the substance of the legislation in the body of the Bill. We hope this will limit the need for consumers to move back and forward between clauses and schedules, thereby making the legislation easier to understand.
- 3.3 Our recommendations for consumer contracts remain almost entirely as set out in the Consultation Paper. In broad terms these are:–
- (1) there should be a single piece of legislation for the whole of the UK;
  - (2) as far as possible, the new, unified regime should be clearer and more accessible to the reader rather than being based on UCTA or the UTCCR;
  - (3) with some minor exceptions, there should be no reduction of consumer protection;
  - (4) those terms that are of no effect under UCTA should remain of no effect; and
  - (5) other “non-core” terms (including terms that were individually negotiated) should be required to satisfy a “fair and reasonable” test.

<sup>1</sup> See Terms of Reference, Consultation Paper, para 1.1 and generally at paras 2.20 – 2.29 and 4.17.

<sup>2</sup> See Consultation Paper, paras 2.35 – 2.39 and 4.19.

- 3.4 The Consultation Paper contained a detailed comparison of UCTA and the UTCCR.<sup>3</sup> It is not intended to repeat that analysis here. A summary can be found in paragraphs 2.6 – 2.7 above.
- 3.5 In the paragraphs that follow we discuss our recommendations in detail, highlighting any changes we have made to our provisional proposals as well as areas where we have answered questions raised in the Consultation Paper or expanded areas which were dealt with only in outline.

## **GENERAL POLICIES**

### **Geographical scope of the Draft Legislation**

- 3.6 As we mentioned in the Consultation Paper,<sup>4</sup> UCTA contains separate provisions for England and Wales and Northern Ireland on the one hand (Part I) and Scotland (Part II) on the other. We provisionally proposed to unify the two parts in order to make integrated legislative provision for the whole of the UK. We said that some of the differences between the two Parts should be abolished and that some should remain but be preserved within a single instrument.<sup>5</sup>
- 3.7 Consultees were overwhelmingly in favour of a single piece of legislation for the whole of the UK. Many consultees drew attention to the confusion raised by the differences between English and Scots law in this area and thought that the confusion would be ameliorated by combining the different Parts of UCTA.
- 3.8 We now recommend that there should be a single piece of legislation covering the whole of the UK. Accordingly, the Draft Bill takes this form and there is no separate Part for any one jurisdiction.
- 3.9 **We recommend that there should be a single piece of legislation covering the whole of the United Kingdom.**

### **No reduction in protections**

- 3.10 In the Consultation Paper we stated that, subject to two exceptions to be discussed below, there should be no reduction in consumer protection.<sup>6</sup> This was supported by all the consultees who addressed the issue. It continues to be a key policy objective behind our recommendations on consumer contracts.<sup>7</sup>

<sup>3</sup> In Part III and Appendix F. In the Consultation Paper, we also noted the impact of Council Directive 99/44/EC of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees (“SCGD”). Where necessary this section refers back to SCGD in order to explain the background to some of our recommendations. The SCGD was implemented by the Sale and Supply of Goods to Consumers Regulations 2002 (“SSGCR”), SI 2002 No 3045, which came into effect on 31 March 2003.

<sup>4</sup> Consultation Paper, para 2.13.

<sup>5</sup> *Ibid*, para 4.16.

<sup>6</sup> *Ibid*, paras 4.22 – 4.29 and 4.205 – 4.207.

<sup>7</sup> Some further small reductions have arisen in the protection afforded by UCTA to consumers in the course of unifying and restructuring the regime. We do not think these

- 3.11 This policy is subject to two exceptions. The first is that under the new scheme the definition of consumer should be limited to natural persons.<sup>8</sup>
- 3.12 The second is that we consider that certain sections of UCTA are no longer necessary and need not be replicated in the new scheme. Section 5 [section 19]<sup>9</sup> (guarantee of consumer goods) seems to be superfluous and can be dropped without any loss of consumer protection.<sup>10</sup> We also propose not to replicate sections 9 [section 22] and 28 on the grounds that they are no longer of any practical effect.<sup>11</sup>
- 3.13 **We recommend that there should be no significant reduction in consumer protection.**

#### **Terms of no effect**

- 3.14 In the Consultation Paper we proposed that those terms which were of no effect under UCTA should remain of no effect under the new regime.<sup>12</sup> These cover exclusions or restrictions of liability for death or personal injury, for breach of the implied term that the seller is entitled to sell and for breach of any of the four implied terms of correspondence and quality. They are described in more detail in paragraph 3.43, below. Our proposals received overwhelming support from respondents, most of whom felt that the current system works in this respect and there is no reason to change it.
- 3.15 Below, in paragraph 3.45, we will recommend that those terms which were of no effect under UCTA should remain of no effect under the new regime.<sup>13</sup>

#### **Other rules relating to “unfair” terms**

- 3.16 In the Consultation Paper we said that it would not be appropriate to incorporate into our draft legislation other statutory and common law rules applying to potentially “unfair” terms in consumer contracts.<sup>14</sup> We had in mind statutory rules, for example relating to liability for defective products or rights of cancellation in consumer contracts. We were also thinking of common law rules that prohibit penalty clauses and terms excluding liability for fraud. However, we did propose to incorporate any changes necessitated by the SCGD.<sup>15</sup>

reductions are practically significant. Where these occur they are discussed in the Report. See para 3.129, below.

<sup>8</sup> See below, para 3.23 – 3.24.

<sup>9</sup> See Consultation Paper, paras 4.205 – 4.207.

<sup>10</sup> This is further discussed at para 3.48, below.

<sup>11</sup> See below, paras 6.36 – 6.42.

<sup>12</sup> See Consultation Paper, paras 4.34 – 4.35.

<sup>13</sup> See Draft Bill, clauses 1 and 5.

<sup>14</sup> Paras 4.30 – 4.31.

<sup>15</sup> See above, para 1.1, n 6.

- 3.17 A large majority of consultees agreed with our provisional view. Most thought that it would be both difficult and unnecessary to include a complete list of the rules which protect consumers' contractual rights. Some pointed out that to include common law rules within the proposed new legislation might hinder the development of these rules through judicial guidance and interpretation.
- 3.18 **We recommend that the new legislation should incorporate the requirements of the SCGD but not other statutory or common law rules applying to unfair terms in consumer contracts.**

### **SPECIFIC ISSUES**

- 3.19 We now discuss each of our specific recommendations in greater detail. This involves a summary of the law as it currently stands, our comments in the Consultation Paper and a brief discussion of the relevant clauses of the Draft Bill. For ease of reference, we follow the order in which they were considered in the Consultation Paper. The sole exception is the section on statutory definitions. This is placed first to clarify the essential concepts that delimit the contracts discussed in this Part.

#### **Definitions**

##### ***“Consumers” and “consumer contracts”***

- 3.20 The common element shared by the definitions in UCTA and the UTCCR is that to qualify as a “consumer”, a party to the contract must not be acting in the course of his or her business.
- 3.21 The Consultation Draft referred to persons acting for purposes that were “unrelated to” a business rather than things that were done otherwise than “in the course of” a business.<sup>16</sup> This was to clarify that where a party who is in business enters into a contract for purposes that are merely incidental to the core business but nevertheless related to it,<sup>17</sup> that party should not be treated as acting as a consumer. The great majority of consultees who expressed a view on this point agreed with our proposal. We now recommend preserving the approach taken in the Consultation Draft.
- 3.22 **We recommend that the definition of a “consumer” should refer to a person acting for purposes unrelated to his or her business.**<sup>18</sup>

#### NATURAL PERSONS

- 3.23 In the Consultation Paper we pointed out that in certain circumstances a company may act as a consumer for the purposes of UCTA.<sup>19</sup> The UTCCR apply

<sup>16</sup> Consultation Draft, clause 15.

<sup>17</sup> *R & B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 WLR 321 (a company which purchased a car for the personal and business use of its directors was treated as a consumer).

<sup>18</sup> See Consultation Draft, clause 26.

only in favour of natural persons.<sup>20</sup> Our provisional conclusion was that the definition of a consumer should be limited to natural persons, as under the UTCCR.<sup>21</sup> This was supported by the majority of respondents, many of whom were concerned that there should be a uniform definition of “consumer”. Those who addressed the issue of what form the definition should take overwhelmingly supported the UTCCR form of “natural person”. We therefore maintain our position from the Consultation Paper in our final recommendations and the Draft Bill has been worded accordingly.

**3.24 We recommend that under the new scheme only natural persons should constitute consumers.**<sup>22</sup>

HOLDING OUT

3.25 UCTA further excludes from the definition of “consumer” a person who *holds himself out* as making the contract in the course of a business.<sup>23</sup> Whilst this was not abolished by the SSGCR,<sup>24</sup> we felt compelled by the lack of any equivalent provision in the UTCCR or the SCGD to propose that this rule, or exception, be abolished.<sup>25</sup> A solid majority of respondents agreed. Therefore we recommend that the definition of “consumer” should include all natural persons who act outside the course of a business.<sup>26</sup> Persons should not lose their status as consumers merely by holding themselves out as acting in the course of a business.

**3.26 We recommend that the existing rule in UCTA that persons do not “deal as a consumer” when they hold themselves out as acting in the course of their business should not be replicated.**

AUCTIONS

3.27 It should be noted that the SSGCR<sup>27</sup> have come into force since the publication of our Consultation Paper. Regulation 14 amended the definition of “dealing as a consumer” in UCTA section 12 [section 25 (1)], so that an individual buying goods

<sup>19</sup> *R & B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 WLR 321 (purchase by a company of a car for personal and business use of directors). See also *Feldarol Foundry plc v Hermes Leasing (London) Ltd* [2004] EWCA Civ 747.

<sup>20</sup> See Consultation Paper, para 3.84.

<sup>21</sup> *Ibid*, para 4.153.

<sup>22</sup> See Draft Bill, clause 26(1), which refers to “an individual”. This will not affect the Arbitration Act 1996 ss 89 – 91, which provide that in a consumer contract an arbitration clause is unfair so far as it relates to a ‘modest’ amount (currently fixed at £5,000; by the Unfair Arbitration Agreements (Specified Amount) Order 1999, SI 1999 No 2167 reg 3), and for this purpose a legal person may be a consumer (s 90).

<sup>23</sup> Section 12(1)(a) [s 25(1)].

<sup>24</sup> See above, para 3.4, n 3.

<sup>25</sup> See Consultation Paper, paras 4.166 – 4.167.

<sup>26</sup> Thereby excluding any person actually acting in the course of his or her business.

<sup>27</sup> See para 1.1, n 6, above.

by competitive tender may now “deal as a consumer”. Individuals buying at an auction will be excluded from the definition of consumer only if they are purchasing second-hand goods at a public auction which they have the opportunity of attending in person. The changes were required by SCGD. This means that for the purposes of UCTA the buyer of second-hand goods at a public auction will not generally be a consumer. It does not appear to have been the intention to affect the rights of such a buyer under the UTCCR, which contain no such exception.

- 3.28 We recommend preserving the existing law. This means that people who buy second-hand goods at this type of public auction will not receive the protection of having some terms declared to be no effect. More specifically, if they sign contracts which exclude or restrict liability for breach of the implied undertakings of correspondence or quality, such terms will be subject to a “fair and reasonable” test. They will not be regarded as automatically ineffective.
- 3.29 **We recommend that an individual buying second-hand goods at an auction which individuals may attend in person should not be treated as a consumer for the purposes of the parts of our scheme that replicate provisions found only in UCTA.**<sup>28</sup>

GOODS OF A TYPE ORDINARILY SUPPLIED FOR PRIVATE USE OR CONSUMPTION

- 3.30 For a contract for the supply of goods to qualify as a consumer contract, UCTA also stipulates that the goods supplied should be of a type ordinarily supplied for private use or consumption.<sup>29</sup> In the Consultation Paper we proposed to abolish this rule<sup>30</sup> on the ground that it is incompatible with the SCGD. This recommendation was supported without objection by consultees. Since the publication of the Consultation Paper it has been abolished where the purchaser is an individual.<sup>31</sup> While it remains for those cases in which a company may act as a consumer, we are recommending that a company should never be a consumer under the new legislation.<sup>32</sup> Therefore UCTA section 12(1)(c) [section 25(1)] has not been replicated in the Draft Bill.
- 3.31 **We recommend that the existing rule in UCTA that for a contract for the supply of goods to qualify as a “consumer contract” the goods must be of a type ordinarily supplied for private use or consumption should not be replicated.**

<sup>28</sup> See Draft Bill, clause 5 and, for the exception of some buyers at auction, clause 5(6).

<sup>29</sup> UCTA, s 12(1)(c) [s 25(1)].

<sup>30</sup> At para 4.161.

<sup>31</sup> SSGCR reg 14, inserting a new s 12(1A) [s 25 (1A)] into UCTA.

<sup>32</sup> See para 3.24, above.

### **“Business”**

- 3.32 The definition of “business” under the two instruments is similar but not identical.<sup>33</sup> The most obvious difference is that the definition in UCTA is not exhaustive but government departments and local or public authorities are expressly included. The definition given in the UTCCR is exhaustive. Businesses in public ownership are included.<sup>34</sup> It might be argued that the UTCCR definition does not include a contract between, say, a local authority and a consumer, but this seems an unlikely interpretation<sup>35</sup> and the OFT has secured the removal of unfair terms from a number of such contracts.<sup>36</sup>
- 3.33 In the Consultation Paper, we suggested that the new legislation should make it clear that contracts with government departments or local or public authorities can be consumer contracts.<sup>37</sup> This was unanimously accepted by respondents. The City of London Solicitors Company pointed out that, as government bodies and local authorities are increasingly offering “services” to consumers, they are raising expectations that the rules regulating businesses apply to them.
- 3.34 **We recommend that “business” should include the activities of government departments or local or public authorities.**<sup>38</sup>

### **“Mixed” transactions**

- 3.35 Neither UCTA nor the UTCCR deal in any great detail with the issue of “mixed” transactions, namely where an individual enters into a contract with a business partly for private purposes and partly for business purposes.<sup>39</sup> We proposed that

<sup>33</sup> See UCTA, s 14 [s 25(1)]; “‘business’ includes a profession and the activities of any government department or local or public authority” and UTCCR, reg 3(1); “‘seller or supplier’ means any natural or legal person who, in contracts covered by these Regulations, is acting for purposes relating to his or her trade, business or profession, whether publicly owned or privately”.

<sup>34</sup> Thus it does not seem that the UTCCR are limited to contracts between profit-making organisations and consumers; and so for example a contract between a pupil and an educational charity might be covered: *Chitty on Contracts* (29<sup>th</sup> ed 2004), para 15-021. The same seems true of UCTA: *Chitty*, para 14-065; R Kidner, “The Unfair Contract Terms Act 1977 – Who Deals as Consumer?” (1987) 38 NILQ 46, 53.

<sup>35</sup> *Chitty*, para 15-021 says that the definition clearly does include a local authority. In “Unfair Contract Terms, Public Services and the Construction of a European Conception of Contract” (2000) 116 LQR 95, Simon Whittaker states that it is a fairly clear proposition that, according to the Directive, the *provider of the service* (as opposed to business) may be publicly or privately owned. See also “Rapport sur l’application de la Directive 93/13/1993 aux prestations de service public”, a report by the National Consumer Council and L’Institut National de la Consommation to the European Commission in 1997 (eds Hall and Tixador) p 13, which states that the Directive’s application to public authorities in principle is clearly confirmed by Art 2 and Recitals 14 and 16 of the preamble.

<sup>36</sup> See *Chitty*, para 15-021, n 81.

<sup>37</sup> See Consultation Paper, para 4.171.

<sup>38</sup> Clause 26(1) defines a consumer contract as one between a consumer and a business and clause 32(2) specifically includes a public authority in the definition of a business.

<sup>39</sup> UCTA, s 5 [s 19] deals with this but only for the purposes of that section. UCTA s 12(3) [s 25(1)] provides that it is for the person claiming that a party is not dealing as a consumer to prove that. This is replicated in the Draft Bill, clause 16(3). See Consultation Paper, para 4.156, n 189.

there should be no special provision in the new legislation and that the nature of the contract – consumer or business – could be left to be determined by a judge on the facts of each case.<sup>40</sup> The majority of consultees agreed.

- 3.36 We adhere to the policy set out in the Consultation Paper. However, the Consultation Draft defined “consumer” as

an individual ... who makes the contract for purposes which are not related to any business of his...

This definition required that the contract must not be “related” to “any” business purpose. This would prevent any mixed transaction being a consumer transaction. Consider the case where a sole trader buys a car primarily for private use but with the intention of occasionally using it for business. Under the Consultation Draft’s definition that contract could not be considered to be a consumer contract as it cannot be said that the contract was not related to the buyer’s business.

- 3.37 To overcome this problem, the definition of consumer contract in the Draft Bill now provides that:–

“‘Consumer contract’ means a contract (other than one of employment) between

- (a) an individual (“the consumer”) who enters into it wholly or mainly for purposes unrelated to a business of his, and
- (b) a person (“the business”) who enters into it wholly or mainly for purposes related to his business.”<sup>41</sup>

- 3.38 **We recommend that, in the case of an individual entering into a contract for “mixed purposes”, it should be left to the court to determine the main, or predominant, purpose of the contract and hence whether it is a consumer contract.**

**“Contract”**

- 3.39 Most of UCTA’s provisions apply only where there is a contract of the relevant type between the parties: the exception is for clauses dealing with business liability for negligence or breach of duty.<sup>42</sup> The UTCCR also speak of “contracts” concluded between a seller or a supplier and a consumer, but it has been suggested that the ECJ may adopt an autonomous view of “contract” which would include gratuitous supply arrangements.<sup>43</sup> The Consultation Paper therefore proposed that the new legislation should refer only to “contracts” and

<sup>40</sup> See Consultation Paper, paras 4.155 – 4.157.

<sup>41</sup> See Draft Bill, clause 26.

<sup>42</sup> UCTA, s 2 [s 16].

<sup>43</sup> *Chitty*, para 15-026; S Whittaker, “Unfair Contract Terms, Public Services and the Construction of a European Conception of Contract” (2000) 116 LQR 95.

not attempt to include expressly those kinds of arrangements that may be within the potential EU concept of a contract.<sup>44</sup> This would allow the courts to interpret the word in line with the ECJ. Respondents overwhelmingly agreed. No definition of “contract” is contained in the Draft Bill.

- 3.40 **We recommend that the controls in the Part of the new legislation dealing with consumer contracts<sup>45</sup> should relate only to “contracts”, but “contract” should be left undefined.**

#### **Terms of no effect**

- 3.41 Under UCTA attempts to exclude or restrict certain types of liability are simply of no effect [void]. Other exemption clauses may be valid if they satisfy the requirement of reasonableness.<sup>46</sup> In contrast, the UTCCR do not render any terms automatically void but subject them to a test of fairness.

#### **General**

- 3.42 Following our general policy that the protection currently afforded to consumers should not be reduced, we proposed that the new instrument should contain a list of terms which would be automatically of no effect. In the light of strong support from consultees, we retain the list which was considered in the Consultation Paper.
- 3.43 Our recommendations cover terms excluding or restricting the following liabilities:

- (1) for death or personal injury resulting from negligence [breach of duty] in any type of contract;<sup>47</sup>
- (2) for breach of the implied term that the seller is entitled to sell (in contracts for sale or hire purchase)<sup>48</sup> or that the supplier is entitled to transfer the property (in other contracts that transfer property in goods);<sup>49</sup> and
- (3) for breach of any of the four implied terms of correspondence and quality. Broadly, these state that goods should correspond with a description or

<sup>44</sup> See Consultation Paper, paras 4.172 – 4.175.

<sup>45</sup> The controls imposed in Part 1 apply also to notices that purport to exclude liability in tort [delict]. See Part 6, below.

<sup>46</sup> See Consultation Paper para 3.9 – 3.10.

<sup>47</sup> See UCTA, s 2(1) [s 16(1)(a)]; Draft Bill, clause 1. This restriction applies across the board to all contractual exclusion clauses in any kind of contract and to notices purporting to exclude liability in tort [delict]. On the latter, see Part 6, below.

<sup>48</sup> UCTA, s 6(1) [s 20(1)]. See Draft Bill, clause 5.

<sup>49</sup> UCTA, s 7(3A) [s 21(3A)]. This does not apply to hire contracts. Instead terms which restrict or exclude liability for breach of the implied term to transfer possession in hire contracts (set out in the Supply of Goods and Service Act 1982, s 7 [s 11H]) are subject to the reasonableness test (under UCTA s 7(4) [s 21(1)(b)]). We did not think that UCTA s 7(4) [s 21(1)(b)] needs to be replicated in the consumer part of the Draft Bill because there is a general “fair and reasonable” clause covering all terms in consumer contracts.

sample, should be of satisfactory quality and should be fit for the buyer's purpose.<sup>50</sup> UCTA prevents these terms from being excluded or restricted both in contracts for sale and hire purchase,<sup>51</sup> and in other contracts for the supply of goods.<sup>52</sup>

- 3.44 Our recommendations also cover terms which subject a remedy for breaches of these liabilities to restrictive or onerous conditions which disadvantage a person pursuing such a remedy; or which prevent an obligation or duty arising, or limiting its extent.<sup>53</sup>
- 3.45 **We recommend that terms which are automatically of no effect [void] under UCTA should continue to be of no effect under the new legislation.**
- 3.46 We provisionally proposed<sup>54</sup> that, in relation to consumers, category (1) above should include terms in contracts relating to the creation, transfer or termination of an interest in land.<sup>55</sup> This may represent the current law.<sup>56</sup> Again, respondents were overwhelmingly supportive of this proposal.
- 3.47 **We recommend that exclusions or restrictions of business liability for death or personal injury caused by negligence [breach of duty] should be automatically ineffective even if they are part of a contract for the acquisition, transfer and termination of an interest in land.**<sup>57</sup>

#### ***Consumer guarantees***

- 3.48 UCTA section 5 [section 19] renders exclusion clauses set out in consumer "guarantees" of no effect; that is to say, they are ineffective to exclude liability to the consumer. As we mentioned above,<sup>58</sup> we do not think it is necessary to preserve this section. Its importance was diminished, first, by the breadth of the final version of section 2(1) [section 16] and, secondly, by the Consumer

<sup>50</sup> Sale of Goods Act 1979, ss 13,14 & 15. Similar terms are implied into hire-purchase contracts by the Supply of Goods (Implied Terms) Act 1973, ss 9, 10 & 11; into other contracts for the transfer of property in goods by the Supply of Goods and Services Act 1982, ss 3, 4 & 5; [ss 11C, 11D & 11E] and into contracts for hire by the Supply of Goods and Services Act 1982, ss 8, 9 & 10 [ss 11I, 11J & 11K].

<sup>51</sup> UCTA, s 6(2) [s 20(2)(i)].

<sup>52</sup> UCTA, s 7(2) [s 21(1)(a)(i)]. Contracts covered by these sections include contracts of barter and exchange, for work and materials, and of hire.

<sup>53</sup> Draft Bill, clause 30. This replicates the effect of UCTA, s 13 [s 25(3) & (5)].

<sup>54</sup> See Consultation Paper, para 4.37. Since "goods" refers to moveables (see, for example, s 61(1) Sale of Goods Act 1979) and does not include land, controls over contracts for the supply of goods cannot extend to contracts relating solely to interests in land.

<sup>55</sup> See UCTA, Sch 1 paragraph 1(b), according to which a contract "so far as it relates to" the creation or transfer of an interest in land is exempt from sections 2 – 4 of the Act. [Such contracts are not included in s 15(2).]

<sup>56</sup> It is hard to see how such a clause – as opposed to the contract in which it is found – could "relate to the creation or transfer of an interest in land": see Consultation Paper, para 4.36.

<sup>57</sup> Clause 1 is therefore drafted without any limitation in respect of transactions for land.

<sup>58</sup> See para 3.12.

Protection Act 1987. The 1987 Act makes the manufacturer or distributor liable for loss caused by a defect in goods. Loss includes damage to consumer property above the value of £275. Liability under the 1987 Act cannot be excluded. Thus, as we pointed out in the Consultation Paper,<sup>59</sup> section 5 [section 19] seems only to be applicable in those cases where there is property damage of less than £275. Moreover, all it does is to make the clause automatically void rather than subject to a fair and reasonable test. We argued that the additional protection afforded by retaining section 5 [section 19] is so slight that it would be outweighed by the undesirability of adding to the complexity of the legislation. All but one of the consultees who responded on this point agreed.

**3.49 We recommend that UCTA section 5 [section 19] should not be replicated in the new legislation.**

**Terms not individually negotiated**

3.50 The UTCCR apply only to terms that, in the words of regulation 5(1), have “not been individually negotiated”. Regulation 5(2) provides that terms shall always be regarded as not having been individually negotiated where they have been drafted in advance and the consumer has therefore not been able to influence the substance of the term. In contrast, the application of UCTA to terms *in consumer contracts* does not depend on whether the term was negotiated (though that may be relevant to the question of reasonableness).<sup>60</sup>

3.51 In the Consultation Paper, we pointed out that it would be possible to maintain this distinction. Effectively, this would mean that, following UCTA, exclusion and limitations of liability would be treated differently from unfair terms in general. To do so would make the legislation significantly more complex. We argued that there are good reasons in a consumer contract to apply the “fair and reasonable” controls to all terms (other than “core” terms) whether or not the terms had been individually negotiated. Consumers seldom have sufficient understanding of the possible impact of “non-core” terms to make any negotiation meaningful. We noted that, in its response to the European Commission Review of the Directive,<sup>61</sup> the UK Government had supported bringing negotiated clauses within the controls required by the Directive.<sup>62</sup> We provisionally proposed that the new regime should apply to both negotiated and non-negotiated terms and specifically

<sup>59</sup> See Consultation Paper, para 4.206.

<sup>60</sup> Section 3 [s 17] applies to consumer contracts whether or not the terms were part of the business’s standard written terms. The same is true of s 4 [s 18] (indemnity clauses) and those parts of s 7 [s 21] that apply a test of reasonableness. See further below, para 3.164.

<sup>61</sup> See Consultation Paper, para 2.16. The European Community has recently announced plans to review eight directives, including that on Unfair Terms in Consumer Contracts. See Communication from the Commission to the European Parliament and the Council, “European Contract Law and the review of the acquis: the way forward”, COM (2004) 651 final of 11 October 2004.

<sup>62</sup> UK Response to the European Commission, DTI, 22 February 2001, response A1(a).

invited comments on the practical and economic impact that this proposal would have.<sup>63</sup>

- 3.52 A large majority of consultees agreed with our proposal. They gave three main reasons. First, there is considerable uncertainty over when a term is individually negotiated. Second, a consumer may not realise the implications of negotiating. Third, the proposal would make the legislation simpler, while affecting very few cases. The OFT also gave evidence that firms are currently exploiting the fact that the UTCCR do not apply to individually negotiated terms.<sup>64</sup> Some of those who opposed the proposal argued that a term which had been explained to the consumer or on which the consumer had taken advice, should not be regarded as unfair. We agree, but think that this is relevant to whether or not the term is unfair. It is not a reason for excluding a negotiated term from review.
- 3.53 We recognise that some negotiated terms which are not currently covered by UCTA will be subject to the new regime. We believe that this group will be relatively small because, in a consumer context, most terms that are negotiated are “core” terms and these will continue to be exempt.
- 3.54 Therefore we consider that the new regime should apply to both negotiated and non-negotiated terms. This is reflected in clause 4 of the Draft Bill which does not limit the powers of review to non-negotiated terms.
- 3.55 **We recommend that any term in a consumer contract, with the exception of a “core” term,<sup>65</sup> should be subject to the “fair and reasonable” test, whether or not the term was individually negotiated.<sup>66</sup>**

### **Terms not subject to control**

#### ***The definition of the main subject matter and the contract price***

- 3.56 “Core” terms (or, more properly, the “definition of the main subject matter of the contract” and “the adequacy of the price”) are exempt from review under the UTCCR if they are in plain and intelligible language. UCTA does not need or contain such an exemption, given that it is limited to terms excluding or restricting liability.
- 3.57 In the Consultation Paper, we noted that the Directive does not require us to exempt the main subject matter of the contract from the scope of review and that several Member States have not done so.<sup>67</sup> However, we argued that the main subject matter (if properly defined) should not be subject to challenge. If it were, the challenge would seldom succeed. To omit the exception would interfere with

<sup>63</sup> See Consultation Paper, paras 4.42 – 4.54.

<sup>64</sup> See below, para 3.156.

<sup>65</sup> And one that is automatically ineffective under the provisions already discussed: above, para 3.45.

<sup>66</sup> See Draft Bill, clause 4.

<sup>67</sup> See Consultation Paper, para 4.56.

freedom of contract. It would also give businesses little incentive to make clear to the consumer what the main subject matter is.

- 3.58 We also argued that it is implicit in the UTCCR that the consumer's expectations are an essential part of how "subject matter" is itself defined. We explained that whether a term relates to the definition of the subject matter for the purposes of applying the UTCCR appears to depend (at least in part) on how the "deal" was presented to the consumer. We said:

Terms which are to apply only in certain events, and which are separate from those describing the main features of the performance, do not seem to define the main subject matter. However, a provision to the same legal effect in the description of the main features may do so. So in a contract for a "holiday with travel by air", a clause in the "small print" allowing the company, in the event of air traffic control strikes, to carry the consumer by rail and sea seems to be reviewable for fairness; but it can be argued that if the holiday is "with travel by air or, in the event of strikes, by rail and sea", the option of mode of travel *might* be part of the definition of the main subject matter. In other words, whether the term relates to the definition of the subject matter depends (at least in part) on how the "deal" was presented to the consumer. This seems to be the corollary of a point made by the OFT:

In our view, it would be difficult to claim that any term was a core term unless it was central to how consumers perceived the bargain. A supplier would surely find it hard to sustain the argument that a contract's main subject matter was defined by a term which a consumer had been given no real chance to see and read before signing.<sup>68</sup>

We argued that if this is correct, then the question of "definition of the main subject matter" under the UTCCR is similar to the question whether the term purports to permit a performance substantially different from that which the consumer reasonably expected.

- 3.59 In order to make the position clear to consumers and particularly to business, we provisionally proposed that the new legislation should exclude the main subject matter and the price from the scope of review, but only in so far as the term is:-

- (1) not substantially different from what the consumer reasonably expected; and
- (2) stated in plain language.<sup>69</sup>

- 3.60 In the Consultation Paper, we also stated our provisional conclusion that, as currently under the UTCCR, the adequacy of the price should not be reviewable under the new legislation. This was on the assumptions (1) that the payment was

<sup>68</sup> *Ibid*, paras 3.23 – 3.23 (footnotes omitted).

<sup>69</sup> See Consultation Draft , clause 6.

not merely a sum payable under a default or similarly subsidiary term to which the consumer might have paid little attention;<sup>70</sup> and (2) that the payment was one that the consumer reasonably expected to make. We argued that payments due only on default are not “the price” within the meaning of the Directive and the UTCCR. Furthermore:

the same may be true of a provision which allows the borrower to pay off the loan within the first two years but only at the price of having to make up the difference between the low rate paid and some higher rate over the period between the start of the loan and repayment. This depends, we believe, on whether at the time the contract was made the option of early repayment was presented to the consumer as a main feature of the contract....

[W]hether an amount payable under the contract is subject to review may well depend on how the “deal” is presented to the consumer. If, for example, the consumer is told explicitly that the deal is “x% for two years and then y% for two years; you can pay off early but then you must make your payments up to z%”, we think that the rates could not be challenged; they would then form part of the price the consumer knows he has to pay and the amounts go to the adequacy of the price. In other words, the exemption for the “adequacy of the price” should be interpreted in a similar way to that for the “main subject matter of the contract”. The adequacy of the price will be exempt from review only to the extent that the sum payable was part of how the consumer “perceived the bargain”; and what the consumer should reasonably have expected to pay during the normal operation of the contract.<sup>71</sup>

3.61 Thus we considered that these are also requirements implicit in the UTCCR and should be made clear in the new legislation. We provisionally proposed that the adequacy of the price should be exempt from review, provided that

- (1) having to make the payment or the way in which it is calculated is not substantially different from what the consumer reasonably expected;
- (2) the price is not contained in a subsidiary term; and
- (3) it is stated in plain language.

3.62 The majority of respondents agreed. Those who disagreed did so on the grounds that there is already sufficient legislation governing “core” terms and that our proposals allowed consumers to challenge the price in instances where they simply did not understand it. This may already happen under the UTCCR if the price is not clearly stated. Our proposals do not change the law but seek to show a business the risk it runs if the price is not clearly stated. We therefore maintain the position set out in the Consultation Paper.

<sup>70</sup> See Consultation Paper, paras 3.27 – 3.34. That the price does not include sums payable on default or under an incidental or subsidiary term was decided in *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481.

<sup>71</sup> Consultation Paper, paras 3.30 and 3.33 (footnotes omitted).

- 3.63 We also argued that it was desirable, and indeed may already be the law, that terms must not only be in “plain, intelligible language” but be presented in a clear manner and accessible. This is because Recital 20 to the Directive states that “the consumer should actually be given the opportunity to examine all the terms”.<sup>72</sup> Thus we asked consultees whether the requirement that the core terms be in plain language should be expanded to state that the term needed to be “transparent”<sup>73</sup> in the sense that it must be (a) expressed in plain language, (b) presented in a clear manner, and (c) accessible to the consumer.<sup>74</sup> A substantial majority of the consultees who responded on this point agreed with our suggestion to expand the requirement of “plain language” to that of “transparency”. Some queried what “accessible to the consumer” meant. In the light of this uncertainty, we have decided to replace “accessible” with “available”. Our aim here is to provide that any term which is not physically available to the consumer at the point of contracting is subject to review whether or not it is a “core” term. An example of a situation in which terms are not available to the consumer would be *Thompson v LM & S Railway*.<sup>75</sup> In this case, the ticket for travel referred the customer to the railway’s standard terms and conditions in a separate document which the customer had to buy for 6d at a main railway station.
- 3.64 The OFT suggested to us that any term should be subject to review unless it is “readily legible”. We have accepted that suggestion and the Draft Bill now includes legibility in the definition of “transparent”.<sup>76</sup>
- 3.65 **We recommend that the definition of the main subject matter of the contract should be immune from challenge as long as it is: (a) substantially the same as the consumer reasonably expected; and (b) transparent.**<sup>77</sup>
- 3.66 **We recommend that the price payable under a consumer contract should be immune from challenge as long as it is: (a) payable in circumstances substantially the same as those the consumer reasonably expected; (b) calculated in substantially the same way as the consumer reasonably expected; (c) not payable under a default or subsidiary term of the contract; and (d) transparent.**<sup>78</sup>

***Mandatory and permitted terms***

- 3.67 Both UCTA and the UTCCR contain provisions designed to exclude from their operation terms that conform to what is required or permitted by other legislation,

<sup>72</sup> *Ibid*, para 3.75, n 156.

<sup>73</sup> *Ibid*, para 4.106(1).

<sup>74</sup> *Ibid*, para 4.106 and Consultation Draft, clause 6(6).

<sup>75</sup> [1930] 1 KB 41.

<sup>76</sup> See Draft Bill, clause 14(3).

<sup>77</sup> See Draft Bill, clause 4(2).

<sup>78</sup> See Draft Bill, clause 4(3) and (5).

an international convention or the decision of a competent authority.<sup>79</sup> In the Consultation Paper, we made the following provisional proposals in respect of mandatory and permitted terms:–

- (1) terms required or authorised by an international convention should be exempt from the new regime but terms which merely reflect principles said to be inherent in such a convention should not be,<sup>80</sup>
- (2) terms not substantially different from a “default rule” of common law or statute (in other words, that would apply in the absence of the express contractual term) should continue to be exempt but only in so far as they are in plain language,<sup>81</sup>
- (3) a term should not be exempt merely because it represents the law of another EU Member State,<sup>82</sup> and
- (4) terms required by regulators should be exempt but not terms merely approved by regulators.<sup>83</sup>

3.68 The vast majority of those who responded to our consultation proposals in respect of mandatory and permitted terms were in agreement.

3.69 All respondents who dealt with the issue agreed that terms required by an international convention to which the UK was a party should not be subject to the reasonableness test. The majority of them also agreed that terms which reflect the common law should be outside the scope of review unless they are not transparent. For example, a term in a contract stipulates that a consumer who defaults before receiving full performance must pay the full price less various deductions. This term would be outside the scope of review if the deductions have the effect of reducing the sum to be paid to the amount payable under the general law of damages, provided that the term was presented in a clear and transparent way. If the deductions to be made were so difficult to understand that consumers might well believe they were obliged to pay the whole price without any deduction, the clause would be subject to review. More importantly, the OFT or other authorised body could take steps to prevent the business from continuing to use the clause.

3.70 One substantial objection came from the OFT who felt that this exemption would create an impediment to effective enforcement and would close off an avenue that they are beginning to use. We feel that if a rule of the common law is “unfair”, the common law should be amended by targeted legislation rather than by the OFT using preventive powers. Alternatively, the courts themselves can change the common law rule. Thus the Draft Bill states that a term cannot be challenged

<sup>79</sup> UCTA, s 29; UTCCR, reg 4(2).

<sup>80</sup> See Consultation Paper, para 4.70.

<sup>81</sup> *Ibid*, para 4.73.

<sup>82</sup> *Ibid*, para 4.74.

<sup>83</sup> *Ibid*, para 4.76.

under the general clause governing consumer contracts if it would lead to “substantially the same result as would be produced as a matter of law if the term were not included”, provided that the term is also transparent.<sup>84</sup>

3.71 The majority of respondents also agreed that a term should not be automatically exempt simply because it represents the law of another Member State.

3.72 **We recommend that terms**

- (a) **required by an enactment or rule of law;**
- (b) **required or authorised by an international convention; or**
- (c) **required by a competent authority**

**should continue to be exempt under the new legislation.<sup>85</sup> Terms that produce substantially the same result as would be produced as a matter of law if the term were not included should be exempt, but only if the term is also transparent.**

#### **Excluded contracts**

3.73 In the Consultation Paper, we looked in detail at five areas of contract law to see whether the relevant contracts should be specifically included or excluded from our proposed regime.<sup>86</sup> These are dealt with below.

#### ***The consumer as supplier***

3.74 There are some contracts under which a consumer supplies goods or services to a business: for example, when a private motorist sells a car to a dealer. The UTCCR only apply to contracts “concluded between a seller or a supplier and a consumer”:<sup>87</sup> this may mean that they would not protect the consumer when he or she is a seller or supplier. On the other hand, UCTA section 3 [section 17] applies where the consumer is the buyer or the seller, the supplier or the recipient.

3.75 In the Consultation Paper we proposed that the new regime should apply where a consumer is the seller or supplier.<sup>88</sup> Thus, for example, a consumer who sells a used car to a dealer would be able to challenge an unfair term in the dealer’s conditions of purchase. Those who responded to this question unanimously supported the inclusion of these contracts into the regime; some believed it to be the law already but felt that it would be good to have it stated expressly in the legislation.

<sup>84</sup> Draft Bill, clause 4(4).

<sup>85</sup> See Draft Bill, clause 22 and Sch 3.

<sup>86</sup> See Consultation Paper paras 4.77 – 4.86.

<sup>87</sup> Reg 4(1).

<sup>88</sup> See Consultation Paper, para 4.78.

- 3.76 **We recommend that the general control over unfair terms in consumer contracts should apply where a consumer is the seller or supplier.**<sup>89</sup>

***Expressly excluded categories of contract***

- 3.77 The UTCCR do not expressly exclude any types of contract. In contrast, consumer contracts of insurance<sup>90</sup> and any contract so far as it relates to the creation, transfer or termination of interests in land<sup>91</sup> or the creation or transfer of securities or any rights or interests in securities<sup>92</sup> are excluded from UCTA in English and Scots law.

- 3.78 Because they are within the scope of the UTCCR, contracts of insurance, contracts for the transfer of an interest in land and contracts for the creation or transfer of interests in securities fall within the new regime.<sup>93</sup> Thus the Draft Bill does not include any exemption from the recommended controls over these kinds of consumer contracts.

- 3.79 In the Consultation Paper, we took the view that contracts of guarantee might also be excluded in Scots law. We can see no reasons of policy why such contracts should be excluded and have taken the view that they should not be exempted from the new legislation.

- 3.80 **We recommend that consumer contracts of insurance and contracts for the transfer of an interest in land and for the creation or transfer of interests in securities should not be exempt from the new regime.**

***Contracts of employment***

- 3.81 We consider this issue in Part 6.

***International contracts***

- 3.82 Although both consumer and non-consumer “cross-border” contracts for the supply of goods are exempt from UCTA, there is no exemption for cross-border contracts of sale in SCGD. Equally, the UTCCR have no exemption for international contracts. We provisionally proposed that the controls should apply to terms in cross-border consumer contracts for the sale or supply of goods in the same way as domestic contracts. This is discussed fully in Part 7.

***Choice of law***

- 3.83 UCTA exempts from the operation of its provisions contracts in which English or Scots law applies *only because* the parties have chosen that law to govern their

<sup>89</sup> See below, paras 6.14 – 6.27 for further discussion on controls over terms excluding liability for breach of statutory implied terms in contracts where a consumer supplies goods to a business or to another individual.

<sup>90</sup> See Sch 1 [s 15(3)(a)(i)].

<sup>91</sup> See Sch 1 [Not listed in s 15(2) and therefore excluded].

<sup>92</sup> *Ibid.*

<sup>93</sup> See Consultation Paper, para 4.79.

contract. There is no similar exemption in the UTCCR. Our recommendations on choice of law clauses are discussed in Part 7.

### **The test to be applied**

#### ***Fairness, reasonableness and good faith***

3.84 When a term is subject to the UCTA controls and is not of no effect [void], under English law it must satisfy the requirements of reasonableness in section 11 if it is to be effective. Under Scots law the test as defined in section 24 is whether it was “fair and reasonable” to incorporate the term into the contract. The test in the UTCCR is whether the term is unfair. Regulation 5 (1)<sup>94</sup> provides:–

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.

3.85 In the Consultation Paper, we took the view that there is very little difference between the “requirement of reasonableness” [“fair and reasonable” test] under UCTA and the test of “fairness” used in the UTCCR. Our provisional proposal was that the new legislation would give the greatest possible guidance by combining and expanding the two tests.

3.86 We thought that it was neither necessary nor desirable to include an explicit reference to good faith.<sup>95</sup> First, the question of “forms and methods” of implementation of EU Directives is a matter for each Member State as long as the intended result is ultimately achieved. Secondly, good faith is a concept which is unfamiliar to English and Scots lawyers in this area of law.

3.87 Slightly more than half of our respondents agreed with the provisional proposal. Those who did so tended to favour the absence of a specific reference to good faith on the grounds that it was confusing and likely to mislead.

3.88 Those who did not agree with our proposals felt that it would be a retrograde step to remove the reference to good faith. They questioned whether the Directive would be implemented effectively in its absence. They also considered that in the ongoing process of unification and codification of European contract law, our proposals should refer to good faith which is a standard generally recognised in Civilian systems.

3.89 As we explained in the Consultation Paper,<sup>96</sup> we consider that our proposed test does meet the requirements of the Directive. It will be easier for UK lawyers to apply than a more “European” test which makes express reference to good faith. Therefore we still recommend that the test should be one of “fairness and reasonableness”.

<sup>94</sup> And the text of Directive 93/13, art 3(1).

<sup>95</sup> See Consultation Paper, paras 4.7 – 4.10 and 4.87 – 4.106.

<sup>96</sup> *Ibid.*

- 3.90 **We recommend that the test to be applied to contract terms which are challengeable but which are not automatically of no effect should be a “fair and reasonable” test.**
- 3.91 **We recommend that the “fair and reasonable” test in the new legislation should not include any express reference to “good faith”.**

### ***The basic formula***

#### THE TIME WHEN FAIRNESS SHOULD BE ASSESSED

- 3.92 In the Consultation Paper we argued that the question of fairness should be judged by reference to the time when the contract was agreed. Accordingly, if circumstances change during the performance of the contract – for example, if it becomes possible for one party to insure against a certain risk when previously they were unable to do so – this will not affect the fairness of the term. This provision is similar to the rule in section 11 [section 24] of UCTA, that reasonableness shall be determined by reference to “the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties to the contract when the contract was made”. It also replicates the substance of the UTCCR regulation 6(1) where fairness is assessed “by referring, at the time of the conclusion of the contract, to all the circumstances”. The formula provisionally proposed in the Consultation Paper was whether, judged by reference to the time the contract was made, the term is fair and reasonable.<sup>97</sup>

#### FAIRNESS IN SUBSTANCE AND PROCEDURAL UNFAIRNESS

- 3.93 We also argued that a term could be unfair because of its substance, whatever the circumstances in which the contract was made. Conversely, a term could be unfair simply because of the circumstances in which the contract was made; for example, if the consumer had no reason to suspect that such a clause was in the contract. In other circumstances the same term might be fair; for example, if the consumer had agreed to the term after being offered a choice and having an opportunity to read the terms.<sup>98</sup> We proposed that this should be reflected in the new legislation.

#### THE CONSULTATION PAPER PROPOSAL AND RESPONSES

- 3.94 The Consultation Draft provided that the question “whether a contract term is fair and reasonable is to be determined (a) by reference to the time when the contract was made, and (b) by taking into account the substance and effect of the term and all the circumstances existing when the contract was made”.
- 3.95 The majority of consultees agreed with our proposals.
- 3.96 **We recommend that whether a term is fair and reasonable should be determined (a) by reference to the time when the contract was made, and**

<sup>97</sup> See Consultation Paper, para 4.94.

<sup>98</sup> See Consultation Paper, paras 3.63 – 3.69.

**(b) by taking into account the substance and effect of the term, and all the circumstances existing when the contract was made.**<sup>99</sup>

***“Plain and intelligible language” and “transparency”***

- 3.97 Mirroring the Directive, the UTCCR require that “any written term of a contract is expressed in plain, intelligible language”.<sup>100</sup> They provide that a “core” term which is not in plain and intelligible language loses the exemption from the controls which it would otherwise have enjoyed. UCTA has no equivalent requirement. However, in assessing whether a term satisfies the requirement of reasonableness, a court may take into account whether it is intelligible<sup>101</sup> as well as other factors relating to “transparency”.
- 3.98 In the Consultation Paper, we said that the use of plain and intelligible language was a vital aspect of fairness and, in any new legislation, should be listed specifically among the factors to be taken into account in assessing the fairness of a term.<sup>102</sup> For reasons explained above,<sup>103</sup> we refer to factors such as intelligible language as “transparency”. Thus in the Consultation Draft the requirement of “transparency” appeared in relation to core terms<sup>104</sup> and to “default” terms that reflect the position as it would otherwise be at common law.<sup>105</sup> It also appeared in the list of matters relevant to the knowledge and understanding of the party adversely affected by the term.<sup>106</sup> However, it did not feature in the clause setting out the “basic test” of reasonableness.<sup>107</sup>
- 3.99 In the Consultation Paper we also argued that it should be possible for the court to hold a term to be unfair merely because it was not transparent; for example, because the term was expressed in complex language or printed in a small font size. We therefore proposed that a term should be capable of being found to be unfair *principally* or *solely* because it was not transparent.<sup>108</sup>
- 3.100 Consultees strongly supported the proposals on transparency. A substantial majority agreed that a term could be unfair solely or principally because it was not transparent.<sup>109</sup> Consequently, clause 14(1) of the Draft Bill expressly provides

<sup>99</sup> Draft Bill, clause 14(1).

<sup>100</sup> Reg 7(1).

<sup>101</sup> See Consultation Paper, para 3.76, n 157.

<sup>102</sup> *Ibid*, para 4.104.

<sup>103</sup> See paras 3.63 – 3.64.

<sup>104</sup> See paras 3.56 – 3.58, above.

<sup>105</sup> See para 3.67(2), above.

<sup>106</sup> Consultation Draft, Schedule 1, para 3(1)(g). For a discussion of this list of matters, see below, para 3.103.

<sup>107</sup> Consultation Draft, clause 9.

<sup>108</sup> See Consultation Paper, paras 4.107 – 4.109.

<sup>109</sup> Some consultees were in favour of our using the word “clear” instead of “transparent”. However, we think that “clear” could be taken to mean only that the language of the term should be plain and easily comprehensible. We wanted to ensure that factors such as legibility and presentation should also be taken into account.

that whether a term is “fair and reasonable” should be assessed according to “the extent to which the term is transparent” as well as “the substance and effect of the term, and all the circumstances existing at the time it was agreed”.

- 3.101 **We recommend that whether a term is “fair and reasonable” should be assessed according to (a) whether it is transparent; (b) its substance and effect; and (c) the circumstances in existence at the time the contract was made.**
- 3.102 **We recommend that it should be possible for a contract term to be found to be unfair principally or solely because it is not transparent.**

### ***Guidelines***

- 3.103 In the Consultation Paper, we also proposed that the new legislation should contain detailed guidelines on the application of the “fair and reasonable” test. This was supported by the majority of consultees, though there was some concern that it should be made clear that the guidelines were only indicative. They should not be so specific that the generality of the test would be eclipsed. We think that this concern is largely met by the way in which the Draft Bill requires the court to take the factors listed by the guidelines into account but allows the court to have regard to any other considerations.<sup>110</sup>
- 3.104 Those who opposed the use of guidelines did so because they thought guidelines might create loopholes to the detriment of consumers. Nevertheless, we feel that guidelines will help businesses and consumers alike in understanding the new regime. Thus clause 14(4) of the Draft Bill contains a non-exhaustive list of matters to be taken into account when assessing whether a term is fair and reasonable.<sup>111</sup> The guidelines we recommend refer to the following considerations:–
- (a) the other terms of the contract,
  - (b) the terms of any other contract on which the contract depends,
  - (c) the balance of the parties’ interests,
  - (d) the risks to the party adversely affected by the term,
  - (e) the possibility and probability of insurance,
  - (f) other ways in which the interests of the party adversely affected by the term might have been protected,

<sup>110</sup> At clause 14(4).

<sup>111</sup> The Consultation Draft made reference to a schedule containing a lengthy list of factors to be taken into account in determining whether a term was fair and reasonable. In the Draft Bill this list has been condensed and brought into the main body of the Bill. Since the list is expressed to be non-exhaustive, there is nothing to prevent a court from taking into account additional factors not contained in the condensed list.

- (g) the extent to which the term (whether alone or with others) differs from what would have been the case in its absence,
- (h) the knowledge and understanding of the party adversely affected by the term,
- (i) the strength of the parties' bargaining positions,
- (j) the nature of the goods or services to which the contract relates.

Explanation of these guidelines is given in the Explanatory Notes to the Draft Bill. We hope that these Notes will provide useful assistance, particularly in understanding the relevance of "inequality of bargaining power" which, as we stated in the Consultation Paper,<sup>112</sup> is an ambiguous and much misunderstood concept. Further guidance on what terms are likely to be regarded as not "fair and reasonable" may also be obtained from the Draft Bill's version of the Indicative List.<sup>113</sup>

**3.105 We recommend that the new legislation should contain substantive guidelines for the application of the "fair and reasonable" test.**

#### **Interpretation in favour of the consumer**

3.106 There is a common law rule that if the meaning of a term is doubtful or ambiguous, it will be construed against the interest of the party putting it forward.<sup>114</sup> The UTCCR require that "any written term of a contract is expressed in plain, intelligible language"<sup>115</sup> and provide that if there is doubt about the meaning of a written term, the interpretation which is most favourable to the consumer should prevail.<sup>116</sup> We provisionally proposed that the new legislation should include a rule of interpretation in favour of the consumer similar to this *contra proferentem* rule. Amongst those consultees who considered the issue, there was overwhelming support.<sup>117</sup> Accordingly, the Draft Bill contains a rule of

<sup>112</sup> See Consultation Paper, para 4.102.

<sup>113</sup> See paras 3.117 – 3.119, below.

<sup>114</sup> Still often referred to as the *contra proferentem* rule.

<sup>115</sup> Reg 7(1).

<sup>116</sup> Reg 6(2), reflecting Directive, Art 5. The rule does not apply to proceedings brought under reg 12. In some cases it may be in the interests of the consumer to give an exclusion term a narrow meaning (so as to prevent it from excluding the liability that has arisen). More commonly, it will be in the consumer's interests to give the term a wide meaning, so as to show that it is unreasonably broad. For discussion of this point, see M Furmston (ed), *Butterworths Law of Contract* (2<sup>nd</sup> ed 2003) para 3.107.

<sup>117</sup> It is possible that a specific statutory provision is required in spite of the common law rule. In *Commission v Kingdom of the Netherlands* Case C-144/99 [2001] ECR I-3541, the ECJ held that the Netherlands were in breach of the implementation requirements by relying on a "settled" rule of interpretation rather than specifically transposing Articles 4(2) and 5 into legislation. It is our understanding that a settled rule of Dutch law does not have the status of a binding precedent of common law, so it remains uncertain whether the UK is bound to transpose these Articles into legislation (See Beale, "Unfair Terms in Contracts: Proposals for Reform in the UK" (2004) 27 J Consumer Policy 289). However, we think it is desirable to do so.

interpretation that where there is doubt about the meaning of a term, the meaning most favourable to the consumer must prevail.<sup>118</sup>

- 3.107 **We recommend that the new legislation should contain a rule of interpretation in favour of the consumer, providing that the consumer should have the benefit of any doubt about the meaning of a term.**

#### **Indicative List**

- 3.108 The UTCCR contain an indicative or “grey” list copied from the Annex to the Directive, referred to as an “indicative and non-exhaustive list of terms which may be regarded as unfair”. It appears that the list must be implemented in some form in order to comply with the Directive.<sup>119</sup> We recommend retaining the list in the new legislation.

- 3.109 In the Consultation Paper we proposed the following modifications to the Indicative List:–

- (1) expanding the list to encompass terms that the OFT has required firms to stop using;<sup>120</sup>
- (2) adding contractual terms which purport to exclude or restrict the business’s liability in tort [delict] for loss or damage to the consumer other than death or personal injury;<sup>121</sup>
- (3) reformulating the list in terms which are more directly applicable to UK law and more readily comprehensible to UK readers;
- (4) as part of this reformulation, adding examples of potentially unfair terms to the general guidance on such terms already given in the list;<sup>122</sup> and
- (5) providing a power to add to the list by Ministerial Order.<sup>123</sup>

<sup>118</sup> See Draft Bill, clause 16. This will not apply to proceedings under Schedule 1: see clause 16(2).

<sup>119</sup> In *Commission v Sweden* Case C-478/99 [2002] ECR I-04147, the ECJ held that the list in the Directive’s Annex need not be directly included in national legislation implementing the 1993 Directive. However, the Court stated that “[i]nasmuch as [it] is of indicative and illustrative value, it constitutes a source of information both for the national authorities responsible for *applying* the implementing measures and for individuals affected by those measures,” and so its “form and method of implementation [must] offer a sufficient guarantee that the public can obtain knowledge of it” (*Chitty* 15-069, n 279). We think that the usefulness of the list as a source of information will be enhanced by retaining the list in the new legislation itself.

<sup>120</sup> Specifically those listed in the Consultation Paper at para 4.113.

<sup>121</sup> See Consultation Paper, para 4.116.

<sup>122</sup> See Consultation Paper, paras 4.125.

<sup>123</sup> See Consultation Paper, para 4.116.

### ***Expanding the list***

- 3.110 In the Consultation Paper we suggested adding a number of new terms to the Indicative List. A small majority of respondents agreed that the new Indicative List should include terms against which the Office of Fair Trading had already taken action. However, when we came to re-examine the list put forward in the Consultation Paper, we discovered that some of the suggested terms could not safely be regarded as likely to be unfair. Others did not admit of a sufficiently clear and certain definition to be appropriate for inclusion in primary legislation. Therefore we have decided not to include the suggested additional terms in the list at present.
- 3.111 However, we accept that if an unfair term has become sufficiently common and can be defined with certainty, it is desirable that it should be added to the list in order to put businesses on notice. We therefore think it would be useful for the Secretary of State to have a statutory power to add to or otherwise amend the list. Most consultees who commented on this issue agreed.
- 3.112 **We recommend that the replacement for the Indicative List in the new legislation should not include the additional types of term against which the OFT has taken action; but the Secretary of State should have a statutory power to add appropriate terms to the list.**<sup>124</sup>

### ***Terms excluding business liability for negligence***

- 3.113 In the Consultation Paper, we raised the question whether the onus should lie on the consumer to establish that a term is unfair if the term did not appear in the Indicative List. In that context, we thought that it would be important to add to the list terms which purport to exclude or restrict the liability of a business in tort [delict] for damage other than death or personal injury. In the event, we have decided that the burden of proving that a such term is fair should always fall on the business: and so the Draft Bill expressly provides.<sup>125</sup> In other words, the consumer does not need to rely on the term's appearance in the Indicative List to overcome any hurdle before challenging the term. Accordingly, there is no need to add such exemption clauses to the list for that reason.
- 3.114 However, in the Consultation Paper we also said, "although if terms are unfair the bodies listed in Schedule 1 to UTCCR can act to prevent their use even if they are not listed, it would be clearer for all concerned if they appeared on the list."<sup>126</sup> For this reason, we think that consideration should be given to using the statutory power to add to the list terms which purport to exclude or restrict the liability of a business in tort [delict] for damage other than death or personal injury.<sup>127</sup>

<sup>124</sup> See Draft Bill, clause 14(7).

<sup>125</sup> Draft Bill, clause 15.

<sup>126</sup> See Consultation Paper, para 4.116.

<sup>127</sup> The controls imposed on non-contractual notices that purport to exclude liability in negligence are discussed in Part 6, paras 6.28-6.35.

### ***Reformulating the list***

- 3.115 An overwhelming majority of consultees who commented on this issue agreed that it would be useful to reformulate the Indicative List in terms that would be more readily comprehensible to readers in the UK. We have therefore included in the Draft Bill a reformulated list.
- 3.116 **We recommend that the Indicative List should be reformulated using concepts and language more likely to be understood by readers in the UK.**

### ***The use of examples***

- 3.117 The Consultation Paper also considered the use of examples to illustrate the application of the terms in the Indicative List.<sup>128</sup> A substantial majority of respondents supported the use of examples, arguing that it would make the regime more “user-friendly”. Those who did not agree were concerned that the presence of examples might affect the application of the “fair and reasonable” test and ultimately lead to greater uncertainty in the law. The Financial Services Authority (FSA) were concerned that examples of terms we considered to be unfair might not be regarded as unfair in other jurisdictions: this, they argued, could have adverse implications for consistency in cross-border business carried out by UK firms in Europe. There was also concern that as time passed and contractual drafting techniques changed, the examples might become dated and unhelpful.
- 3.118 Given the preference of the majority of respondents and their utility for consumers, we still think that it is important to provide accessible examples of the terms set out in the Indicative List. However, it was put to us that previous experience of using examples in primary legislation has not always been happy: the examples may quickly date and may turn out to be incorrect. Accordingly, we believe that a suitable compromise can be reached by including the examples not in the Draft Bill but in the accompanying Explanatory Notes.<sup>129</sup>
- 3.119 **We recommend that the Explanatory Notes to the Bill should contain examples of terms that would fall within the types of terms in the Indicative List.**

### ***The exceptions to the Indicative List***

- 3.120 Attached to the Indicative List in the UTCCR is a list of exceptions<sup>130</sup> relating primarily to financial services contracts where the presumption of unfairness does not apply. In our Consultation Paper we stated that we were not aware that these exemptions had caused any difficulty and invited views on whether they should continue.<sup>131</sup>

<sup>128</sup> Consultation Paper, paras 4.125 – 4.143.

<sup>129</sup> See Explanatory Notes, Appendix A, para 101.

<sup>130</sup> See Sch 2(2).

<sup>131</sup> Consultation Paper, paras 4.144 – 4.145.

- 3.121 The majority of respondents who dealt with this issue agreed that the exceptions list should continue. However, the OFT strongly disagreed. They argued for its abolition, informing us that it had been the cause of considerable problems, conflicting interpretations and in their experience was the most difficult part of the legislation. More worryingly, perhaps, they informed us that the presence of the exceptions had been used by some parties to argue for the exclusion of terms from the fairness test altogether, not merely the Indicative List.
- 3.122 We agree with the OFT's interpretation of the law, namely that the exceptions are exempt from the Indicative List but still subject to the fairness test. But we do not agree with their argument that having a list of exceptions serves no useful purpose. We think that the indication that certain terms are not likely to be regarded as unfair is useful. We agree with the FSA which told us that "these terms' current inclusion provides formal... recognition of the legitimate interests of suppliers of on-going services in markets that are prone to uncertainty or contain variable pricing elements." We accept that some of the exceptions could be reworded in order to reduce confusion. The list of exceptions is therefore maintained. It has been reformulated and included in the Draft Bill at Part 3 of Schedule 2.
- 3.123 **We recommend that the list of exceptions to the Indicative List in the UTCCR should be retained but reformulated in the interests of clarity.**

#### **The burden of showing unfairness**

- 3.124 As we explained in Part 2, UCTA and the UTCCR deal differently with the question of which party to a consumer contract should carry the burden of establishing whether a contract term is fair or reasonable.<sup>132</sup> UCTA section 11(5) [section 24(4)] provides that the burden of proof rests on the party claiming that a term or notice satisfies the requirement of reasonableness.<sup>133</sup> In contrast, the UTCCR do not specifically allocate the burden of proof so it naturally falls on the party alleging that the term is unfair – that is, the consumer. However, where a term is clearly unfair, the court is able to raise the issue of fairness of its own motion.<sup>134</sup>
- 3.125 The Consultation Paper made no firm proposal on the burden of showing that a term is fair or unfair. Instead we asked consultees to consider the following options: (a) that the burden of showing that a term was fair should always be on the business; or (b) that it should be on the business only when the term was included in the Indicative List: otherwise, the consumer had to establish that the term was unfair. We included alternative versions in our Consultation Draft.<sup>135</sup>

<sup>132</sup> Consultation Paper, para 3.79.

<sup>133</sup> The Scottish provision provides that "[t]he onus of proving that it was fair and reasonable to incorporate a term in a contract or that it is fair and reasonable to allow reliance on a provision of a notice shall lie on the party so contending."

<sup>134</sup> This was the ruling of the European Court of Justice in *Oceano Grupo Editorial SA v Quintero* (Joined Cases C-240/98 to C-244/98) of 27 June 2000, [2000] ECR I-4941.

<sup>135</sup> See Consultation Draft, clause 13.

- 3.126 Consultees were evenly divided on the question. Of those who expressed a clear opinion, around half thought that the burden should always rest on the business as in option (a) and the same number favoured option (b). Those who favoured (a) said that any other approach would present too great an obstacle to consumers who wished to use the new legislation. Those who favoured (b) thought that this would be fairer, particularly as the consumer would be challenging a term to which he or she has already agreed.
- 3.127 On further reflection, we realised that the burden of showing that a term was fair and reasonable could not depend on whether it appeared in the Indicative List. This was because some of the paragraphs in that list only apply when the term has “unreasonable” or “disproportionate” elements. Thus any reference to the List in order to determine the burden of proving reasonableness would be circular. We have concluded that in individual (as opposed to preventive<sup>136</sup>) proceedings the burden should always rest on the business. This is for the reason given by the Scottish Consumer Council :-

the reasonableness of a term will only come into question where that term alters the consumer’s rights or obligations from the usual position under the rules of contract law. In such cases, business is attempting to achieve an advantage, and should therefore bear the burden of justifying its position.

- 3.128 However, we have taken the view that a business should not have to justify any term of the contract unless and until the issue has been raised by the consumer (or by the court of its own motion) in relation to a specific term. In other words there must be sufficient grounds, whether these arise from the clause itself or from extrinsic points made by the consumer, for the court to infer that the fairness of the term is a real issue. We therefore recommend that the business should only have to prove a term is fair and reasonable once the court is satisfied that the fairness of the term is a real issue in the case. The Draft Bill makes provision to this effect.<sup>137</sup>
- 3.129 We do not think that this represents a reduction of consumer protection compared with the position under UCTA section 3(2)(a) [section 17(1)(a)], whereby the party claiming that an exclusion or limitation clause is fair and reasonable must prove that it does. The burden of raising the issue will not require the consumer to do significantly more than claim in his or her statement of the case [pleadings] that a specific term is unfair or unreasonable.
- 3.130 **We recommend that where an issue has been raised as to whether a term is fair and reasonable, the burden of proving that it is fair and reasonable should rest on the business.**

<sup>136</sup> See below, para 3.163.

<sup>137</sup> Clause 16(1).

### The effect of an invalid term

- 3.131 The formula adopted by UCTA for describing the effect of an unreasonable or invalid term is that a party cannot “by reference to [that term] exclude or restrict any liability” (sections 2 and 3). Similarly, sections 5, 6 and 7 state that “liability ... cannot be excluded or restricted by reference to [that term]”.
- 3.132 This “purposive” formula allows either party to rely on the clause for any purpose other than that of seeking to exclude or restrict liability. If, for example, the term contains parts that use neutral words to define or clarify a concept relevant to the contract, either party can rely on those words no matter how closely they may be integrated into the exclusionary provisions. This is a useful approach to contractual clauses: it means that when a clause is found to be partly invalid there is no need for complicated arguments about which words should be struck out and which left to stand.
- 3.133 Another facet of the purposive formulation adopted in UCTA is that if the clause is unreasonable a party cannot rely on it to exclude or restrict *any* liability, even a liability which it would have been reasonable to exclude. This means that there will be no question about the extent to which it would have been reasonable to exclude or limit liability. Under UCTA, an unreasonable clause is wholly ineffective to exclude or restrict liability and wholly effective for any other purpose.
- 3.134 The Scottish provisions of UCTA describe terms excluding or restricting liability to be “void” or to “have no effect” (sections 16, 17, 19, 20 and 21). However, they are void or have no effect only to the extent that the clauses purport to exclude or restrict liability. Accordingly, the result is the same as the purposive formula used in the English provisions.
- 3.135 The position under the UTCCR on the partial effectiveness of terms is not entirely clear. It would not have been appropriate, of course, to take a purposive approach to the effect of unfair terms in the UTCCR. Virtually any “non-core” term may be held to be unfair according to the provisions of the Directive and it is impossible to say in advance for what purpose the business had intended to rely on the term. This means that under the UTCCR the question of how much of the clause “goes” once it has been found to be partly unfair is far more difficult than under UCTA.
- 3.136 It is clear that under the UTCCR terms can be partially effective in the sense that they bind the business but are not binding on the consumer (regulation 8(1)); and that the court cannot redraft an unfair term so as to make it fair. It is not clear whether a “blue pencil” approach can be taken to the term in any other sense. One view is that if a term contains an unfair part, the *whole term* must be struck out in the sense that no part of it will be binding on the consumer. Support for this can be found in the wording of the Regulations as a whole (which contain no reference to part-terms) and in regulation 8(2) in particular. This provides:

[Where a term is unfair and does not bind the consumer] [t]he contract shall continue to bind the parties if it is capable of continuing in existence *without the unfair term*.

Common sense suggests, however, that a term may have distinct parts and that only the unfair parts should be struck down. In *Director General of Fair Trading v First National Bank plc*,<sup>138</sup> counsel for the Director General seems to have accepted that the first part of the clause in question, stating that interest was payable on the amount outstanding, was fair but not the subsequent parts of the clause.

3.137 In the Consultation Paper we opted for a compromise: we proposed that, where part of a term is detrimental to the consumer and the rest is not, the business should only be prevented from relying on the detrimental part. It would be able to rely on any other part or parts of the term. The Consultation Draft expressly provided for this.<sup>139</sup> Most consultees who dealt with this issue supported our recommendations and the reasoning put forward in the Consultation Paper. On reflection, however, we think that an express provision to this effect is unnecessary. A term is not necessarily the same as a clause. One sentence or paragraph within a contract may contain several terms. Where one term ends and another begins will always be a matter of judgement on the facts of the case, but it will normally be relatively straightforward to identify each term and, if it is unfair, to prevent the business from relying on it without affecting the others. We think that adding a new concept to the legislation, namely “part of a term”, may bring confusion rather than clarity.

3.138 **We recommend that the provision in the Draft Bill that if a term of a consumer contract is detrimental to the consumer, the business cannot rely on the term unless the term is fair and reasonable,<sup>140</sup> should be applied so that when one of several terms in a clause is not fair and reasonable the remainder should be treated as effective.**

3.139 In the Consultation Paper we also suggested that in any new legislation an equivalent is needed to the UTCCR, regulation 8. This was met with broad support from consultees who dealt with the point.

3.140 **We recommend that, where a term is shown to be unfair or partly unfair, the rest of the contract should continue in existence if possible.<sup>141</sup>**

### **Attempted evasion**

#### ***By secondary contract***

3.141 Section 10 [section 23] of UCTA (“Evasion by means of secondary contract”) ensures that the protection provided by the Act is not lost because of a second contract under which, for example, the party who would otherwise be protected agrees to waive that protection. This problem does not arise in the same way in the UTCCR: since these apply to any type of contract, the secondary contract

<sup>138</sup> [2001] UKHL 52; [2002] 1 AC 481. See the speech of Lord Hope, at para 41.

<sup>139</sup> Consultation Draft, clause 6(2).

<sup>140</sup> Draft Bill, clause 4(1).

<sup>141</sup> See Draft Bill, clause 24.

itself could be held to be unfair.<sup>142</sup> We proposed retaining a provision subjecting terms in secondary contracts to the same controls as if they appeared in the main contract. Genuine agreements to settle an existing dispute should be exempted. There was unanimous support for our proposals and we confirm this recommendation.

- 3.142 **We recommend retaining a provision, applicable to all types of contract governed by the new legislation, subjecting terms in secondary contracts to the same controls as if they appeared in the main contract; but that genuine agreements to settle existing disputes should be exempted.**<sup>143</sup>

### **Preventive powers**

- 3.143 UCTA allows individuals to treat particular terms as ineffective, but it does not prevent businesses from continuing to include them in their contracts. The use of terms falling within section 6 [section 20] has been made an offence by Orders made under the Fair Trading Act 1973, Part II.<sup>144</sup> However, other terms which were never of legal effect<sup>145</sup> or which, if challenged, would probably not have satisfied the requirement of reasonableness, continued to be used for years after UCTA came into force. This may have been simply because the businesses did not trouble to change them or it may have been a deliberate tactic to deter claims.
- 3.144 In contrast, the 1994 Regulations empowered the Director General of Fair Trading to bring proceedings for an injunction [interdict] against persons appearing to be using or recommending the use of unfair terms in contracts concluded with consumers.<sup>146</sup> The UTCCR have preserved this power and extended it to a number of “qualifying bodies”. These include a variety of industry regulators, all weights and measures departments in Great Britain and the Consumers’ Association.<sup>147</sup> Amending Regulations in 2001 added the Financial Services Authority to the list.<sup>148</sup>
- 3.145 The substance of the preventive powers contained in the UTCCR must be maintained in order to implement the Unfair Terms in Consumer Contracts Directive. However, since the Consultation Paper was published, the Enterprise Act 2002 has been enacted. There is now a question whether separate powers to prevent the use of unfair terms are necessary.

<sup>142</sup> Unless the waiver were the main subject matter of the secondary contract. See Consultation Paper, paras 4.187 – 4.192 for a discussion in detail.

<sup>143</sup> See clause 23.

<sup>144</sup> Consumer Transactions (Restrictions on Statements) Order 1976, SI 1976 No 1813, as amended by Consumer Transactions (Restrictions on Statements) (Amendment) Order 1978, SI 1978 No 127.

<sup>145</sup> For example, exclusions of business liability for death or personal injury.

<sup>146</sup> 1994 Regulations, reg 8.

<sup>147</sup> UTCCR, Reg 12 and Sch 1.

<sup>148</sup> Unfair Terms in Consumer Contracts (Amendment) Regulations 2001, SI 2001 No 1186.

### ***The UTCCR and the Enterprise Act 2002, Part 8***

- 3.146 Part 8 of the Enterprise Act 2002 came into force on 20 June 2003. It replaces Part III of the Fair Trading Act 1973 and the Stop Now Orders (EC Directive) Regulations 2001.<sup>149</sup> It gives enforcement bodies broad powers to prevent businesses using practices and terms that infringe various EC Directives, including the UTCCD. There is thus some overlap between the UTCCR preventive powers regime and Part 8 enforcement orders under the 2002 Act.
- 3.147 We have considered whether separate provisions for unfair contract terms are still needed. We have concluded that they are needed for the following reasons:
- (1) The new legislation is intended to provide a plain, clear and accessible “code” for consumers wishing to understand their rights with regard to unfair contract terms. This is one of the fundamental objectives of the project. For that reason we are keen to have all the key provisions in one place. It is important for consumers to understand not only that they can challenge terms of contracts but that they can also complain about terms to a public body who will take action on their complaints.
  - (2) The qualifications at sections 211(1)(c) and 212(1) of the Enterprise Act 2002, namely that a domestic or community infringement must be an infringement which harms the collective interests of consumers, may be too restrictive for our purposes. We intend that the bodies with preventive powers should be required to consider all complaints about unfair terms. This should include complaints about unfair terms in general use in small market areas. We are not certain that these would be included under sections 211(1)(c) and 212(1) if unfairness in a very small market does not impact statistically on the consumer economy as a whole.
  - (3) Our overriding objection is that Part 8 contains no provisions allowing the consumer to bring a complaint to the attention of the enforcer and no provisions requiring the enforcer to act on the complaint. These are essential aspects of the regime now recommended. Part 8 is clearly intended to work in conjunction with other parts of the Enterprise Act, for example section 11, which create mechanisms through which unfair practices can come to the attention of enforcing bodies. We do not want to adopt these mechanisms, or the parts of the Enterprise Act that created them, for our scheme.
  - (4) Our recommendations for consumer contracts cover contracts for the transfer of an interest in land. These are not covered by Part 8.
- 3.148 In short, there are two parallel regimes under the Enterprise Act and the UTCCR. We think it is necessary to preserve the latter and we do not expect difficulties in continuing to have two regimes.

<sup>149</sup> SI 2001 No 1422.

- 3.149 **We recommend that the new legislation should contain a regime of preventive powers, conferred on authorised bodies, to take steps to prevent a business using an unfair term.**

***Preserving the UTCCR's provisions***

- 3.150 While we have preserved the substantive detail of the powers and obligations described above, the Draft Bill has been drafted with the parallel regime of Part 8 of the Enterprise Act 2002 in mind and, as far as possible, in a way that is consistent with that Act.
- 3.151 Preserving the substantive detail of the UTCCR's provisions entails: (i) preserving the existing powers of the OFT and the qualifying bodies as set out in the regulations; and (ii) retaining most of the conditions and requirements imposed on those powers. Thus:
- (1) the OFT and qualifying bodies are still able to seek injunctions [interdicts] as set out in regulation 12;
  - (2) the OFT and qualifying bodies<sup>150</sup> still have the power to require a person to supply documents and information as described in regulation 13. The conditions on the use of that power are preserved;<sup>151</sup>
  - (3) qualifying bodies are still required to notify the OFT of undertakings given to them or the outcome of any applications made by them for injunctions [interdicts] or to enforce previous court orders, as set out in regulation 14;
  - (4) the OFT is still subject to the publication, information and advice obligations as set out in regulation 15; and
  - (5) the burden of proving that the term is unfair remains on the OFT or qualifying body.

***Expanding the basic powers***

- 3.152 In the Consultation Paper we proposed that the preventive powers should be extended to terms which under UCTA are automatically of no effect in any circumstances.<sup>152</sup> When presenting a combined regime, it did not seem sensible to restrict the power of review to that inherited from the Directive. While such terms can of course be challenged as unfair, our proposal would save the authorised body from the burden of having to show that the term was unfair. It would also be clear to businesses that the use of such terms is likely to be prohibited. Our proposals were welcomed by a majority of consultees. In particular, the OFT supported the proposed change.

<sup>150</sup> See Enterprise Act 2002, s 11.

<sup>151</sup> These conditions are also set out in UTCCR, reg 13.

<sup>152</sup> See Consultation Paper, para 4.204.

- 3.153 **We recommend that the powers should extend to preventing the use of any terms that under the Draft Bill<sup>153</sup> would be automatically ineffective.<sup>154</sup>**
- 3.154 In the Consultation Paper we noted concerns that terms or notices which are not incorporated into a contract may be outside the scope of the OFT's powers.<sup>155</sup> Consumers are unlikely to know whether or not a term has been effectively incorporated and may wrongly believe that it is a legally enforceable provision. It seems desirable that the relevant bodies have a power to take action even where an objectionable "term" has not been – nor is likely to be – effectively incorporated into the contract. This includes terms which the business has tried to incorporate but failed to do so; and notices which may not even have been intended to form part of the contract but were meant to deter consumers from claiming. A substantial majority of our respondents supported this proposal.
- 3.155 **We recommend that the preventive powers should cover terms that the business has tried to incorporate into the contract but failed; and notices which may not even have been intended to form part of the contract.<sup>156</sup>**
- 3.156 During consultation, the OFT drew our attention to the problem of businesses making a practice of regularly imposing unfair terms which had a bespoke or negotiated element. An example is where a business encourages a sales force negotiating contracts with consumers to insist on very high deposits for work not yet undertaken. It might be the case that the sales person is instructed to ask for, say, a 100% deposit but to reduce the figure in the face of a reluctant consumer to anything above 75%.<sup>157</sup> However, the UTCCR only confer preventive powers in relation to complaints made about terms "drawn up for general use".<sup>158</sup> Concern was therefore expressed that the OFT or other regulators could be precluded from taking action against a term negotiated in this way on the grounds that it is an individually negotiated term. We think it desirable to ensure that preventive powers under the new legislation can be exercised in situations where an unfair term is regularly imposed on consumers, albeit with a bespoke or negotiated element to the term.
- 3.157 **We recommend that the OFT or other regulator should have power to seek an injunction [interdict] against the use of unfair terms of a kind which the business usually seeks to include in the type of consumer contract in question.<sup>159</sup>**

<sup>153</sup> Under Draft Bill, clauses 1(1) and 5.

<sup>154</sup> See Draft Bill, clause 7 and Sch 1, in particular paras 1 and 3(1) and (2).

<sup>155</sup> See Consultation Paper, paras 3.122 and 4.197 – 4.198.

<sup>156</sup> See Draft Bill, clause 7 (especially clause 7(d)) and Sch I, especially para 5(3).

<sup>157</sup> These figures are chosen at random and should not be taken to delimit the Law Commissions' view of what might, or might not, constitute an unfair term.

<sup>158</sup> Reg 10(1).

<sup>159</sup> See Draft Bill, Sch 1, para 3(4).

- 3.158 A substantial majority of consultees supported our proposal that the new legislation should make it clear that a term can fail the fair and reasonable test principally or solely because it lacks transparency.<sup>160</sup> It was also widely agreed that this principle should extend into preventive powers so that the OFT and qualifying bodies are able to take action in respect of terms that are not fair and reasonable principally or solely because they are not transparent, even if the term is not substantively unfair. This is now the position under the Draft Bill.<sup>161</sup>
- 3.159 **We recommend that the preventive powers should permit the OFT, or a regulator, to take action in respect of terms that are not fair or reasonable principally or solely because they are not transparent.**
- 3.160 In the Consultation Paper we asked whether enforcement bodies should have the power to act against terms that omit important information.<sup>162</sup> This was supported by only a minority of those who responded on the question. On further reflection, we do not think it is necessary. If the business uses a term which omits important information so that it is misleading, then the term itself may be unfair. No special provision is required to achieve this. If the business's terms say nothing on a particular topic so that in effect it relies upon the general law, we do not think it is appropriate for the powers against the use of unfair terms to be used to force the business to provide a written statement of the general law.
- 3.161 **We recommend that the new scheme of preventive powers should not include a specific power to prevent the use of general terms just because they omit important information.**

***The burden of proof in preventive proceedings***

- 3.162 We proposed in the Consultation Paper that in respect of the burden of proving that a term is unfair, the new legislation should follow the current law<sup>163</sup> and the burden of proof should be on the OFT or qualifying body, as the case may be. A clear majority of those who responded said that the burden should not be on the business. The principal reason given was the skill and resources of the OFT. We agree. The OFT has much greater resources than the typical individual consumer and should not find it as difficult to collate the evidence necessary to establish its case. Moreover, we think that a reverse burden of proof in preventive proceedings would be unduly restrictive for business.

<sup>160</sup> See para 3.100, above.

<sup>161</sup> See Draft Bill, clause 14 and Sch 2.

<sup>162</sup> See Consultation Paper, paras 4.199 – 4.200.

<sup>163</sup> Under the UTCCR, there is no provision displacing the normal burden of proof (compare UCTA s 11(5) [s 24(4)]). Accordingly, in preventive proceedings the burden of showing that the term is not fair rests on the party alleging that the term is not fair – ie on the OFT or qualifying body.

- 3.163 **We recommend that the burden of showing that a term is unfair in proceedings brought by an authorised body under its preventive powers should be borne by the authorised body.**<sup>164</sup>

#### **Terms not replicated**

- 3.164 Some sections of UCTA are not replicated in the same or similar form in the Draft Bill because a specific rule about unfair or unreasonable exemption or indemnity clauses is now covered by the Draft Bill's general clause on unfair terms, namely clause 4(1). For example, section 3 [section 17] (insofar as it relates to consumers) and section 4 [section 18] on consumer contracts are covered by this general clause.
- 3.165 There are three sections of UCTA which do not need to be reproduced in the new legislation in any form. Section 5 [section 19] which prevents exclusion or restriction of liability by means of a term or notice in a "guarantee" of a manufacturer's or distributor's liability in tort [delict] was considered earlier.<sup>165</sup> The others are section 9 [section 22], which was originally inserted to deal with the fundamental breach doctrine, and section 28 which was a temporary measure pending implementation of the Athens Convention. These provisions, which apply to business contracts as well as to consumer contracts, are discussed in Part 6.<sup>166</sup>

<sup>164</sup> See Draft Bill, clause 16(2).

<sup>165</sup> At para 3.48, above.

<sup>166</sup> See below, paras 6.37 – 6.42.

# PART 4

## PRESERVING THE PROTECTION AFFORDED BY UCTA IN BUSINESS CONTRACTS

### INTRODUCTION

4.1 UCTA contains a number of provisions that apply to contracts between one business and another.<sup>1</sup>

- (1) Section 2 [section 16] applies to any exclusion or restriction of “business liability”<sup>2</sup> for negligence,<sup>3</sup> whether the victim was acting in the course of business or not.<sup>4</sup> Liability for death or personal injury cannot be excluded or restricted. Other loss or damage can only be restricted where the clause satisfies the requirement of reasonableness.<sup>5</sup> Section 2 [section 16] applies whether or not the clause was negotiated between the parties.
- (2) Section 3 [section 17] applies in favour of a party that is a business when it is dealing on the other’s “written standard terms of business”.<sup>6</sup> It applies to those standard terms that exclude or restrict the party’s liability when in breach of contract<sup>7</sup> and those that purport to allow the party in question to render a performance substantially different from that which was reasonably expected or not to perform at all.<sup>8</sup> The term will be valid if it is reasonable.
- (3) Section 6(1) [section 20(1)] applies to sale and hire-purchase contracts. It prevents any business seller from excluding or restricting liability for breach of its implied undertaking that it is entitled to sell,<sup>9</sup> whether or not the term was negotiated.

<sup>1</sup> This account does not cover terms under which a business may be treated as dealing as a consumer, see below, para 4.41 – 4.44. For England, s 8 (which amends the Misrepresentation Act 1967, s 3) applies to any kind of contract but only to clauses excluding or restricting liability, or the remedies available, for misrepresentation. Amendment of the Misrepresentation Act 1967 is not within the scope of this project save insofar as that Act refers to the test of reasonableness in UCTA.

<sup>2</sup> See s 1(3). Pt II (Scotland) does not use this phrase but the effect of s 16 is similar.

<sup>3</sup> Whether the liability is under a contract or in tort: UCTA section 1(1) [or in Scotland, delict: breach of duty is defined in s 25(1).] On notices purporting to exclude liability in tort [delict], see below, paras 6.28 – 6.35.

<sup>4</sup> See s 2(1) [s 16(1)(a)].

<sup>5</sup> See s 2(2) [s 16(1)(b)].

<sup>6</sup> On s 3 [s 17], see para 4.45, below.

<sup>7</sup> See s 3(2)(a) [s 17(1)(a)].

<sup>8</sup> See s 3(2)(b) [s 17(1)(b)].

<sup>9</sup> These undertakings are the Sale of Goods Act 1979, s 12 (for sales) and the Supply of Goods (Implied Terms) Act 1973, s 8 (for hire purchase). Section 6(1) [s 20(1)] applies

- (4) Similarly, section 7(3A) [section 21(3A)] covers other contracts of supply where property in the goods is intended to be transferred (such as barter, exchange and contracts for work and materials). It also provides that the supplier cannot exclude or restrict liability for breach of its implied undertaking that it is entitled to transfer the property. Again, it applies whether or not the term was negotiated.<sup>10</sup>
- (5) Section 7(4) [section 21(1)(b)] applies to hire contracts.<sup>11</sup> It covers terms which exclude or restrict liability for breach of the hirer's implied undertaking that it is entitled to transfer possession. Such terms are valid if they are reasonable, whether or not the term was negotiated.
- (6) Sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)] apply to the exclusion or restriction of liability for breach of any of the four implied undertakings of correspondence and quality. Briefly these undertakings require that goods should correspond with their description or sample, and should be of satisfactory quality and fit for the buyer's purpose.<sup>12</sup> In a contract between two businesses, terms which exclude or restrict these undertakings will be valid if they are reasonable. Again, these provisions apply to terms in business contracts even if they were negotiated between the parties.

4.2 Thus as far as business contracts are concerned, UCTA principally affects various forms of exclusion clauses. The UTCCR affect a wider range of potentially unfair clauses provided that the term was not a "core" term and was not individually negotiated. They also include mechanisms for bodies to take preventive action to stop the use of unfair terms. But the UTCCR apply only to consumer contracts.

4.3 In the Consultation Paper, we provisionally proposed that the protection against unfair terms in contracts between one business and another ("business contracts") should be extended along the lines of the protection afforded to consumer contracts by the UTCCR. This proposal proved to be controversial.

irrespective of whether the seller is a business or a purely private seller and irrespective of whether the buyer is buying for business or private purposes: see further below, paras 6.14 – 6.16.

<sup>10</sup> The implied term is to be found in the Supply of Goods and Services Act 1982, ss 2 [s 11B]. Note that s 7(3A) [s 21(3A)] only applies to contracts where the seller is acting in the course of a business, by virtue of s 1(3) [the opening words of s 21(3)].

<sup>11</sup> It may also apply to some other supply contracts where property does not pass such as contracts of deposit or pledges: see para 4.33 below.

<sup>12</sup> Section 6(3) [s 20(2)(ii)] applies to sale and hire-purchase. It covers the implied undertakings in the Sale of Goods Act 1979, ss 13,14 & 15 and the Supply of Goods (Implied Terms) Act 1973, ss 9, 10 & 11. UCTA, s 7(3) [s 21(1)(a)(ii)] applies to other types of contract "under or in pursuance" of which possession or ownership of goods passes. It covers the equivalent implied undertakings set out in the Supply of Goods and Services Act 1982, ss 3, 4, 5, 8, 9 & 10 [ss 11B – 11E and 11H – 11K]. The way in which these provisions apply to private sales is discussed in paras 6.11 – 6.27, below.

## **SUMMARY OF RECOMMENDATIONS ON BUSINESS CONTRACTS**

- 4.4 For reasons given below, we no longer recommend that protection of the type afforded by the UTCCR be extended to business contracts in general. It should, however, be extended to protect small businesses. This is discussed in Part 5. As for other business contracts, we recommend that the new legislation should broadly replicate the existing controls imposed by UCTA.<sup>13</sup>
- 4.5 There are some sections of UCTA which we think perform no useful function and could be omitted. In particular, we think that businesses should be allowed to negotiate terms to exclude or restrict liability for breach of any of the four implied undertakings of correspondence and quality. We recommend that the provisions which currently subject such terms to a reasonableness test<sup>14</sup> should be confined to cases where one party contracts on the other's "written standard terms of business". On the other hand, we think that the controls on terms which limit business liability for negligence<sup>15</sup> should remain in place and should continue to apply to both negotiated and non-negotiated terms.<sup>16</sup>
- 4.6 It will be necessary to fit the UCTA controls which we wish to retain into the structure of the new legislation. This involves a number of difficult questions, in particular, whether the replacement for UCTA section 3 [section 17] should refer to "written standard terms of business" or some other criterion such as whether the term was "not individually negotiated".<sup>17</sup>
- 4.7 Finally, in this Part we discuss those provisions of UCTA which apply to business contracts and which we think can be replicated in the new legislation without substantive amendment.<sup>18</sup>

## **THE REACTION ON CONSULTATION**

### **Controls over non-negotiated clauses in general business contracts**

- 4.8 Our proposals to apply an UTCCR-style regime to all business contracts found significant support amongst consultees, both academics and businesses. Griffiths & Armour, for example, "believe, very strongly, that business contracts should be subject to a test of fairness" and the Specialist Engineering Construction Group agreed with our assertions that unfair terms are still a real problem in business contracts. Radamec Defence Systems also informed us that in the defence industry smaller contractors are forced to accept unfair terms from larger suppliers and that the nature of competition within the industry is such that larger suppliers are unwilling to negotiate such terms.

<sup>13</sup> See below, paras 4.18 – 4.24.

<sup>14</sup> UCTA, ss 6(3) and 7(3) [ss 20(2)(ii) and 21(1)(a)(ii)]; see below, para 4.25.

<sup>15</sup> UCTA, s 2(2) [s 16(1)(b)].

<sup>16</sup> See below, paras 4.36 – 4.40.

<sup>17</sup> See below, paras 4.45 – 4.57.

<sup>18</sup> See below, paras 4.72 – 4.83.

- 4.9 However, a significant number of consultees limited their support to instances involving small businesses. The British Toy and Hobby Association informed us that “small and medium-sized toy companies suffer from what can only be described as a form of corporate bullying”. Both Bassetts the Ironmongers and Findaphone submitted responses informing us of similar circumstances in their respective industries.
- 4.10 A substantial majority of consultees, and in particular lawyers who deal regularly with business contracts, disagreed with our provisional proposals to apply broader controls to all business contracts. They argued that any expansion in the ability of businesses to challenge terms as unfair would have undesirable consequences. The principal objection was that it would inject an additional element of uncertainty into a legal system that thrives because it offers businesses a higher degree of contractual certainty than is available elsewhere. For example, Herbert Smith (solicitors) said:

Extending the rules to all businesses would in our view have very bad consequences for British business, far outweighing any gain in fairness... Although the burden of proof would be on the party alleging that a term is unfair, legal certainty will nevertheless be affected. It is easy to see how businesses will be tempted to try and challenge the fairness of a term when the real reason behind the challenge is to try and avoid contractual obligations....

The CBI made a similar point:

We believe this proposal would have serious implications for all business in terms of certainty. It would introduce a significant degree of uncertainty into business deals which could later be open to challenge in the courts and, in effect, renegotiation of the contractual arrangement.

- 4.11 The Financial Markets Law Committee argued that certainty is one of the foundation stones of activity in the financial markets. They thought the increased uncertainty which would arise from our proposals would seriously threaten the markets’ efficiency and profitability. In particular, the Committee stated that much of the commercial justification for buying financial instruments would disappear as a consequence of the increased uncertainty:

Indeed, why do so when, at the precise moment when you want [the financial instrument] to work, the counterparty will be striving to contest your rights under the contract and will be assisted in its efforts by English law, which will hear arguments as to whether the contract was fair?

Linklaters (solicitors) made the point that the relative certainty currently offered by contract law has fostered the role of English law as a governing law of choice in international commercial contracts. They suggested that this would change if our proposals were implemented:

Weakening the extent to which certainty can be achieved would be a colossal change to English contract law in its current form and would risk the end of its dominant international role.

- 4.12 According to these consultees, businesses value certainty above protection and, with the exception of small businesses,<sup>19</sup> neither need nor want additional protection. Whatever benefits expanded protection might bring to those subjected to harsh terms not covered by UCTA would, they argued, be far outweighed by the additional element of uncertainty injected into the law of contract.

#### **Clauses that there was no opportunity to negotiate**

- 4.13 A particular concern was that our proposals would make it possible for a business to challenge a term which it could perfectly well have negotiated before the contract was made but chose not to do so. The challenge might not succeed but it could still be an effective delaying tactic. Some of those who opposed our proposal generally thought that an extension of the controls might be justifiable if it were limited to clauses that genuinely “took the business by surprise”. This would arise when in the circumstances – for example, when a contract had to be made at short notice – the business had no opportunity to digest or negotiate the terms presented by the other party.<sup>20</sup>

- 4.14 We worked with a number of respondents to see if we could develop a “surprise clause” test. We attempted a formula that would exclude from review:

Any term that was altered or discussed and any terms whose existence or extent was known (or ought to have been known), provided that there was an opportunity to discuss the term.

- 4.15 We eventually concluded that this formulation was unworkable. The test seemed to provide little certainty as to when the clause may be reviewed. It would still offer opportunities to businesses to challenge terms which did not genuinely take them by surprise. It therefore offered little advantage over the test proposed in the Consultation Paper which most consultees had so firmly rejected.

- 4.16 As a result of this response and the lack of success with an alternative formulation, the Commissions have decided against recommending expanded protection for businesses in general. Equally, we do not now recommend the introduction of any regime of preventive powers to enforce the controls in respect of such contracts. This follows from our decision to maintain the status quo for business contracts in general.

#### **Small businesses**

- 4.17 Even among those who objected to our provisional proposals for broader controls over business contracts in general, there was widespread (though not universal) support for greater protections for smaller businesses. Small businesses are subject to many of the disadvantages which apply to consumers. We therefore consider the benefits of a protective regime specifically for small businesses in Part 5.

<sup>19</sup> Discussed in Part 5, below.

<sup>20</sup> And where it was the lack of time that prevented negotiation rather than the claimant's indifference or the refusal of the other party to negotiate.

## **BUSINESS CONTRACTS IN GENERAL: MAINTAINING UCTA**

- 4.18 For business contracts in general, we recommend that the controls currently provided by UCTA should be preserved in the new legislation. (This is subject to two minor exceptions, which we discuss below.<sup>21</sup>)
- 4.19 It follows that certain terms in business contracts will continue to be of no effect; for example, clauses which purport to exclude business liability for death or personal injury caused by negligence or breach of duty.<sup>22</sup>
- 4.20 In the Consultation Paper we explained why, in relation to business contracts, no seller should be able to exclude its undertaking that it is entitled to sell. Equally, in supply contracts involving transfer of title (such as contracts for exchange or for work and materials) no supplier should be able to exclude the undertaking that it is entitled to transfer the property. This is presently provided for in UCTA, sections 6(1) and 7(3A) [sections 20(1)(a) and (b) and 21(3A)].<sup>23</sup> We provisionally proposed that the substance of these sections should be incorporated into the new legislation. The vast majority of consultees supported this.
- 4.21 **We recommend that**
- (1) clauses which purport to exclude business liability for death or personal injury caused by negligence should continue to be of no effect;<sup>24</sup> and**
  - (2) in business contracts of sale and hire purchase, or in other business supply contracts that involve the transfer of property in goods, a seller or supplier should not be able to exclude or restrict the implied undertaking that it is entitled to sell or transfer the property in those goods. Any such attempt should continue to be of no effect, as provided in sections 6(1) and 7(3A) [sections 20(1)(a) and (b) and 21(3A)] of UCTA.<sup>25</sup>**
- 4.22 We also recommend that, broadly, the provisions of UCTA that invalidate certain types of clause unless they are fair and reasonable should be replicated in the new legislation. As we explain below, we are preserving those parts of section 2 [section 16] which subject exclusions or restrictions of business liability for negligence to a reasonableness test. We are also preserving the effect of section 3 [section 17] which applies where one party deals on the other's written standard terms of business. The section is broadly worded to cover terms which restrict or exclude the other party's liability when in breach of contract, and terms which

<sup>21</sup> Paras 4.25 – 4.35.

<sup>22</sup> It will be seen that the Draft Bill treats all attempts to exclude business liability for negligence, including death or personal injury, in a single clause, namely clause 1.

<sup>23</sup> See Consultation Paper paras 5.13 – 5.14. The position in “private sales” and sales by consumers to businesses is considered in Part 6 below, paras 6.11 – 6.27.

<sup>24</sup> See Draft Bill, clause 1(1).

<sup>25</sup> See Draft Bill, clause 10.

purport to allow the party to render a performance substantially different from that which was reasonably expected or not to perform at all.

- 4.23 However, two issues need to be discussed. First, the responses to our Consultation Paper have confirmed our view that certain provisions of UCTA which currently apply to business contracts are of little value and should not be replicated in the new legislation.
- 4.24 Secondly, there was general support for our attempt to draft the new legislation in clearer and more accessible terms. This should apply to those parts that deal with business contracts as much as to the parts concerned with consumer contracts. The question is to what extent the business provisions should follow a similar structure and share the same definitions and concepts as those dealing with consumer contracts and private contracts.

### **UCTA provisions that should not be replicated**

#### ***Negotiated terms and the implied undertakings of correspondence and quality***

- 4.25 As we have seen, UCTA controls the way in which sellers and suppliers may exclude or restrict liability for breach of any of the four implied undertakings of correspondence and quality. Any term which attempts to exclude or restrict liability for breaches of such undertakings must be reasonable. These controls are set out in UCTA sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)]. They apply even if the term has been negotiated between the parties. In the Consultation Paper we argued that in the light of the broad controls over non-negotiated terms that we were proposing, it was unnecessary to subject negotiated clauses to a reasonableness test.<sup>26</sup> We thought it would be very rare for a *negotiated* exclusion clause to be considered unfair. We therefore asked whether consultees had any evidence that negotiated or non-standard terms were being held to be unfair under sections 6(3) or 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)].
- 4.26 The Specialist Officers Group for Fair Trading of the North of England Trading Standards Group believed that all terms should be subject to the power of review; leaving an exemption would only encourage unscrupulous sellers and suppliers to try and work around the protective regime. A few other respondents agreed but they were in the minority. No significant evidence was submitted which suggested that such terms were being held to be unfair. Overwhelmingly, consultees agreed with our proposals and supported our reasoning.
- 4.27 We are no longer recommending the same broad controls that were proposed in the Consultation Paper. Nonetheless, it will be very seldom that an exclusion clause of this kind will be found to be unreasonable when it is not one of the seller's or supplier's written standard terms of business. To maintain these

<sup>26</sup> See Consultation Paper, paras 5.45 – 5.47.

controls over negotiated clauses is not only unnecessary but gives businesses the opportunity to use a challenge as a delaying tactic.<sup>27</sup>

- 4.28 On the other hand, it is important to retain the controls where a term is one of a set of clauses that have not been negotiated. Exclusion clauses which have not been negotiated will normally be covered by the replacement for UCTA section 3 [section 17], which will apply to clauses in a party's "written standard terms of business".<sup>28</sup> Accordingly, we do not think it necessary to include in the Draft Bill separate provisions replicating any part of UCTA sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)].
- 4.29 **We recommend that UCTA sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)] should not be replicated in the new legislation.**

***Negotiated terms in hire contracts and the implied undertaking of a right to transfer possession***

- 4.30 We have already discussed the way in which UCTA treats the implied undertaking of entitlement to sell in contracts of sale and hire purchase. The effect is relatively straightforward: any attempt to exclude or restrict liability for breach of the undertaking is of no effect [void].<sup>29</sup> The way that UCTA deals with the equivalent undertakings in other supply contracts is not so simple. Section 7 [section 21] distinguishes between contracts where property in goods is transferred (such as barter or exchange, or contracts for work and materials)<sup>30</sup> and other supply contracts.
- 4.31 Where property is transferred, any exclusion or restriction of liability for breach of the implied undertaking that the supplier is entitled to transfer the property is also of no effect.<sup>31</sup> As discussed above,<sup>32</sup> we recommend that this provision is preserved.
- 4.32 When property is not transferred, section 7(4) [section 21(1)(b)] provides that any attempt to exclude or restrict the equivalent undertaking (that is, the right to transfer possession) is subject to the reasonableness test. The main effect of section 7(4) [section 21(1)(b)] is on contracts of hire. Under section 7 [section 11H] of the Supply of Goods and Services Act 1982, hire contracts are subject to

<sup>27</sup> We believe that subjecting clauses to a reasonableness, or a fairness, test where there is very little chance that the term will be found to be unreasonable, or unfair, amounts to creating uncertainty about a term with very little justification.

<sup>28</sup> See below, paras 4.45 – 4.57.

<sup>29</sup> UCTA, s 6(1) [s 20(1)].

<sup>30</sup> UCTA, s 7(3)(A) [s 21(3A)] refers to those contracts to which the Supply of Goods and Services Act 1982, s 2 [s 11B] applies. This category is defined in the Supply of Goods and Services Act 1982, s 1 as "contracts under which one person transfers or agrees to transfer to another property in goods, other than an excepted contract". The only exception relevant for these purposes are contracts "intended to operate by way of mortgage, pledge, charge or other security". [Section 11A is to similar effect for Scots law].

<sup>31</sup> Section 7(3A) [s 21(3A)].

<sup>32</sup> Para 4.21(2).

an implied term that the supplier has a right to transfer possession in the goods. UCTA allows this term to be excluded or restricted only if the exemption clause is reasonable. Again, this applies equally to negotiated and non-negotiated clauses.

- 4.33 It is possible that section 7(4) [section 21(1)(b)] may also apply to some other contracts, such as contracts of deposit or chattel mortgages and pledges. However, there are no statutory implied terms relating to the right to transfer possession in such cases. Some obligations may be implied at common law but we have not been able to find any definitive authority.
- 4.34 The effect of section 7(4) [section 21(1)(b)] is uncertain in theory and minimal in practice. The section would only be needed where the exclusion or restriction does not form part of the other party's standard terms. It would be very rare for such a term to be negotiated and, if it were, it is unlikely that the resulting term would be held to be unfair. Where one party contracts on the other's written terms of business, any exclusion or restriction would normally fall within the replacement for UCTA section 3 [section 17].
- 4.35 **We recommend that UCTA section 7(4) [section 21(1)(b)] should not be replicated in the new legislation.**

#### **Business liability for other loss or damage caused by negligence**

- 4.36 In the Consultation Paper we did not think that the same arguments applied to UCTA section 2(2) [section 16(1)(b)]. This controls terms that purport to exclude or restrict liability for damage to property, or economic loss, caused by negligence. This provision also applies whether or not the term was negotiated. We argued that section 2(2) [section 16 (1)(b)] should remain because it applies to non-contractual notices as well as contractual terms.<sup>33</sup>
- 4.37 A few consultees suggested that rather than expanding the scope of UCTA, we should be repealing substantial parts of the legislation. For example, DJ Freeman (solicitors) considered that

There is a reasonable argument that should be debated for reducing the application of the UCTA principles to all other business to business contracts [ie outside contracts with small businesses].

- 4.38 Discussion with some of those who responded in this way suggested that they would like to see UCTA restricted so that it would not be possible to challenge any term that was negotiated or even any term which could have been negotiated. At a minimum, this approach would mean that section 2(2) [section 16(1)(b)] should not be replicated in the new legislation.
- 4.39 The majority of consultees, however, seemed to accept our argument that because section 2(2) [section 16(1)(b)] applies not only to exclusions and

<sup>33</sup> It may also be argued that to exclude or restrict liability for negligence is more anti-social than to exclude (strict) liability for goods failing to correspond to description or sample, or not being fit for the purpose.

restrictions of liability for breach of contract but also liability in tort [delict], it is in a different category from sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)]. They did not suggest any change. Moreover, because the terms of reference required us to consider *expanding* UCTA, we did not consult on whether in general UCTA controls should be abolished or significantly constrained in business contracts. The provisions of section 2(2) [section 16(1)(b)] were replicated in the Consultation Draft. Nor was there any suggestion in the responses to our Consultation Paper that the principal protections instituted by UCTA have outlived their usefulness. In our view, while some large, sophisticated businesses might see an advantage in being able to contract without any constraints being imposed on the fairness of the exclusion and limitation of liability clauses they have negotiated, we have no evidence that this view is representative of businesses at large.

**4.40 We therefore recommend that UCTA section 2(2) [section 16(1)(b)] should be replicated in the new legislation.**

**Businesses “dealing as consumers”**

4.41 We saw in Part 3 that in *R & B Customs Brokers v United Dominions Trust Ltd*<sup>34</sup> the Court of Appeal held that a company may “deal as consumer” within UCTA if it enters a transaction which is only incidental to its business activity and which is not of a kind that it makes with any degree of regularity.<sup>35</sup> Consequently, any clause excluding or restricting any of the four implied undertakings of correspondence and quality is of no effect by virtue of UCTA sections 6(2) and 7(2) [sections 20(2)(i) and 21(1)(a)(i)], rather than being subjected to a reasonableness test.

4.42 In the Consultation Paper we addressed the question of whether a company or even a natural person making a contract to obtain goods or services “related to” but not “in the course of” business should continue to be treated as a consumer.<sup>36</sup> We were not convinced that exclusion clauses of the type described in the previous paragraph should be treated as automatically ineffective in cases where such a contract was not of a kind regularly made by the business.<sup>37</sup> We suggested that it would be sufficient in business contracts if such clauses purporting to exclude liability for breach of any of the four implied terms of correspondence and quality were subject to a fair and reasonable test.<sup>38</sup> The

<sup>34</sup> [1988] 1 WLR 321.

<sup>35</sup> See para 3.21 above. In *Stevenson v Rogers* [1999] QB 1028 (sale by a fisherman of his old working boat held to be made in course of business within Sale of Goods Act 1979, s 14(2)) Potter LJ, delivering the leading judgment, seems to cast some doubt on *R & B Customs*. However, in *Feldarol Foundry plc v Hermes Leasing (London) Ltd* [2004] EWCA Civ 747 the Court of Appeal held that it was bound to follow *R & B Customs*.

<sup>36</sup> SSGCR, reg 14(3) which inserts s 12(2) [s 25 (1B)] into UCTA regulates instances where a party may be deemed to “deal as a consumer” but the changes do not affect this point: compare para 3.27, above.

<sup>37</sup> One reason is that the supplier will find it difficult to know whether the purchaser-business is “dealing as consumer” without quite detailed enquiries.

Consultation Paper concluded that “a person who makes a contract to obtain goods or services related to, even if not in the course of, business should be treated as dealing as a business and not as a consumer.”<sup>39</sup>

4.43 Almost all of the responses to this proposal agreed with it.<sup>40</sup> This is now our recommendation.

4.44 **We recommend that a person who makes a contract for purposes mainly related to his or her business should not be classified as a consumer.**

### **Fitting the controls over business contracts to the structure of the new legislation**

#### ***Written standard terms of business***

4.45 As mentioned above, we propose to retain an equivalent of UCTA section 3 [section 17] in business-to-business contracts. In broad terms, the section imposes a reasonableness test on terms which exclude or restrict liability for breach of contract, or which allow one party to render a contractual performance substantially different from that which was reasonably expected. At present, it applies when the party challenging the clause is dealing “on the other’s written standard terms of business” [or, under section 17, when the contract in which the term occurs is “a standard form contract” and the party is dealing on the business’s “written standard terms of business”]. The question is whether to retain the concept of “written standard terms of business”, or whether to replace it with some other test, such as whether the term was not negotiated.

4.46 In the Consultation Paper we proposed that any type of term in a business contract, other than a “core” term, should be challengeable on grounds of unfairness provided that it had not been negotiated.<sup>41</sup> We have explained that we shall no longer be recommending this for business contracts in general. However, we shall be recommending a similar rule (though with a number of important exceptions) to protect small businesses.<sup>42</sup> As we shall see, we recommend for small businesses that the test which has to be satisfied before the controls are triggered should be whether the term:–

<sup>38</sup> The same point would apply when it is the party supplying the goods or service who is making the contract for purposes related to business but the transaction is not made regularly. In *Stevenson v Rogers* [1999] QB 1028 (above, note 35) a transaction of this kind was held to be made in the course of his business within Sale of Goods Act 1979, s 14(2). We think that the same approach would and should be applied to the question whether a supplier using a potentially unfair term is acting in the course of his or her business.

<sup>39</sup> See para 5.12.

<sup>40</sup> Of the two dissenters, the Specialist Engineering Contractors Group was concerned about the effects on small businesses rather than the wider business community. On small businesses see Part 5.

<sup>41</sup> Consultation Paper, para 5.44.

<sup>42</sup> See Part 5.

- (a) was put forward as one of the other party's standard terms of business, and
- (b) was not individually negotiated.

The aim is to permit a small business to challenge a term that was one of the other party's standard terms (rather than a "bespoke" term) if that particular term was not negotiated, even if other standard terms were negotiated.

- 4.47 It would simplify the legislation to have only one test applicable in both situations. However, it is more important to reach the result that is most appropriate for the purpose of the controls.
- 4.48 The formula "deals on the other's written standard terms of business" was used in the English version of the Draft Bill attached to the Law Commissions' Second Report on Exemption Clauses, whilst the Scottish Bill used "standard form transaction".<sup>43</sup> These formulae made their way into the different parts of UCTA virtually unchanged. The formulae were thought by the Commissions to be capable of identifying standard form contracts to which the chief objection was that they were not negotiated.<sup>44</sup> Thus the formula "written standard terms of business" ["standard form transaction"] was intended to go some way towards identifying, albeit indirectly, non-negotiated terms. As we explained in the Consultation Paper, the main mischiefs of standard form contracts are twofold. First, the party who has been offered the standard terms may agree to them without having the chance to read, let alone understand, them. As a result, it may be taken by "unfair surprise". Secondly, even if the customer is aware of the term, it may find that the business is unwilling to remove or alter it; the business will often be reluctant to incur the cost of altering its terms for a single customer unless the customer is of particular importance.<sup>45</sup>
- 4.49 The difficulty is to find a legislative formula that reflects these concerns without creating too much uncertainty or permitting too many challenges to terms which the party was prepared to agree at the time the contract was made but now regrets. Worse still, the formula should not permit challenges that are purely delaying tactics.
- 4.50 In UCTA, "written standard terms of business" was deliberately left undefined. The case law interpreting UCTA was discussed in the Consultation Paper.<sup>46</sup> Our survey of the decisions suggests that the preponderant opinion is:
- (1) The question is simply whether the parties ultimately dealt on what were one party's standard terms regardless of whether negotiations preceded the conclusion of the contract;<sup>47</sup> and

<sup>43</sup> Exemption Clauses (Scotland) Bill, s 2.

<sup>44</sup> Law Com No 69; Scot Law Com No 39, para 151.

<sup>45</sup> Consultation Paper, paras 2.4 – 2.6.

<sup>46</sup> *Ibid*, paras 5.49 – 5.53.

- (2) The fact that negotiations resulted in some small amendments to some of the terms does not prevent the set of terms remaining standard;<sup>48</sup> but at some undefined point there may be sufficient alteration so that the terms as a whole are no longer the party's written standard terms. At this point, none of the terms (whether negotiated or not) can be reviewed under section 3 [section 17].<sup>49</sup>

4.51 Two principal issues<sup>50</sup> have concerned us.

4.52 The first was whether the fact that some terms were negotiated excludes others that were not negotiated from review. In the Consultation Paper we provisionally proposed a "term by term" approach.<sup>51</sup> We were concerned that, while those faced with a set of terms may attempt to amend some terms which they understand and regard as important, they may well overlook others entirely, even if those terms are very harsh. From this point of view, the UCTA test does not catch all the situations we believed to be problematic. It was this concern that led

<sup>47</sup> *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481. In *Salvage Association v CAP Financial Services Ltd* [1995] FSR 654 (QB), His Honour Judge Thyne Forbes QC took a rather different approach. He set out a non-exhaustive list of factors that should be considered when determining whether, as a matter of fact, it continues to be correct to describe the terms of the contract eventually agreed as the standard terms of business of the party originally putting them forward. Those factors are as follows: (i) the degree to which the standard terms are considered by the other party as part of the process of agreeing the terms of the contract; (ii) the degree to which the standard terms are "imposed on the other party"; (iii) the relative bargaining power of the parties; (iv) the degree to which the party putting forward the standard terms is prepared to entertain negotiations with regard to the terms of the contract generally and the standard terms in particular; (v) the extent and nature of any agreed alterations to the standard terms made as a result of the negotiations; and (vi) the extent and duration of the negotiations. In *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481, the Court of Appeal was less concerned about contextual factors than Judge Forbes, merely enquiring whether the parties ultimately dealt on the terms proffered regardless of whether negotiations preceded the conclusion of the contract. While this approach may appear at odds with Judge Forbes's approach, it should be stressed that the Court of Appeal was considering the question of whether the parties *dealt* on the standard terms, not whether the terms themselves were standard. It should also be noted that Nourse LJ did refer to Judge Forbes's judgment when he said that Judge Forbes' words should not be read as indicating that "dealing" depends on the absence of negotiations.

<sup>48</sup> *Pegler Ltd v Wang (UK) Ltd* [2000] EWHC Technology 127 (25 February 2000): "A standard term is nonetheless a standard term even though the party putting forward that term is willing to negotiate some small variations of that term."

<sup>49</sup> *Salvage Association v CAP Financial Services Ltd* [1995] FSR 654: "[i]n such circumstances, whether it continues to be correct to describe the terms of the contract eventually agreed by the parties as the standard terms of business of the party who originally put them forward will be a *question of fact and degree* to be decided in all the circumstances of the particular case."

<sup>50</sup> There are of course other points. One is whether the party uses the particular set of terms on a sufficiently regular basis for them to amount to its written *standard* terms. This has been the subject of a number of decisions, in particular *Salvage Association v CAP Financial Services Ltd* [1995] FSR 654: see above, notes 47 and 49. We see no need to make provision on this point in the Draft Bill. Another is whether a set of terms drafted by a third party (such as a trade association) amount to *the party's* written standard terms. On the latter point see below, paras 4.58 – 4.62.

<sup>51</sup> Consultation Paper, para 5.56.

us to say we preferred a term-by-term approach under which the status of each term (negotiated or non-negotiated) would be assessed independently.<sup>52</sup>

- 4.53 The second concern was flagged by responses to the Consultation Paper. In some cases the current approach may be over-inclusive. This is because (a) it allows a contracting party to challenge a term in a contract that was negotiated but which was ultimately left unchanged; and (b) a party may be able to challenge a term about which it could have negotiated at the time the contract was made but chose not to do so. Of course, in neither case is the challenge likely to succeed, but it could still be made as a delaying tactic.
- 4.54 We have tried to find a formula that would exclude the second type of case from review but we have failed.<sup>53</sup> It is simply not feasible to develop a clear criterion to distinguish the case where the term could have been raised for negotiation but was not, from the case in which there was no real opportunity to do so (for example, because the contract had to be concluded in a hurry). We do not pursue this approach any further. We recognise that legislation is a relatively blunt tool.
- 4.55 We have also been persuaded that for business contracts in general it is not appropriate to adopt a “term by term” approach. A business party that has the expertise, time and bargaining power to negotiate substantial changes to some of the other party’s standard terms<sup>54</sup> should not have the opportunity to challenge other standard terms of the contract at a later stage. However, we do not take the rigid view adopted by a few consultees that any change whatever to the “written standard terms” prevents them from being “standard”. We think that the approach currently taken by the courts<sup>55</sup> is satisfactory.
- 4.56 We therefore conclude that, for business contracts in general, the UCTA test has advantages. For all its faults, the phrase “deals on the other party’s written standard terms of business” is as good as any that can be achieved.
- 4.57 **We recommend that for the replacement of section 3 [section 17] applying to exclusion clauses and clauses which purport to allow performance in a way substantially different to what was reasonably expected, the new legislation should use the current test of whether the party challenging the clause was “dealing on the other party’s written standard terms of business”.**

#### INDUSTRY STANDARD TERMS AND TRADE ASSOCIATION TERMS

- 4.58 A related issue raised by consultees was the question of whether there should be a special exemption for trade association terms or industry standard terms that

<sup>52</sup> The UTCCR adopt a clear term-by-term approach: any term that was “not individually negotiated” can be challenged as unfair: reg 5(1).

<sup>53</sup> See paras 4.13 – 4.16, above.

<sup>54</sup> Compare the position of small businesses, below, Part 5.

<sup>55</sup> See para 4.50, above.

are adopted as a party's (or both parties') written standard terms. For the reasons explained below we have concluded that there should not be such an exemption.

- 4.59 It is not wholly clear whether industry standard terms would be included in the existing reference in UCTA to "the other's written standard terms of business".<sup>56</sup> In their Second Report, the Law Commissions did mention such terms. They said:

Broadly speaking, standard form contracts are of two different types. One type is exemplified by forms which may be adopted in commercial transactions of a particular type or for dealings in a particular commodity, such as the different forms of sale contracts used by the Grain and Feed Trade Association or the forms for building and engineering contracts sponsored by the Royal Institute of British Architects, the Institution of Civil Engineers and the Federation of Associations of Specialists and Sub-contractors. Such forms may be drawn up by representative bodies with the intention of taking into account the conflicting interests of the different parties and producing a document acceptable to all. The other type is the form produced by, or on behalf of, one of the parties to an intended transaction for incorporation into a number of contracts of that type without negotiation.... Although it is the second type of standard form contract that has attracted most criticism, both types have in common the fact that they were not drafted with any particular transaction between particular parties in mind and are often entered into without much, if any, thought being given to the wisdom of the standard terms in the individual circumstances.<sup>57</sup>

The Commissions decided to leave the phrase "written standard terms of business" to be interpreted by the courts.

- 4.60 Terms like those promulgated by the Grain and Feed Trade Association ("GAFTA") seem to fall within the phrase "written standard terms"; but it could be argued that because they are drawn up by a third party they are not "the other party's" written standard terms. The only authority to address this question, *British Fermentation Products Ltd v Compare Reavell Ltd*,<sup>58</sup> leaves it open. In that case, Judge Bowsher concluded that section 3 did not apply on the facts as it had not been shown that the defendants consistently used the trade association terms (in that case a model contract developed by the British Institute of Mechanical Engineers). He said :

I shall not attempt to lay down any general principle as to when or whether the Unfair Contract Terms Act applies in the generality of cases where use is made of Model Forms drafted by an outside body. However, if the Act ever does apply to such Model Forms, it

<sup>56</sup> Section 3(1). For Scotland, s 17 speaks of a "standard form contract" that affects the rights of a customer. Section 17(2) defines "customer" as "a party to a standard form contract who deals on the basis of written standard terms of business of the other party."

<sup>57</sup> *Exemption Clauses Second Report* (Law Com no 69; Scot Law Com no 39), para 152.

<sup>58</sup> [1999] EWHC Technology 227; [1999] 2 All ER (Comm) 389.

does seem to me that one essential for the application of the Act to such forms would be proof that the Model Form is invariably or at least usually used by the party in question... Without such proof, it could not be said that the form is, in the words of the Act, “the other’s standard terms of business.” I leave open the question what would be the position where there is such proof, and whether such proof either alone or with other features would make section 3 of the Act applicable.<sup>59</sup>

It seems probable that where trade association or industry standard terms are *commonly* used by a business, those terms are its written standard terms of business, even though they are also the written standard terms of others in the same market.<sup>60</sup>

4.61 We can see an argument for exempting from review terms that have been drawn up by a neutral body such as GAFTA or the Joint Contracts Tribunal.<sup>61</sup> As the Second Report said, such terms are likely to have been negotiated carefully by representatives of each side of the industry and to represent a fair balance. However, we have concluded that it would not be practicable to create an exemption for such terms. The reason is that there can be no guarantee that terms will be fair simply because they were drawn up by a third party and are used widely in the relevant market. The terms might have been drawn up by a trade association that represents the interests of one party and not those of the other party; and yet may be used in the vast majority of contracts in the market because, for example, the other party usually lacks the sophistication or the bargaining power to demand terms that would be more favourable to it. The provenance of the terms and the degree of acceptance of them in “the market” are highly relevant to their reasonableness but there is no sufficiently precise criterion by which it can be decided whether or not industry standard terms should be exempt from review.

4.62 **We do not recommend creating an exemption for trade association, or industry standard, terms from the new legislation’s provisions on business contracts. We recommend that the questions of whether these terms are one party’s “written standard terms of business” and whether they are fair and reasonable be left to the court to decide on a case-by-case basis.**

<sup>59</sup> *Ibid*, at para 46.

<sup>60</sup> In *Hadley Design Associates Ltd v Westminster City Council* [2003] EWHC 1617; [2004] TCLR 1, the claimants contracted with the defendant on the basis of a contract that incorporated standard terms drafted by the Royal Institute of Chartered Surveyors. Judge Richard Seymour QC took the view that terms which the defendant later referred to as its “standard conditions” (based on a version of the RICS Conditions of Engagement) were not the defendant’s written standard terms of business because they were drawn up especially for the deal in question. However, at paragraphs 77– 79 of the transcript, Judge Seymour implies that by the time a later contract between the parties was agreed the same “standard conditions” might have become the defendant’s written standard terms.

<sup>61</sup> The standard forms of building contracts once issued under the auspices of the RIBA and other bodies referred to in the Second Report, above para 4.59, are now issued by the Joint Contracts Tribunal.

## ***The test of reasonableness***

### GENERAL

- 4.63 In the context of consumer contracts,<sup>62</sup> we have explained the “fair and reasonable” test which we recommend to replace the reasonableness test set out in UCTA section 11 [section 24].<sup>63</sup> The new test will be supplemented by a list of factors to replace the guidelines in Schedule 2 to UCTA. In the Consultation Paper we suggested that the same test should be applied to determine the fairness of terms in business contracts. We thought that it would simplify and lend coherence to the new legislation if the basic “fair and reasonable” test were the same for business and consumer contracts.<sup>64</sup> We also proposed that the court should take into account the same list of factors though it was expected that the factors would be applied somewhat differently in the case of businesses.<sup>65</sup>
- 4.64 A small majority of respondents agreed that the same guidelines could be used for business and consumer contracts. However, many expressed concern that the guidelines proposed should not be so over-prescriptive as to endanger their generality.
- 4.65 We are no longer recommending a wide extension of controls over unfair terms in general business contracts. Nevertheless, we think that the same guidelines (set out in clause 14 of the Draft Bill) should still be used in respect of the controls which will be applicable to business contracts.<sup>66</sup> They are as relevant to exclusion clauses as they are to other kinds of unfair term. But we reiterate that, as the City of London Solicitors Company put it, “whilst the same test could be used in both cases [consumer and business contracts], it should not imply that the same standards are to apply in both cases”. While we anticipate that the guidelines will be understood and applied differently in consumer and business settings, this does not necessitate the creation of a separate list. Some of the guidelines adopt language more appropriate for individuals than legal persons, particularly language referring to experience, understanding and knowledge. Nevertheless, we do not see this as a particular problem. The guidelines in Schedule 2 to UCTA<sup>67</sup> adopt similar language and the courts do not appear to have encountered any difficulties in applying these guidelines to terms in contracts between businesses.

<sup>62</sup> See paras 3.84 – 3.105, above.

<sup>63</sup> See Draft Bill, clause 14.

<sup>64</sup> See Consultation Paper, paras 5.74 – 5.75.

<sup>65</sup> See Consultation Paper, para 5.83.

<sup>66</sup> The Indicative List will not apply. The majority of the list is concerned with clauses that will not be subject to control in business contracts generally; it would make no sense to apply it to business contracts.

<sup>67</sup> They are applicable to cases where one party “deals otherwise than as a consumer” as well as to terms in consumer contracts.

PLAIN AND INTELLIGIBLE LANGUAGE

4.66 The extent to which an exclusion clause is transparent is already a factor to be taken into account under UCTA. Schedule 2, paragraph (c) directs the court to consider

whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties).

4.67 For consumer contracts, we have recommended that a lack of transparency should be listed among the factors to be taken into account in assessing fairness.<sup>68</sup> In the Consultation Paper we proposed that transparency should also be taken into account when assessing fairness in business contracts.<sup>69</sup>

4.68 This was supported by a substantial majority of our respondents. Respondents as diverse as COMBAR, the Institute for Commercial Law Studies at the University of Sheffield and Orange Personal Communications Services each informed us that it was important that transparency remains as prominent in the business, as in the consumer, regime.

4.69 We asked consultees whether they felt that transparency should be capable of being the principal or sole reason for a finding of unfairness.<sup>70</sup> Half of our respondents agreed that this should be so, several again stressing the importance of transparency in business contracts. The Specialist Engineering Contractors Group told us that this was important in the construction industry which is “bedevilled by the use of lengthy contractual documentation, even for contracts of low value” and went on to stress the difficulties encountered by small businesses. Though we think the number of cases in which a clause in a business contract will be unfair simply because it was not transparent will be very small, we accept these arguments.

4.70 **We therefore recommend that**

- (1) the same “fair and reasonable” test, including whether the term is transparent, which we propose for consumer contracts should apply to business-to-business contracts;**
- (2) the same expanded set of guidelines for the application of the “fair and reasonable” test should apply to both consumer and business contracts; and**
- (3) in applying the test and the guidelines, the court should have regard to whether the contract is a consumer contract, a small business contract or a general business-to-business contract.**

<sup>68</sup> See paras 3.97 – 3.101, above.

<sup>69</sup> See Consultation Paper, para 5.79.

<sup>70</sup> See Consultation Paper, para 5.81.

### ***Choice of law and conflicts issues***

- 4.71 Issues relating to choice of law and issues of private international law in relation to business contracts are dealt with in Part 7.

### **Other aspects of UCTA that will be replicated in the new legislation**

- 4.72 In this section we comment on five aspects of UCTA which will be replicated in the new legislation without substantial change. These are mentioned to avoid any doubt as to our recommendations.

### ***Burden of showing that a term is fair***

- 4.73 Under UCTA the burden of showing that a term is reasonable is on the party claiming that the term satisfies the requirement of reasonableness. This applies to all contracts, including business contracts.<sup>71</sup> In the Part of the Draft Bill affecting business contracts in general, we are largely replicating the status quo; it will apply only to exclusion and restriction of liability clauses. We think this burden of proof should continue to apply to the new business provisions. Any other approach would amount to a significant alteration of the balance of interests currently protected under UCTA.
- 4.74 **We recommend that the burden of proving that an exemption clause is fair and reasonable should continue to rest on the business seeking to rely upon that clause.**

### ***The effect of an invalid term***

- 4.75 We said in Part 3 that the formula adopted by UCTA for describing the effect of an unreasonable or invalid term is “purposive”.<sup>72</sup> It prevents a party relying on an unreasonable term for the purpose of excluding liability but allows either party to rely on the clause for any other purpose.<sup>73</sup> This will remain the case under the Draft Bill.
- 4.76 UCTA tests the reasonableness of a contractual clause not by whether it would be reasonable to rely on the clause to exclude a particular liability but by whether it was reasonable to include [or incorporate] the clause in the contract.<sup>74</sup> This prevents a party from relying on an unreasonably broad clause to exclude or restrict a liability that it would have been reasonable to exclude. It also prevents it from relying on any part of a clause that would be reasonable were the unreasonable element excised (a “blue pencil” approach). Under UCTA an unreasonable term is wholly ineffective to exclude or restrict liability though it remains effective for any other purpose. We see no reason to alter the existing position. The alternative approach would encourage businesses to draft overly

<sup>71</sup> UCTA, s 11(5) [s 24(4)].

<sup>72</sup> As opposed to treating the term as of no effect in any circumstances. See Part 3 paras 3.131 – 3.134.

<sup>73</sup> The effect of an invalid term under the Scottish provisions of UCTA is discussed in para 3.134, above.

<sup>74</sup> s 11(1) [ss 16(1), 17(1), 18(1), 20(2), 21(1)].

wide exclusion clauses (thereby deterring claims), safe in the knowledge that they can still rely on reasonable parts of the clause if challenged in court. The majority of our respondents supported maintaining the status quo.

- 4.77 **We recommend that the effect of a term which is to any extent unfair or unreasonable should be the same as it is under UCTA.**

***Mandatory and permitted terms***

- 4.78 As stated in Part 3,<sup>75</sup> UCTA contains provisions designed to exclude from its operation terms that conform to what is required or permitted by other legislation, an international convention or the decision of a competent authority.<sup>76</sup> In the Consultation Paper we proposed keeping these provisions.<sup>77</sup> This saving is necessary if we are to preserve the new legislation's coherence with the law as a whole. It will mean that the position on mandatory and permitted terms will be the same under the new legislation for both consumer and business contracts. Almost all our respondents agreed with our proposals and our Draft Bill therefore includes such a provision.<sup>78</sup>

- 4.79 **We recommend that a saving should be retained for contract terms in business contracts if the terms are required by law, or are required or authorised by an international convention to which the UK or the EC is a party, or are required by the decision of a competent authority.**

***Attempted evasion by secondary contract***

- 4.80 Just as for consumer contracts, it should not be possible to evade the controls over business contracts by means of a secondary contract, whether between the same parties or different parties. The issues are the same as they are for consumer contracts and we refer readers to the discussion in Part 3.<sup>79</sup>

***Excluded contracts***

- 4.81 Under UCTA, certain categories of contract are excluded from the proposed controls over business contracts. They are:

- (1) contracts of insurance;
- (2) any contract so far as it relates to the creation or transfer of any interest in land, or the termination of such an interest;
- (3) any contract so far as it relates to the creation or transfer of any interest in intellectual property, or the termination of such an interest;

<sup>75</sup> See para 3.67, above.

<sup>76</sup> UCTA, s 29; UTCCR, reg 4(2).

<sup>77</sup> Consultation Paper, paras 5.62 – 5.63.

<sup>78</sup> Draft Bill, clause 22 and Schedule 3.

<sup>79</sup> See paras 3.141 – 3.142, above.

- (4) any contract so far as it relates to the formation or dissolution of a company or to its constitution or the rights or obligations of its members;<sup>80</sup>
- (5) any contract so far as it relates to the creation or transfer of securities or of any right or interest in securities; and
- (6) (except in so far as the contract purports to exclude or restrict liability for negligence or breach of duty in respect of death or personal injury)
  - (a) any contract of marine salvage or towage;
  - (b) any charterparty of a ship or hovercraft; and
  - (c) any contract for the carriage of goods by ship or hovercraft.<sup>81</sup>

4.82 In the Consultation Paper we provisionally proposed to maintain the existing categories of excluded contract in respect of business contracts (although we were, at the time, proposing to implement controls similar to those recommended for consumer contracts to business contracts as well).<sup>82</sup> The majority of consultees who responded on this issue agreed with our position on excluded categories.

4.83 Since we are not attempting to extend the amount of regulation over contracts between larger businesses, we believe that those categories of contract expressly excluded from the operation of UCTA should continue to be exempt.

4.84 **We recommend that those categories of contract currently excluded from the operation of UCTA, should continue to be exempt from controls over unfair contract terms.**<sup>83</sup>

#### ***Contracts of employment***

4.85 As already mentioned, the Draft Bill makes separate provisions for contracts of employment. These are discussed in Part 6 below.<sup>84</sup>

#### ***Application outside contract***

4.86 As we have seen,<sup>85</sup> UCTA section 2 [section 16] applies not only to contractual terms but also to non-contractual notices which purport to exclude liability in tort [delict]. This is dealt with in Part 6.

<sup>80</sup> Sch 3, para 6 [s 15(3)(a)(ii)].

<sup>81</sup> Sch 3, paras 9 and 10 [s 15(3)(b) and (4)].

<sup>82</sup> Consultation Paper, paras 5.64 – 5.66.

<sup>83</sup> See Draft Bill, Sch 3.

<sup>84</sup> See paras 6.2 – 6.10, below and also 2.14, above. Although under clause 1(4) of the Draft Bill, business liability may include acts done by an employee, we do not think that a contract of employment would ever amount to a business contract, as employees would not be regarded as acting in the course of their own business. For reasons of clarity we treat employment contracts as a separate category.

<sup>85</sup> See para 2.6 (10).

# **PART 5**

## **EXTENDING THE PROTECTION AGAINST UNFAIR TERMS TO SMALL BUSINESSES**

### **INTRODUCTION**

- 5.1 The UTCCR affect a wider range of potentially unfair clauses than UCTA.<sup>1</sup> In the Consultation Paper we provisionally proposed that the controls over unfair terms in contracts between businesses should be extended. We suggested that businesses should receive protection similar to that currently enjoyed by consumers under the UTCCR. As we explained in Part 4, this proposal proved to be controversial and the Commissions have now decided not to recommend such expanded protection.<sup>2</sup> However, many consultees (including some of those who opposed our proposals for contracts between larger businesses) said there was a need for greater protection for small businesses. In this Part we make specific recommendations to increase the protection afforded to small businesses.
- 5.2 In summary, we recommend that most of the protections currently given by the UTCCR to consumers should be extended to small businesses, defined as those with nine or fewer employees. A small business, when dealing with a larger business or another small business, should be able to challenge any standard term even if it is not an exclusion or restriction of liability clause currently covered by UCTA. The protection would not apply to certain types of contract including most of those currently exempt from UCTA and those regulated by the Financial Services Authority. Transactions over £500,000 would also be exempt, as would those that form part of a series of similar transactions likely to exceed that sum in a two-year period.

### **Consultation responses**

#### ***Responses to our Consultation Paper***

- 5.3 Many of those who responded to our Consultation Paper referred to the particular problems experienced by small businesses.
- (1) Many of those who supported our provisional proposals for business contracts in general did so without elaborating on their reasons for thinking that expanded protection is warranted. Those who did give reasons usually stressed the need for small businesses to be protected. They explained how very harsh terms shifting risk often result from inequalities of bargaining power that are particularly persistent in industries such as construction, manufacturing and farming where small businesses are common.

<sup>1</sup> See para 2.31.

<sup>2</sup> See paras 4.4 and 4.8 – 4.12, above.

- (2) Those consultees who represented small businesses<sup>3</sup> were unanimously in favour of increased protection for (small) businesses and greater control over business contracts.
- (3) A significant number of those who did not agree with our Consultation Paper proposals for expanding controls over business contracts in general qualified their opposition by acknowledging that small businesses are more vulnerable and that additional protection may be appropriate in this area.

### ***Further consultation on protection for small businesses***

- 5.4 Following our analysis of the consultation responses we developed proposals specifically for small businesses alone and consulted on these new proposals. We sought views on our proposals at a seminar organised in conjunction with the Society of Advanced Legal Studies<sup>4</sup> and in correspondence with interested parties. As we shall see, the response was on the whole favourable. We have decided, therefore, to adopt these proposals as our recommendations on unfair terms in contracts with small businesses.

### **The problems for small businesses revealed by the consultation exercises**

#### ***Small businesses as customers***

- 5.5 Because they had received complaints the DTI asked us to consider extending the UTCCR regime to businesses and, in particular, small enterprises.<sup>5</sup> Most of these complaints seemed to involve contracts made by small businesses acting as customers<sup>6</sup> for goods or services outside their particular field of expertise – for example, a newsagent who enters a contract to rent a photocopier.<sup>7</sup> Our consultation confirmed that in this context small businesses often find themselves bound by harsh terms. Small businesses and their representatives complained about unfair terms in what appeared to be standard form contracts. In particular, problems arising from hire-purchase and leasing contracts were drawn to our attention by the Specialist Officers Group for Fair Trading of the North of England Trading Standards Group.

<sup>3</sup> A variety of representatives of small business interests responded to the Law Commissions' Consultation Paper on unfair terms. These included: small companies, self-employed professionals, industry-sector representatives and bodies such as the Federation of Small Businesses (FSB) and the Small Business Service at the Department of Trade and Industry (SBS), representing small businesses as a whole.

<sup>4</sup> In July 2003, a background paper setting out our thinking in this area was circulated to interested parties.

<sup>5</sup> See our Terms of Reference, set out in Consultation Paper, para 1.1.

<sup>6</sup> The word "customer" is used here to refer to a party who buys goods or services – usually on a rare or one-off basis – in a situation where it can be expected to have much less knowledge and experience than the supplier. While a small business may act as a "customer" in the course of its business, it will not be acting as a "customer" in any contract for the goods or services that represent its core business. For example, a small pub will probably be acting as a "customer" when it buys a television to display sporting events in the bar area but not when it buys supplies of beer.

- 5.6 Consultation also confirmed our suspicion<sup>8</sup> that small businesses face similar problems even when the contracts under which they obtain goods or services are in what might be called their area of expertise. The terms complained of usually appeared to be the other party's standard terms.<sup>9</sup> It was suggested that small businesses can sometimes only obtain goods and services essential to their business on terms that seem to be unfair.
- 5.7 A particular example cited to us were terms that prevent a small retailer which has incurred liability when it resells defective goods from passing that liability "back up the chain" to its supplier. The retailer is in effect "squeezed" between consumers, on the one hand, and the supplier or manufacturer, on the other. This can happen where a relatively small number of large suppliers dominate the supply of goods to the retail sector. It can also occur in an entirely competitive retail environment: a retailer that faces a "brand-specific" demand from its consumers cannot afford *not* to do business with a particular supplier. So, for the benefit of the consumer, a retailer may have to replace the manufacturer's faulty goods with new goods yet be unable to obtain compensation or replacement stock from the manufacturer because of clauses allowing the manufacturer to observe lower standards in its dealings with the retailer.
- 5.8 Many of the complaints of this type appeared to be about exemption clauses which already fall within the controls imposed by UCTA on all business contracts. (This indicates the limited efficacy of controls which have to be triggered by an individual person, a point to which we return below.<sup>10</sup>) Nonetheless, it seems that some of these contracts contain harsh terms which fall outside the existing UCTA controls: for example, terms requiring the small business to renew contracts at escalating prices;<sup>11</sup> or terms giving the supplier excessive discretion over prices.<sup>12</sup> A frequent cause for complaint was terms allowing the supplier to terminate the contract forthwith if the small business commits any default, while the small business cannot terminate for breach by the supplier without giving the supplier the opportunity to cure the default.
- 5.9 Representatives of small businesses acting as suppliers complained about clauses that imposed an unfair distribution of risk. Respondents observed that ancillary clauses are being used to offload risks such as force majeure and third party default onto the small business. Some of these clauses required the small business to indemnify a large purchaser or client against a loss caused by a third party or, indeed, the large business's own defective performance. These terms appeared in all kinds of supply contracts. Many were clearly examples of the large business's standard terms and conditions. Some were apparently

<sup>7</sup> See Consultation Paper, para 2.30, especially at n 39.

<sup>8</sup> See Consultation Paper, para 5.7, especially at n 7.

<sup>9</sup> The responses did not always specify this.

<sup>10</sup> See paras 5.92 – 5.95, below.

<sup>11</sup> See Consultation Paper, para 2.30, n 39.

<sup>12</sup> *Ibid.*

“bespoke” clauses imposed on a one-off basis with the large business drafting the term in advance and refusing to negotiate on it.

- 5.10 Many respondents pointed out that the practice of offloading risk onto the party who can least afford to bear it is detrimental to small businesses. They thought it could discourage enterprise at this level. In all cases reported to us, the viability of the small business was significantly affected and in some cases the impact was said to be “nearly fatal”.
- 5.11 We were told that these clauses are agreed by small businesses for a variety of reasons that reflect distortions in the market, including bargaining pressure, lack of information and failure to understand the implications of the clause. In most of the cases drawn to our attention, it was said that the objectionable clauses are reluctantly agreed by the small business because the larger business has excessively disproportionate bargaining power and simply refuses to negotiate its standard terms. In some cases, however, the clauses were apparently agreed without the small business appreciating the nature or effect of the clause.

### **THE CASE FOR EXTENDING THE CONTROLS TO PROTECT SMALL BUSINESSES**

- 5.12 It is clear from the responses to our Consultation Paper and subsequent informal consultation that some of the harsh terms encountered by small businesses could be challenged by the small business under UCTA. However, there are significant numbers of clauses which are potentially unfair to the small business but are currently outside the reach of UCTA. This is particularly so in contracts in which the small business is a customer for goods and services.<sup>13</sup>
- 5.13 When a small business contracts as a customer for goods or services which are outside its field of expertise, it is in a position that is very similar to that of a consumer. We accept, of course, that most small businesses are run by people of intelligence and skill. But outside their area of experience they may be in a poor position to look after their own interests.
- 5.14 It is important to bear in mind the makeup of the small business sector. Many small businesses are in fact very small: 69% of all UK enterprises have no employees at all,<sup>14</sup> 20% have between one and four employees, and a further 5% have between five and nine employees.<sup>15</sup> The number of enterprises with no employees (mostly sole traders) strongly points to the vulnerability and lack of sophistication of small businesses. Moreover, even businesses in the category of Small-and-Medium-sized Enterprises (“SMEs”, a larger category, covering businesses with up to 250 employees) very rarely seek legal advice. Statistics published by the DTI suggest that only 3% of SMEs sought legal advice in the

<sup>13</sup> See para 5.8, above.

<sup>14</sup> They are sole proprietorships and partnerships comprising only the self-employed owner-manager(s) and companies comprising only an employee director.

<sup>15</sup> Statistics are taken from the report, *UK 2003* issued by National Statistics, and relate to the reference year beginning 2001.

previous 12 months.<sup>16</sup> In addition, many entrepreneurs who run small businesses are relatively young (25% are 25 or younger, 46% are 35 or younger).<sup>17</sup> Furthermore, only 64% of entrepreneurs have vocational training or a degree: around 5% have no educational qualifications at all.<sup>18</sup> These factors reinforce our view that many small businesses are in a similar position to consumers.

- 5.15 Practically speaking, small businesses are unlikely to be able to afford to seek legal advice on the terms of a proposed contract and are much less likely than a larger business to have appreciable in-house legal expertise. As such, small businesses are distinctly more vulnerable than larger businesses to unfair terms.
- 5.16 In particular, many small businesses are unlikely to have anything like a full understanding of standard terms put forward by the other party. As we explained in the Consultation Paper, while standard terms of business have many advantages to both sides, they carry a significant risk that the party who deals on the other's written standard terms will agree to them without understanding them or their implications. Moreover, that party will seldom have the resources to obtain legal advice on a contract of this type. As a result, it may be taken unfairly by surprise. Obviously, this can be a problem even if the small business attempts to negotiate the terms but it is most likely to be a problem with standard terms. In addition, when a small business is a customer for goods or services on a one-off basis, it is most unlikely to have the bargaining power to persuade the other business to alter its standard terms. Simply to avoid having to alter its standard terms in the instant case, the larger business may insist on terms that do not represent the best interests of either party or the best practical outcome for both: in other words, the parties contract on terms that are inefficient.<sup>19</sup>
- 5.17 The problem is not limited to small businesses that are customers for goods and services outside their field of expertise. Responses confirmed that many small businesses do not fully understand the standard terms on which they obtain supplies regularly and certainly are not able to persuade suppliers to alter the terms in the small business's favour. This is just as true for terms that fall outside UCTA as it is for exclusions and restrictions of liability that are currently subject to the Act.
- 5.18 Many of our respondents were themselves, or represented, small suppliers or service providers forced to contract on the standard terms of business of a larger retailer, prime contractor or client. Where the small business is the supplier it is even more likely that the terms will be outside UCTA, since UCTA applies only to

<sup>16</sup> Small Business Service, *Omnibus Survey* (November 2001) p 22.

<sup>17</sup> Small Business Service, *Small Firms: Big Business*, chapter 3 (Characteristics of Entrepreneurs).

<sup>18</sup> 5.5% have no educational qualifications, 30.4% have not gone beyond secondary school, 32.6% have had some vocational training, 16.5% have a first degree and 15% have a postgraduate degree: Small Business Service *Small Firms: Big Business*, chapter 3 (Characteristics of Entrepreneurs).

<sup>19</sup> See Consultation Paper, paras 2.4 – 2.7.

exclusion or restrictions of liability in various forms and does not affect terms that impose additional obligations on the other party (the small business).<sup>20</sup>

- 5.19 When a small business is making a contract (whether as customer or as supplier) that is within its area of expertise, the problems associated with a lack of information are less pressing than in the context of one-off contracts. Nevertheless, in the course of our consultations, some of our respondents emphasised that unfair term controls have a role to play in upholding existing regulatory protections and in offsetting some of the market distortions created by power imbalances.
- 5.20 We do not think that it is appropriate for our scheme to attempt to address all the problems reported by our consultees. Some complaints were about clauses which were well-known to and understood by the small business but over which it had tried to negotiate and had failed to obtain what it wanted. This represents a different kind of problem to that outlined above. A term cannot be looked at in isolation: it is part of an overall “package”. A change in one term may be balanced by a change in another so that, for example, a reduction in the risk carried by a small business supplier might be at the cost of a reduction in the price the customer is prepared to pay. Where the parties have been prepared to negotiate a term, if at the end of the day the term is left unaltered, it is probable that this is because the original term represents the most efficient balance of risk and price. Any attempt to regulate the term allocating risk will merely reduce the price the customer is willing to pay. The effect would be to reduce the price payable to the small business.<sup>21</sup>
- 5.21 It may be that standard terms also represent a balanced package. However, when it is a standard term there is a much greater risk that the small business will not have understood it or will be met with a blanket refusal to negotiate it because of the cost of altering a standard contract for “one small customer or supplier”. In these circumstances, the term will not in fact represent an efficient outcome. Thus it is the unfairness produced when small businesses deal on the other party’s standard terms which we think should be addressed in any new protective regime.
- 5.22 In the further round of consultation mentioned earlier,<sup>22</sup> we decided to address these concerns by proposing to extend a UTCCR-style regime to small business contracts. A small business would be allowed to challenge any non-core, non-negotiated term of the contract on the grounds that it was unfair or unreasonable.<sup>23</sup> By restricting the controls to non-negotiated terms, we hoped primarily to cover unfair “surprise” terms. It is also important to avoid regulation where it is not needed. We therefore proposed certain exemptions for particular contracts or contracts with special categories of business.

<sup>20</sup> See para 2.6(1), above.

<sup>21</sup> Assuming the small business is the supplier.

<sup>22</sup> See para 5.4, above.

<sup>23</sup> See para 5.30, below.

5.23 The response to our consultation on controls over small business contracts was not unanimous. The CBI opposed the scheme on the ground that it would increase the risks of dealing with a small business and would therefore operate against their interests. The organisations which represent small businesses took a completely different view and welcomed the proposals. So did the large majority of those who attended our seminar or who wrote to us, though some consultees wished to see certain types of small business or small business contracts exempted from the scheme.

5.24 In broad terms we agree with the reservation. We have sought to devise a series of exemptions for contractual contexts in which either (i) the small business is sufficiently sophisticated or sufficiently likely to take legal advice so that the protection is not necessary or (ii) where the contract falls into a category or field which is already sufficiently regulated. These include:

- (1) a “transaction value limit” according to which contracts with a value greater than £500,000 would be excluded and would not count as small business contracts no matter what the size of the businesses involved;
- (2) an exemption for businesses under the control of a larger business; and
- (3) an exemption for financial services contracts.

These are discussed below.<sup>24</sup>

## **OUR RECOMMENDATIONS**

### **Background: controls over business contracts in general**

5.25 The existing protections afforded to businesses were outlined in Part 4. We have recommended that, broadly speaking, these should continue to apply. In other words, the controls that apply to businesses in general would apply equally to protect a small business.

5.26 For example, under UCTA clauses which purport to exclude business liability for breach of any of the four implied terms of correspondence and quality are valid only if they are reasonable.<sup>25</sup> We have already recommended that under the new scheme such clauses should be subject to a “fair and reasonable” test where the buyer deals on the seller’s written standard terms.<sup>26</sup> This would also apply in respect of small business contracts. It is not necessary to specify this result in the Draft Bill as, in relation to the replacement for the UCTA regime, small business contracts are simply a sub-category of business contracts.

<sup>24</sup> See paras 5.50 – 5.67. See also Excluded Contracts at paras 5.76 – 5.78, below.

<sup>25</sup> See para 4.1, above.

<sup>26</sup> See paras 4.25 – 4.29.

### **The new general clause**

- 5.27 The chief constraint on these protections is that the controls over general business contracts reproduced from UCTA are restricted to what effectively amount to exclusion and limitation clauses. Thus, under the existing legislation, a party who is acting in the course of a business is not protected against unfair terms which, say, relate to its own performance rather than that of the other party. Some protection is provided by the common law, for example in relation to penalty clauses, but this is narrow and to some degree uncertain in its scope.<sup>27</sup>
- 5.28 Our recommendation for small business contracts is that small businesses<sup>28</sup> should be able to challenge any “non-core” contract term under the “fair and reasonable” test,<sup>29</sup> provided it is a standard term.
- 5.29 The significant difference between this regime and that which we have recommended for consumers is that a consumer will be able to challenge a “non-core” term even if it was negotiated. We have explained why we do not think that this would be appropriate for small businesses. The exact meaning of what we have referred to as a “standard” term is considered below.<sup>30</sup>
- 5.30 **We recommend that small businesses should be given powers to challenge any “non-core”, standard term of a contract under a “fair and reasonable” test.**
- 5.31 Another difference is that small businesses, unlike consumers, must bear the burden of proving that a term is not fair and reasonable. In other respects, however, the general clause<sup>31</sup> mirrors the consumer general clause.<sup>32</sup> It would be repetitious to discuss in this Part the provisions which have been replicated from the consumer regime and the reader is referred to the relevant discussions in Part 3.

<sup>27</sup> See Consultation Paper, paras 2.1 and 4.141.

<sup>28</sup> We consider that there are instances where some small businesses do not warrant this protection. We recommend certain exceptions to the small business regime in paras 5.50 – 5.67 and 5.76 – 5.78, below.

<sup>29</sup> The details of the test are discussed in Parts 3 and 4 above.

<sup>30</sup> See paras 5.68 – 5.75.

<sup>31</sup> See Draft Bill, clause 11.

<sup>32</sup> See Draft Bill, clause 4. Note that:

Subsection (1) of clause 4 (relating to terms that are detrimental) is replicated in subsection (2) of clause 11;

Subsection (4) of clause 4 (excluding a term that is transparent and is not substantially different from what would apply as a matter of law in the absence of the term) is replicated in clause 11 as subsection (5). The exemptions for the definition of the subject matter and price (the core terms exceptions) in subsections (2) and (3) of clause 4 are replicated (with the same definition of transparency applying) in clause 11 at subsections (3) and (4).

## **Definitions**

### “SMALL BUSINESS CONTRACT”

- 5.32 Under our recommended regime a small business contract is defined as a contract between a small business and another business, whether or not the second business is also a small business. If only one business is small, only the small business can take advantage of the provisions to challenge unfair terms. We decided to protect small businesses in their dealings with large businesses because we believe this is the situation in which small businesses are most vulnerable and least likely to be able to influence the “non-core” terms of the contract. However, small businesses are also to be protected in their dealings with each other because we believe (i) that a lack of sophistication and access to legal advice is still likely to disadvantage some small businesses in this situation and (ii) that doing so will lead to a regime that is simpler and more consistent overall and therefore more accessible.
- 5.33 **We recommend that small businesses should be protected in their dealings with any other business, no matter what the size of the other business.**

### “SMALL BUSINESS”

- 5.34 Finding a suitable criterion for the size of a small business has been a difficult task. Definitions of “small business” vary enormously. Although the European Commission is promoting the adoption of harmonised definitions,<sup>33</sup> there is no consistent domestic approach. The primary aspect of such definitions is always the number of employees, although it is quite common for definitions to refer to business turnover as well. We thought carefully about a range of tests (including VAT registration) and looked closely at the possibility of a turnover criterion, which found favour with some of our consultees. However, we have settled for a criterion based solely on employee numbers.
- 5.35 We are aiming to protect the least sophisticated businesses, which are so small that they are unlikely to have expertise in contracting or the resources to seek legal advice. We have therefore confined protection to those normally categorised as “micro” businesses, namely those with nine or fewer employees.<sup>34</sup> We are conscious that many definitions of small businesses extend to those with less than 50 employees and this group may also find it difficult to access legal advice in contractual negotiations. Nevertheless, as the definition expands, the need for protection declines. We have therefore restricted the scheme to the most vulnerable businesses. As a matter of terminology, we have decided to use the term “small business” throughout this Report and in the Draft Bill, rather than the more technical phrase, “micro” business. We believe this better accords with the fundamental principle of clear and accessible drafting.

<sup>33</sup> See the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (*Official Journal L 124, 20/05/2003 P 0036 – 0041*). Also the Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises (*Official Journal L 107, 30/04/1996 P 0004 – 0009*).

<sup>34</sup> Annex 1, Art 1.5, Commission Recommendation of 3 April 1996 concerning the definition of small and medium sized enterprises (1996/280/EC).

- 5.36 We have rejected a turnover criterion for three reasons. The first is that we do not believe turnover is, in fact, an accurate guide to the size of a business. Businesses in some sectors (for example, building, construction and farming) typically have a small profit to turnover ratio because there is considerable outlay involved in reaching the finished saleable product. These businesses may be less sophisticated than professional service providers (such as consultants or software developers) with a lower turnover but a higher profit. The many regimes which use a turnover criterion are all devised for other purposes and we do not feel that those purposes are sufficiently close to our own to justify using the same approach.
- 5.37 Secondly, key elements in the rules must be certainty, accessibility and predictability for persons acting in the market. Turnover is rarely accurately ascertainable on the “face” of the business. It will be easier for the other party to determine whether it is dealing with a small business if the criterion is simply one of employee numbers. A turnover criterion may be suitable for administrative regimes setting tax exemptions or subsidy levels where it would be used as a threshold criterion which, once satisfied, would entitle a business to membership of a certain class for a period of time. It is more difficult to see how it would work in regard to transactions. The fact that the size of the business must be reassessed with each transaction means that the inherent variability of a turnover criterion would be likely to cause problems for a business of marginal size. This difficulty is recognised in the European Commission’s definitions, which assume that it may be appropriate to refer only to the number of employees when there are no state aid implications.<sup>35</sup>
- 5.38 Thirdly, there is a more specific objection to a turnover criterion. Many of the representatives of small businesses who responded to our consultation papers were keen to point out that small businesses are all too often economically dependent on a small number of key contracts. For example, small farmers may be dependent on supermarket chains, small publishers on bookseller chains or sub-contractors on large construction concerns. In such circumstances, for a small business to provide details of turnover to one contracting party might be tantamount to revealing the price of its contracts with that party's competitors. This in turn could place the other party in a strong position to exact stricter terms from the small business. For this reason, small businesses would often be reluctant to reveal such market-sensitive information as turnover to their contracting partners and to require them to do so would place them in an invidious position.
- 5.39 In suggesting that we should define the small business category by reference only to the number of employees, we have used as a model the commencement

<sup>35</sup> Art 2 of the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (*Official Journal L 124, 20/05/2003 P. 0036 – 0041*). Also Art 2 of the Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises (*Official Journal L 107, 30/04/1996 P. 0004 – 0009*).

provisions of the Late Payment of Commercial Debts regime.<sup>36</sup> In defining “small business” for the purpose of these commencement provisions, a relatively simple definition was adopted, namely: a small business was one with 50 or fewer full-time employees and no financial criteria were applied.<sup>37</sup> This approach has been adopted in the Draft Bill but the number of employees is reduced to nine. This number corresponds to the upper limit of the category used by the DTI to identify the smallest businesses, which the DTI calls “micro” businesses.

**5.40 We recommend that only businesses with nine or fewer employees should be included in the new regime.**

“EMPLOYEE”

5.41 In defining who should be counted as an employee, we decided to use a fairly wide definition in order to generate a figure which reflects the true size of the business in practice. Thus “employee” is defined in the Draft Bill as an individual who works “in the business” under a contract of employment or a contract for services.<sup>38</sup> This is a simplified version of a provision that was used in the Late Payment of Debts regime.<sup>39</sup>

THE NUMBER OF EMPLOYEES

*Counting employees*

5.42 There are two issues. The first is that it should not be necessary to calculate the size of a business on each day that a contract is made. Therefore Schedule 4 starts from the assumption that the relevant number of employees will be the number at the end of the last day of the preceding month. The second is that the number of employees that a business has can fluctuate, sometimes dramatically. For example, a fruit farm with a small number of year-round staff may employ a large number of seasonal pickers. We thought it desirable to follow the approach that has been taken in domestic legislation and at the EU level and provide that, in determining whether a business is a small business, the number of employees is to be assessed according to an averaging calculation. The calculation that seems to us best to combine certainty with simplicity is the average daily number of employees over the course of the preceding twelve months. For the averaging

<sup>36</sup> Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 SI 1998 No 2479.

<sup>37</sup> Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 SI 1998 No 2479, Art 2(2). (This commencement order was followed by three subsequent commencement orders which all defined “small business” in the same way. The Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 5) Order 2002 SI 2002 No 1673 ultimately extended the regime to all commercial debts, regardless of the sizes of the businesses involved.)

<sup>38</sup> Ours is a wide definition because it includes those employed under a contract for services. A contrasting example is provided by the Employment Rights Act 1996, s 230, which draws a distinction between “employee” and “worker”. The former includes only those persons employed under an employment contract. The latter includes those employed under a contract for services. Our definition would cover both.

<sup>39</sup> See Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 SI 1998 No 2479, Sch 2, para 2.

calculation we have used “a full-time equivalent basis”, whereby part-time employees are counted as fractions of a full-time employee. Short-term employees are, of course, simply included in the general averaging calculation. This was the approach taken by the commencement provisions of the Late Payment of Commercial Debts regime. There are supplementary provisions for companies that have been in business for less than a year.

#### *Relevant time*

- 5.43 In our view, the period over which the number of employees is averaged must be the period immediately preceding the conclusion of the contract and not the period preceding the commencement of proceedings. Our reasons are twofold. First, our concern for small businesses arose from their susceptibility to outside pressure to contract on harsh terms. Any protective regime must therefore take into account the sophistication and bargaining power of the small business at the time when that pressure would be applied, that is, at the time the contract was made.
- 5.44 Secondly, if this were not the case, a business might contract with a large business on terms that assume maximum freedom of contract only to find that the large business had become a small business over the course of the contract. This would allow the shrinking business to challenge contract terms even though both businesses had contracted on the basis that the small business controls would not apply. This would lead to unfairness and uncertainty.

#### *Small businesses that form part of a larger group*

- 5.45 We see no need to protect small businesses that, by virtue of their membership of or links with a larger organisation, have access to the resources and expertise of other businesses in the group. Thus the Draft Bill provides that, in calculating the number of employees, the court is to take into account the total number of persons employed not only by the business itself but also by any associated person.<sup>40</sup> Below, we discuss the need for a wide definition of “associated person” so as to exclude a range of sophisticated businesses.<sup>41</sup>
- 5.46 **We recommend that the size of a business should be calculated by averaging the number of persons employed by that business or by it and any associated business over the preceding year.**

<sup>40</sup> See Draft Bill, clause 27. According to Sch 2 (para 6(3)) to the Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 SI 1998/2479, two employers will be treated as associated if, either, one is a body of which the other employer (directly or indirectly) has control, or both are bodies of which a third person (directly or indirectly) has control. Sch 2, para 6(4) goes on to provide that “‘body’ means a body of persons corporate or unincorporate” and that “‘control’, ‘directly’, ‘indirectly’ and ‘third person’ have the same meaning as in section 231 of the Employment Rights Act 1996”.

<sup>41</sup> See paras 5.52 – 53, below.

### *Uncertainty*

- 5.47 There will remain areas in which the regime is likely to lead to problems of predictive uncertainty for parties entering into small business contracts. The proposed test for calculating the size of a business is necessarily complex. Employee numbers is not the straightforward concept that it might at first appear: there is the question of how to deal with short-term and part-time workers, seasonal fluctuations and natural wastage. The test that we have proposed addresses these questions and has the virtue of generating a certain, fixed figure should the issue of a business's size arise in court. However, it is impractical to expect the parties to perform the entire calculation prior to contracting. One business will have a rough idea of the number of people employed by another but in a marginal case it will be unable to perform the entire calculation with exactitude. This means that businesses approaching a contract with a business of marginal size may be uncertain whether they are dealing with a small business.
- 5.48 The question is whether anything needs to be or can be done to reduce these uncertainties. We looked, for instance, at whether the legislation might provide that the parties could agree on the size of the business. This would be complicated. It would be necessary to ensure that larger companies could not pressure a small business to accept a standard term under which the other party, whatever its actual size, "agreed" that it was not a small business. In other words, it would be necessary to provide that the agreement would only be effective if it was reached in good faith.
- 5.49 We consider that legislative provision is not necessary. The common law offers a solution which the parties could put into operation themselves without statutory intervention. When it is dealing with a small-medium sized business whose status is in doubt, the other party may require as a term of the contract a "warranty"<sup>42</sup> that the small-medium business is of a particular size. Such a statement provides protection provided the other party has relied upon it when entering the contract. If the other party knew it was incorrect, there would be no protection as that party would not have entered into the contract in reliance on the statement.<sup>43</sup>

### SOPHISTICATED BUSINESSES WITH FEW EMPLOYEES

- 5.50 During consultation our attention was drawn to the problem of businesses which meet the employee numbers criterion but which operate in such a sophisticated environment that it would not be appropriate for them to be treated as small businesses under the Draft Bill. These include City businesses set up to act as

<sup>42</sup> Scots law does not recognise "warranties" as such. A similar result could be achieved by a different route. Where in the course of negotiating the contract a party asks what the size of the "small" business is, this could be noted in the contract. If it turned out to be untrue the party relying on the statement could sue in delict [tort] for misrepresentation.

<sup>43</sup> In *Watford Electronics v Sanderson CFL Ltd* [2001] EWCA Civ 317; [2001] 1 All ER (Comm) 696, Chadwick LJ, citing *Lowe v Lombank Ltd* [1960] 1 WLR 196, suggested that where a party seeks to set up a contractual representation as an evidential estoppel, the clause in question may not be able to achieve its purpose if that party cannot satisfy the court that he entered into the contract in the belief that the contractual statement was true: [2001] 1 All ER (Comm) 696, at 711.

vehicles for tax-driven financial arrangements (“special purpose vehicles” or “SPVs”) or to be responsible for specific projects (“project companies”). We have been told that it is quite common for such companies to have only a handful of employees but to operate in extremely sophisticated ways and do business worth millions of pounds.

- 5.51 We have developed three ways of excluding these businesses from small business protection. We are excluding small businesses that are quasi-subidiaries of larger organisations; contracts with a value of more than £500,000; and contracts for regulated financial business.

*Excluding quasi-subidiaries*

- 5.52 As already discussed, our scheme defines the number of employees by reference to the total number of persons employed not only by the business itself but also by any “associated person”.<sup>44</sup> We looked in some detail at the requirements of the “associated person” test to ensure that it will cover sophisticated SPVs and project companies.

- 5.53 SPVs and project companies are often set up as “orphan” companies which are not directly owned by another business. They would not therefore fall within the traditional test that two persons are associated when one controls the other as its owner or majority shareholder. SPVs are sometimes referred to as quasi-subidiaries because, although they are not owned by another business, they are in fact run in accordance with the wishes of the business that created them. In order to cover these quasi-subidiaries, we recommend that an associated person should include those who have the *de facto* ability to dictate how the business is run as well as those who have the ability to control a business through a majority shareholding.<sup>45</sup>

- 5.54 **We recommend that widely-defined group exemptions should be put in place so as to exempt from the small business regime those businesses that are associated with larger businesses.**

*Contracts of value higher than £500,000*

- 5.55 After some deliberation and consultation, we decided to recommend that transactions above a certain value should not qualify as small business contracts. Thus the Draft Bill provides that a business will not be treated as a small business in respect of a particular contract if the anticipated value of the transaction exceeds a certain pre-set limit.<sup>46</sup> The limit has been set at £500,000 for three reasons.

- 5.56 First, the figure needs to be reasonably high as it is not intended to exclude the contracts of ordinary small businesses but rather to exclude finance businesses that deal with very high value transactions but happen to have very few

<sup>44</sup> See para 5.45, above.

<sup>45</sup> See Draft Bill, clause 28.

<sup>46</sup> See Draft Bill, clause 29.

employees. We have been given to understand that we are not in danger of including the typical business transaction of an SPV within our limit so long as it is below £1 million.

- 5.57 Secondly, during consultation it came to our attention that some of the most vulnerable small businesses were those dependent for their entire trade on one, or perhaps two, commercial relationships. Examples of this were diverse and included small suppliers supplying to one or two large retail chains (for example, chains of bookstores, department stores or supermarkets) as well as small retailers buying from one or two suppliers (for example, mobile phone companies). We wanted to include these contracts within our recommended regime of protection for small businesses. We therefore sought to identify the average turnover of a small business in the expectation that, in acute cases, this sum might reflect outlay on a single contract with a large business. Our (admittedly limited) research suggested that the average annual turnover of a small business is in the order of £500,000.<sup>47</sup> This is therefore the sum on which we settled as our transaction limit.
- 5.58 Finally, the justification for our small business regime is that we wish to protect unsophisticated businesses from the rigours of contract terms that they do not understand or expect. We anticipate that any business entering into a contract of a certain value would be ill-advised not to take legal advice on the contract and as such will not require the protections of the small business regime. We feel that the majority of small businesses would seek legal advice before entering into a contract of more than £500,000 and have therefore set that figure as our transaction value limit.
- 5.59 **We recommend that contracts with a value of more than £500,000 should not be controlled under the small business regime.**<sup>48</sup>
- 5.60 In order to prevent small businesses circumventing the transaction value limits by splitting contracts into distinct parts we are proposing to aggregate the sums contained in contracts that form part of a series of contracts or a larger transaction. We also think that a small business that is about to establish a series of contracts which have a high aggregate value is as likely to take legal advice as one that is about to enter a single contract of high value. Clause 29 of the Draft Bill provides for contracts which form part of a larger transaction (or series of transactions) to be aggregated with other contracts in the series over a two year period to determine whether the value-threshold for small business contracts has been surpassed.
- 5.61 **We recommend that where a contract is one of a series, the transactions should be aggregated so that if the aggregated value of the contracts is**

<sup>47</sup> £500,000 is a median figure drawn from data on micro business turnovers, published by the DTI's Small Business Service on its website.

<sup>48</sup> See Draft Bill clause 29(2) – (3).

**greater than £500,000 the whole series or arrangement should be exempt from the small business controls.**<sup>49</sup>

- 5.62 This transaction limit proposal is likely to present the parties with problems of ascertainability and predictability similar to those presented by the employee numbers test for business size. No matter how sophisticated the test, it will not be able to deal in a straightforward way with contracts where the contract price, although ultimately certain, cannot be calculated by the parties in advance when the contract is made. Examples might be contracts for services on an emergency call out basis when the number of emergencies that will occur is not known in advance, or contracts for building work where the cost of materials and labour cannot be ascertained in detail in advance. There are other contracts where the contract price is intended to vary during the performance of the contract or where it is difficult to talk about a contract price at all. This means that a business entering such a contract with a small business will be uncertain whether it is agreeing to a small business contract or not.
- 5.63 Once again, we believe there may be common law solutions to the difficulty of determining whether a transaction will fall within the financial limit. These can be instituted by the parties themselves. For example, the parties could make a statement in the contract that the value of the agreement exceeds the transaction value limit. Such a statement would, we believe, be effective unless the party seeking to rely on it knows that it is incorrect since it cannot then be said to have entered into the contract in reliance on the statement.<sup>50</sup>

*Financial services contracts*

- 5.64 It was pointed out that protections are largely unnecessary in areas where businesses dealing with small businesses are already regulated. To extend protection to small businesses in these situations could result in over-regulation of the market.
- 5.65 The most obvious example is contracts for the provision of financial services. Most contracts of this kind are already subject to regulation by the FSA. Therefore we decided to explore the possibility of creating an exemption for such contracts. The response to our further consultation on this point was favourable. We therefore recommend that any contracts made by an “authorised person”<sup>51</sup> pursuant to a “regulated activity”<sup>52</sup> should be excluded from the small business regime. Thus small businesses buying banking, insurance and financial advice services from a body regulated by the FSA will not be able to challenge the terms of the contract under our proposed legislation.

<sup>49</sup> See Draft Bill clause 29(5) – (8).

<sup>50</sup> See *Watford Electronics v Sanderson CFL Ltd* [2001] EWCA Civ 317 [2001] 1 All ER (Comm) 696, discussed in n 43, above.

<sup>51</sup> As defined under the Financial Services and Markets Act 2000.

<sup>52</sup> *Ibid.*

- 5.66 The exemption extends only to regulated activities and not to the provision of financial services more generally.
- 5.67 **We recommend that there should be an exemption from the controls over small business contracts for contracts entered into in pursuance of regulated financial services business.**<sup>53</sup>

***Terms not individually negotiated***

- 5.68 The scheme is intended to protect small businesses from unfair standard terms which were not negotiated. The question, then, is how the concept of non-negotiated terms should be defined. In particular, should the “written standard terms of business” formula in UCTA section 3 be retained, or should the UTCCR’s “not individually negotiated” formula be used, or should some other formula be devised?

A TERM-BY-TERM APPROACH

- 5.69 A small business faced with a set of terms may well attempt to amend some terms they understand and regard as important but may also overlook others entirely, even if those terms are very harsh. From this point of view, the UCTA test – which focuses on a set of standard terms – does not include all the situations that we believed to be problematic. Under the UCTA test, significant changes to only a few terms may prevent the whole set (including the unchanged terms) from amounting to written standard terms. Thus we prefer a term-by-term approach. This means that the status of each term in the set would be assessed independently to see whether it had been altered in favour of the small business from the version put forward by the other party as a result of negotiations.

ONLY “STANDARD” TERMS

- 5.70 The UTCCR’s “not individually negotiated” formulation is wider than this. Because there is no reference to standard terms, it would allow a small business to challenge any term that was drawn up in advance by the other party and not subsequently negotiated. This applies even if all the terms of the contract were tailor-made for the particular transaction in question. We do not think that this would be appropriate. As we explained earlier,<sup>54</sup> if the term has been drawn up for the particular contract, by definition the other party will not refuse to negotiate it simply because it is one of a set of standard terms. If the other party refuses to negotiate the term, that is probably because the business finds the overall balance of the contract appropriate to its needs.
- 5.71 In the light of these concerns, we think that the starting point for identifying a non-negotiated term should be that it has been *put forward* by the other party as *one of its written standard terms of business*.<sup>55</sup> The reference to written standard terms of business is intended to target standard terms and to leave bespoke

<sup>53</sup> See Draft Bill, clause 29(4) and (10).

<sup>54</sup> See para 5.20, above.

<sup>55</sup> This approach is encapsulated in clause 11(1)(a) of the Draft Bill.

contracts unregulated. However, by referring to individual terms put forward by the other party (as part of a set of written standard terms) the definition is intended to engender a term-by-term approach to the question of challengeability, avoiding the risk of the all-or-nothing approach that was outlined in paragraph 5.69.

#### NOT ALTERED IN FAVOUR OF THE SMALL BUSINESS

- 5.72 The purpose of taking a term-by-term approach is to discriminate between those terms which, although originally part of a set of written standard terms, have subsequently been changed as a result of negotiation and those which have not. If the small business asked for and obtained some change during negotiation – even a change less than it sought – this shows that the other party was not unwilling to alter its terms just because they are standard. The reason we have given for allowing a challenge falls away.
- 5.73 To achieve this result, we have added a second limb to our definition of challengeable terms which specifies that the substance of the term must not have been altered in favour of the small business as a result of negotiation.
- 5.74 The reason that a term in the other party's standard terms was not altered in favour of the small business may not have been that the other party did not want to alter its standard terms as such but that the term reflects the best balance of risk and price.<sup>56</sup> This might suggest that a term should not be subject to review if there was negotiation over it even though the negotiation led to no change. The difficulty is that there is no criterion by which to distinguish such a case from one in which the party refused to alter its term for other reasons. Thus the criterion for the control to apply must simply be whether the standard term was altered in favour of the small business. Arguments that it was left unaltered because it reflected the best balance of risk and price will have to be taken into account when the court assesses whether the term was fair and reasonable.
- 5.75 **We recommend that only certain terms in small business contracts should be open to challenge: those terms which have been put forward by the other party as one of its standard terms of business and which have not been subsequently changed in favour of the small business as a result of negotiation.**<sup>57</sup>

#### ***Expressly excluded categories of contract***

##### BUSINESS CONTRACTS IN GENERAL

- 5.76 In Part 4 we recommended that certain categories of contract should be excluded from the proposed controls over business contracts.<sup>58</sup> We now recommend that all these categories of contract also be excluded from the small business regime. Contracts relating to land, intellectual property, company constitutions and

<sup>56</sup> See above, para 5.20.

<sup>57</sup> See Draft Bill, clause 11(1).

<sup>58</sup> See paras 4.81 – 4.84. The categories of contract (1 – 6) are listed in para 4.81.

securities involve specialised categories of activity in which either certainty is usually highly-prized in the market or where it is customary for parties to seek legal advice so that harsh terms are not usually agreed to unwittingly (or both). Insurance contracts are also exempted; many would in any event be covered by the larger exemption we have recommended for financial services contracts.<sup>59</sup> Contracts in category (6) were exempted from UCTA to maintain existing arrangements in the commercial maritime field – arrangements which had, at that time, developed over the course of a century and were thought to achieve a valuable level of certainty. We see no reason to disrupt these tried and tested arrangements in relation to small business contracts any more than in relation to business contracts generally.

- 5.77 **We recommend that the same categories of contract should be exempt from the small business controls as are expressly exempt from the business controls.**<sup>60</sup>

#### INTERNATIONAL CONTRACTS

- 5.78 This is discussed in Part 7.

#### CHOICE OF LAW

- 5.79 This is discussed in Part 7.

#### *The “fair and reasonable” test*

- 5.80 In Part 3, we proposed that the basic test in the new legislation for consumer contracts should be whether, judged by reference to the time the contract was made, the term was fair and reasonable.<sup>61</sup> In Part 4 we recommended using the same test for the controls on general business contracts.<sup>62</sup> We now recommend adopting the same test in respect of small business contracts. Having one test for all the various controls we recommend will lend coherence to the new legislation and, more importantly, make its provisions easier to understand and apply.

- 5.81 **We recommend that the same “fair and reasonable” test should apply to the new general clause for small business contracts as to other contracts under the new legislation.**

#### *Indicative List*

- 5.82 For consumer contracts the legislation must include a list of terms which may be unfair. In Part 3 we recommended that the Indicative List be reformulated to make it easier to understand and apply in the UK.<sup>63</sup> We also recommended that the

<sup>59</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544), Art 10 specifies effecting or carrying out a contract of insurance as principal as a regulated activity for the purposes of the Financial Services and Markets Act 2000.

<sup>60</sup> See Draft Bill, Sch 3, paras 3 – 7 and 9 – 10.

<sup>61</sup> See paras 3.84 – 3.105, above.

<sup>62</sup> See para 4.70, above

<sup>63</sup> See paras 3.108 – 3.116, above.

Secretary of State should be given powers to add to the list.<sup>64</sup> In the Consultation Paper, we proposed that there should be an indicative list of business contracts to assist businesses in knowing what terms were likely to be unfair.<sup>65</sup> We proposed, however, that such a list should be limited to clauses excluding and restricting liability for breach of contract or negligence.<sup>66</sup>

5.83 Now that our proposed extension of controls is only to small business contracts, the question arises whether it is desirable to have an Indicative List as part of the small business regime. The list would indicate what terms are likely to be regarded as unfair and unreasonable and would provide businesses with useful guidance. We believe that the same terms which are likely to be objectionable in a consumer contract are likely to be unfair and unreasonable in relation to a small business. We therefore recommend that the reformulated Indicative List should also apply to small business contracts.

5.84 **We recommend that the Indicative List of terms that may be regarded as unfair should apply to small business contracts as well as consumer contracts.**<sup>67</sup>

***The burden of showing unfairness***

5.85 We recommend that a small business should have the burden of proving that any term which it challenges is unfair. This is the current position under the UTCCR in relation to consumers and we see no reason to change it for small businesses. The imperative of protection for the inexperienced which underlies our recommendations on consumer contracts does not apply with such force to small business contracts.

5.86 **We recommend in relation to small business contracts that the small business should bear the burden of showing unfairness.**<sup>68</sup>

***The effect of an invalid term***

5.87 The issues over the effect of a term being invalid because it is not fair and reasonable are the same for small business contracts as they are for consumer contracts. Again we refer readers to the earlier discussion.<sup>69</sup>

<sup>64</sup> See para 3.112, above.

<sup>65</sup> See Consultation Paper, paras 5.84 – 5.88.

<sup>66</sup> In the Consultation Paper we proposed that, as under UCTA s 11(5) [s 24(4)], where a business seeks to rely on an exclusion or limitation of liability clause it should bear the burden of showing that the clause is fair and reasonable. We proposed to achieve this by including such terms in the Indicative List for the purposes of business to business contracts. As we have explained in Part 3, we are no longer proposing that the burden of proof should vary according to whether or not a term is on the Indicative List. There is instead an express provision on the burden of proof: see Draft Bill, clause 17(1).

<sup>67</sup> See Draft Bill, clause 14(6).

<sup>68</sup> See Draft Bill, clause 17(2).

<sup>69</sup> See paras 3.131 – 3.140, above.

- 5.88 **We recommend that, where a term of a small business contract is found to be unfair, the contract should continue in existence in all other respects insofar as possible.**

***Attempted evasion***

BY SECONDARY CONTRACT

- 5.89 As in the case of consumer contracts, it should not be possible to evade the controls over small business contracts by means of a secondary contract, whether between the same parties or different parties. The issues are the same as they are for consumer contracts and we refer readers to the discussion in Part 3.<sup>70</sup>

- 5.90 **We recommend that controls should be put in place to prevent businesses evading the small business controls by means of secondary contracts.**

BY CHOICE OF LAW

- 5.91 This is discussed in Part 7.

***Prevention***

- 5.92 It is clear from the responses that the right of individuals to challenge unreasonable exclusion clauses has not eliminated their use from small business contracts any more than it did from consumer contracts.<sup>71</sup> Nor is there likely to be an effective distribution of information among small businesses. A case can be made for a body having power to prevent the use of unfair terms by businesses in their contracts with small businesses. Such controls are found in some continental countries.<sup>72</sup>

- 5.93 In the Consultation Paper<sup>73</sup> we said that the decision whether to recommend the extension of the preventive powers of the UTCCR to business contracts depended on the answers to at least two questions. The first is whether it is desirable in principle to extend the controls. The second is whether there is some body which is suitable to take on the task. We observed that to operate a scheme effectively would be expensive and that we did not know whether any organisation would be prepared to meet the necessary expenditure.

- 5.94 We have now concluded that, in principle, it would be desirable to extend the preventive regime to small business contracts. Allowing parties to challenge individual terms has a limited impact on general contracting practice when compared to the general powers of an authorised body.<sup>74</sup> While respondents did

<sup>70</sup> See paras 3.141 – 3.142, above.

<sup>71</sup> See Consultation Paper, para 5.99.

<sup>72</sup> In Sweden it appears that the powers have seldom resulted in reported cases, but there may have been informal settlements resulting in unfair terms being withdrawn and the existence of the powers may have had influence.

<sup>73</sup> See Consultation Paper, para 5.110.

<sup>74</sup> See Consultation Paper, paras 5.99 – 5.100.

not support the idea of extending UTCCR-style preventive controls into the business sector in general, a substantial number indicated that such protections might be justifiable for small businesses only. We note that the Late Payment of Commercial Debts Regulations 2002<sup>75</sup> grant preventive powers to certain representative bodies.

- 5.95 We accept these submissions and we would like to recommend this extension. However, our enquiries into the practical implementation of such a scheme have led to doubts over whether there are suitable enforcement bodies capable of meeting the cost and willing to do so. In particular, the Office of Fair Trading has indicated that it would not be willing to take on the role of policing small business contracts. In short, there appear to be no bodies which currently have the resources effectively to carry out this role. We have not, therefore, made provision in the Draft Bill for a preventive powers regime in respect of terms in small business contracts.

<sup>75</sup> SI 2002 No 1674, reg 3.

## PART 6

### PARTICULAR ISSUES

- 6.1 In this Part we deal with four particular issues. These are employment contracts; private contracts for the sale or supply of goods; non-contractual notices; and provisions in UCTA which are no longer required.

#### EMPLOYMENT CONTRACTS

- 6.2 The current law has two components: UCTA section 2 [section 16] and UCTA section 3 [section 17].<sup>1</sup>
- (1) In England and Wales, UCTA section 2 applies only in favour of the employee.<sup>2</sup> In Scotland, it is not wholly clear whether section 16 applies similarly.<sup>3</sup>
  - (2) UCTA section 3 [section 17] applies to consumer contracts and contracts concluded on one party's written standard terms of business. It has been held to apply to employment contracts on the basis either that the employee is a consumer or that the employment was on the employer's written standard terms of business.<sup>4</sup>

#### Employees' liability for negligence

- 6.3 The effect of UCTA in England and Wales is that any attempt by an employer to exclude or restrict its liability to an employee for negligence is subject to section 2; but this section does not prevent an employee excluding or restricting liability for negligence to the employer. In the Consultation Paper we said that this should be retained.<sup>5</sup>
- 6.4 The provision that achieves this result in UCTA for England and Wales<sup>6</sup> has no equivalent in the Scottish part of UCTA and so, wishing to preserve what we thought was the status quo, the Consultation Draft provided that the exception

<sup>1</sup> For a more detailed discussion of the current law, see the Consultation Paper, para 3.45.

<sup>2</sup> See UCTA, Sch 1, para 4.

<sup>3</sup> The position in Scots law is discussed below, para 6.4.

<sup>4</sup> More recent cases bring employment contracts within section 3 by treating the employee as a consumer. See *Chapman v Aberdeen Construction Group Plc* 1993 SLT 1205, *Brigden v American Express* [2000] IRLR 94 and *Peninsula Business Services Ltd v Sweeney* [2004] IRLR 49 (EAT). But an older Court of Appeal case included contracts of employment under the written standard terms of business limb. See *Liberty Life Assurance Co Ltd v Sheik*, *The Times* 25 June 1985 (CA).

<sup>5</sup> Consultation Paper, para 4.80. We did not make an explicit proposal on the point and it was not challenged by consultees. In clause 2(1) of the Consultation Draft we created an exception from the controls in clause 1 for exclusion of liability clauses relied on by employees attempting to limit their liability for negligence towards their employers.

<sup>6</sup> Schedule 1, para 4.

should not extend to Scotland.<sup>7</sup> As the project progressed, however, we discovered that the difference between the Scottish and English parts of UCTA on this point is probably one of form rather than substance. It seems that an employee's liability in negligence would not "arise in the course of a business" so as to fall within section 16.<sup>8</sup> We therefore thought it best to extend the exception to Scotland to reflect our policy of allowing employees to exclude or restrict liability to their employers. Thus the Draft Bill attached to this Report no longer creates a special position for Scotland. Clause 2(1), which permits an employee to exclude or restrict his or her liability for negligence towards the employer, now extends to England and Wales, Scotland and Northern Ireland.

- 6.5 **We recommend that the provisions of the new legislation that apply to business liability for negligence should not prevent an employee from restricting his or her liability to the employer.**

#### **The employer's terms of employment**

- 6.6 In the Consultation Paper we did not make any firm proposals on how employment contracts should be treated under the new regime. We asked whether employment contracts should be included in our regime as business contracts, consumer contracts or in a category of their own. We expressed the provisional view that it might be best to subject employment contracts to much the same regime as consumer contracts.<sup>9</sup>
- 6.7 After our general consultation we sought the views of a number of employment law specialists. Most favoured treating employment contracts as a separate category, but views were evenly divided on the level of control that should be implemented. Some consultees were in favour of extending to employees the protections currently afforded to consumers by the UTCCR. In one case this was because employers are now providing employees with additional services, such as health plans and holidays; in doing so the employer is a quasi-supplier and therefore should be regulated as such. On the other hand, an equal number of consultees thought there were already sufficient controls over employment contracts, so there was no need to extend the proposed consumer protections to employees. These consultees were divided on whether or not the existing UCTA controls should be abandoned.
- 6.8 In the light of the further consultation, we have concluded that it is not appropriate to treat employment contracts in the same way as consumer contracts or small business contracts. In other words, we do not wish to apply UTCCR-type protections to "non-core" terms. To do so might interfere with the existing legislation and common law rules affecting the obligations that are owed by each party under an employment contract. On the other hand, employers often provide

<sup>7</sup> Consultation Draft, clause 2(3).

<sup>8</sup> For Part II there is no equivalent to the provision of section 1(3) that "business liability" may arise "from things done ... by a person in the course of a business (whether his own business or another's)". It is arguable that it is only the words in brackets that make the exception in Sch 1, para 4 necessary.

<sup>9</sup> See Consultation Paper, paras 4.80 – 4.81.

employees with additional services, such as health plans and holidays. The additional benefits may be under separate contracts that amount to consumer contracts but sometimes the benefits will be provided under the contract of employment itself. For these cases it is desirable to maintain controls along the lines of UCTA section 3 [section 17]. By reference to its standard written terms, an employer should not be able to exclude or restrict its liability to provide the promised services (or render services which are substantially different from what the employee reasonably expected) unless it is fair and reasonable to do so. We see less objection if this is done by a one-off negotiated term.

- 6.9 Thus, for employment contracts there should be a section replicating UCTA section 3 [section 17] that applies wherever the employment contract is on the employer's written standard terms of employment (as is usually the case).<sup>10</sup> Employment contracts are not consumer contracts for the purposes of the Draft Bill and are excluded from the wider protections afforded to small business and consumer contracts. The practical effect of our recommendations is that the employer's *standard* terms will be subject to the "fair and reasonable" test in so far as they purport to exclude or restrict liability or allow the employer to render a performance substantially different from that reasonably expected by the employee. In addition the effect of UCTA section 2 [section 16] is preserved: it will apply only in favour of the employee.<sup>11</sup> The employee will therefore retain nearly all of the protections which exist under the current law, but will not be given additional protection by our scheme.
- 6.10 **We recommend preserving UCTA's controls over employment contracts when the employment is on the employer's standard terms of employment. We do not recommend extending consumer protections to employees.**

#### **SALE OR SUPPLY OF GOODS NOT RELATED TO BUSINESS**

- 6.11 In the Consultation Paper we devoted a chapter to the problem of controls over contracts for the sale or supply of goods by an individual who does not act in the course of a business. This would include both a consumer supplying goods to a business and a person "privately" supplying goods to another individual.<sup>12</sup> Typical examples would be where a private motorist sells a used car to a car dealer or where one private individual sells a car to another.
- 6.12 Private individuals who sell to a business would be classified as consumers and would therefore be entitled to the protections outlined in Part 3.<sup>13</sup> These, however, only protect the consumer against the business. Here we are concerned with how far sellers may exclude their own obligations, whether they

<sup>10</sup> See clause 12.

<sup>11</sup> See Draft Bill, clauses 1 and 2(1).

<sup>12</sup> Consultation Paper, Part VI.

<sup>13</sup> Thus, under the Draft Bill, if the car dealer's terms of purchase contained an unfair term which was detrimental to the consumer seller, the consumer would be entitled to challenge it under clause 4. (This would not apply to a core term, or one that was substantially the same as the law that would apply in the absence of the term, provided the term was transparent: see clause 4(2) – (4)).

are dealing with a business or another private individual. At present, in both cases private sellers are under some, fairly limited, obligations to their buyers. The question is how far such sellers should be able to exclude their obligations through the use of contract terms.

- 6.13 In order to understand the existing law in this area, it is worth distinguishing between sale contracts, hire purchase contracts and other contracts for the supply of goods. Below we look at each in turn.

### **Sales by a consumer to a business and between private individuals**

- 6.14 Under the Sale of Goods Act 1979, only some of the usual implied terms apply to private sellers. Private sales are subject to an implied term that the seller is entitled to sell.<sup>14</sup> If the sale is by description, there is an implied term that the goods correspond to their description:<sup>15</sup> if the sale is by sample, there is an implied term that the goods correspond to the sample.<sup>16</sup> In contrast, the implied terms that goods are of satisfactory quality and fit for their purpose only apply where the seller sells “in the course of a business”.<sup>17</sup> There are no equivalent provisions where the seller acts in a private capacity.
- 6.15 How far private sellers can exclude these terms is governed by UCTA section 6 [section 20].<sup>18</sup> Section 6(1) [section 20(1)] has the effect that, in contracts for the sale of goods, persons selling goods to a business or under a private contract cannot restrict or exclude liability for breach of the statutory implied undertaking that they are entitled to sell.
- 6.16 UCTA section 6(3) [section 20(2)] has the effect that liability for breach of the other implied terms can only be excluded in so far as it is reasonable to do so. Thus a consumer selling to a business or a seller under a private contract cannot use a contract term to restrict or exclude liability for breach of the implied undertakings as to correspondence with description or sample unless the term is reasonable.<sup>19</sup>

<sup>14</sup> Sale of Goods Act 1979, s 12.

<sup>15</sup> Sale of Goods Act 1979, s 13.

<sup>16</sup> Sale of Goods Act 1979, s 15.

<sup>17</sup> Sale of Goods Act 1979, s 14(2).

<sup>18</sup> Section 6 applies irrespective of whether the seller is acting in the course of a business. Part 1, relating to England and Wales, is structurally complex. First s 1(3) states that sections 2 – 7 only apply to business liability, but then s 6(4) creates an exception to s 1(3), and says that s 6 does not just apply to business liability. For Scotland, s 20 is drafted in a more straightforward manner but has the same effect.

<sup>19</sup> Section 6(2) is expressed to apply “as against a person dealing as consumer” and does not apply to a contract between two persons neither of whom is acting in the course of a business. The definition of “deals as consumer” which is contained in s 12 [s 25 (1)] will not allow a buyer to be categorised as dealing as a consumer unless the seller sells “in the course of a business”. The Scottish provisions (s 20(2) and s 21(1)) are worded differently: the equivalent provisions refer to “a consumer contract” which cannot be a contract between two persons acting privately by virtue of s 25(1). The effect is the same.

- 6.17 In the Consultation Paper we provisionally proposed that these controls should be retained, both where a consumer sells to a business and where a private seller sells to another private individual. The vast majority of respondents agreed with our proposals on this point without further comment.<sup>20</sup> Therefore, we now recommend preserving UCTA's controls over contracts for the sale of goods where the seller does not act in the course of business.
- 6.18 Following the scheme of the Draft Bill, contracts between a private individual and a business are classified as consumer contracts (under Part 2), and those between private individuals are classified as private contracts (under Part 3). Each Part contains identical clauses which replicate the current law.<sup>21</sup> The effect is that private sellers cannot exclude the implied term of entitlement to sell in any circumstances; and they can exclude the implied terms of correspondence with description and sample only in so far as is reasonable.
- 6.19 **We recommend that the UCTA controls relating to implied terms as to entitlement to sell and correspondence with description or sample should be retained for contracts for the sale of goods by a consumer to a business; and should also continue to apply when neither party is acting in the course of a business (a "private" sale).**

#### **Hire purchase contracts under which a private individual supplies goods**

- 6.20 Under UCTA, hire purchase contracts are treated in exactly the same way as sales. They also fall within section 6 [section 20]. In the unlikely event that a private individual supplied goods under a hire purchase contract, the individual would not be able to exclude the implied term of entitlement to transfer property at all, and could restrict the implied terms of correspondence with description and sample only as far as was reasonable.<sup>22</sup>
- 6.21 We believe that the obligations imposed on the supplier – particularly the obligation to transfer ownership at the relevant time – are of such importance that these controls should be maintained in their present form.
- 6.22 **We recommend that in hire purchase contracts in which the supplier is a private individual the UCTA controls relating to implied terms as to title and sale by description or sample should be retained.**

#### **Other contracts under which a private individual supplies goods**

- 6.23 As we have seen, there are many possible contracts which are not sales or hire purchase but which involve the supply of goods. These include barter, exchange, contracts for work and materials and hire. These contracts are also subject to

<sup>20</sup> Two respondents argued that the section 6(3) [section 20(2)] controls should be limited to clauses that were not individually negotiated.

<sup>21</sup> Draft Bill, clause 6 (for consumer contracts); and clause 13 (for private contracts).

<sup>22</sup> These implied terms are similar to those implied into sales and are set out in by the Supply of Goods (Implied Terms) Act 1973.

implied statutory undertakings which are written in very similar terms to those found in the Sale of Goods Act 1979.<sup>23</sup>

- 6.24 All other supply contracts (such as exchange, work and materials or hire) are subject to section 7 [section 21]. This is restricted to business liability, which means that it has no application to private individuals.<sup>24</sup> The result is that if two private individuals were to exchange cars, either of them could exclude liability for breach of the implied term that they were entitled to transfer ownership. Similarly, one party could add in a clause to the effect that “no liability is accepted if the car does not match its description”. Such terms would fall outside any current legislative controls.
- 6.25 During consultation, this issue generated almost no discussion. Although it is possible to find theoretical faults with the current position, we received no evidence that it causes problems in practice. Although it is relatively common for individuals to supply a business with old goods in part-exchange for new, these arrangements will almost always be on the business’s terms. We are not aware of any instances in which the individual has imposed inappropriate terms on the business. When private individuals exchange or barter goods among themselves, these tend to be informal arrangements. It would be extremely unusual for one party to impose an exclusion clause on the other.
- 6.26 Although we considered extending UCTA controls to all private contracts for the supply of goods, we concluded that we should not extend statutory controls unless there was a clear demand for them. We did not wish to over-regulate private, informal arrangements. Given that the existing law seems to work in practice and that there are no calls for change, we have decided to preserve the existing position.
- 6.27 **We recommend that the UCTA controls relating to implied terms as to title and correspondence with description or sample should not be extended to other contracts in which a private individual supplies goods.**

#### **NON-CONTRACTUAL NOTICES AFFECTING LIABILITY IN TORT [DELICT]**

- 6.28 In the Consultation Paper we provisionally proposed that the existing controls over notices excluding business liability for negligence<sup>25</sup> in tort [delict] should be retained.<sup>26</sup> Almost all consultees who expressed a view on this proposal supported it.

<sup>23</sup> Supply of Goods and Services Act 1982.

<sup>24</sup> See UCTA, s 1(3) and n 18, above.

<sup>25</sup> In the Consultation Draft, we provided separate definitions for “negligence” and “breach of duty” the latter being the term more widely used in Scotland. In the Draft Bill, however, we have condensed these definitions into the definition of “negligence”, which now extends to breaches of the relevant duties in Scotland (Draft Bill, clause 1).

<sup>26</sup> See para 7.3.

- 6.29 **We recommend that the effect of the UCTA controls relating to notices excluding business liability in tort [delict] for negligence should be reproduced in the new legislation.**
- 6.30 We further recommended that, because UCTA's controls over business liability for negligence apply to both contract terms and notices and because we wished to retain controls over notices as well as contract terms, the new legislation should follow UCTA in having a separate part dealing with exclusions and restrictions of liability for negligence, whether they purport to exclude liability in contract or tort [delict] and whether they take the form of a notice or a contract term.<sup>27</sup>
- 6.31 Thus the Consultation Draft contained a separate part making provision for such controls.<sup>28</sup> An overwhelming majority of consultees supported our proposals for non-contractual notices. We recommend that the effect of these provisions be reproduced in the new legislation in a separate Part.
- 6.32 **We recommend that controls of business liability for negligence should be treated in a separate Part of the new legislation.**<sup>29</sup>
- 6.33 We also proposed that the existing preventive powers conferred on the OFT and other regulators by the UTCCR should be extended to cover notices excluding or restricting liability for negligence in addition to contract terms.<sup>30</sup> We said that although such notices may be of no effect we considered that they may deter claimants who have suffered injury or loss and do not know that the notice is invalid.<sup>31</sup> For this reason there should be a power to act against the routine use of such notices.
- 6.34 Again, almost all consultees who expressed a view supported this proposal. The Institute for Commercial Law Studies at the University of Sheffield said that notices purporting to exclude liability for personal injury or death have remained "in widespread use" and that preventive powers to control the continued use of such notices are very much needed. We agree.

<sup>27</sup> Consultation Paper, para 7.4. There is a difference between England and Scotland as to what counts as business liability. Business liability includes liability arising from the occupation of land for business purposes but in England there is an exception where the injured party was allowed access to the land for recreational or educational purposes not connected to the occupier's business. This exception does not apply under Scots law. Moreover, under the Occupiers' Liability (Scotland) Act 1960, s 2(1), the statutory obligation to take reasonable care can only be altered by a contractual term: a non-contractual notice is ineffective. Clause 2 of the Draft Bill reflects these differences between English and Scots law.

<sup>28</sup> Clauses 1 to 3.

<sup>29</sup> See Draft Bill, Part 1 (Business liability for negligence).

<sup>30</sup> Para 7.7.

<sup>31</sup> Para 7.6.

- 6.35 **We recommend that the preventive powers be extended to cover non-contractual notices which purport to exclude or restrict a business's liability in tort [delict].**

#### **GENERAL PROVISIONS NO LONGER REQUIRED**

- 6.36 We have already recommended that UCTA section 5 [section 19] ("guarantee" of consumer goods) should not be replicated in the new legislation. This provision applies only to consumers.<sup>32</sup> We now discuss two provisions of UCTA that are of more general application: section 9 (effect of breach) [section 22 (consequence of breach)] and section 28 (temporary provision for sea carriage of passengers).

#### **Effect of breach**

- 6.37 Section 9 [section 22] was originally inserted to ensure that the doctrine of fundamental breach, under which a party might escape the effect of an exemption clause by terminating the contract for so-called fundamental breach, would not prevent a valid clause applying. In the Consultation Paper<sup>33</sup> we argued that this section is no longer necessary because the doctrine has been abolished by the House of Lords.<sup>34</sup> Those who responded on our proposal not to replicate section 9 supported it unanimously.

- 6.38 **We recommend that section 9 [section 22] of UCTA should not be replicated in the new legislation.**

#### **Sea passengers**

- 6.39 Section 28 applies to contracts for the carriage by sea of a passenger (with or without luggage) made before the coming-into-force of the Athens Convention 1974.<sup>35</sup> It provides that, in such cases, the carrier may exclude liability for loss or damage within the contemplation of the Convention.

- 6.40 In the Consultation Paper we argued that this section is no longer required.<sup>36</sup> The Athens Convention was not in force when UCTA was passed in 1977 but it has been since 1987: contracts made after that date do not fall within section 28. Moreover, the section only applies to contracts for the carriage by sea of passengers and their luggage and such contracts will almost always be consumer contracts so that it would not be appropriate to allow any exclusion of liability on the part of the carrier.

<sup>32</sup> See above, paras 3.48 – 3.49.

<sup>33</sup> Consultation Paper, para 4.209.

<sup>34</sup> *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.

<sup>35</sup> The Athens Convention 1974 entered into force on 28 April 1987 when it became part of the Merchant Shipping Act 1979, Sch 3, Part I. Subsequent protocols amended the Convention and an updated version was implemented by the Merchant Shipping Act 1995, Sch 6, Part I, although a 1990 Protocol never came into force. A further protocol was agreed on 1 November 2002, although it has not yet been ratified by the number of states required to bring it into force.

<sup>36</sup> Consultation Paper, para 4.211.

- 6.41 The Carriage of Passengers and their Luggage by Sea (Interim Provisions) Order 1980, Article 2 stipulates that section 28 ceases to apply to any contract to which the order relates after it comes into force on 1 January 1981. That still leaves those contracts signed prior to 1 January 1981 as well as those contracts to which section 28 relates but the Order does not. However since we do not intend the new legislation to have retrospective effect, these early contracts will continue to be governed by UCTA section 28 without the need for that section to be replicated in the new legislation.
- 6.42 **We recommend that section 28 of UCTA should not be replicated in the new legislation.**

# **PART 7**

## **INTERNATIONAL CONTRACTS AND CHOICE OF LAW**

### **INTRODUCTION**

- 7.1 UCTA has three provisions dealing with international contracts and choice of law issues: section 26, section 27(1) and section 27(2).
- (1) Section 26 creates an exemption from UCTA's controls for the cross-border sale or supply of goods.
  - (2) Section 27(1) creates an exemption from UCTA's controls for contracts that are subject to the law of a part of the UK only by virtue of the parties' choice of law (and would otherwise be governed by the law of another country).
  - (3) Section 27(2) applies UCTA to any contract despite a choice of foreign law if (i) that choice of law has been adopted to evade the provisions of the Act; or (ii) the contract was concluded with a UK-resident consumer who took all necessary steps to conclude the contract in the UK.
- 7.2 The UTCCR have just one such provision which is closely based on Article 6(2) of the Directive. Regulation 9 provides that the UTCCR shall apply notwithstanding any term that applies the law of a non-Member State if the contract has a close connection with the territory of the Member States.
- 7.3 We took a close look at these provisions to see whether they should be replicated or substituted in the new legislation. In the process we encountered a number of difficult issues including the UK's compliance with international treaty obligations and EU legislation. The question of whether and how to replace section 27(2) gave rise to the greatest difficulty in relation to consumer contracts. The question of whether and how to replace section 26 presented greater difficulties in relation to business contracts.

### **CONSUMER CONTRACTS**

#### **Cross-border contracts**

- 7.4 At present, UCTA exempts cross-border contracts for the sale or supply of goods.<sup>1</sup> There is no similar exemption in the UTCCR. In the Consultation Paper, we said that the new legislation could not have a blanket exemption for international contracts (such as in UCTA). This is because neither the Directive nor the SCGD provides an exemption for international contracts.<sup>2</sup> Thus no

<sup>1</sup> UCTA, s 26.

<sup>2</sup> It appears that in this respect the SCGD has not been correctly implemented in the UK because the SSGCR leave exclusions of the seller's obligations to be regulated by UCTA

exemption could apply to those parts of the new legislation that implement the Directive. Nor could it apply to legislation within the scope of the SCGD (which covers clauses excluding liability for breach of any of the four implied terms of correspondence and quality in consumer contracts for the sale of goods). We concluded that there should be no exemption for cross-border *consumer* contracts. Thus UCTA section 26 should not be replicated for consumer contracts of sale or supply of goods.<sup>3</sup>

7.5 A large majority of consultees agreed with our proposal that the controls in the new legislation should apply to cross-border contracts for the supply of goods to consumers in the same way as they would apply to domestic contracts. Therefore, we recommend that there should be no exemption for cross-border consumer contracts of sale or supply of goods.

7.6 **We recommend that UCTA section 26 on international contracts for the sale or supply of goods should not be replicated for consumer contracts.**

#### **Choice of the law of a part of the UK in foreign contracts**

7.7 UCTA section 27(1) provides that where the law of a part of the UK is chosen by the parties as the governing law but, were it not for that choice, the law of some other country would be the proper law, many of the protections afforded by the Act will not apply. To reproduce section 27(1) in its present form would mean that, in many contracts where the consumer is resident abroad, the supplier would be able to impose a choice of Scots or English law without having to pay regard to the statutory consumer protections. We are bound under the Directive to protect consumers who are resident in other Member States.<sup>4</sup> A provision which allowed suppliers to evade the Directive's regime by imposing an English or Scottish choice of law in cases involving consumers resident in other Member States would not adequately implement its terms.

7.8 We stated in the Consultation Paper<sup>5</sup> that in the new legislation this exemption should not apply to consumer contracts. A large majority of consultees agreed with our provisional proposal that there should be no special treatment of consumer contracts to which the law of a part of the UK applies only through the choice of the parties. We therefore recommend that the consumer contract controls should apply to contracts governed by an English or Scottish choice of law even where the contract has little, or no, connection with the UK.

7.9 **We recommend that UCTA section 27(1) should not be replicated for consumer contracts.**

(as amended by the SSGCR) without apparently noticing that UCTA does not apply to international sales contracts.

<sup>3</sup> See Consultation Paper, para 4.82, which argued that the rule rendering certain clauses of no effect should apply whether the contract is one of sale (and therefore covered by the SCGD) or of hire (which is not).

<sup>4</sup> By virtue of Art 6(2). That is, wherever the contract has a close connection to the territory of the Member States.

<sup>5</sup> See paras 4.83 – 4.85.

### **Evasion by choice of non-UK law**

7.10 The question now to be addressed is when the consumer protection provisions in the new legislation should be applicable notwithstanding the choice of a foreign proper law. UCTA section 27(2) provides that the choice of a foreign law is to be respected unless the choice of law “appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act”;<sup>6</sup> or the consumer was habitually resident in the UK and “the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf”.<sup>7</sup> Regulation 9 of the UTCCR<sup>8</sup> is a similar provision to UCTA section 27(2)(a). It implements Article 6(2) of the Directive, which imposes an obligation on Member States to ensure that consumers do not lose protection “by virtue of the choice of the law of a non-Member country as the law applicable to the contract” where the contract has a close connection to a Member State. Regulation 9 stays close to the wording of Article 6(2) and also refers to the choice of a non-Member State’s law rather than the choice of a non-UK law.

7.11 When writing the Consultation Paper, we took the view that where the contract has a close connection with the UK the consumer protection provisions of the new legislation should apply even if the contract is governed by the law of another Member State. We proposed that

It should be made clear that the rules on unfair clauses in consumer contracts are mandatory so that, if the contract has a close connection to the UK, they will be applied under the Rome Convention despite a choice of another system of law.<sup>9</sup>

7.12 Consultees offered broad support for the principle that consumer contract rules should be mandatory. However, we received requests to articulate more clearly how we envisaged our provisions relating to the Rome Convention. The following paragraphs set out our thinking in this area.

7.13 The Rome Convention (which is implemented in the UK by the Contracts (Applicable Law) Act 1990) provides that an express or implied choice of law is to be respected but, in the absence of a choice, the governing law will be the law of the country with which the contract is “most closely connected”.<sup>10</sup> However, even where there is an express choice, various articles of the Rome Convention provide for the choice of law to be overridden in relation to certain contractual

<sup>6</sup> UCTA, s 27(2)(a).

<sup>7</sup> UCTA, s 27(2)(b).

<sup>8</sup> See para 7.2, above.

<sup>9</sup> Consultation Paper, para 4.194.

<sup>10</sup> In general (and as specified by Art 4(1) – (2) Rome Convention), a contract has its closest connection with the country where the party who is to effect *characteristic performance* has their habitual residence or central administration. Where, however, the contract is made in the course of that party’s trade or profession, the country of closest connection is where the principal place of business is situated or, where the contract provides that the contract is to be performed through another place of business, the country where that other place of business is situated.

issues and for the law of another country to be applied. The following Articles may apply to international contracts with consumers:<sup>11</sup>

- (1) Article 5(2) provides that a consumer is not to be deprived of the protection afforded by the mandatory rules of his country of habitual residence if:
  - (a) in that country the conclusion of the contract was preceded by a specific invitation addressed to him or by advertising, and he had taken in that country all the steps necessary on his part for the conclusion of the contract; or
  - (b) the other party or his agent received the consumer's order in that country; or
  - (c) the contract is for the sale of goods and the consumer travelled from that country to another country and there gave his order, provided that the consumer's journey was arranged by the seller for the purpose of inducing the consumer to buy.
- (2) Article 3(3) provides that, where the contract is wholly connected to another country, an express choice of law shall not "prejudice the application" of the mandatory rules of that country.
- (3) Article 7(2) provides that an express choice of law shall not "restrict the application" of the mandatory rules of the forum where they are mandatory irrespective of the law otherwise applicable to the contract.

7.14 In the course of the project, we considered whether it might be possible to rely on the independent operation of these provisions of the Rome Convention to ensure the application of our consumer protections in all the situations contemplated by Article 6(2) of the Directive, irrespective of the choice of law of a non-Member State. We eventually decided the Rome Convention would not achieve this objective independently. Instead it would be necessary to include express provisions in the new legislation which nullified attempts to evade its consumer protections by means of a choice of foreign law. In part, this is because Article 5(2) is limited in respect of the consumers to whom and the circumstances in which it applies:<sup>12</sup> in part, it is because we thought it necessary to ensure that the new legislative controls should be "mandatory in a conflicts sense".<sup>13</sup>

<sup>11</sup> Article 7(1) is not listed here as it does not apply in the UK: Contracts (Applicable Law) Act 1990 s 2(2). It does apply in other Member States, which may be called upon to apply UK law according to their own rules of private international law.

<sup>12</sup> Our chief concern was that Art 5(2) will not benefit a consumer who is only temporarily resident in the Member State with which the contract is most closely connected. One aspect of this problem is that habitual residence is quite a stringent requirement: an au pair or student visiting a part of the EU for a year probably would not qualify as habitually resident there. In our opinion, a contract can still be closely connected to the territory of the EU even when a person is within the relevant territory on a temporary basis. Another aspect of the problem is that the circumstances listed in subsections (1) to (3) must occur within the same part of the EU that constitutes the consumer's habitual residence – and

7.15 In exploring the exact scope and nature of the relevant provisions in the new legislation, we were persuaded by the suggestion that a clause replicating the wording of Article 6(2) (as Regulation 9 of the UTCCR does) would give UK consumers less protection than a clause enforcing UK mandatory provisions in wider circumstances, for instance whenever the consumer is living in the UK and takes the necessary steps to conclude the contract there.<sup>14</sup> This is because UK law gives consumers stronger protection than is required by the Directive and which the consumer would not necessarily have under the law of another Member State. But even if the law of the other Member State is equally or more protective, it will still benefit the consumer to be able to rely on the protection of UK law. As Dr Simon Whittaker said in his initial report for the DTI on the consolidation of unfair terms legislation:

From the point of view of practical consumer protection, the choice of, say, Italian or Dutch law for the regulation of a consumer contract will by no means help a United Kingdom consumer's task in any dispute with a seller or supplier. The substantive law of Italy or the Netherlands may in fact be as protective as United Kingdom law here (it may, indeed, be more so) but it will be difficult and very expensive for a United Kingdom consumer to establish this.

7.16 We take the view that it is desirable to provide extra "practical consumer protection" by overriding the parties' choice of law of another Member State in

not another part. We think that a contract may be closely connected to the EU when these qualifying requirements occur in different Member States.

We were also concerned about the related issue of how Art 5(2) applies as between the different parts of the UK. Under the Rome Convention, by virtue of Art 19(1), each territorial unit of the UK is treated as a separate country for the purpose of applying the Convention. Therefore, a provision such as Art 5(2) is not engaged unless all the qualifying requirements occur *within one part of the UK*. In the new legislation we would want the statutory protections to apply even where the qualifying requirements occur in different parts of the UK.

<sup>13</sup> See Jackson "Mandatory Rules and Rules of 'ordre public'" in North (ed), *Contract Conflicts* (Oxford: North-Holland Publishing Company 1982) p 65.

We did consider the possibility that if Art 5(2) could not guarantee the application of the new legislative controls in the range of situations contemplated by Art 6(2) of the Directive, Art 7(2) might operate to cover most of the unprotected cases. However, we no longer think that the independent operation of Art 7(2) can, without more, guarantee the application of the new legislation in these situations.

Art 7(2) applies the mandatory rules of the forum but only such rules as are expressed to be mandatory *irrespective of the governing law of the contract*. (The default rule is that a United Kingdom statute does not normally apply to a contract unless the governing law of the contract is English law or Scots law.) Art 7(2) will not be engaged unless the new legislation contains express provisions prohibiting evasion by choice of law.

<sup>14</sup> It is not, in fact, safe to assume that the UK courts will always be dealing with a UK consumer. Cases on unfair terms may arise where the consumer is the claimant. An EU consumer is entitled to sue the seller in the courts of the place where the seller is domiciled, by virtue of Art 14 of the Brussels and Lugano Conventions (as amended) (Art 16 of the "Brussels I" Regulation). The UK courts may also have and accept jurisdiction over cases involving consumers domiciled outside the EU/EFTA in accordance with Art 4 of the "Brussels I" Regulation/the Brussels Convention/the Lugano Convention. In such cases, permission to serve the claim form out of the jurisdiction may be required in accordance with the requirements of Civil Procedure Rules, rule 6.20.

certain cases where the contract is, from the consumer's perspective, closely connected to the UK. Usually this will be because the consumer ordered the goods or services here. We consider that in these cases consumers can justifiably expect their "home" law to apply.

7.17 Our policy is that UK consumers should have the benefit of UK protective legislation in cases where the contract is, from the consumer's perspective, closely connected to the UK because he or she ordered the goods or services there.

7.18 We would not want to encourage businesses to attempt to evade the restrictions by insisting that the order is placed abroad even though the consumer was the object of a sales pitch in the UK and took all the necessary steps here. Therefore we think it desirable to provide that UK consumers should have the benefit of the new legislation not only when they place their order with the supplier in the UK but also where they take the necessary steps to do so. In these circumstances, we think UK consumers can justifiably expect their own "home" law to apply.<sup>15</sup>

7.19 **Thus we recommend that the new legislation should be applied despite a choice of foreign law if:-**

**(a) when the contract was made, the consumer was living in the United Kingdom and**

**(b) all the steps necessary for the conclusion of the contract were taken there by the consumer or on his or her behalf.<sup>16</sup>**

7.20 We did consider drafting a provision that would apply the protective regime of the new legislation to *all* contracts which could be said to have a close connection to the territory of the Member States. We decided against this on the ground that it would be inappropriate to apply UK law to contracts with a more substantial connection to another Member State, especially when by virtue of our existing rules of private international law that State's own Directive-compliant regime would normally apply to protect the consumer. Therefore, in cases not covered by

<sup>15</sup> It will be observed that our recommendations now begin to look very much like the text of Art 5(2) of the Rome Convention. That should not be surprising. We believe that Art 5(2) represents a sound attempt at identifying the circumstances in which consumers are most deserving of the protection of their "home" laws. However, we would want our legislation to apply in the qualifying circumstances not only where the consumer is habitually resident in the UK (as required by Art 5(2)) but also where he or she is merely resident here. This is a more generous and, we believe, appropriate test. It would enable a student, say, who had come to study in the UK from outside the EU, to rely on the protection afforded by UK law rather than the law of another Member State.

<sup>16</sup> See Draft Bill, clause 18. We did consider drafting provisions to echo Art 5(2) of the Rome Convention, which in effect provides that protections afforded by the law of a consumer's habitual residence cannot be overridden by a choice of foreign law in the circumstances listed. However, in the event we decided to use wording based on UCTA, s 27(2)(b) which was clearly designed to summarise the circumstances listed in Art 5(2)(c). This wording has the virtue of greater simplicity but, strictly speaking, allows a consumer to claim the protection of UK law in circumstances where he or she has sought out a foreign business and placed an order without having been induced to do so by advertising or invitation. We are not aware that the UCTA formulation has caused any problems to date.

the provisions set out above, we recommend that the laws of other Member States should be applied if they would be applicable by virtue of existing rules of private international law as long as the consumer is afforded the protections contemplated by the Directive.

7.21 **We recommend that where the contract is not closely connected to the UK but is nevertheless closely connected to the territory of the Member States, the consumer-protective laws of other Member States should be applied as they would normally be under the existing rules of private international law.**<sup>17</sup>

7.22 There may be a small remainder of cases where the contract is closely connected to the territory of the Member States but the rules of private international law do not guarantee the application of consumer protections. In these cases, in order to comply with Article 6(2) of the Directive, we recommend that the new legislation should apply by default. Thus the Draft Bill provides that in cases where a consumer contract has a close connection with the territory of the Member States but the provisions discussed at paragraph 7.19 do not apply,

this Act has effect in relation to the contract unless, according to the law of the forum, the provisions of the law of a member State (other than the United Kingdom) which give effect to the Directive have effect in relation to the contract.<sup>18</sup>

7.23 The only loophole in the protection afforded by such a clause is if the Member State whose laws are applied has implemented EC Directive 93/13 but has not done so properly and the laws do not, in fact, afford consumers the proper range of protections. But we do not think that our duty under Article 6(2) of the Directive extends to closing loopholes caused solely by another Member State's breach of its Community obligations.

7.24 **We recommend that the new legislation should contain a default provision to ensure that it applies to any contract which is closely connected to the territory of the Member States but which is not covered by the other recommended choice of law provisions.**

7.25 Given the wording of the Directive, inevitably our recommendations revolve around the category of contracts that have a "close connection to the territory of the Member States". When exploring this category we became concerned that its inherent indeterminacy – which confers, in effect, a degree of discretion on the Court – might lead to an undesirable expansion of the Directive's sphere of influence. We thought that jurisprudence in this area might develop incrementally to subsume contracts with a weaker and weaker connection to the territory of the Member States into the general category. In particular, we were concerned that a practice might develop where export contracts under which goods and services are exported to non-EU consumers, come within the category merely because the supplier, or exporter, is located within the territory of the Member States and

<sup>17</sup> See Draft Bill, clause 18(2) – (3).

<sup>18</sup> See Draft Bill, clause 18(3).

the goods are delivered from that location. This would be undesirable because the additional layer of consumer regulation that would be applicable to such contracts would undermine the competitive standing internationally of our domestic businesses vis-à-vis other businesses. We think that it is important to state that contracts under which goods and services are exported outside the EU should prima facie be regarded as falling outside the provisions of Article 6(2) (as they are transposed into the new legislation).

- 7.26 **We recommend that the new legislation should presumptively provide that contracts for the sale or supply of goods and services to be delivered or supplied outside the territory of the Member States are not to be regarded as closely connected to the territory of the Member States if the consumer took all steps necessary for the conclusion of the contract overseas.**<sup>19</sup>

## **BUSINESS CONTRACTS**

### **Choice of law of a part of the UK in a foreign contract**

- 7.27 As we have seen, UCTA section 27(1) provides that, where the law of a part of the UK is chosen by the parties as the governing law but, were it not for that choice, the law of some other country would be the proper law, UCTA sections 2 to 7 and 16 to 21 will not apply.

- 7.28 We recommend retaining this provision in relation to business contracts on the grounds that where foreign commercial parties choose English or Scots law to govern their relationship, their background understanding is that it is a law where freedom of contract prevails. This can only have been reinforced by section 27(1) and, in the absence of any demand for change, we see no reason to apply the new legislation in these circumstances.

- 7.29 **We recommend that the new legislation should contain a provision replicating UCTA section 27(1) in relation to business contracts.**<sup>20</sup>

### **Evasion by choice of non-UK law**

- 7.30 UCTA section 27(2)(a)<sup>21</sup> provides that the protective provisions of the Act apply notwithstanding any choice of foreign law where

The term appears to the court... to have been imposed wholly or mainly for the purpose of enabling the party to evade the operation of [the] Act....

- 7.31 This section has been criticised on the grounds that it introduces a highly subjective element into the law.<sup>22</sup> We felt that it was important to investigate alternative means by which inappropriate evasion of the new legislation might be

<sup>19</sup> See Draft Bill, clause 18(4).

<sup>20</sup> See Draft Bill, clause 19(1).

<sup>21</sup> UCTA, s 27(2)(b) applies only to consumers.

<sup>22</sup> See Hartley, "Consumer Protection Provisions in the EEC Convention" in North (ed), *Contract Conflicts* (Oxford: North Holland Publishing 1982) at p 121.

prevented. Following a suggestion made by Dr Simon Whittaker in his Report to the DTI, we looked at the possibility of introducing a provision along the lines of Article 3(3) of the Rome Convention. That Article provides that the application of the mandatory rules of the country with which a “situation” is wholly connected shall not be prejudiced by the parties’ different choice of law clause in the contract.

- 7.32 Although adding a welcome degree of objectivity, this approach might allow businesses to evade the controls of the new legislation in a wider range of circumstances than section 27(2)(a) would do. Depending on the circumstances of the case, section 27(2)(a) could potentially apply in any case where the parties adopt a choice of foreign law. On the other hand, a provision modelled on Article 3(3) would only prevent evasion in those cases where the contract, apart from the choice of law, is wholly connected to the UK.
- 7.33 We decided that the possible objection did not offer a compelling reason for rejecting the proposed approach. Given that we are recommending stricter controls over contracts with small businesses which will make it harder to evade the protective regime by a choice of foreign law, we think that a small degree of relaxation in the controls over contracts between larger businesses is acceptable. This is particularly compelling where there is a foreign element to the contract, as there must be for the contract to fall outside the terms of the proposed anti-avoidance provision. We found support for this view in the fact that we are not aware of any authorities in which section 27(2)(a) has played a key role in determining a party’s contractual rights. If parties seeking to bring themselves within UCTA’s protections do not now rely upon the broader provisions of section 27(2)(a), it should not matter if those provisions are restricted. Therefore we recommend that the revised UCTA-type regime which is instituted by the business contracts clauses of the new legislation should apply notwithstanding a choice of foreign law, where the contract is otherwise wholly connected to the UK.
- 7.34 **We recommend that the business contracts part of the new legislation should apply notwithstanding a choice of foreign law where the contract is, in every other respect, wholly connected to the UK.**<sup>23</sup>

#### **Cross-border contracts**

- 7.35 As we have seen, UCTA section 26 exempts cross-border contracts for the sale or supply of goods. Section 26 has a considerable history. The desirability of such a clause has been considered twice by the Law Commissions<sup>24</sup> and was previously incorporated into the Sale of Goods Act 1893, section 62(1) by the Supply of Goods (Implied Terms) Act 1973, section 7. The language of the section owes much to Article 1 of the Uniform Law on the International Sale of Goods (“ULIS”). Despite the extensive attention the text received prior to its final

<sup>23</sup> See Draft Bill, clause 19(2).

<sup>24</sup> In the Law Commissions’ First and Second Reports on *Exemption Clauses in Contracts* (Law Com Nos 24 and 69, Scot Law Com Nos 12 and 39).

enactment in UCTA, there are still some significant flaws and the section has recently been criticised by the Court of Appeal.<sup>25</sup>

- 7.36 In their First Report on Exemption Clauses in Contracts, the Law Commissions offered three policy justifications for including the precursor to section 26 in the appended draft legislation:–

[(1)] In the first place, where goods are exported from the United Kingdom to another country, it is for the legal system of that country rather than for our own to specify how far contractual freedom should be limited or controlled in the interests of consumers or other purchasers. [(2)] In the second place, contracts of an international character ordinarily involve transactions of some size between parties who are engaged in commerce and who wish to be free to negotiate their own terms. They would stress, and we would agree, that in such contracts contractual freedom is of particular importance. [(3)] In the third place, it has been represented to us by persons with experience of international commerce that it would be undesirable to make proposals which would place United Kingdom exporters under restrictions which would not apply to some of their foreign competitors.<sup>26</sup>

The Commissions went on to adopt the definition of international contract in Article 1 of ULIS as an appropriate model.

- 7.37 Excepting the assumption that international contracts will be contracts of a fair size – which no longer holds necessarily true – the justifications offered by the Law Commissions seem just as valid today as they were in 1969.

- 7.38 Following the Law Commissions' First Report on Exemption Clauses, the Supply of Goods (Implied Terms) Act 1973, section 7 was enacted incorporating the section supplied by the Commissions based on ULIS. The definition of international contracts thus incorporated was the subject of severe academic criticism in an article by Mr Clifford Hall, *International Sales and the Supply of Goods (Implied Terms) Act 1973*.<sup>27</sup> Hall made many points against the section – not least that it should not have been adapted so as to apply to individual consumers – but of particular concern to the Law Commissions was his comment that the clause did not match up to their avowed policy objectives. Hall argued that the clause did not protect consumers and other purchasers because many importers into the UK would be able to bring themselves within the definition and so escape the controls. Furthermore, many export contracts would not amount to international contracts.<sup>28</sup> His proposed solution was to redraft the section so as

<sup>25</sup> In *Amiri Flight Authority v BAE Systems plc* [2003] EWCA Civ 1447. It was also described as “not altogether clear and suffer[ing] from shifts in language” by Hallgarten J in *Ocean Chemical Transport Inc v Exnor Craggs Ltd* (unreported July 26, 1999, quoted in the Court of Appeal judgment in the same case: [2000] 1 All ER (Comm) 519, 526).

<sup>26</sup> Law Com 24, Scot Law Com 12, para 120.

<sup>27</sup> (1973) 22 ICLQ 740.

<sup>28</sup> *Ibid*, p 745 - 6. For example, a contract made in London between two French businesses for the export of goods to France would not be an international supply contract within the

more accurately to identify *non-UK* contracts, rather than contracts with an international, or cross-border, flavour.

- 7.39 Even today, the enacted version of section 26 appears to be oddly drafted given the Law Commissions' avowed policy objectives in 1969, which emphasised only the importance of freeing UK *exporters* from control. On its face, the section applies just as much to UK *consumers* importing foreign goods for private consumption and to contracts involving the supply of goods within the UK.<sup>29</sup> We have already addressed the need to remove consumer contracts from the ambit of any section exempting international supply contracts. The oddity as regards non-consumer imports remains.
- 7.40 It is now apparent that the Law Commissions were trying to achieve more than merely to implement the policy objectives outlined in their First Report. This accounts for the apparent departure from those policy objectives. Although the Law Commissions were keen to release UK exporters from restrictions that might make them less competitive in foreign markets, whilst still protecting domestic consumers, they were also mindful of the UK's treaty obligations. Under the Hague Convention on the International Sale of Goods 1964 each state was obliged to respect the autonomy of the international business community by allowing businesses to have their contracts governed by ULIS, unmodified by statutory implied terms or other regulatory adjustments.<sup>30</sup> Thus, the *territory-unspecific* policy of deregulating the international commercial environment within which large businesses operate was thought to take precedence over the Law Commissions' *territory-specific* policies of protecting UK consumers (or purchasers) and assisting UK exporters to remain competitive.
- 7.41 Since the Law Commissions wrote their Second Report, the force of ULIS has declined. Twelve states signed the Hague Convention, but only eight of those ratified it and one further State (Gambia) acceded to it. Of those who ratified the Convention only San Marino, Gambia and the United Kingdom have not adopted the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), signed at Vienna. All those States signing up to CISG have denounced the Hague Convention as they are required to do by Article 99(3) of the Vienna Convention. The regulatory force of ULIS therefore only binds the three remaining States: the UK, Gambia, and San Marino. As a rationale for reshaping the law of contract our international obligations under the Hague Convention have lost most of their justificatory force.
- 7.42 The Law Commissions' territory-specific policy objectives, outlined in their First Report, remain an effective justification for section 26. In relation to business contracts today, Hall's observation that the Law Commissions' draft term

terms of s 27 because the parties do not have places of business in different States. See also Hartley, *supra* n 22 at p 120.

<sup>29</sup> In the latter case, the act of either offer or acceptance must be done abroad by a party resident there.

<sup>30</sup> This was made clear in the Second Report on Exemption Clauses, Law Com No 69. See para 235.

achieved neither of their two avowed policy objectives – protection of UK consumers and deregulation of UK exports – really begins to bite. A provision which was designed to be sensitive to these policy objectives would have differentiated between, on the one hand, international export contracts and other contracts for the supply of goods abroad and, on the other hand, all contracts of supply in or to the UK including both international import contracts and purely domestic contracts.

- 7.43 Accordingly, we provisionally settled on a draft clause that would exempt only those contracts under which the goods are exported or supplied abroad.

**Article 12 EC Treaty**

- 7.44 During the consultation exercise it was drawn to our attention that the existing exemption for international contracts, in UCTA section 26, had been the subject of criticism on the grounds that it may amount to unlawful discrimination under Article 12 of the EC Treaty.<sup>31</sup> It was therefore desirable to investigate whether our suggested alternative could be said to be discriminatory.

- 7.45 Article 12 provides:–

Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.

- 7.46 Article 12 has been given a wide interpretation by the ECJ in several different contexts. First, it is clear that it applies to legal as well as natural persons.<sup>32</sup> Secondly, “nationality” here encompasses residence and domicile as well as nationality proper.<sup>33</sup> Thirdly, it is likely that “all that matters for indirect discrimination is that the clear majority of those disadvantaged by the provision are foreign nationals”.<sup>34</sup>

- 7.47 Given that section 26 removes the UCTA controls which predominantly (but not wholly) benefit the purchaser,<sup>35</sup> it has been argued that the effect is to put a buyer in another state at a disadvantage compared with a buyer in the UK. Whereas British buyers can object to exclusion clauses in their contracts, the overseas resident buyer cannot.<sup>36</sup> In short, there will be circumstances where, when dealing with a UK seller, buyers will be protected if they are based in the UK but

<sup>31</sup> See Burbridge, “Selling in the single market – the control of exemption clauses under EC law” [2000] NLJ 1544.

<sup>32</sup> See, for example, *R v Inland Revenue Comrs, ex p Commerzbank AG* Case C-330/91 [1993] 4 All ER 37, [1993] ECR I-4017 (in relation to the former Article 7 EEC Treaty).

<sup>33</sup> Burbridge cites *Factortame* [1992] 2 QB 680 and *Cowen v Le Tresor Public* [1989] ECR 195 in support of this proposition.

<sup>34</sup> *Supra*, n 31 at 1545.

<sup>35</sup> For example, controls over attempts to exclude liability for breach of implied conditions as to title to the goods, their fitness for the purpose, their quality etc.

<sup>36</sup> *Supra*, n 31.

not protected if they are based abroad. In the light of the wide interpretation that Article 12 has received, this begins plausibly to look like discrimination.

7.48 Yet the issue is not as simple as first appears. For example, section 26 applies equally to contracts between British purchasers and foreign sellers, when the goods are to be imported into the UK.<sup>37</sup> The threshold criterion for the application of section 26 is the movement of goods across borders or the fact that negotiation and agreement take place at a distance: in either case the parties must also be resident in different states. A contract between a UK buyer and a foreign supplier will often also amount to an international supply contract. This means that a UK business buying imported goods may find itself subject to a valid exemption clause just as much as a foreign purchaser would in an export contract from the UK. It began to look to us as though the issue concealed at the heart of the question of discrimination is what is being subjected to comparison.

7.49 First, let us compare the situation of (i) a UK supplier supplying a UK business with (ii) a UK supplier supplying, say, a German business. Although there could be said to be discrimination between the two buyers because only the latter contract is likely to be exempt from UCTA's controls, we think that the arguments are not clear-cut. It could be argued that it is not particularly relevant to compare purchasers in two different markets. The overseas purchaser will very likely be protected by the laws of its "home" state when it buys from a UK supplier whereas a UK purchaser must rely entirely on the protections afforded by UCTA.<sup>38</sup>

7.50 Secondly, if the comparison is made between parties competing in the same market, the pattern produced by section 26 looks different.

- (1) If two sellers, one in the UK and one in France, are competing to supply the same buyer in the UK (in each case under English law), then section 26 produces the result that the buyer can challenge the terms in the contract with the UK seller but not those in any contract with the French seller. There would seem to be discrimination against the English seller.
- (2) However, if the same two sellers are competing to sell (again under English law) to a buyer in France, then section 26 and section 27(1) taken together mean that the sellers can compete on equal terms. The

<sup>37</sup> Burbridge's statement that "clearly the vast majority of buyers who have their place of business... in another state will be non-nationals" is misleading. Section 26 does not require that buyers have their business in another state, merely that the parties are in different states from one another. Therefore, it applies to foreign sellers selling to English purchasers. This was, in fact, Clifford Hall's objection to the clause (see (1973) ICLQ 740).

<sup>38</sup> It could also be argued that to repeal the s 26 exemption would be discriminatory. It would mean that a UK seller to an overseas buyer would, if the contract were subject to English or Scots law, have to comply with UCTA. However, an overseas seller supplying the same overseas buyer, if it was agreed that the contract should be governed by English or Scots law, would be exempt from UCTA by reason of s 27(1). Thus the simple removal of s 26, without additional changes to s 27(1), would not remove discrimination. It would, in effect, shift the discrimination from one party to the other.

English seller's terms would be exempt from UCTA by virtue of section 26 while the French seller's terms would be exempt by virtue of section 27.

Were section 26 to be repealed, the position would be the other way about, with discrimination in case (2) but not in case (1).

- 7.51 Thus we suspect that no clear case either for or against replicating section 26 can be made on the grounds of discrimination alone.
- 7.52 We have sought expert advice on the question of how the ECJ might deal with this question. We have been told that the question is difficult and that it cannot be said with any confidence which model the European Court would choose. The issue has not been debated with rigour in the case law or in academic commentary. The Court's approach to discrimination is not consistent and has been criticised across a wide range of areas: gender, taxing fruit, regulating pollution and trade law generally. Discrimination tests are slippery and the fundamental question in nearly every case appears to be whether like is being compared with like.
- 7.53 Our suggested replacement does not track exactly the provisions of section 26. Rather it distinguishes between contracts for the supply of goods in the UK (not exempt) and contracts for the supply of goods abroad (exempt). At first sight, this exemption might appear to be sailing close to the wind since it is foreign businesses that can generally be expected to buy goods which are exported abroad. It is they rather than UK businesses that will be deprived of UCTA's controls over contracts for the supply of goods. Nevertheless, we have decided to make the recommendation. Our reasons for doing so are set out in the following paragraphs.
- 7.54 First, we think it is at least arguable that, under the suggested provisions, the location of the purchaser is not decisive. This is because the exemption will apply just as much to purchasers resident and domiciled in the UK that buy goods abroad – whether foreign goods or UK exports. There may be many reasons why UK businesses take delivery of goods abroad: these include goods for use in satellite offices abroad or goods ordered remotely to be delivered to clients and trading partners in other countries. Therefore we do not think that it can be said that the exemption will operate exclusively to the disadvantage of foreign businesses – although we accept that the majority of those affected are likely to be foreign companies.
- 7.55 Secondly, we believe that there is some merit in the argument that other Member States should look after the interests of purchasers located there. Where other states have legislation that covers business contracts, the purchaser can pursue its remedy in the courts of its “home” state. If the purchaser pursues its remedy in the courts of a part of the UK then it may find that the protective laws of its “home” jurisdiction are applied anyway under the rules of private international law, for example under Article 3(3) of the Rome Convention.
- 7.56 Thirdly, specialists have advised us that our recommended substitute for section 26 was a plausible alternative. Although there might be a debate about whether or not it is compatible with EU law, the outcome would not be clear-cut. In these circumstances, we have decided to resolve the uncertainty in favour of UK businesses exporting goods abroad. Not to have done so might have meant

wasting a valuable opportunity to ensure the continued competitiveness of UK businesses in foreign markets.

7.57 Therefore we recommend replacing section 26 with a clause creating an exemption for business contracts for the supply of goods<sup>39</sup> to be delivered overseas. The controls will still apply to business contracts for the supply of goods to be delivered in the UK, whether the seller is in the UK or overseas.

7.58 **We recommend replacing UCTA section 26 in the new legislation with a clause creating an exemption for business contracts under which goods are exported overseas.**<sup>40</sup>

## **SMALL BUSINESS CONTRACTS**

### **Cross-border contracts**

7.59 Having recommended an “export contracts” exemption for businesses generally, the question remains whether those dealing with small businesses should be subject to the restrictions of the new legislation in cases of international supply contracts. The policy considerations adopted in the Consultation Paper would suggest that we should protect small companies. However, since our existing recommendation is that the international contracts exemption should focus on *export* contracts, the small businesses that might fall within the exemption can only be small domestic exporters or foreign purchasers.

7.60 As to small exporters, the controls would only apply when the exporter was contracting on terms which had been put forward by the foreign buyer as its standard terms of business. Almost inevitably, those standard terms would seek to have the contract governed by the foreign rather than English law. It would thus be a question of providing that the controls should apply despite any choice of foreign law. We have, of course, proposed something similar for consumers but it is our belief that UK businesses engaged in exports would generally find the controls cumbersome rather than beneficial. Equally, we do not see a case for protecting foreign purchasers even if they are small businesses. These policy considerations suggest that we should remove controls from small business contracts for the export of goods abroad just as we recommend doing for business contracts in general.

<sup>39</sup> If the main justification for the exemption is to lift the burden of regulation incumbent upon UK exporters, at first sight it may seem somewhat arbitrary to exclude contracts for *services* to be performed abroad. On reflection, we believe that extending the international contracts exemption to contracts for the supply of services would present the following problems:

1. It would leave business people relatively unprotected when they make arrangements to travel abroad on business.
2. It would present serious drafting difficulties. The idea of performance in a particular jurisdiction may be easy to apply to engineers and technicians, but it is not so easy to apply to consultants, accountants and lawyers who provide cross-border advice. The difficulty is that with services there is not always something tangible, whereas with goods there is something tangible which can be identified in a particular jurisdiction.

<sup>40</sup> See Draft Bill, Sch 3, para 8.

- 7.61 **We recommend that the intended replacement for UCTA section 26 (exempting business contracts for the supply of goods abroad) should also operate to exempt relevant contracts from the small business controls.**<sup>41</sup>

#### **Choice of law of a part of the UK in a foreign contract**

- 7.62 As we have seen, UCTA section 27(1) provides that where the law applicable to a contract is the law of a part of the United Kingdom only by choice of the parties, the contractual controls implemented by the Act do not apply. We recommend that this provision be retained for small business contracts as well as for business contracts in general. If the contract is substantially unconnected to the UK then it is less likely that the parties are located here and there is less reason to protect them. In addition, as stated above, we think that where foreign commercial parties – of any size – choose English law to govern their relationship, their background understanding is that it is a law where freedom of contract prevails. According to this recommendation, small business contracts governed by English or Scots law only by virtue of the parties' choice of law, and which otherwise would be governed by the law of another country, will be exempt from both the preserved UCTA regime and the specific small business controls.
- 7.63 **We recommend that the intended provision replicating UCTA section 27(1) should also apply to small business contracts.**

#### **Evasion by choice of non-UK law**

- 7.64 In the case of small business contracts, the point of the restrictions we have imposed is to afford small businesses protection against larger businesses who are able to impose their standard terms on the contract. The very point and purpose of these protections would be wholly undermined if the protective regime could be avoided by means of a choice of law clause to the contrary. Other than in international supply contracts (as defined), the section echoing the terms of Article 3(3) that we have recommended for business contracts to replace UCTA section 27(2)(a) will, to a certain extent, fulfil the task of entrenching the protective provisions in cases where the contract is wholly connected to the UK. However, we thought it would be desirable to incorporate a section more generous to small businesses to enable them to claim the protection of the new legislation in a wider range of circumstances. In drafting this clause we used as our model the draft clause intended to ensure that *consumers* receive the protections of the new legislation in circumstances where they might justifiably expect to do so.
- 7.65 Thus we now recommend that the new legislation should be applied, despite a choice of foreign law, if:–

when the contract was made, the small business had a place of business in the United Kingdom and

<sup>41</sup> See Draft Bill, Sch 3, para 8.

- (a) the making of the contract was preceded by an invitation addressed specifically to the small business, or by advertising, about the main subject matter of the contract and all the steps necessary for the conclusion of the contract were taken in the United Kingdom by the small business through its place of business there or on its behalf; or
- (b) the small business's order was received by or on behalf of the other business in the United Kingdom.

7.66 **We recommend that small businesses should have the benefit of UK protective legislation in cases where the contract is closely connected to the UK because the small business took the necessary steps to order the goods or services here.**<sup>42</sup>

<sup>42</sup> See Draft Bill, clause 20.

## **PART 8**

# **SUMMARY OF RECOMMENDATIONS**

We make the following recommendations:

- 8.1 There should be a single piece of legislation covering the whole of the United Kingdom. (Paragraph 3.9)

### **CONSUMER CONTRACTS**

- 8.2 There should be no significant reduction in consumer protection. (Paragraph 3.13)
- 8.3 The new legislation should incorporate the requirements of the SCGD but not other statutory or common law rules applying to unfair terms in consumer contracts. (Paragraph 3.18)

#### **Definitions**

- 8.4 The definition of a “consumer” should refer to a person acting for purposes unrelated to his or her business. (Paragraph 3.22)
- 8.5 Under the new scheme, only natural persons should constitute consumers. (Paragraph 3.24)
- 8.6 The existing rule in UCTA that persons do not “deal as a consumer” when they hold themselves out as acting in the course of their business should not be replicated. (Paragraph 3.26)
- 8.7 An individual buying second-hand goods at an auction which individuals may attend in person should not be treated as a consumer for the purposes of the parts of our scheme that replicate provisions found only in UCTA. (Paragraph 3.29)
- 8.8 The existing rule in UCTA that for a contract for the supply of goods to qualify as a “consumer contract” the goods must be of a type ordinarily supplied for private use or consumption should not be replicated. (Paragraph 3.31)
- 8.9 “Business” should include the activities of government departments or local or public authorities. (Paragraph 3.34)
- 8.10 In the case of an individual entering into a contract for “mixed purposes”, it should be left to the court to determine the main, or predominant, purpose of the contract and hence whether it is a consumer contract. (Paragraph 3.38)
- 8.11 The controls in the Part of the new legislation dealing with consumer contracts should relate only to “contracts”, but “contract” should be left undefined. (Paragraph 3.40)

#### **Terms of no effect**

- 8.12 Terms which are automatically of no effect [void] under UCTA should continue to be of no effect under the new legislation. (Paragraph 3.45)

8.13 Exclusions or restrictions of business liability for death or personal injury caused by negligence [breach of duty] should be automatically ineffective even if they are part of a contract for the acquisition, transfer and termination of an interest in land. (Paragraph 3.47)

8.14 UCTA section 5 [section 19] should not be replicated in the new legislation. (Paragraph 3.49)

#### **Negotiated terms**

8.15 Any term in a consumer contract, with the exception of a “core” term, should be subject to the “fair and reasonable” test, whether or not the term was individually negotiated. (Paragraph 3.55)

#### **Terms not subject to control**

8.16 The definition of the main subject matter of the contract should be immune from challenge as long as it is: (a) substantially the same as the consumer reasonably expected; and (b) transparent. (Paragraph 3.65)

8.17 The price payable under a consumer contract should be immune from challenge as long as it is: (a) payable in circumstances substantially the same as those the consumer reasonably expected; (b) calculated in substantially the same way as the consumer reasonably expected; (c) not payable under a default or subsidiary term of the contract; and (d) transparent. (Paragraph 3.66)

8.18 Terms that are

- (a) required by an enactment or rule of law;
- (b) required or authorised by an international convention; or
- (c) required by a competent authority

should continue to be exempt under the new legislation. Terms that produce substantially the same result as would be produced as a matter of law if the term were not included should be exempt, but only if the term is also transparent. (Paragraph 3.72)

#### **Questions over whether some types of contract should be excluded**

8.19 The general control over unfair terms in consumer contracts should apply where a consumer is the seller or supplier. (Paragraph 3.76)

8.20 Consumer contracts of insurance and contracts for the transfer of an interest in land and for the creation or transfer of interests in securities should not be exempt from the new regime. (Paragraph 3.80)

#### **The general test**

8.21 The test to be applied to contract terms which are challengeable but which are not automatically of no effect should be a “fair and reasonable” test. (Paragraph 3.90)

8.22 The “fair and reasonable” test in the new legislation should not include any express reference to “good faith”. (Paragraph 3.91)

8.23 Whether a term is fair and reasonable should be determined (a) by reference to the time when the contract was made, and (b) by taking into account the

substance and effect of the term, and all the circumstances existing when the contract was made. (Paragraph 3.96)

- 8.24 Whether a term is “fair and reasonable” should be assessed according to (a) whether it is transparent; (b) its substance and effect and (c) the circumstances in existence at the time the contract was made. (Paragraph 3.101)
- 8.25 It should be possible for a contract term to be found to be unfair principally or solely because it is not transparent. (Paragraph 3.102)
- 8.26 The new legislation should contain substantive guidelines for the application of the “fair and reasonable” test. (Paragraph 3.105)
- 8.27 The new legislation should contain a rule of interpretation in favour of the consumer, providing that the consumer should have the benefit of any doubt about the meaning of a term. (Paragraph 3.107)

#### **The Indicative List**

- 8.28 The replacement for the Indicative List in the new legislation should not include the additional types of term against which the OFT has taken action; but the Secretary of State should have a statutory power to add appropriate terms to the list. (Paragraph 3.112)
- 8.29 The Indicative List should be reformulated using concepts and language more likely to be understood by readers in the UK. (Paragraph 3.116)
- 8.30 The Explanatory Notes to the Bill should contain examples of terms that would fall within the types of terms in the Indicative List. (Paragraph 3.119)
- 8.31 The list of exceptions to the Indicative List in the UTCCR should be retained but reformulated in the interests of clarity. (Paragraph 3.123)

#### **The burden of proof**

- 8.32 Where an issue has been raised as to whether a term in a consumer contract is fair and reasonable, the burden of proving that it is fair and reasonable should rest on the business. (Paragraph 3.130)

#### **The effect of finding that a term is invalid**

- 8.33 The provision in the Draft Bill that if a term of a consumer contract is detrimental to the consumer, the business cannot rely on the term unless the term is fair and reasonable, should be applied so that when one of several terms in a clause is not fair and reasonable the remainder should be treated as effective. (Paragraph 3.138)
- 8.34 Where a term is shown to be unfair or partly unfair, the rest of the contract should continue in existence if possible. (Paragraph 3.140)
- 8.35 The new legislation should retain a provision, applicable to all types of contract governed by the new legislation, subjecting terms in secondary contracts to the same controls as if they appeared in the main contract; but genuine agreements to settle existing disputes should be exempted. (Paragraph 3.142)

### **Preventive powers**

- 8.36 The new legislation should contain a regime of preventive powers, conferred on authorised bodies, to take steps to prevent a business using an unfair term. (Paragraph 3.149)
- 8.37 The powers should extend to preventing the use of any terms that under the Draft Bill would be automatically ineffective. (Paragraph 3.153)
- 8.38 The preventive powers should cover terms that the business has tried to incorporate into the contract but failed; and notices which may not even have been intended to form part of the contract. (Paragraph 3.155)
- 8.39 The OFT or other regulator should have power to seek an injunction [interdict] against the use of unfair terms of a kind which the business usually seeks to include in the type of consumer contract in question. (Paragraph 3.157)
- 8.40 The preventive powers should permit the OFT, or a regulator, to take action in respect of terms that are not fair or reasonable principally or solely because they are not transparent. (Paragraph 3.159)
- 8.41 The new scheme of preventive powers should not include a specific power to prevent the use of general terms just because they omit important information. (Paragraph 3.161)
- 8.42 The burden of showing that a term is unfair in proceedings brought by an authorised body under its preventive powers should be borne by the authorised body. (Paragraph 3.163)

### **BUSINESS CONTRACTS**

- 8.43 The present position under UCTA should be preserved, so that:
- (1) clauses which purport to exclude business liability for death or personal injury caused by negligence should continue to be of no effect; and
  - (2) in business contracts of sale and hire purchase, or in other business supply contracts that involve the transfer of property in goods, a seller or supplier should not be able to exclude or restrict the implied undertaking that it is entitled to sell or transfer the property in those goods. Any such attempt should continue to be of no effect, as provided in sections 6(1) and 7(3A) [sections 20(1)(a) and (b) and 21(3A)] of UCTA. (Paragraph 4.21)
- 8.44 UCTA sections 6(3) and 7(3) [sections 20(2)(ii) and 21(1)(a)(ii)] should not be replicated in the new legislation. (Paragraph 4.29)
- 8.45 UCTA section 7(4) [section 21(1)(b)] should not be replicated in the new legislation. (Paragraph 4.35)
- 8.46 UCTA section 2(2) [section 16(1)(b)] should be replicated in the new legislation. (Paragraph 4.40)
- 8.47 A person who makes a contract for purposes mainly related to his or her business should not be classified as a consumer. (Paragraph 4.44)

- 8.48 For the replacement of section 3 [section 17] applying to exclusion clauses and clauses which purport to allow performance in a way substantially different to what was reasonably expected, the new legislation should use the current test of whether the party challenging the clause was “dealing on the other party’s written standard terms of business”. (Paragraph 4.57)
- 8.49 There should be no exemption for trade association, or industry standard, terms from the new legislation’s provisions on business contracts. Questions of whether these terms are one party’s “written standard terms of business” and whether they are fair and reasonable should be left to the court to decide on a case-by-case basis. (Paragraph 4.62)
- 8.50 To replace the current test of reasonableness
- (1) the same “fair and reasonable” test, including whether the term is transparent, which we propose for consumer contracts should apply to business-to-business contracts;
  - (2) the same expanded set of guidelines for the application of the “fair and reasonable” test should apply to both consumer and business contracts; and
  - (3) in applying the test and the guidelines, the court should have regard to whether the contract is a consumer contract, a small business contract or a general business-to-business contract. (Paragraph 4.70)
- 8.51 The burden of proving that an exemption clause is fair and reasonable should continue to rest on the business seeking to rely upon that clause. (Paragraph 4.74)
- 8.52 The effect of a term which is to any extent unfair or unreasonable should be the same as it is under UCTA. (Paragraph 4.77)
- 8.53 A saving should be retained for contract terms in business contracts if the terms are required by law, or are required or authorised by an international convention to which the UK or the EC is a party, or are required by the decision of a competent authority. (Paragraph 4.79)
- 8.54 Those categories of contract currently excluded from the operation of UCTA should continue to be exempt from controls over unfair contract terms. (Paragraph 4.84)

### **SMALL BUSINESS CONTRACTS**

- 8.55 Small businesses should be given powers to challenge any “non-core”, standard term of a contract under a “fair and reasonable” test. (Paragraph 5.30)
- 8.56 Small businesses should be protected in their dealings with any other business, no matter what the size of the other business. (Paragraph 5.33)
- 8.57 Only businesses with nine or fewer employees should be included in the new regime. (Paragraph 5.40)

- 8.58 The size of a business should be calculated by averaging the number of persons employed by that business or by it and any associated business over the preceding year. (Paragraph 5.46)
- 8.59 Widely-defined group exemptions should be put in place so as to exempt from the small business regime those businesses that are associated with larger businesses. (Paragraph 5.54)
- 8.60 Contracts with a value of more than £500,000 should not be controlled under the small business regime. (Paragraph 5.59)
- 8.61 Where a contract is one of a series, the transactions should be aggregated so that if the aggregated value of the contracts is greater than £500,000 the whole series or arrangement should be exempt from the small business controls. (Paragraph 5.61)
- 8.62 There should be an exemption from the controls over small business contracts for contracts entered into in pursuance of regulated financial services business. (Paragraph 5.67)
- 8.63 Only certain terms in small business contracts should be open to challenge: those terms which have been put forward by the other party as one of its standard terms of business and which have not been subsequently changed in favour of the small business as a result of negotiation. (Paragraph 5.75)
- 8.64 The same categories of contract should be exempt from the small business controls as are expressly exempt from the business controls. (Paragraph 5.77)
- 8.65 The same “fair and reasonable” test should apply to the new general clause for small business contracts as to other contracts under the new legislation. (Paragraph 5.81)
- 8.66 The Indicative List of terms that may be regarded as unfair should apply to small business contracts as well as consumer contracts. (Paragraph 5.84)
- 8.67 In relation to small business contracts, the small business should bear the burden of showing unfairness. (Paragraph 5.86)
- 8.68 Where a term of a small business contract is found to be unfair, the contract should continue in existence in all other respects insofar as possible. (Paragraph 5.88)
- 8.69 Controls should be put in place to prevent businesses evading the small business controls by means of secondary contracts. (Paragraph 5.90)

## **EMPLOYMENT CONTRACTS**

- 8.70 The provisions of the new legislation that apply to business liability for negligence should not prevent an employee from restricting his or her liability to the employer. (Paragraph 6.5)
- 8.71 UCTA's controls over employment contracts should be preserved when the employment is on the employer's standard terms of employment. Consumer protections should not be extended to employees. (Paragraph 6.10)

## **PRIVATE SALES**

- 8.72 UCTA controls relating to implied terms as to entitlement to sell and correspondence with description or sample should be retained for contracts for the sale of goods by a consumer to a business; and should also continue to apply when neither party is acting in the course of a business (a “private” sale). (Paragraph 6.19)
- 8.73 In hire purchase contracts in which the supplier is a private individual the UCTA controls relating to implied terms as to title and sale by description or sample should be retained. (Paragraph 6.22)
- 8.74 UCTA controls relating to implied terms as to title and correspondence with description or sample should not be extended to other contracts in which a private individual supplies goods. (Paragraph 6.27)

## **NON-CONTRACTUAL NOTICES**

- 8.75 The effect of the UCTA controls relating to notices excluding business liability in tort [delict] for negligence should be reproduced in the new legislation. (Paragraph 6.29)
- 8.76 Controls of business liability for negligence should be treated in a separate Part of the new legislation. (Paragraph 6.32)
- 8.77 The preventive powers be extended to cover non-contractual notices which purport to exclude or restrict a business’s liability in tort [delict]. (Paragraph 6.35)

## **GENERAL PROVISIONS THAT ARE NO LONGER REQUIRED**

- 8.78 Section 9 [section 22] of UCTA should not be replicated in the new legislation. (Paragraph 6.38)
- 8.79 Section 28 of UCTA should not be replicated in the new legislation. (Paragraph 6.42)

## **INTERNATIONAL CONTRACTS AND CHOICE OF LAW**

### **Consumer contracts**

- 8.80 UCTA section 26 on international contracts for the sale or supply of goods should not be replicated for consumer contracts. (Paragraph 7.6)
- 8.81 UCTA section 27(1) should not be replicated for consumer contracts. (Paragraph 7.9)
- 8.82 The new legislation should be applied despite a choice of foreign law if:–
- (a) when the contract was made, the consumer was living in the United Kingdom and
  - (b) all the steps necessary for the conclusion of the contract were taken there by the consumer or on his or her behalf. (Paragraph 7.19)

- 8.83 Where the contract is not closely connected to the UK but is nevertheless closely connected to the territory of the Member States, the consumer-protective laws of other Member States should be applied as they would normally be under the existing rules of private international law. (Paragraph 7.21)
- 8.84 The new legislation should contain a default provision to ensure that it applies to any contract which is closely connected to the territory of the Member States but which is not covered by the other recommended choice of law provisions. (Paragraph 7.24)
- 8.85 The new legislation should presumptively provide that contracts for the sale or supply of goods and services to be delivered or supplied outside the territory of the Member States are not to be regarded as closely connected to the territory of the Member States if the consumer took all steps necessary for the conclusion of the contract overseas. (Paragraph 7.26)

**Business contracts**

- 8.86 The new legislation should contain a provision replicating UCTA section 27(1) in relation to business contracts (Paragraph 7.29)
- 8.87 The business contracts part of the new legislation should apply notwithstanding a choice of foreign law where the contract is, in every other respect, wholly connected to the UK. (Paragraph 7.34)
- 8.88 UCTA section 26 should be replaced in the new legislation with a clause creating an exemption for business contracts under which goods are exported overseas. (Paragraph 7.58)

**Small business contracts**

- 8.89 The intended replacement for UCTA section 26 (exempting business contracts for the supply of goods abroad) should also operate to exempt relevant contracts from the small business controls. (Paragraph 7.61)
- 8.90 The intended provision replicating UCTA section 27(1) should also apply to small business contracts. (Paragraph 7.63)
- 8.91 Small businesses should have the benefit of UK protective legislation in cases where the contract is closely connected to the UK because the small business took the necessary steps to order the goods or services here. (Paragraph 7.66)

*(Signed)*

ROGER TOULSON, *Chairman, Law Commission*  
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JANE MCLEOD, *Chief Executive*  
 31 December 2004



# **APPENDIX A**

## **DRAFT UNFAIR CONTRACT TERMS BILL**

The appendix begins with a short guide to the Draft Bill. This is followed by the contents section. The Draft Bill is then set out with the clauses on the left hand pages and Explanatory Notes on the corresponding right hand pages.

### **A GUIDE TO THE DRAFT UNFAIR CONTRACT TERMS BILL**

1. This Draft Bill introduces a new regulatory regime for unfair contract terms in place of the Unfair Contract Terms Act 1977 (“UCTA”) and the Unfair Terms in Consumer Contracts Regulations 1999 (“the UTCCR”). The UTCCR implemented Council Directive 93/13/EEC (“the Directive”), replacing earlier implementing regulations in 1994 (“the 1994 Regulations”).
2. For consumer contracts, the purpose of the Draft Bill is “to create a unified regime reproducing the combined effect of UCTA and the UTCCR” with only minor changes of substance, while implementing the Directive in full. The substantive changes that do occur are, primarily, that (1) (as with those terms of consumer contracts that fall within UCTA) any unfair term will be invalid whether or not it was “individually negotiated”, unless it is a “core” term such as the main definition of the subject matter; and (2) (again as under UCTA) the burden of proving that a term is fair will be on the business.
3. For business contracts in general, the purpose of the Draft Bill is to retain the effect of UCTA, which regulates various kinds of contract term excluding or restricting liability, but in a form that is consistent with the unified regime for consumer contracts. It disposes of some provisions that are unnecessary.
4. The Draft Bill also establishes an additional regime for contracts where at least one of the parties is a small business. The purpose of these provisions is to extend to small businesses many of the protections currently available to consumers. However, two consumer protections have not been extended to small businesses. These are the possibility of challenging negotiated terms and the burden of proof falling on the business.
5. The Draft Bill also aims to make the new legislation more accessible for those who will use it on a day-to-day basis. It is intended to be readily understandable not only by lawyers but by business people with some knowledge of contracting and by consumer advisers. (See this Report, paragraph 2.45.) One of the principal ways in which the Draft Bill seeks to achieve this is by having separate Parts for consumer contracts and other contracts (including business contracts, employment contracts and “private” contracts in which neither party acts in the course of a business). There is also a Part reproducing those provisions of UCTA which deal with exclusions of business liability for negligence [breach of duty] and which apply to notices that purport to exclude liability in tort [delict] as well as to contractual terms.
6. To make the Draft Bill easier for the lay reader to follow, the interpretation provisions are located at the end of the Bill. The interpretation provisions (clauses 25 – 32) have been drafted to cross-refer to defined terms located elsewhere in

the Bill. This provides a point of reference for any reader wishing to establish whether a term is defined and, if so, its meaning.

7. Thus the Draft Bill is divided into Parts as follows:

Part 1 replicates the effect of that part of UCTA which deals with contract terms and non-contractual notices excluding business liability for negligence.

Part 2 contains provisions relating to consumer contracts (including sales, etc by a consumer to a business).

Part 3 contains provisions relating to non-consumer contracts, including private contracts. It is sub-divided so that it deals with business contracts in general; the additional protection for small businesses; employment contracts; and private contracts.

Part 4 sets out the “fair and reasonable test”, including provisions on the burden of proof.

Part 5 contains provisions on choice of law rules.

Part 6 contains interpretation, commencement and other miscellaneous provisions.

Schedule 1 contains provisions relating to powers to prevent the use of unfair terms in consumer contracts.

Schedule 2 contains an indicative list of terms that may be regarded as unfair or unreasonable.

Schedule 3 lists exceptions: contracts and contract terms that will not be covered by the Draft Bill's provisions.

Schedule 4 sets out the method of calculating the size of a small business by counting employees.

Schedules 5 and 6 contain consequential amendments and repeals.

8. Unlike UCTA, there is no separate part making provision for the law in Scotland. Our policy is that there should be a single piece of legislation covering the whole of the United Kingdom

# Unfair Contract Terms Bill

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Limit the exclusion or restriction of civil liability by contract terms or notices; to limit the effect of unfair terms in consumer and small business contracts; to make provision about the protection of the collective interests of consumers; and for connected purposes.

**B**E IT ENACTED by the Queen’s most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

**PART 1**

BUSINESS LIABILITY FOR NEGLIGENCE

**1 Business liability for negligence**

- (1) Business liability for death or personal injury resulting from negligence cannot be excluded or restricted by a contract term or a notice.
- (2) Business liability for other loss or damage resulting from negligence cannot be excluded or restricted by a contract term or a notice unless the term or notice is fair and reasonable.
- (3) “Business liability” means liability arising from—
  - (a) anything that was or should have been done for purposes related to a business, or
  - (b) the occupation of premises used for purposes related to the occupier’s business.
- (4) The reference in subsection (3)(a) to anything done for purposes related to a business includes anything done by an employee of that business within the scope of his employment.
- (5) “Negligence” means the breach of—

# EXPLANATORY NOTES

In these Explanatory Notes, references to UCTA are normally first to the provisions that apply to England, Wales and Northern Ireland; the equivalent sections that apply to Scotland are then given in square brackets.

## **PART 1 BUSINESS LIABILITY FOR NEGLIGENCE**

### ***Clause 1 Business liability for negligence***

1. Clause 1 replicates the effect of UCTA section 2 [section 16] but it is placed at the beginning of the Part to make the meaning of Part 1 of the Draft Bill more obvious. For the same reason, the restriction to business liability is not in a separate sub-section (as in UCTA section 1(3)) but [as with the UCTA provision for Scotland, section 16] is contained in the principal subsections, (1) and (2).
2. The definition of “negligence” (a term that encompasses what in UCTA Part II was called “breach of duty”) at clause 1(5) relates exclusively to Part 1 of the Draft Bill so it appears here where it is easily available to the reader. Clause 32(1) directs the reader to this definition.
3. UCTA section 2(1) [section 16(1)] refers to the exclusion or restriction of liability by a notice “given to persons generally or to particular persons”. These words are not included in the Draft Bill because the meaning of the word “notice” seems clear without them. No change of substance is intended. “Notice” is defined in the Draft Bill at clause 32(1).

- (a) an obligation to take reasonable care or exercise reasonable skill in the performance of a contract where the obligation arises from an express or implied term of the contract,
  - (b) a common law duty to take reasonable care or exercise reasonable skill,
  - (c) the common duty of care imposed by the Occupiers' Liability Act 1957 (c. 31) or the Occupiers' Liability Act (Northern Ireland) 1957 (c. 25 NI), or
  - (d) the duty of reasonable care imposed by section 2(1) of the Occupiers' Liability (Scotland) Act 1960 (c. 30).
- (6) It does not matter –
- (a) whether a breach of obligation or duty was, or was not, inadvertent, or
  - (b) whether liability for it arises directly or vicariously.

## **2 Exceptions to section 1**

- (1) Section 1 does not prevent an employee from excluding or restricting his liability for negligence to his employer.
- (2) Section 1 does not apply to the business liability of an occupier of premises to a person who obtains access to the premises for recreational or educational purposes if –
  - (a) that person suffers loss or damage because of the dangerous state of the premises, and
  - (b) allowing that person access to those premises for those purposes is not within the purposes of the occupier's business.
- (3) Subsection (2) does not extend to Scotland.

## **3 Voluntary acceptance of risk**

The defence that a person voluntarily accepted a risk cannot be used against him just because he agreed to or knew about a contract term, or a notice, appearing to exclude or restrict business liability for negligence in the case in question.

# EXPLANATORY NOTES

## ***Clause 2 Exceptions***

4. Subsection (1) replaces UCTA Schedule 1, paragraph 4, but states the effect of that provision in terms of what it permits rather than in the form of a double exception. UCTA Schedule 1, paragraph 4 does not extend to Scotland. Thus UCTA appears to make different provision in the English and Scottish Parts about whether employees may exclude or restrict their liability. However, it is unclear whether this distinction is one of form or substance (see this Report, paragraph 6.4). The effect of subsection (1) is to ensure that employees in either jurisdiction may exclude or restrict liability to their employers.
5. Subsection (2) replicates the effect of the proviso to UCTA section 1(3) (relating to occupiers' liability); subsection (3) creates an exception for Scotland. This is because when the proviso was added to UCTA by the Occupiers' Liability Act 1984, section 2 and by the Occupiers' Liability (Northern Ireland) Order 1987, SI 1987/1280, Article 4, the proviso was not extended to Scotland. The Draft Bill preserves this difference.

## ***Clause 3 Voluntary acceptance of risk***

6. The clause replicates the effect of UCTA section 2(3) [section 16(3)].

## PART 2

### CONSUMER CONTRACTS

#### *Contracts in general*

#### **4 Terms of no effect unless fair and reasonable**

- (1) If a term of a consumer contract is detrimental to the consumer, the business cannot rely on the term unless the term is fair and reasonable.
- (2) But subsection (1) does not apply to a term which defines the main subject-matter of a consumer contract, if the definition is—
  - (a) transparent, and
  - (b) substantially the same as the definition the consumer reasonably expected.
- (3) Nor does subsection (1) apply to a term in so far as it sets the price payable under a consumer contract, if the price is—
  - (a) transparent,
  - (b) payable in circumstances substantially the same as those the consumer reasonably expected, and
  - (c) calculated in a way substantially the same as the way the consumer reasonably expected.
- (4) Nor does subsection (1) apply to a term which—
  - (a) is transparent, and
  - (b) leads to substantially the same result as would be produced as a matter of law if the term were not included.
- (5) The reference to the price payable under a consumer contract does not include any amount, payment of which would be incidental or ancillary to the main purpose of the contract.
- (6) “Price” includes remuneration.

# EXPLANATORY NOTES

## PART 2 CONSUMER CONTRACTS

7. The purpose of this Part of the Draft Bill is to set out a comprehensive regime for consumer contracts. It makes provision first (in clause 4) for review of contract terms in general and then goes on to make special provision for contracts for the sale or supply of goods by a business to a consumer (clause 5) and by a consumer to a business (clause 6). Clauses 7 and 8 are supplemental.

### ***Clause 4 Terms of no effect unless fair and reasonable***

8. Clause 4 replaces the general control over unfair terms in consumer contracts currently contained in the UTCCR regulation 5(1). The only difference in substance is that clause 4 applies to terms (other than “core” terms, see below) whether or not they were individually negotiated. One reason is that the nearest equivalent in UCTA (section 3 [section 17]) applies to exclusions and limitations of liability in consumer contracts whether negotiated or not. Thus clause 4 maintains existing levels of consumer protection whilst avoiding the complexity of having different sets of rules relating to exclusions and limitations of liability and to other clauses. There are also good reasons of policy for making this change (see this Report, paragraph 3.51 above). Because clause 4 extends to non-negotiated clauses there is no equivalent to regulation 5(2) – (4) of the UTCCR.
9. The main proposition of clause 4 is set out shortly in subsection (1). This makes it clear that it is only a term which is detrimental to the consumer that may be challenged under this clause. It applies a basic test of whether the clause is “fair and reasonable” rather than the complex and unfamiliar phrases of the UTCCR regulation 5(1) and the Directive, namely, whether “contrary to the requirements of good faith, [the term] causes a significant imbalance in the rights and obligations arising under the contract, to the detriment of the consumer”. The meaning is the same.
10. Subsection (1) uses the formula that “the business cannot rely on the term” to make it clear that consumers, if it is in their interest to do so, may rely on a clause that might be seen as unfairly detrimental to them. This is to the same effect as regulation 8(1) of the UTCCR which provides that “an unfair term...shall not be binding on the consumer”.
11. Subsections (2), (3), (5) and (6) deal with the exemptions for what are commonly referred to as the “core” terms; more accurately, “the main definition of the subject matter” and “the adequacy of the price or remuneration”. They replicate the effect of regulation 6(2) of the UTCCR. They are more detailed than the regulations they replace but there is no change of substance. They merely make it clearer to both consumers and businesses what, on a correct interpretation of the Directive, is required for a term to be exempt from review.
12. The effect of subsection (2) is that a term which defines the main subject matter is not subject to review provided (a) that it is “transparent” (the term used to incorporate the “plain, intelligible language” requirement of the Directive) and (b) that it is substantially the same as the consumer reasonably expected.
13. The “plain, intelligible language” requirement of the Directive is probably not satisfied if the term is in print that is difficult to read, the layout of the contract document is difficult to follow or if the terms are not readily accessible to the consumer. Subsection (2)(a) qualifies the exemption in subsection (2) by imposing an explicit requirement of what we have called “transparency”. This is defined in clause 14(3). The requirement of transparency also qualifies the exceptions created by subsections (3) and (4).

**NOTES ON CLAUSE 4 CONTINUE ON PAGE 147**

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*Sale or supply of goods***5 Sale or supply to consumer**

- (1) This section applies to a consumer contract for the sale or supply of goods to the consumer.
- (2) In the case of a contract for the sale of the goods, the business cannot rely on a term of the contract to exclude or restrict liability arising under any of the following sections of the 1979 Act –
  - (a) section 12 (implied term that seller entitled to sell),
  - (b) section 13 (implied term that goods match description),
  - (c) section 14 (implied term that goods satisfactory and fit for the purpose),
  - (d) section 15 (implied term that goods match sample).
- (3) In the case of a contract for the hire-purchase of the goods, the business cannot rely on a term of the contract to exclude or restrict liability arising under any of the following sections of the 1973 Act –
  - (a) section 8 (implied term that supplier entitled to supply),
  - (b) section 9 (implied term that goods match description),
  - (c) section 10 (implied term that goods satisfactory and fit for the purpose),
  - (d) section 11 (implied term that goods match sample).
- (4) In the case of any other contract for the transfer of property in the goods, the business cannot rely on a term of the contract to exclude or restrict liability arising under any of the following sections of the 1982 Act –
  - (a) section 2 or 11B (implied term that supplier entitled to supply),
  - (b) section 3 or 11C (implied term that goods match description),
  - (c) section 4 or 11D (implied term that goods satisfactory and fit for the purpose),
  - (d) section 5 or 11E (implied term that goods match sample).
- (5) In the case of a contract for the hire of the goods, the business cannot rely on a term of the contract to exclude or restrict liability arising under any of the following sections of the 1982 Act –
  - (a) section 8 or 11I (implied term that goods match description),
  - (b) section 9 or 11J (implied term that goods satisfactory and fit for the purpose),
  - (c) section 10 or 11K (implied term that goods match sample).
- (6) Subsection (2)(b) to (d) does not apply if the contract is –
  - (a) for the sale of second-hand goods, and
  - (b) made at a public auction which the consumer had the opportunity to attend in person.

## EXPLANATORY NOTES

14. Under the Directive a term cannot be exempt as a definition of the main subject matter if, because of the way that the “deal” was presented to consumers, they reasonably expected something different. (For the explanation of this implicit requirement of the Directive and the Regulations, see this Report, paragraph 3.58.) It will be observed that the net effect is similar to UCTA section 3(2)(b)(i) [section 17(1)(b)] which provides that a party cannot, by reference to any contract term, claim to be entitled “to render a contractual performance substantially different from that *which was reasonably expected of him*”, except insofar as the term is reasonable.
15. Clause 4, subsections (3), (5) and (6) achieve the equivalent result in relation to the “adequacy of the price or remuneration”. Subsection (3) makes clear the effect of the Directive that a term setting the contract price will be exempt from challenge only if the price (a) is transparent and (b) is payable in circumstances, and calculated in a way, substantially the same as those the consumer reasonably expected. Thus consumers will not be able to challenge the amount of the “principal” price simply on the ground that it was higher than might reasonably have been expected. But they will be able to challenge the fairness of having to make a payment in circumstances in which they reasonably did not expect to have to make a payment: for example, when an additional charge was not clearly explained in the contract or before the contract was made. (For the explanation of this implicit restriction, see this Report, paragraphs 3.60 – 3.62.)
16. Subsection (5) provides that the exemption for terms that set the price does not extend to incidental or ancillary terms outside the main price clause. Again, it spells out a point that is currently implicit within the UTCRR. An example of an “ancillary” term might be a term which requires the consumer to pay additional sums if certain events occur outside the ordinary and expected performance of the contract, such as the consumer’s own default. (On this limit, see *Director General of Fair Trading v First National Bank* [2001] UKHL 52; [2002] 1 AC 481 and this Report, paragraph 3.60.)
17. Subsection (4) aims at another exemption that is not explicit in the UTCCR or the Articles of the Directive but that is made clear by Recital 13 of the Directive. This is that contract terms need not be subject to review if they do no more than state “rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established” (in other words, terms that do no more than provide what would be the legal position without the express term). (See this Report, paragraph 3.67.)

### **Clause 5 Sale or supply to consumer**

18. The purpose of clause 5 is to replicate the effect of UCTA sections 6(1) and (2) and 7(2), and (3A) [sections 20 and 21] relating to a supplier’s statutory obligations in consumer contracts for the sale or supply of goods. These prevent the business excluding or restricting its liability for breach of its obligations as to the right to sell or supply the goods, as to quiet possession of the goods, as to the goods’ correspondence with description or sample and as to their satisfactory quality and fitness for a particular purpose.
19. To make the provisions easier for the user, clause 5 has separate subsections for contracts of sale, contracts of hire-purchase, contracts of hire and other contracts under which possession or ownership of goods passes, and refers in each case to the statutory provisions that impose the relevant obligation.
20. Subsection (2) replicates the effect of those provisions of UCTA that relate to liability under the Sale of Goods Act 1979.

**NOTES ON CLAUSE 5 CONTINUE ON PAGE 149**

## **6 Sale or supply to business**

- (1) This section applies to a consumer contract for the sale or supply of goods to the business.
- (2) In the case of a contract for the sale of the goods, the consumer cannot rely on a term of the contract to exclude or restrict liability –
  - (a) arising under section 12 of the 1979 Act (implied term that seller entitled to sell), or
  - (b) unless the term is fair and reasonable, arising under either of the following sections of that Act –
    - (i) section 13 (implied term that goods match description),
    - (ii) section 15 (implied term that goods match sample).
- (3) In the case of a contract for the hire-purchase of the goods, the consumer cannot rely on a term of the contract to exclude or restrict liability –
  - (a) arising under section 8 of the 1973 Act (implied term that supplier entitled to supply), or
  - (b) unless the term is fair and reasonable, arising under either of the following sections of that Act –
    - (i) section 9 (implied term that goods match description),
    - (ii) section 11 (implied term that goods match sample).

## EXPLANATORY NOTES

21. Clause 5(3) replicates the effect of those provisions of UCTA that relate to liability under the Supply of Goods (Implied Terms) Act 1973 regarding contracts of hire-purchase.
22. Subsections (4) and (5) replicate the effect of UCTA section 7(2) and (3A) [section 21]. Section 7 [section 21] applies to exclusions and restrictions of liability of the kinds mentioned in contracts under which possession or ownership of goods passes but which are not contracts for the sale of goods or hire-purchase. In practice this covers contracts of hire, dealt with in subsection (5) of this clause, and contracts for work and materials which are covered by subsection (4). Subsection (4) refers, however, not to any other contract for the transfer of property in goods but only to those covered by the Supply of Goods and Services Act 1982, section 2–5 [11B – 11E]. Because of the exceptions contained in section 1 [section 11A] of the 1982 Act, this has the effect of excepting certain contracts which are very different in nature, including contracts executed by deed without other consideration and contracts intended to operate by mortgage, pledge, charge or other security. In this, the Draft Bill follows UCTA section 7(3A) [section 21(3A)].
23. Subsection (2) uses a different form of words to that in UCTA. For England and Wales, UCTA sections 6(2) and 7(2) state that the relevant liabilities “cannot be excluded or restricted by reference to any contract term”. For Scotland, sections 20(2)(i) and 21(1)(a)(i) provide that the relevant type of clause shall “be void against the consumer”. The Draft Bill uses the formula that “the business cannot rely on a term of the contract to exclude or restrict liability”, which is consistent with clause 4(1).
24. Subsection (6) replaces UCTA section 12(2) [section 25(1B)], as amended by the Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002 No 3045). It exempts from these particular controls sales of second-hand goods bought at public auctions which the consumer had the opportunity to attend in person.

### ***Clause 6 Sale or supply to business***

25. Clause 6 replicates the effect of UCTA section 6(1) and (3) [section 20(1) and (2)] insofar as it applies to a sale by a person who is not acting in the course of a business and who sells goods, or supplies them on hire-purchase, to a business. An example might be a consumer selling a car to a motor dealer. It prevents consumers from contracting out of their obligations as to entitlement to sell or transfer property and requires that any exclusion or restriction of the consumer’s obligations as to the goods’ correspondence with description or sample be fair and reasonable. A specific provision imposing a “fair and reasonable” test is required because the general test under clause 4 applies only in favour of consumers.
26. There is no equivalent for other contracts for the supply of goods. UCTA section 7 [section 21] which deals with contracts other than sale and hire purchase applies only to a supplier who is supplying goods in the course of his business: UCTA section 1(3) [in Scotland, the wording of section 21 itself]. It would be very rare for a consumer to supply goods to a business under such a contract. (See this Report, paragraphs 6.24 – 6.26.)

*Supplemental***7 Regulation and enforcement**

Schedule 1 confers functions on the OFT and regulators in relation to—

- (a) consumer contract terms,
- (b) terms drawn up or proposed for use as consumer contract terms,
- (c) terms which a trade association recommends for use as consumer contract terms, and
- (d) notices relating to the rights conferred or duties imposed by consumer contracts.

**8 Ambiguity**

- (1) If it is reasonable to read a written term of a consumer contract in two (or more) ways, the term is to be read in whichever of those ways it is reasonable to think the more (or the most) favourable to the consumer.
- (2) This section does not apply in relation to proceedings under Schedule 1 (regulation and enforcement of consumer contract terms, etc.).

## EXPLANATORY NOTES

### ***Clause 7 and Schedule 1 Regulation and enforcement***

27. Clause 7 confers powers on the OFT and regulators to prevent the use of unfair terms. It implements Article 7 of the Directive. The details are set out in Schedule 1. The provisions are lengthy. They have been placed in a schedule to simplify the structure of the Draft Bill itself and because they will seldom be required by individual consumers.

### ***Clause 8 Ambiguity***

28. Subsection (1) replicates the effect of regulation 7(2) of the UTCCR that a consumer shall be given the benefit of any doubt about the meaning of a term. It implements Article 5 of the Directive. This provision is similar to the rule at common law that any doubt about the meaning of a term should be resolved against the party seeking to rely on the term (often called the “contra proferentem” rule). In some cases it may be in the interests of the consumer to give an exclusion term a narrow meaning (so as to prevent it from excluding the liability that has arisen). In others, it will be in the consumer’s interests to give the term a wide meaning, so as to show that it is unreasonably broad. The provision is included because it is possible that the Directive requires that the rule be expressly incorporated into the implementing legislation; and to bring the rule to the attention of consumers and businesses. It is not intended to affect the common law rule in any way.
29. Subsection (2) replicates the effect of regulation 7(2) of the UTCCR and implements the last sentence of Article 5 of the Directive.

## PART 3

### NON-CONSUMER CONTRACTS

#### *Business contracts*

#### **9 Written standard terms**

- (1) This section applies where one party to a business contract (“A”) deals on the written standard terms of business of the other (“B”).
- (2) Unless the term is fair and reasonable, B cannot rely on any of those terms to exclude or restrict its liability to A for breach of the contract.
- (3) Unless the term is fair and reasonable, B cannot rely on any of those terms to claim that it has the right –
  - (a) to carry out its obligations under the contract in a way substantially different from the way in which A reasonably expected them to be carried out, or
  - (b) not to carry out all or part of those obligations.

#### **10 Sale or supply of goods**

- (1) In the case of a business contract for the sale of goods, the seller cannot rely on a term of the contract to exclude or restrict liability arising under section 12 of the 1979 Act (implied term that seller entitled to sell).
- (2) In the case of a business contract for the hire-purchase of goods, the supplier cannot rely on a term of the contract to exclude or restrict liability arising under section 8 of the 1973 Act (implied term that supplier entitled to supply).
- (3) In the case of any other business contract for the transfer of property in goods, the supplier cannot rely on a term of the contract to exclude or restrict liability arising under section 2 or 11B of the 1982 Act (implied term that supplier entitled to supply).

#### *Small business contracts*

#### **11 Non-negotiated terms**

- (1) This section applies where there is a small business contract and –
  - (a) the terms on which one party (“A”) deals include a term which the other party (“B”) put forward during the negotiation of the contract as one of its written standard terms of business,
  - (b) the substance of the term was not, as a result of negotiation, changed in favour of A, and
  - (c) at the time the contract is made, A is a small business.
- (2) If that term is detrimental to A, B cannot rely on the term unless the term is fair and reasonable.
- (3) But subsection (2) does not apply to a term which defines the main subject-matter of a small business contract, if the definition is –
  - (a) transparent, and

# EXPLANATORY NOTES

## PART 3 NON-CONSUMER CONTRACTS

30. The purpose of this Part of the Draft Bill is to set out a comprehensive regime for non-consumer contracts. The first cross-heading introduces a regime for business contracts in general. Clause 9 provides for the review of terms in business contracts where one party deals on the written standard terms of business of the other party. Clause 10 makes special provision for contracts for the sale or supply of goods. The subsequent cross-headings introduce additional provisions for small business contracts (clause 11), and provisions for employment contracts (clause 12) and for “private” contracts where neither party deals as a business (clause 13).

### Business contracts

#### *Clause 9 Written standard terms*

31. Clause 9 replicates the effect of UCTA section 3 [section 17] in so far as it applies to business contracts, but in a structure that is easier to understand.

#### *Clause 10 Sale or supply of goods*

32. The purpose of this section is to replicate for business contracts the provisions of UCTA by which any attempt to exclude or restrict the supplier’s statutory obligations as to entitlement to sell, freedom from encumbrances and quiet possession in contracts for the sale or supply of goods is rendered ineffective (UCTA sections 6(1) and 7(3A) [sections 20(1) and 21(3A)]).
33. For business contracts the Bill does not reproduce the provisions of UCTA section 7(4) [section 21(1)], which apply a reasonableness test to other clauses affecting implied obligations as to title and the like, mainly in contracts of hire (see this Report, paragraphs 4.30 – 4.35). Nor does it reproduce UCTA section 6(3) or 7(3) [sections 20(2)(ii) or 21(1)(a)(ii) and (3)(a)], by which clauses purporting to exclude or restrict liability for breach of suppliers’ statutory implied obligations as to conformity with description or sample, quality or fitness for purpose are subjected to a reasonableness test. The general provision of clause 9 is adequate to deal with these clauses since clauses not contained in a set of written standard terms of business will generally have been negotiated and it will be very rare for such a term to be unreasonable. (See this Report, paragraphs 4.25 – 4.35.)

### Small business contracts

#### *Clause 11 Non-negotiated terms*

34. The purpose of this general clause is to protect small businesses against unfair terms that fall outside clauses 9 and 10. The provision is similar to the general clause applying to unfair terms in consumer contracts (clause 4) but the class of terms that can be challenged by small businesses is significantly narrower. First, only a term that was originally put forward as one of the other party’s written standard terms of business (subsection (1)(a)) and that has not subsequently been changed in favour of the small business (subsection 1(b)) can be challenged under subsection (2). Secondly, those types of contract that are exempt from the business contracts provisions (and were exempt from UCTA under Schedule 1) are also exempt from clause 11: see Schedule 3 to the Bill. A third difference is that small businesses, unlike consumers, bear the burden of proving that the term is not fair and reasonable: see clause 17(2).
35. Subsections (3) to (5) create exceptions for core terms and terms that do no more than provide what would be the legal position even without the express term. These exceptions are identical to those exceptions created in respect of consumer contracts at clause 4(2) to (4).

- (b) substantially the same as the definition A reasonably expected.
- (4) Nor does subsection (2) apply to a term in so far as it sets the price payable under a small business contract, if the price is –
  - (a) transparent,
  - (b) payable in circumstances substantially the same as those A reasonably expected, and
  - (c) calculated in a way substantially the same as the way A reasonably expected.
- (5) Nor does subsection (2) apply to a term which –
  - (a) is transparent, and
  - (b) leads to substantially the same result as would be produced as a matter of law if the term were not included.
- (6) The reference to the price payable under a small business contract does not include any amount, payment of which would be incidental or ancillary to the main purpose of the contract.
- (7) “Price” includes remuneration.

*Employment contracts*

**12 Written standard terms**

- (1) This section applies in relation to an employment contract under which an individual (“the employee”) is employed by a business on its written standard terms of employment.
- (2) Unless the term is fair and reasonable, the business cannot rely on any of those terms to exclude or restrict its liability for breach of the contract.
- (3) Unless the term is fair and reasonable, the business cannot rely on any of those terms to claim it has the right –
  - (a) to carry out its obligations under the contract in a way substantially different from the way in which the employee reasonably expected them to be carried out, or
  - (b) not to carry out all or part of those obligations.

# EXPLANATORY NOTES

## Employment contracts

### **Clause 12 Written standard terms**

36. Clause 12 deals with written standard terms in employment contracts. UCTA section 3 [section 17] has been applied to employment contracts by the courts either by treating the employee as a consumer (see *Brigden v American Express* [2000] IRLR 94) or by treating the employment contract as the employer's written standard terms of business (see *Liberty Life Assurance Co Ltd v Sheik*, *The Times* 25 June 1985 (CA)). Thus an employee can challenge a term under which the employer purports to exclude or restrict its liability when in breach of contract or to justify performing in a way that is substantially different to what the employee reasonably expected. The effective difference between the two approaches is that, on the first approach, the employee can challenge the relevant term of employment even if it was not part of the employer's written standard terms. Clause 12 replicates the effect of section 3 [section 17] in relation to employment contracts but only where the relevant term is part of the employer's written standard terms of business.

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*Private contracts*

**13 Sale or supply of goods**

- (1) This section applies if neither party to a contract for the sale or supply of goods enters into it for purposes related to a business of his.
- (2) In the case of a contract for the sale of the goods, the seller cannot rely on a term of the contract to exclude or restrict liability –
  - (a) arising under section 12 of the 1979 Act (implied term that seller entitled to sell), or
  - (b) unless the term is fair and reasonable, arising under either of the following sections of that Act –
    - (i) section 13 (implied term that goods match description),
    - (ii) section 15 (implied term that goods match sample).
- (3) In the case of a contract for the hire-purchase of the goods, the supplier cannot rely on a term of the contract to exclude or restrict liability –
  - (a) arising under section 8 of the 1973 Act (implied term that supplier entitled to supply), or
  - (b) unless the term is fair and reasonable, arising under either of the following sections of that Act –
    - (i) section 9 (implied term that goods match description),
    - (ii) section 11 (implied term that goods match sample).

# EXPLANATORY NOTES

## Private contracts

### ***Clause 13 Sale or supply of goods***

37. Clause 13 replicates the effect of UCTA section 6(1) and (3) [section 20(1) and 20(2)(ii)] as those subsections apply to “private” contracts for the sale or hire-purchase of goods where neither party enters into the contract for business purposes. It limits the extent to which the supplier of goods under such contracts can exclude liability for breach of statutory implied terms as to title or for breach of statutory implied terms as to the goods’ correspondence with a description or sample.
38. A “private” contract is not a consumer contract because under clause 26 a consumer contract must be one between an individual and a business (similarly, under UCTA section 12(1) a person can deal as a consumer only if the other party acts in the course of a business [under section 25(1) a “consumer contract” means a contract in which one party deals in the course of a business]).
39. Clause 13 does not apply to other contracts for the supply of goods. This replicates the effect of UCTA: section 7 [section 21] is limited by section 1(3) [the language of section 21 itself] to clauses affecting business liability.

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**PART 4**

## THE "FAIR AND REASONABLE" TEST

*The test***14 The test**

- (1) 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.
- (2) Whether a notice is fair and reasonable is to be determined by taking into account –
  - (a) the extent to which the notice is transparent, and
  - (b) the substance and effect of the notice, and all the circumstances existing at the time when the liability arose (or, but for the notice, would have arisen).
- (3) “Transparent” means –
  - (a) expressed in reasonably plain language,
  - (b) legible,
  - (c) presented clearly, and
  - (d) readily available to any person likely to be affected by the contract term or notice in question.

# EXPLANATORY NOTES

## PART 4 THE “FAIR AND REASONABLE” TEST

### **Clause 14 and Schedule 2 The test**

40. Clause 14 sets out the test to be applied to determine whether a term or notice is fair and reasonable. As under UCTA, the test of whether a contract term is fair and reasonable is slightly different from that applied to non-contractual notices. Under both UCTA section 11(1) [section 24(1)] and the Directive, Article 4(1), the fairness of a contract term is to be judged as at the time the contract was concluded. This rule cannot be applied to notices that are not incorporated into any contract but purport to exclude liability in tort [delict] for negligence. The fairness of these must be judged at the time the liability arises. The two tests are set out in subsections (1) and (2) of clause 14.
41. Paragraph (a) of clause 14(1) and (2) has the effect that the fact that a term or notice is not transparent may be the main, or sole, ground for determining that a term is not fair and reasonable. Subsection (3) defines “transparent”. Paragraph (d) covers cases where the term is set out by the party who seeks to rely upon it in a document which is not physically available to the other party at the point of contracting. An example of a situation in which terms were held to be part of the contract but were not readily available to the consumer, and thus might fall within paragraph (d), would be *Thompson v LM & S Railway* [1930] 1 KB 41. In that case the ticket for travel 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.
42. Paragraph (b) of clause 14(1) and (2) requires that, in determining whether in an individual case the term or notice was fair and reasonable, both substantive fairness (“the substance and effect of the term”) and procedural fairness (“the circumstances existing at that time”) be taken into account.

In deciding “the substance and effect of the term, and all the circumstances existing at the time it was agreed” a court should have regard to the factors listed in subsection (4) (overleaf). The effect of subsection (4) is explained more fully on page 161.

**CLAUSE 14 WITH ACCOMPANYING EXPLANATORY NOTES IS  
CONTINUED OVERLEAF**

- (4) Matters relating to the substance and effect of a contract term, and to all the circumstances existing at the time it was agreed, include the following –
  - (a) the other terms of the contract,
  - (b) the terms of any other contract on which the contract depends,
  - (c) the balance of the parties' interests,
  - (d) the risks to the party adversely affected by the term,
  - (e) the possibility and probability of insurance,
  - (f) other ways in which the interests of the party adversely affected by the term might have been protected,
  - (g) the extent to which the term (whether alone or with others) differs from what would have been the case in its absence,
  - (h) the knowledge and understanding of the party adversely affected by the term,
  - (i) the strength of the parties' bargaining positions,
  - (j) the nature of the goods or services to which the contract relates.
- (5) Subsection (4) applies, with any necessary modifications, in relation to a notice as it applies in relation to a contract term.
- (6) Schedule 2 contains an indicative and non-exhaustive list of consumer contract terms and small business contract terms which may be regarded as not being fair and reasonable.
- (7) The Secretary of State may by order amend Schedule 2 so as to add, modify or omit an entry.

## EXPLANATORY NOTES

43. Subsection (4) sets out a non-exhaustive list of factors to be taken into account in deciding whether a term is fair and reasonable. It replaces the guidelines in UCTA Schedule 2. The list sets out the principal factors to be taken into account more clearly and somewhat more fully than in UCTA. Some of the factors are themselves quite general and below we explain them further.
44. In considering a party's knowledge and understanding under clause 14(4)(h), any of the following might be relevant:
- (a) any previous course of dealing between the parties,
  - (b) whether the party knew of a particular term,
  - (c) whether the party understood its meaning and implications,
  - (d) what a person other than the party, but in a similar position, would usually expect in the case of a similar transaction,
  - (e) the complexity of the transaction,
  - (f) the information given to the party about the transaction before or when the contract was made,
  - (g) whether the contract was transparent,
  - (h) how the contract was explained to the party,
  - (i) whether the party had a reasonable opportunity to absorb any information given,
  - (j) whether the party took professional advice or it was reasonable to expect the party to have done so, and
  - (k) whether the party had a realistic opportunity to cancel the contract without charge.

Points (f) to (k) would be particularly relevant where the transaction is complex.

45. Similarly, "the strength of the parties' bargaining positions" (clause 14(4)(i)) may involve questions such as:
- (a) whether the transaction was unusual for either or both of them,
  - (b) whether the complaining party was offered a choice over a particular term,
  - (c) whether that party had a reasonable opportunity to seek a more favourable term,
  - (d) whether that party had a realistic opportunity to enter into a similar contract with other persons, but without that term,
  - (e) whether that party's requirements could have been met in other ways,
  - (f) whether it was reasonable, given that party's abilities, for him or her to have taken advantage of any choice offered under (b) or available under (e).
46. We have not thought it appropriate to include such amplification of the factors in the legislation itself but we think that its inclusion in these Explanatory Notes (which we hope will be copied in collections of legislation) will prove useful to consumer advisers and also to businesses that wish to ensure that, in the words of Recital 16 to the Directive, they "deal fairly and equitably" with the other party. Subsection (5) provides that these factors apply in relation to notices as well as to contract terms.
47. Subsection (6) refers to Schedule 2 which contains an indicative and non-exhaustive list of terms that may be regarded as not being fair and reasonable. An indicative list appears in an Annex to the Directive and is required to be implemented by some method (although not necessarily by being enacted in primary legislation: see this Report, paragraph 3.108). This list may assist in determining whether a challenged term is fair and reasonable and act as a warning to businesses of terms that may be regarded with suspicion. Subsection (7) provides that the Secretary of State may amend Schedule 2 by order so as to add, modify or omit an entry.

*Burden of proof***15 Business liability for negligence**

It is for a person wishing to rely on a contract term or a notice which purports to exclude or restrict liability of the kind mentioned in section 1(2) (business liability for negligence other than in case of death or personal injury) to prove that the term or notice is fair and reasonable.

**16 Consumer contracts**

- (1) If an issue is raised as to whether a term in a consumer contract is fair and reasonable, it is for the business to prove that it is.
- (2) But in proceedings under Schedule 1 (regulation and enforcement of consumer contracts) it is for a person claiming that a term in a consumer contract, or a notice, is not fair and reasonable to prove that it is not.
- (3) It is for a person wishing to rely on a contract not being a consumer contract to prove that it is not.

**17 Business contracts**

- (1) It is for a person wishing to rely on a term of a business contract to prove that the term is fair and reasonable.
- (2) But in relation to a term to which section 11(2) (non-negotiated terms in small business contracts) applies, it is for a person claiming that the term is not fair and reasonable to prove that it is not.

# EXPLANATORY NOTES

## BURDEN OF PROOF

### ***Clause 15 Business liability for negligence***

48. Clause 15 replicates the effect of UCTA section 11(5) [section 24(4)] in so far as that section relates to contract terms or notices excluding or restricting business liability for negligence other than in the case of death or personal injury.

### ***Clause 16 Consumer contracts***

49. Clause 16 governs the burden of showing that a clause is “fair and reasonable” in relation to consumer contracts. The approaches taken by UCTA and the UTCCR to the equivalent burden differ. The UTCCR follow the Directive and make no provision for the burden so that it seems to be for the consumer to make the case that a term is unfair. UCTA section 11(5) [section 24(4)] places the burden on the party seeking to rely on the term. Clause 16 largely follows the approach taken by UCTA. However, this applies only once the issue of fairness has been raised. In other words, only if it has been indicated which term is allegedly unfair and there are sufficient grounds for the court to infer that the fairness of the term is a real issue does the business have the burden of showing that the term is fair and reasonable. For the purposes of this section, the issue of whether a term is fair and reasonable may be raised, for example, by the consumer or by the court under clause 21.
50. Subsection (2) creates an exception from subsection (1) in the case of proceedings brought under enforcement powers conferred on the OFT or another regulator under Schedule 1. In such cases the burden is placed on the regulator.
51. Subsection (3) follows UCTA section 12(3) [section 25(1) “consumer contract”]. There is no provision on this issue in the UTCCR.

### ***Clause 17 Business contracts***

52. Clause 17(1) replicates for business contracts the effect of UCTA section 11(5) [section 24(4)].
53. Subsection (2) provides that, if a party wishes to challenge a term under the “small business contracts” provisions of the Bill (clause 11), the burden of showing that the term is not “fair and reasonable” rests on that party.

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**PART 5**

CHOICE OF LAW

**18 Consumer contracts**

- (1) Where a term of a consumer contract applies (or appears to apply) the law of somewhere outside the United Kingdom, this Act has effect in relation to the contract if –
  - (a) the consumer was living in the United Kingdom when the contract was made, and
  - (b) all the steps which the consumer had to take for the conclusion of the contract were taken there by him or on his behalf.
- (2) Subsection (3) applies where –
  - (a) a consumer contract has a close connection with the territory of the member States, and
  - (b) subsection (1) does not apply.
- (3) This Act has effect in relation to the contract unless, according to the law of the forum, the provisions of the law of a member State (other than the United Kingdom) which give effect to the Directive have effect in relation to the contract.
- (4) A court is not, for the purposes of this section, to treat a consumer contract as having a close connection with the territory of the member States if –
  - (a) the contract provides for goods to be supplied, or services to be performed, outside the European Union, and
  - (b) all the steps which the consumer had to take for the conclusion of the contract were taken outside the European Union by him or on his behalf.
- (5) Subsection (4) does not apply if it nevertheless appears to the court from all the circumstances of the case that the contract does have a close connection with the territory of the member States.
- (6) “Territory of the member States” means the same as it does for the purposes of the Treaty establishing the European Community (and, for the avoidance of doubt, any reference in this section to the territory of the member States is to be read as including a part of that territory).
- (7) “The Directive” means Council Directive 93/13/EEC on unfair terms in consumer contracts.

**19 Business contracts**

- (1) Part 1 (business liability for negligence) does not apply to a business contract term, and sections 9 to 11 (business contracts) do not apply to a business contract, if –
  - (a) the law applicable to the term, or contract, is the law of a part of the United Kingdom,
  - (b) it is the applicable law only by the choice of the parties, and
  - (c) were it not for that choice, the applicable law would be the law of somewhere outside the United Kingdom.

# EXPLANATORY NOTES

## PART 5 CHOICE OF LAW

54. This Part contains the Bill's provisions on the conflicts of laws.

### ***Clause 18 Consumer contracts***

55. Clause 18(1) replicates the effect of UCTA section 27(2)(b).
56. Subsections (2) and (3) supplement subsection (1) in order to implement fully Article 6(2) of the Directive. Article 6(2) requires that consumers should not lose the protection of the Directive by virtue of a choice of law of a non-Member State as the law applicable to the contract if the contract has a close connection with the territory of the Member States. There will be cases in which the contract has a close connection with the territory of the Member States but which do not fall within subsection (1), for example because the consumer took steps necessary to conclude the contract in another Member State. If according to the law of the forum the law of another Member State applies to the contract, and the consumer will be protected by the measures implementing the Directive in that law, there is no need for the United Kingdom legislation to apply. There may be cases in which neither subsection (1) nor the law of another Member State will protect the consumer but the contract nonetheless has a close connection with the territory of the Member States. Subsections (2) and (3) have the effect that the new legislation will apply in such cases.
57. Subsections (4) and (5) relate to the question whether a consumer contract is closely connected to the territory of the Member States. Subsection (4) prevents a consumer contract being treated as closely connected in this way if the only connection is that the supplier of goods or services is located in the UK and the contract is to be performed, and the necessary contractual steps are taken by the consumer, outside the European Union. Subsection (5) is a safeguard to eliminate any risk that adequate effect will not be given to Article 6(2) of the Directive: it provides that if it nevertheless appears to the court that the case does have a close connection with the territory of the Member States, the Act will apply.

### ***Clause 19 Business contracts***

58. Subsection (1) replicates the effect of UCTA section 27(1).
59. Subsection (2) prevents avoidance of the Bill's provisions by means of a choice of foreign law where the contract is wholly connected with the UK. It replaces UCTA section 27(2)(a) but has a slightly different effect. This is explained in this Report, paragraphs 7.30 – 7.34.

- (2) This Act has effect in relation to a business contract despite a term of the contract which applies (or appears to apply) the law of somewhere outside the United Kingdom if the contract is in every other respect wholly connected with the United Kingdom.

## **20 Small business contracts**

- (1) This Act has effect in relation to a small business contract despite a term of the contract which applies (or appears to apply) the law of somewhere outside the United Kingdom if –
- (a) A had a place of business in the United Kingdom when the contract was made, and
  - (b) either of the following conditions applies in relation to the contract.
- (2) The first condition is that –
- (a) the making of the contract was preceded in the United Kingdom by an invitation addressed specifically to A, or by advertising, about the main subject-matter of the contract, and
  - (b) all the steps which A had to take for the making of the contract were taken in the United Kingdom by A through A’s place of business there or on A’s behalf.
- (3) The second is that A’s order was received by B in the United Kingdom.
- (4) “A” and “B” mean, respectively, the persons referred to as A and B in section 11.

## EXPLANATORY NOTES

### ***Clause 20 Small business contracts***

60. Clause 20 prevents avoidance of the Bill's provisions by means of a choice of foreign law where either (i) the contract was preceded by advertising addressed to the small business in the UK and it took all the necessary steps for the conclusion of the contract there; or (ii) the small business's order was received by the other party in the UK.

## PART 6

### MISCELLANEOUS AND SUPPLEMENTARY

#### *Miscellaneous*

#### **21 Unfairness issue raised by court**

A court may, in proceedings before it, raise an issue about whether a contract term or a notice is fair and reasonable even if none of the parties to the proceedings has raised the issue or indicated that it intends to raise it.

#### **22 Exceptions**

Schedule 3 sets out types of contract, and of contract term, to which this Act does not apply or to which specified provisions of this Act do not apply.

#### **23 Secondary contracts**

- (1) A term of a contract (“the secondary contract”) which reduces the rights or remedies, or increases the obligations, of a person under another contract (“the main contract”) is subject to the provisions of this Act that would apply to the term if it were in the main contract.
- (2) It does not matter for the purposes of this section whether the parties to the secondary contract are the same as the parties to the main contract.
- (3) This section does not apply if the secondary contract is a settlement of a claim arising under the main contract.

#### **24 Effect of unfair term on contract**

Where a contract term cannot be relied on by a person as a result of this Act, the contract continues, so far as practicable, to have effect in every other respect.

#### *Interpretation, etc.*

#### **25 Preliminary**

Sections 26 to 32 define or otherwise explain expressions for the purposes of this Act.

#### **26 “Consumer contract” and “business contract”**

- (1) “Consumer contract” means a contract (other than one of employment) between—
  - (a) an individual (“the consumer”) who enters into it wholly or mainly for purposes unrelated to a business of his, and
  - (b) a person (“the business”) who enters into it wholly or mainly for purposes related to his business.

# EXPLANATORY NOTES

## PART 6 MISCELLANEOUS AND SUPPLEMENTARY

### **Clause 21 Unfairness issue raised by court**

61. This clause reflects the decision of the European Court of Justice in *Oceano Grupo Editorial SA v Quintero* (C-240/98) [2000] ECR I-4941 that a national court can adjudicate of its own motion as to the compatibility of a contract term with the Directive.

### **Clause 22 and Schedule 3 Exceptions**

62. Clause 22 exempts from the Bill various categories of contract and contract term; these are set out in Schedule 3.

### **Clause 23 Secondary contracts**

63. This clause replaces UCTA section 10 [section 23]. It prevents evasion of the Bill's provisions by means of a secondary contract, a term of which reduces the rights or remedies or increases the obligations of one of the parties under the main contract, whether that secondary contract is between the same two parties or different parties. There was some doubt whether section 10 applied in both situations: *Tudor Grange Holdings Ltd v Citibank NA* [1992] Ch 53. Subsection (3) makes it clear that, as that case held to be the position under section 10 [section 23], a settlement of an existing claim does not fall within the provision.

### **Clause 24 Effect of unfair term on contract**

64. This clause reproduces the effect of UTCCR regulation 8. UCTA takes a similar approach. For example, sections 2 and 3 use the formula "cannot by reference to any contract term...exclude or restrict any liability", thus allowing the relevant term to operate for other purposes. Although the equivalent Scottish provisions [sections 16 and 17] describe terms as "void" or of "no effect", this is only to the extent that the clause purports to exclude or restrict liability. This means that the Scottish position is also that the clause continues for other purposes. (See this Report, paragraphs 3.131 to 3.140.)

### **Interpretation etc**

#### **Clause 25 Preliminary**

65. Clause 25 introduces the Bill's interpretative provisions.

#### **Clause 26 "Consumer contract" and "business contract"**

66. Clause 26(1) defines a consumer contract for the purposes of the Bill in line with the definition of "consumer" in Article 2(b) of the Directive. This is narrower than the definition under UCTA. Under UCTA section 12 [section 25(1)], (1) a consumer need not be an "individual", that is, a natural person; (2) a consumer may be someone who enters into the contract for purposes related to a business of his but not in the course of a business (see *R & B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 WLR 321). However, under UCTA a person who *holds himself out* as making the contract in the course of a business is not a consumer. The last restriction cannot survive the Directive on certain aspects of the sale of consumer goods and associated guarantees, 1999/44/EC of 25 May 1999, which permits no such exception to the definition of a consumer.
67. The effect of UCTA section 12(1)(c) [section 25(1)], whereby a contract for the sale or hire-purchase of goods is not a consumer contract unless the goods are of a type ordinarily supplied for private use or consumption, is not reproduced. This does not apply to individual consumers as the result of Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002 No 3045), regulation 14.

- (2) “Business contract” means a contract between two persons, each of whom enters into it wholly or mainly for purposes related to his business.

**27 “Small business”**

- (1) “Small business” means a person in whose business the number of employees does not exceed –
- (a) nine, or
  - (b) where the Secretary of State specifies by order another number for the purposes of this section, that number.
- (2) But a person is not a small business if adding the number of employees in his business to the number of employees in any other business of his, or in any business of an associated person, gives a total exceeding the number which for the time being applies for the purposes of subsection (1).
- (3) A reference to the number of employees in a business is to the number calculated according to Schedule 4.

**28 “Associated person”**

- (1) For the purposes of this Act, two persons are associated if –
- (a) one controls the other, or
  - (b) both are controlled by the same person.
- (2) A person (“A”) controls a body corporate (“B”) if A can secure that B’s affairs are conducted according to A’s wishes, directions or instructions.
- (3) The reference in subsection (2) to wishes, directions or instructions does not include advice given in a professional capacity.
- (4) Subsection (2) applies, with any necessary modifications, in relation to an unincorporated association (other than a partnership) as it applies in relation to a body corporate.
- (5) A person controls a partnership if he has the right to a share of more than half the assets or income of the partnership.
- (6) For the purposes of this section, one person does not control another just because he grants that other person a right to supply goods or services.

## EXPLANATORY NOTES

68. Subsection (2) defines a business contract for the purposes of the Bill. Neither UCTA nor the UTCCR employ an equivalent definition.
69. The words "or mainly" in subsections (1) and (2) invite the court to categorise transactions that are for a mixture of purposes (for example, the purchase of a car partly for business use and partly for pleasure) by identifying the predominant purpose for which each party entered into the contract. This is believed to replicate the present position under UCTA section 12 [section 25(1) "consumer contract"].

### ***Clause 27 and Schedule 4 "Small business"***

70. Clause 27 defines "small business" for the purpose of the Bill's provisions on small business contracts. A small business is one in which the number of employees is nine or fewer. This number is variable by an order of the Secretary of State under subsection (1)(b).
71. However, under subsection (2), a business is not a small business if it is associated with another business and the total number of employees in the two businesses is more than nine. The definition of an "associated person" is set out in clause 28 (below).
72. Subsection (3) provides that the method of calculating the number of employees in a business is to be that set out in Schedule 4 (below).

### ***Clause 28 "Associated person"***

73. Clause 28 defines "associated person" for the purposes of clause 27(2). The definition is based on Article 6 of the Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 (SI 1998 No 2479).
74. Under subsection (1), two persons are associated if one controls the other or both are controlled by the same person.
75. The meaning of "controls" and "controlled" in subsection (1) is further developed in subsections (2) to (6) where it is made clear that the person being controlled may be a body corporate, an unincorporated association or a partnership. By extension it is clear that the person who controls another may also be a body corporate, an unincorporated association or a partnership. Thus "person" for the purposes of this clause includes not only the paradigmatic cases of a natural person and a body corporate but also a partnership or unincorporated association.
76. Subsections (3) to (5) apply definitions of "control" which are well-established in, for example, revenue law (for a recent example see section 574 of the Capital Allowances Act 2001). The definition includes, under subsection (3), cases where a company is run in accordance with the directions or instructions of another person. (This draws on the definition of "director" in section 417(1) of the Financial Services and Markets Act 2000 to cover the case of a shadow director).
77. Subsection (6) is to prevent the definition of control applying in relation to franchises.

## 29 “Small business contract”

- (1) “Small business contract” means a business contract –
  - (a) to which at least one of the parties is, at the time the contract is made, a small business, and
  - (b) which does not come within any of four exceptions.
- (2) The first exception is that the price payable under the contract exceeds £500,000.
- (3) The second is that –
  - (a) the transaction provided for by the contract forms part of a larger transaction, or part of a scheme or arrangement, and
  - (b) the total price payable in respect of the larger transaction, or the scheme or arrangement, exceeds £500,000.
- (4) The third is that –
  - (a) a person agrees to carry on a regulated activity under the contract, and
  - (b) he is an authorised person or, in relation to that activity, an exempt person.
- (5) The fourth is that the contract is a series contract.
- (6) A contract is a series contract if –
  - (a) the transaction provided for by the contract forms part of a series, and
  - (b) during the period of two years ending with the date of the contract, the total price payable under contracts providing for transactions in the series exceeds £500,000.
- (7) A contract is also a series contract if, at the time the contract was made, both parties intended that –
  - (a) the transaction provided for by the contract would form part of a series, and
  - (b) the total price payable under contracts providing for transactions in the series and made during any period of two years, would exceed £500,000.
- (8) Where a contract is a series contract, every subsequent contract providing for a transaction in the series is a series contract.
- (9) The Secretary of State may by order vary the amount specified in subsections (2), (3), (6) and (7).
- (10) “Authorised person”, “exempt person” and “regulated activity” have the same meaning as in the Financial Services and Markets Act 2000 (c. 8).

## EXPLANATORY NOTES

### ***Clause 29 “Small business contract”***

78. This clause defines a “small business contract” for the purposes of the Bill’s provisions.
79. Subsection (1) defines a “small business contract” as a contract to which at least one of the original parties is a small business. Therefore a contract between a small business and a larger business may be a small business contract and so may a contract between two small businesses.
80. Subsections (2) to (5) set out exceptions to the definition of small business contract.
81. Subsection (2) creates an exemption for transactions with a value greater than £500,000.
82. Subsections (3) and (5) create an exemption for contracts forming part of a series, scheme or arrangement where the value of that series, scheme or arrangement exceeds £500,000. Subsections (6) and (7) make further provision about how a series of contracts qualifying for the exemption may be identified.
83. Subsection (4) creates an exemption for contracts for financial services where the provision of the services is a regulated activity performed by an authorised person or an exempt person. Subsection (10) defines “authorised person”, “exempt person” and “regulated activity” by reference to the Financial Services and Markets Act 2000.

**30 “Excluding or restricting liability”**

- (1) A reference to excluding or restricting a liability includes—
  - (a) making a right or remedy in respect of the liability subject to a restrictive or onerous condition;
  - (b) excluding or restricting a right or remedy in respect of the liability;
  - (c) putting a person at a disadvantage if he pursues a right or remedy in respect of the liability;
  - (d) excluding or restricting rules of evidence or procedure.
- (2) A reference in Part 1 or section 5, 6, 10 or 13 to excluding or restricting a liability includes preventing an obligation or duty arising or limiting its extent.
- (3) A written agreement to submit current or future differences to arbitration is not to be regarded as excluding or restricting the liability in question.

## EXPLANATORY NOTES

**Clause 30 “Excluding or restricting liability”**

84. This clause explains the meaning of “excluding or restricting liability” where those terms appear in the Bill. It replicates the effect of UCTA section 13 [section 25(3) and (5)]. The following are examples of clauses excluding or restricting liability:

TERMS REFERRED TO IN CLAUSE 30(1) TO (2)	EXAMPLES
A term making a right or remedy in respect of the liability subject to a restrictive or onerous condition	<p>A term which requires claims to be made within a short period of time</p> <p>A term which provides that defective goods will be replaced only if a person returns them to a particular place at his own expense</p>
A term excluding or restricting a right or remedy in respect of the liability	<p>A term which restricts a person’s right to terminate a contract</p> <p>A term which limits the damages which may be claimed by a person</p> <p>A term which prevents a person from deducting compensation due to him from payments due from him</p>
A term putting a person at a disadvantage if he pursues a right or remedy in respect of the liability	<p>A term which provides for a deposit paid by a person to be forfeited if he pursues any remedy</p> <p>A term which provides that a purchaser who exercises a right to have defective goods repaired by a third party will invalidate any rights he has against the seller</p>
A term excluding or restricting rules of evidence or procedure	A term which provides that a decision of the seller, or a third party, that goods are or are not defective is to be conclusive
A term preventing an obligation or duty arising or limiting its extent	<p>A term which excludes all conditions or warranties</p> <p>A term or notice under which A states that A does not undertake responsibility for the economic interests of B, thereby stopping a duty of care to prevent B sustaining pure economic loss from arising</p>

### 31 “Hire-purchase” and “hire”

- (1) A reference to a contract for the hire-purchase of goods is to a hire-purchase agreement within the meaning of the Consumer Credit Act 1974 (c. 39).
- (2) A reference to a contract for the hire of goods is to be read with the 1982 Act.

### 32 General interpretation

- (1) In this Act –
  - “the 1973 Act” means the Supply of Goods (Implied Terms) Act 1973 (c. 13),
  - “the 1979 Act” means the Sale of Goods Act 1979 (c. 54),
  - “the 1982 Act” means the Supply of Goods and Services Act 1982 (c. 29),
  - “associated person” has the meaning given in section 28,
  - “business contract” has the meaning given in section 26(2),
  - “business liability” has the meaning given in section 1(3) and (4),
  - “consumer”, in relation to a party to a consumer contract, has the meaning given by section 26(1)(a),
  - “consumer contract” has the meaning given in section 26(1),
  - “court” means –
    - (a) in England and Wales and Northern Ireland, the High Court or a county court, and
    - (b) in Scotland, the Court of Session or a sheriff,
  - and, except in Schedule 1, includes a tribunal, arbitrator or arbiter,
  - “enactment” includes –
    - (a) a provision of, or of an instrument made under, an Act of the Scottish Parliament or Northern Ireland legislation, and
    - (b) a provision of subordinate legislation (within the meaning of the Interpretation Act 1978 (c. 30)),
  - “fair and reasonable”, in relation to a contract term or a notice, has the meaning given in section 14,
  - “goods” has the same meaning as in the 1979 Act,
  - “injunction” includes interim injunction,
  - “interdict” includes interim interdict,
  - “negligence” has the meaning given in section 1(5),
  - “notice” includes an announcement, whether or not in writing, and any other communication,
  - “the OFT” means the Office of Fair Trading,
  - “personal injury” includes any disease and any impairment of physical or mental condition,
  - “public authority” has the same meaning as in section 6 of the Human Rights Act 1998 (c. 42),
  - “regulator” has the meaning given in paragraph 10 of Schedule 1,
  - “small business” has the meaning given in section 27,
  - “small business contract” has the meaning given in section 29,
  - “statutory” means conferred by an enactment,

## EXPLANATORY NOTES

### ***Clause 31 “Hire-purchase” and “hire”***

85. This clause defines certain terms relating to the supply of goods for the purposes of the Bill's provisions. The Bill's provisions on contracts for the supply of goods are contained in clauses 5, 6, 10 and 13.

### ***Clause 32 General interpretation***

86. This clause provides a list of general definitions. Where terms are defined elsewhere in the Bill the term is listed in this clause with a cross-reference to the primary definition.
87. Many of the definitions are derived from UCTA section 14 [section 25]. Of those which are different in substance or new, the majority are merely cross-references to other clauses and are considered in the appropriate Note.

“supplier”, in relation to a contract for the hire-purchase of goods or a contract for the hire of goods, means the person by whom goods are bailed or (in Scotland) hired to another person under the contract, and “transparent” has the meaning given in section 14(3).

- (2) A reference to a business includes a profession and the activities of a public authority.
- (3) A reference to excluding or restricting liability is to be read with section 30.
- (4) A reference to a contract for the hire-purchase or hire of goods is to be read with section 31.

#### *Final provisions*

### **33 Orders**

- (1) Any power of the Secretary of State to make an order under this Act is exercisable by statutory instrument.
- (2) A statutory instrument containing an order under this Act, other than one containing an order under section 35 (commencement), is subject to annulment in pursuance of a resolution of either House of Parliament.

### **34 Consequential amendments and repeals, etc.**

- (1) Schedule 5 contains minor and consequential amendments.
- (2) Schedule 6 contains repeals and revocations.

### **35 Short title, commencement and extent**

- (1) This Act may be cited as the Unfair Contract Terms Act 2005.
- (2) The preceding provisions come into force on such day as the Secretary of State may by order appoint.
- (3) Different days may be appointed for different provisions.
- (4) No provision of this Act applies in relation to a contract term agreed before the commencement of the provision (except in so far as the term has been varied after that commencement).
- (5) An amendment, repeal or revocation contained in Schedule 5 or 6 has the same extent as the enactment to which it relates.
- (6) This Act extends to Northern Ireland.

## EXPLANATORY NOTES

88. Subsection (2) provides that a reference to a business includes a profession and the activities of a public authority. The definition in UCTA section 14 [section 25] additionally includes the activities of any government department or local authority. These words have been omitted from the Bill because the clause adopts the definition of “public authority” given in section 6 of the Human Rights Act 1998. That section gives a broad definition of “public authority” by including “any person certain of whose functions are functions of a public nature” (other than the Houses of Parliament). This would include a government department or local authority.

### **Final provisions**

#### ***Clause 33 Orders***

89. This clause contains provisions relating to the Secretary of State's powers to make orders under the Act. Under subsection (2) the powers conferred are subject to the negative Parliamentary procedure.

#### **Clause 34, Schedule 5 and Schedule 6 Consequential amendments and repeals, etc**

90. Clause 34 introduces the Schedules containing the Bill's consequential amendments and repeals.

#### **Clause 35 Short title, commencement and extent**

91. Subsection (2) provides for commencement on such date as the Secretary of State may appoint.
92. Subsection (4) provides that the Act shall apply only to new contracts or variations of contract terms agreed after the commencement date.
93. Subsection (6) provides that the Act shall extend to Northern Ireland. The Bill applies to the UK as a whole in default of any provision to the contrary but by convention an express provision is made in respect of Northern Ireland.

## SCHEDULES

### SCHEDULE 1

Section 7

#### CONSUMER CONTRACT TERMS, ETC.: REGULATION AND ENFORCEMENT

##### *Cases where this Schedule applies*

- 1 (1) This Schedule applies to a complaint about –
  - (a) a consumer contract term,
  - (b) a term drawn up or proposed for use as a consumer contract term, or
  - (c) a term which a trade association recommends for use as a consumer contract term.
- (2) This Schedule also applies to a complaint about –
  - (a) a notice relating to the rights conferred or duties imposed by a consumer contract on the parties, or
  - (b) any other notice purporting to exclude or restrict liability for negligence.

##### *Consideration of complaints*

- 2 (1) If the OFT receives a complaint to which this Schedule applies, it must consider the complaint unless –
  - (a) it thinks that the complaint is frivolous or vexatious,
  - (b) it is notified by a regulator that that regulator intends to consider the complaint, or
  - (c) in the case of a complaint under paragraph 1(2)(b), it thinks that sub-paragraph (2) applies in relation to the notice.
- (2) This sub-paragraph applies in relation to a notice which –
  - (a) does not exclude or restrict business liability for negligence, or
  - (b) excludes or restricts such liability only in relation to a person who, at the time when the liability arises, is acting for purposes related to a business.
- (3) If the regulator intends to consider a complaint to which this Schedule applies, it must –
  - (a) notify the OFT that it intends to consider the complaint, and
  - (b) consider the complaint.

##### *Application for injunction or interdict*

- 3 (1) The OFT (or a regulator) may apply for an injunction or interdict against such persons as it considers appropriate if it thinks that the term or notice to which the complaint relates comes within this paragraph.

# EXPLANATORY NOTES

## SCHEDULE 1 CONSUMER CONTRACT TERMS, ETC; REGULATION AND ENFORCEMENT

94. The regime of enforcement powers provided for under Schedule 1 replaces that provided for by regulations 10 – 16 of the UTCCR. It does not replicate that regime exactly. In particular, Schedule 1 has been drafted to take account of the similar regime afforded by Part 8 of the Enterprise Act 2002 and is in a form as consistent as possible with that Act. (The reasons for preserving preventive powers separate from those under the Enterprise Act are set out in full in this Report, paragraph 3.146 – 3.147.) Part 8 contains no provisions allowing the consumer to bring a complaint to the attention of the enforcer and no provisions requiring the enforcer to act on the complaint. These are essential aspects of the UTCCR's regime. Part 8 is clearly meant to work in conjunction with other parts of the Enterprise Act, for example section 11, which create mechanisms through which unfair practices can come to the attention of enforcing bodies, but these mechanisms are not wholly appropriate for the purposes of legislation implementing the Directive.
95. The enforcement powers are conferred and the concomitant duties (such as on the OFT to consider a complaint and on a regulator to notify the OFT if it is considering one) are imposed on the OFT and additional "regulators" (defined in paragraph 10, subparagraph (2) of which provides that the Secretary of State may by order amend the list so as to add, modify or omit an entry).
96. The most significant change from the regime set out in the UTCCR is the inclusion of powers in respect of unfair or unreasonable notices in addition to the powers in respect of unfair or unreasonable contract terms. These are set out in paragraph 1(2).
97. Under paragraphs 1 and 2 of the Schedule, the powers are conferred on the basis of complaints, made to the OFT or another regulator, about
- (1) consumer contract terms (paragraph 1(1)(a));
  - (2) terms drawn up or proposed for use as consumer contract terms (paragraph 1(1)(b)). This category includes terms put forward for inclusion in a consumer contract but which do not form part of the contract because the consumer refused to agree to them. It also includes terms drawn up for inclusion in a consumer contract which are not incorporated under the common law relating to the incorporation of contract terms, for example, because the term is presented to the consumer after the contract is agreed. It is not clear that these terms are presently covered by the UTCCR;
  - (3) terms which a trade association recommends for use as consumer contract terms (paragraph 1(1)(c));
  - (4) notices relating to the rights conferred or duties imposed by a consumer contract (paragraph 1(2)(a)). This would permit a complaint to be made about a notice that purports to restrict contractual rights even if the restriction was not incorporated in the contract (for example, because the notice was displayed only after the contract was made). It would even apply if the notice was not intended to be incorporated, but was merely designed to deter consumers from exercising their rights. Such notices are not caught under paragraphs 1(1)(a) or (b) because they are not contractual terms and are not put forward for inclusion in the contract; and
  - (5) notices purporting to exclude or restrict liability for negligence (paragraph 1(2)(b)). This would allow action to be taken against notices that purport to exclude liability in tort [delict] which exists independently of a contractual relationship. Thus it would allow action to be taken against a notice in a free supermarket car park stating that no liability is accepted for negligence causing death or personal injury. It would not matter that there was no contractual relationship between the car park users and the store. Under paragraph 2(2), the

- (2) A term or notice comes within this paragraph if it purports to exclude or restrict liability of the kind mentioned in—
  - (a) section 1(1) (business liability for death or personal injury resulting from negligence), or
  - (b) section 5 (implied terms in supply of goods to consumer).
- (3) A term or notice also comes within this paragraph if it—
  - (a) is drawn up for general use, and
  - (b) is not fair and reasonable.
- (4) A term also comes within this paragraph if—
  - (a) however it is expressed, it is in its effect a term of a kind which the business usually seeks to include in the kind of consumer contract in question, and
  - (b) it is not fair and reasonable.
- (5) A term which comes within paragraph 1(b) or (c) (but not within paragraph 1(a)) is to be treated for the purposes of section 14 (the “fair and reasonable” test) as if it were a contract term.

#### *Notification of application*

- 4 (1) If a regulator intends to make an application under paragraph 3—
  - (a) it must notify the OFT of its intention, and
  - (b) it may make the application only if this paragraph applies.
- (2) This paragraph applies if—
  - (a) the period of 14 days beginning with the date of the notification to the OFT has ended, or
  - (b) before the end of that period, the OFT allows the regulator to make the application.
- (3) Where the OFT (or a regulator), having considered a complaint to which this Schedule applies, decides not to make an application under paragraph 3 in response to the complaint, it must give its reasons to the person who made the complaint.

#### *Determination of application*

- 5 (1) On an application under paragraph 3, the court may grant an injunction or interdict on such conditions, and against such of the respondents, as it thinks appropriate.
- (2) The injunction or interdict may include provision about—
  - (a) a term or notice to which the application relates;
  - (b) any consumer contract term, or any notice, of a similar kind or like effect.
- (3) It is not a defence to show that, because of a rule of law, a term to which the application relates is not, or could not be, an enforceable contract term.
- (4) If a regulator makes the application, it must notify the OFT of—
  - (a) the outcome of the application, and
  - (b) if an injunction or interdict is granted, the conditions on which, and the identity of any person against whom, it is granted.

## EXPLANATORY NOTES

notice must relate to business liability and must be owed to a person who was not acting for purposes related to a business. The supermarket's liability would arise out of their "occupation of premises used for purposes" related to their business, and would therefore meet the definition of business liability set out in clause 1(3)(b). Equally, most users affected by the notice would not be acting for business purposes. However, no complaint could be considered against a homeowner who put up such a notice in their driveway. [NB. In Scots law an occupier cannot exclude or restrict liability under the Occupiers' Liability (Scotland) Act 1960 except by contractual term.]

98. Further changes to the UTCCR are that:
- (1) Under paragraph 3(2) the OFT or regulator may act against terms or notices appearing to exclude or restrict liability without having to show (under the general test in paragraph 3(3)) that the term is unfair where, under the Bill's provisions, the term is automatically of no effect.
  - (2) Paragraph 3(4) enables the OFT or regulator to act against practices of negotiating terms that are unfair. For example, sub-paragraph (4) would apply to clauses which require the consumer to pay a deposit, where the deposit is invariably – or commonly – unfair or unreasonable even if the amount of the deposit varies from contract to contract as the result of negotiation or otherwise.
99. The principal powers and duties conferred by the Schedule are:
- (1) A duty to consider a complaint about a term or notice (paragraph 2);
  - (2) A power to apply to the court for an injunction [interdict] against the use of unfair terms or notices (paragraph 3);
  - (3) A power to accept from a business an undertaking that it will comply with certain conditions about the use of specified terms or notices (paragraph 6);
  - (4) A power to obtain information from a business to facilitate the exercise of the other enforcement powers (paragraph 7); and
  - (5) A power to apply to the court for a "compliance order" requiring a business to comply with a notice made under the paragraph 7 power to obtain information (paragraph 8).

**THE REST OF SCHEDULE 1 IS SET OUT DOUBLE-SIDED ON THE  
FOLLOWING PAGES**

### *Undertakings*

- 6 (1) The OFT (or a regulator) may accept from a relevant person an undertaking that he will comply with such conditions about the use of specified terms or notices, or of terms or notices of a specified kind, as he and the OFT (or the regulator) may agree.
- (2) If a regulator accepts an undertaking under this paragraph, it must notify the OFT of –
  - (a) the conditions on which the undertaking is accepted, and
  - (b) the identity of the person who gave it.
- (3) “Relevant person”, in relation to the OFT or a regulator, means a person against whom it has applied, or thinks it is entitled to apply, for an injunction or interdict under paragraph 3.
- (4) “Specified”, in relation to an undertaking, means specified in the undertaking.

### *Power to obtain information*

- 7 (1) The OFT (or a regulator which is a public authority) may, for a purpose mentioned in sub-paragraph (2)(a) or (b), give notice to a person requiring him to provide it with specified information.
- (2) The purposes are –
  - (a) to facilitate the exercise of the OFT’s (or the regulator’s) functions for the purposes of this Schedule,
  - (b) to find out whether a person has complied, or is complying, with –
    - (i) an injunction or interdict granted under paragraph 5 on an application by the OFT (or the regulator), or
    - (ii) an undertaking accepted by it under paragraph 6.
- (3) The notice must –
  - (a) be in writing,
  - (b) specify the purpose for which the information is required, and
  - (c) specify how and when the notice is to be complied with.
- (4) The notice may require the production of specified documents or documents of a specified description.
- (5) The OFT (or the regulator) may take copies of any documents produced in compliance with the notice.
- (6) The notice may be varied or revoked by a subsequent notice under this paragraph.
- (7) The notice may not require a person to provide information or produce documents which he would be entitled to refuse to provide or produce –
  - (a) in proceedings in the High Court, on the grounds of legal professional privilege;
  - (b) in proceedings in the Court of Session, on the grounds of confidentiality of communication.
- (8) “Specified”, in relation to a notice under this paragraph, means specified in the notice.

*Notices under paragraph 7: enforcement*

- 8 (1) If the OFT (or the regulator) thinks that a person (a “defaulter”) has failed, or is failing, to comply with a notice given under paragraph 7, it may apply to the court for an order under this paragraph (a “compliance order”).
- (2) If the court thinks that the defaulter has failed to comply with the notice, it may make a compliance order.
- (3) A compliance order –
- (a) must specify such things as the court thinks it reasonable for the defaulter to do to ensure compliance with the notice;
  - (b) must require the defaulter to do those things;
  - (c) may require the defaulter to pay some or all of the costs or expenses of the application for the order (“the application costs”).
- (4) If the defaulter is a company or association, the court may, when acting under sub-paragraph (3)(c), require payment of some or all of the application costs by an officer of the company or association whom the court thinks responsible for the failure.
- (5) If a regulator applies for a compliance order, it must notify the OFT of –
- (a) the outcome of the application, and
  - (b) if the order is made, the conditions on which, and the identity of any person against whom, it is made.
- (6) “Officer” –
- (a) in relation to a company, means a director, manager, secretary or other similar officer of the company,
  - (b) in relation to a partnership, means a partner,
  - (c) in relation to any other association, means an officer of the association or a member of its governing body.

*Publication, information and advice*

- 9 (1) The OFT must arrange to publish details of any –
- (a) application it makes for an injunction or interdict under paragraph 3;
  - (b) injunction or interdict granted on an application by it under paragraph 3;
  - (c) injunction or interdict notified to it under paragraph 5(4)(b);
  - (d) undertaking it accepts under paragraph 6(1);
  - (e) undertaking notified to it under paragraph 6(2);
  - (f) application it makes for a compliance order under paragraph 8(1);
  - (g) compliance order made under paragraph 8(2);
  - (h) compliance order notified to it under paragraph 8(5)(b).
- (2) Sub-paragraph (3) applies where a person tells the OFT about a term or notice and asks the OFT whether that term or notice, or one of a similar kind or like effect, is or has been the subject of an injunction, interdict or undertaking under this Schedule.
- (3) The OFT must reply; and if it replies that the term or notice, or one of a similar kind or like effect, is or has been the subject of an injunction, interdict or undertaking under this Schedule, the OFT must give the person –
- (a) a copy of the injunction or interdict or details of the undertaking, and

- (b) if the person giving the undertaking has agreed to amend the term or notice concerned, a copy of the amendments.
- (4) The OFT may arrange to publish advice and information about the provisions of this Act.
- (5) A reference to an injunction or interdict under this Schedule is to an injunction or interdict –
  - (a) granted on an application by the OFT under paragraph 3, or
  - (b) notified to it under paragraph 5(4)(b).
- (6) A reference to an undertaking under this Schedule is to an undertaking –
  - (a) accepted by the OFT under paragraph 6(1), or
  - (b) notified to it under paragraph 6(2).

*Meaning of “regulator”*

- 10 (1) For the purposes of this Schedule, “regulator” means –
- (a) the Financial Services Authority,
  - (b) the Office of Communications,
  - (c) the Information Commissioner,
  - (d) the Gas and Electricity Markets Authority,
  - (e) the Water Services Regulation Authority,
  - (f) the Office of Rail Regulation,
  - (g) the Northern Ireland Authority for Energy Regulation,
  - (h) the Department of Enterprise, Trade and Investment in Northern Ireland,
  - (i) a local weights and measures authority in Great Britain, or
  - (j) a body designated as a regulator under sub-paragraph (3).
- (2) The Secretary of State may by order amend sub-paragraph (1) so as to add, modify or omit an entry.
- (3) Where the Secretary of State thinks that a body which is not a public authority represents the interests of consumers (or consumers of a particular description), he may by order designate the body as a regulator.
- (4) The Secretary of State may cancel the designation if he thinks that the body has failed, or is likely to fail, to comply with a duty imposed on it under this Act.
- (5) The Secretary of State must publish (and may from time to time vary) other criteria to be applied by him in deciding whether to make or cancel a designation under this paragraph.

*The Financial Services Authority*

- 11 Any function that the Financial Services Authority has under this Act is to be regarded, for the purposes of the Financial Services and Markets Act 2000 (c. 8), as a function that it has under that Act.

**SCHEDULE 2 BEGINS OVERLEAF**

SCHEDULE 2

Section 14(6)

CONTRACT TERMS WHICH MAY BE REGARDED AS NOT FAIR AND REASONABLE

PART 1

INTRODUCTION

- 1 (1) A term of a consumer contract or small business contract may be regarded as not being fair and reasonable if it—
- (a) has the object or effect of a term listed in Part 2, and
  - (b) does not come within an exception mentioned in Part 3.
- (2) In this Schedule—
- (a) in relation to a consumer contract, “A” means the consumer and “B” means the business, and
  - (b) in relation to a small business contract, “A” and “B” mean, respectively, the persons referred to as A and B in section 11.

PART 2

LIST OF TERMS

- 2 A term excluding or restricting liability to A for breach of contract.
- 3 A term imposing obligations on A in circumstances where B’s obligation to perform depends on the satisfaction of a condition wholly within B’s control.
- 4 A term entitling B, if A exercises a right to cancel the contract or if B terminates the contract as a result of A’s breach, to keep sums that A has paid, the amount of which is unreasonable.
- 5 A term requiring A, when in breach of contract, to pay B a sum significantly above the likely loss to B.
- 6 A term entitling B to cancel the contract without incurring liability, unless there is also a term entitling A to cancel it without incurring liability.
- 7 A term entitling B, if A exercises a right to cancel the contract, to keep sums A has paid in respect of services which B has yet to supply.
- 8 A term in a fixed-term contract or a contract of indefinite duration entitling B to terminate the contract without giving A reasonable advance notice (except in an urgent case).

## EXPLANATORY NOTES

### SCHEDULE 2 CONTRACT TERMS WHICH MAY BE REGARDED AS NOT FAIR AND REASONABLE

100. Schedule 2 gives effect to the Annex to the Directive, which contains an indicative and non-exhaustive list of terms which may be regarded as unfair. The Schedule applies to consumer and small business contracts (see paragraph 1(1)). Paragraph 1(2) specifies that, for the purposes of the Schedule, "A" means the consumer or the small business seeking to challenge a contract term and "B" means the other party to the contract (that is, the party seeking to rely on the contract term).
101. The following are examples of terms that would fall within the general descriptions provided by the list:

Para	EXAMPLES
2	<p>A term which requires claims to be made within a short period of time</p> <p>A term in a contract for the repair of goods which provides that an ineffective repair will be corrected only if a person returns the goods to a particular place at his own expense</p> <p>A term which restricts a person's right to terminate a contract</p> <p>A term which limits the damages which may be claimed by a person</p> <p>A term which prevents a person from deducting compensation due to him from payments due from him</p> <p>A term which provides for a deposit paid by a person to be forfeited if he pursues any remedy</p> <p>A term which provides that a decision of the supplier, or a third party, that services are or are not in accordance with the contract is to be conclusive</p> <p>A term which excludes all conditions or warranties</p>
3	<p>A term of a loan agreement which obliges the consumer to take the loan in circumstances where the other party is under an obligation to make the loan only with the approval of one of its managers</p>
4	<p>A term of a contract for the sale of a house by a developer to a consumer which requires the consumer to pay a 25 per cent deposit to the developer in circumstances where there is no reasonable justification for the deposit being larger than the customary 10 per cent deposit</p>
5	<p>A term of a contract (other than a loan agreement) which requires the consumer, when late in making any payment, to pay a default rate of interest which is substantially more than the business has to pay when borrowing money</p> <p>A term of a loan agreement which requires the consumer, when late in making a payment, to pay a default rate of interest which is substantially above the rate payable before default</p> <p>A term of a contract for the sale of goods which requires the consumer, if he wrongfully terminates the contract, to compensate the business for the full loss of profit it suffers, without making any allowance for the amount which the business should be able to recover by taking reasonable steps to resell the goods</p>
6	<p>A term that allows a holiday company, in the event of insufficient bookings being received, to cancel a booked package holiday without compensation to the consumer up to three weeks before departure without giving the consumer the right to withdraw from the contract without liability up to three weeks before departure</p>
7	<p>A term that allows a holiday company, if the consumer exercises a right to cancel a booked package holiday, to keep the whole price of the holiday paid by the consumer at the time of booking</p>
8	<p>A term of a contract under which a small partnership is to provide personal property management services, allowing the property managers to terminate the contract without notice, rather than providing that it may be terminated after a reasonably long set period of notice but with a shorter period in the event, for instance, of the death or serious illness of one of the partners</p>

- 9 A term—
  - (a) providing for a contract of fixed duration to be renewed unless A indicates otherwise, and
  - (b) requiring A to give that indication a disproportionately long time before the contract is due to expire.
- 10 A term binding A to terms with which A did not have an opportunity to become familiar before the contract was made.
- 11 A term entitling B, without a good reason which is specified in the contract, to vary the terms of the contract.
- 12 A term entitling B, without a good reason, to vary the characteristics of the goods or services concerned.
- 13 A term requiring A to pay whatever price is set for the goods at the time of delivery (including a case where the price is set by reference to a list price), unless there is also a term entitling A to cancel the contract if that price is higher than the price indicated to A when the contract was made.
- 14 A term entitling B to increase the price specified in the contract, unless there is also a term entitling A to cancel the contract if the business does increase the price.
- 15 A term giving B the exclusive right (and, accordingly, excluding any power of a court) to determine—
  - (a) whether the goods or services supplied match the definition of them given in the contract, or
  - (b) the meaning of any term in the contract.
- 16 A term excluding or restricting B's liability for statements or promises made by B's employees or agents, or making B's liability for statements or promises subject to formalities.
- 17 A term requiring A to carry out its obligations in full (in particular, to pay the whole of the price specified in the contract) in circumstances where B has failed to carry out its obligations in full.
- 18 A term entitling B to transfer its obligations without A's consent.
- 19 A term entitling B to transfer its rights in circumstances where A's position might be weakened as a result.
- 20 A term excluding or restricting A's right—
  - (a) to bring or defend any action or other legal proceedings, or
  - (b) to exercise other legal remedies.
- 21 A term restricting the evidence on which A may rely.

## EXPLANATORY NOTES

Para	EXAMPLES
9	A term in a contract for an annual subscription to a magazine stating that the contract will be renewed for the following year, and the consumer will have to pay the subscription or a cancellation charge, unless the consumer sends a notice that he does not wish to renew by a date which is several months before the end of the current subscription period
10	A term in a document that was signed by the consumer stating that the consumer agrees to be bound by the business's general terms and conditions when the consumer had not seen the general terms and conditions and they were not available for him to look at
11	A term giving the business an unqualified right to alter the date by which it is to deliver goods rather than (a) limiting the right, for instance, to cases in which the delay is caused by reasons outside its control and (b) stating in the contract the circumstances in which it can defer delivery
12	A term that requires the consumer to accept a new car that is in a different colour to that specified, rather than (for instance) limiting the dealer's right to supply the car in a different colour to cases in which a new car in the specified colour is no longer obtainable and giving the consumer a right to cancel the contract without charge if he does not want the car in the colour offered
13	A term that permits the supplier of goods or services to charge a price that is to be determined at the date of delivery, unless the consumer is given the right to cancel the contract if the price is higher than that stated in the contract or quoted to the consumer
14	A term that permits the supplier of goods or services to increase the price charged, unless the consumer is given the right to cancel the contract in the event of a price increase
15	A term that states that the supplier's decision as to whether services were performed correctly shall be final  A term stating that, in the event of goods being returned and a refund sought, the supplier may retain a reasonable sum for the value the consumer obtained from the goods, where the term also states that the seller's assessment of a reasonable sum or of the value obtained by the consumer is final
16	A term providing that an employee or agent who negotiated the contract has no authority to make any promise or statement on behalf of the business  A term providing that no undertaking may be given by an employee or agent that the goods will meet the consumer's particular needs unless that is given in writing authorised by Head Office
17	A term requiring a consumer to pay a monthly rental sum for a phone even if there have been significant periods when the service was not available
18	A term in a contract for the carriage of the consumer's property that allows the business to employ other firms to carry out the contract and states that the business will not be responsible for damage caused by the other firms
19	A term that provides that the business may assign its rights to a debt-collection agency and that the consumer must pay the outstanding price to that agency in full, whatever the circumstances
20	A term that requires the consumer to submit any dispute to arbitration, mediation or any form of alternative dispute resolution before commencing legal action  A term that, when a service has not been performed correctly, excludes the consumer's right to withhold payment
21	A term stating that defective repairs will not be corrected unless the consumer provides proof of the contract by producing the original invoice

PART 3

EXCEPTIONS

*Financial services contracts*

- 22 (1) Sub-paragraph (2) applies where a term in a financial services contract of indefinite duration provides that B may terminate the contract –
- (a) by giving A relatively short advance notice, or
  - (b) if B has a good reason for terminating the contract, without giving A any advance notice.
- (2) Paragraph 8 (termination without reasonable notice) does not apply to the term if the contract also provides that B must immediately inform A of the termination.
- (3) Sub-paragraph (4) applies where a term in a financial services contract of indefinite duration provides that B may vary the interest rate or other charges payable under it –
- (a) by giving A relatively short advance notice, or
  - (b) if B has a good reason for making the variation, without giving A any advance notice.
- (4) Paragraph 11 (variation without good reason) does not apply to a term if the contract also provides that –
- (a) B must as soon as practicable inform A of the variation, and
  - (b) A may then cancel the contract, without incurring liability.
- (5) “Financial services contract” means a contract for the supply by B of financial services to A.

*Contracts of indefinite duration*

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

*Contracts for sale of securities, foreign currency, etc.*

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

## EXPLANATORY NOTES

102. Part 3 of Schedule 2 sets out a series of exceptions to paragraphs 8, 11, 13 and 14 of the Indicative List, which are in effect exceptions for certain terms in financial services contracts and contracts of indefinite duration. This part is similar to paragraph 2 of Schedule 2 to the UTCCR.

*Price index clauses*

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

SCHEDULE 3

Section 22

EXCEPTIONS

*Legal requirements*

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

*Settlements of claims*

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

*Insurance*

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

# EXPLANATORY NOTES

## SCHEDULE 3 EXCEPTIONS

103. This Schedule largely replicates the effect of Schedule 1 to UCTA [in Scotland UCTA sections 15 and 16 achieve a similar effect]. However, the exemptions relating to insurance, land, intellectual property, company formation, securities (such as stocks, shares, bonds and other financial instruments) and shipping do not apply to consumer contracts, as they would have done under UCTA. The Directive does not permit exemption of these types of consumer contract.
104. Paragraph 8 of Schedule 3 creates an exemption for international supply contracts, which is similar but not identical to UCTA section 26. The principal changes are that (1) international consumer contracts of supply are not exempted from the controls over terms excluding or restricting liability as they would have been under UCTA section 26 (this is not permitted by the Directive on certain aspects of the sale of consumer goods and associated guarantees) and (2) business contracts for the supply of goods are exempted when they are export contracts but not when they are import contracts.

**THE REST OF SCHEDULE 3 IS SET OUT DOUBLE-SIDED ON THE  
FOLLOWING PAGES**

*Land*

- 4 The following sections do not apply to a contract term in so far as it relates to the creation, transfer, variation or termination of an interest or real right in land –
- (a) section 1 (exclusion of business liability for negligence),
  - (b) section 9 (exclusion of liability for breach of business contract where one party deals on written standard terms of the other),
  - (c) section 11 (non-negotiated terms in small business contracts).

*Intellectual property*

- 5 Nor do those sections apply to a contract term in so far as it relates to the creation, transfer, variation or termination of a right or interest in any patent, trade mark, copyright or design right, registered design, technical or commercial information or other intellectual property.

*Company formation, etc.*

- 6 Nor do those sections apply to a contract term in so far as it relates to –
- (a) the formation or dissolution of a body corporate or unincorporated association (including a partnership),
  - (b) its constitution, or
  - (c) the rights and obligations of its members.

*Securities*

- 7 Nor do those sections apply to a contract term in so far as it relates to the creation or transfer of securities or of a right or interest in securities.

*International supply contracts*

- 8 The following provisions do not apply to a business contract for the supply of goods where the supply is to be made to a place outside the United Kingdom –
- (a) section 1(2) (business liability for negligence other than in case of death or personal injury),
  - (b) sections 9 to 11 (unfair terms in business contracts),
  - (c) sections 19 and 20 (choice of law in business contracts).

*Shipping*

- 9 (1) Section 1(2) does not apply to a shipping contract unless it is also a consumer contract.
- (2) Sections 9 and 11 do not apply to a shipping contract.
- (3) “Shipping contract” means –
- (a) a contract of marine salvage or towage,
  - (b) a charterparty of a ship or hovercraft, or
  - (c) a contract for the carriage of goods by ship or hovercraft.

- 10 (1) This paragraph applies where goods are carried by ship or hovercraft under a contract which—
  - (a) specifies that as the means of transport for part of the journey, or
  - (b) does not specify a means of transport but does not exclude that one.
- (2) Section 1(2) does not apply to the contract, unless it is also a consumer contract, in so far as it relates to the carriage of the goods by that means of transport.
- (3) Sections 9 and 11 do not apply to the contract in so far as it relates to the carriage of the goods by that means of transport.

## SCHEDULE 4

Section 27

## CALCULATING THE NUMBER OF EMPLOYEES IN A BUSINESS

*Introduction*

- 1 (1) This Schedule sets out how to calculate the number of employees that a party to a business contract, or an associated person, has in its business.
- (2) “The business period” means a continuous period for which –
  - (a) the party to the business contract has been carrying on the business to which the contract relates, or
  - (b) an associated person has been carrying on business.

*Calculation for established business*

- 2 Where the business period is at least twelve months ending on the last day of the month immediately before the month including the contract date –
  - (a) work out how many full-time employees there are in the business on the last day of each of the twelve months ending with the last complete month before the contract date,
  - (b) add together the numbers for those twelve days, and
  - (c) divide the total by twelve.

*Calculation for new business*

- 3 Where the business period is at least one complete month ending on the last day of the month immediately before the month including the contract date (but paragraph 2 does not apply) –
  - (a) work out how many full-time employees there are in the business on the last day of each complete month,
  - (b) add together the numbers for those days, and
  - (c) divide the total by the number of complete months.
- 4 Where the business period is less than one complete month, but more than one day, before the contract date –
  - (a) work out how many full-time employees there are in the business on each day,
  - (b) add together the numbers for those days, and
  - (c) divide that total by the number of days.
- 5 Where the party to the contract enters into it on the first day on which it carries on the business to which the contract relates, or an associated person has been carrying on business for only one day, work out how many full-time employees there are in the business on the day in question.

*The number of full-time employees in a business*

- 6 (1) This paragraph sets out how to work out how many full-time employees there are in a business.
- (2) An employee who works for at least 35 hours a week for a business counts as one full-time employee.

# EXPLANATORY NOTES

## SCHEDULE 4 CALCULATING THE NUMBER OF EMPLOYEES IN A BUSINESS

105. Schedule 4 sets out the manner in which the number of employees in a business is to be calculated. It draws on the approach taken to counting employees under the regime put in place by the Late Payment of Commercial Debts legislation (Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order (SI 1998 No 2479), Schedule 2).
106. The question for most cases – that is, cases involving established businesses – is the number of employees calculated by reference to the 12 complete months preceding the month in which the relevant contract was made; and the basic calculation is set out in paragraph 2. The calculation is different for newly established businesses and these are dealt with in paragraph 3.
107. In either case an averaging calculation is required: the number of employees in a business for the purposes of clause 27 is the average number of employees employed day-to-day or month-to-month over a statutory “business period” of a year or less.
108. The calculation is performed on a full-time equivalent basis: part-time employees are each treated as a fraction of a full-time employee. The calculation for converting part-time employees into full-time equivalents is set out in paragraph 6.
109. “Employee” is defined in paragraph 8 and includes any person working in the business under a contract of employment or a contract for services. This is a wide definition which corresponds to the definition of “worker” in the Employment Rights Act 1996 and the National Minimum Wage Act 1998 (where “employee” is given a narrower definition). “Contract of employment” includes contracts of service or apprenticeship. “Contract for services” includes all independent contractors not covered by “contract of employment”, as well as agency workers, provided they work ‘in the business’.

- (3) An employee who works for under 35 hours a week for a business (a “part-time employee”) counts as a fraction of one full-time employee, with the fraction being calculated as –

$$\frac{A}{B}$$

where A and B are defined as follows.

- (4) A is the number of hours a week which the part-time employee works for the business.
- (5) B is –
- (a) the number of hours a week which a full-time employee of the same description as the part-time employee works for the business, or
  - (b) if there are no full-time employees of that description, 35 hours a week.
- (6) The number of hours a week which an employee works for a business is –
- (a) the number of hours a week which he is contractually required to work for the business, or
  - (b) if he ordinarily works for a longer period than that, or his contract does not specify for how many hours a week he is to work, the number of hours a week he ordinarily works for the business, but does not include any meal break, or rest period, exceeding 15 minutes.

#### *Interpretation*

- 7 “Contract date”, in relation to a business contract, means the date on which the contract is made.
- 8 “Employee” –
- (a) in relation to any business, means an individual who works in the business under a contract of employment or a contract for services;
  - (b) in relation to a business carried on by a partnership (or other unincorporated association), includes a partner (or member);
  - (c) in relation to a business carried on by only one individual, includes that individual.

**SCHEDULES 5 AND 6 BEGIN OVERLEAF**

## SCHEDULE 5

Section 34(1)

## MINOR AND CONSEQUENTIAL AMENDMENTS

*Misrepresentation Act 1967 (c. 7)*

- 1 In section 3 of the Misrepresentation Act 1967 (c. 7) (avoidance of provision excluding liability for misrepresentation), for the words from “that term” to the end, substitute “that term is of no effect unless it is fair and reasonable for the purposes of the Unfair Contract Terms Act 2005 (and, accordingly, Part 4 of that Act applies in relation to the term)”.

*Misrepresentation Act (Northern Ireland) 1967 (c. 14 (NI))*

- 2 In section 3 of the Misrepresentation Act (Northern Ireland) 1967 (c. 14 (NI)) (avoidance of provision excluding liability for misrepresentation), make the same substitution.

*Supply of Goods (Implied Terms) Act 1973 (c. 13)*

- 3 The Supply of Goods (Implied Terms) Act 1973 (c. 13) is amended as follows.
- 4 In section 10 (implied undertakings as to quality or fitness) –
- (a) in subsections (2D) and (2F), for the words from “the person” to “consumer contract”, substitute “the agreement is a consumer contract under which the goods are bailed or hired to the consumer”, and
  - (b) omit subsection (8).
- 5 In section 11A (the title to which becomes “Modification of remedies for breach of statutory condition where bailee not consumer”) –
- (a) in subsection (1), for “the person to whom the goods are bailed does not deal as consumer” substitute “the agreement is not a consumer contract under which the goods are bailed to the consumer”,
  - (b) for subsection (3)(b) substitute –
    - “(b) that the agreement was not a consumer contract under which the goods were bailed to the consumer.”,
    - and
  - (c) omit subsection (4).
- 6 In section 12A (remedies for breach of hire-purchase agreements in Scotland) –
- (a) in subsection (2), after “consumer contract” insert “under which the goods are hired to the consumer”, and
  - (b) for subsection (3) substitute –
    - “(3) For the purposes of subsection (2), if the creditor wishes to rely on a hire-purchase contract not being a consumer contract under which goods are hired to the consumer, it is for the creditor to prove that it is not.”.
- 7 In section 14(1) (special provision about conditional sale agreements), for the words from “where” to the end substitute “which is a consumer contract under which the buyer is the consumer.”.
- 8 In section 15(1) (interpretation) –

# EXPLANATORY NOTES

## SCHEDULES 5 AND 6

### **Schedule 5 Minor and consequential amendments**

110. Schedule 5 makes provision for consequential amendments to existing statutes.

### **Schedule 6 Repeals and revocations**

111. Schedule 6 makes provision for the consequential repeal and revocation of existing statutory provisions.

**THE REST OF THE BILL IS SET OUT DOUBLE-SIDED ON THE  
FOLLOWING PAGES**

- (a) for the definition of “business” substitute –
  - “ “business” includes a profession and the activities of a public authority (within the meaning of the Human Rights Act 1998 (c. 42))”, and
- (b) at the appropriate place insert –
  - “ “consumer contract”, and “the consumer” in relation to a consumer contract, have the same meaning as in section 26 of the Unfair Contract Terms Act 2005;”.

*Sale of Goods Act 1979 (c. 54)*

- 9 The Sale of Goods Act 1979 (c. 54) is amended as follows.
- 10 In section 14 (implied terms about quality or fitness), in subsections (2D) and (2F), for the words from “the buyer” to “consumer contract” substitute “the contract is a consumer contract under which the buyer is the consumer”.
- 11 In section 15A (the title to which becomes “Modifications of remedies for breach of condition where buyer not consumer”), for “the buyer does not deal as consumer” substitute “the contract is not a consumer contract under which the buyer is the consumer”.
- 12 In section 15B (remedies for breach of contract in Scotland), in subsection (2), after “consumer contract” insert “under which the buyer is the consumer”.
- 13 In section 20 (passing of risk), in subsection (4), for the words from “In a case” to “is a consumer” substitute “Where there is a consumer contract under which the buyer is the consumer”.
- 14 In section 30 (delivery of wrong quantity), in subsection (2A), for “A buyer who does not deal as consumer” substitute “Where the contract is not a consumer contract under which the buyer is the consumer, the buyer”.
- 15 In section 32 (delivery to carrier), in subsection (4), for the words from “In a case” to “is a consumer,” substitute “Where there is a consumer contract under which the buyer is the consumer,”.
- 16 In section 35 (acceptance), in subsection (3), for the words from “the buyer deals” to “consumer contract” substitute “there is a consumer contract under which the buyer is the consumer”.
- 17 In section 48A (additional rights of buyer in consumer cases), for subsection (1)(a) substitute –
  - “(a) there is a consumer contract under which the buyer is the consumer;”.
- 18 In section 55(1) (exclusion by parties of implied contractual terms), for “the Unfair Contract Terms Act 1977” substitute “the Unfair Contract Terms Act 2005”.
- 19 In section 61 (interpretation) –
  - (a) in subsection (1), for the definition of “consumer contract” substitute –
    - “ “consumer contract” and, in relation to a consumer contract, “the consumer” have the same meaning as in section 26 of the Unfair Contract Terms Act 2005”, and

(b) for subsection (5A) substitute –

“(5A) For the purposes of this Act, if the seller wishes to rely on a contract for the sale of goods not being a consumer contract under which the buyer is the consumer, it is for the seller to prove that it is not.”.

*Supply of Goods and Services Act 1982 (c. 29)*

- 20 The Supply of Goods and Services Act 1982 (c. 29) is amended as follows.
- 21 In section 4 (implied terms about quality or fitness in contract for transfer of goods), in subsections (2B) and (2D), for “the transferee deals as consumer” substitute “the contract is a consumer contract under which the transferee is the consumer”.
- 22 In section 5A (the title to which becomes “Modification of remedies for breach of statutory condition where transferee not consumer”), in subsection (1), for “the transferee does not deal as consumer” substitute “the contract is not a consumer contract under which the transferee is the consumer”.
- 23 In section 9 (implied terms about quality or fitness), in subsections (2B) and (2D), for “the bailee deals as consumer” substitute “the contract is a consumer contract under which the bailee is the consumer”.
- 24 In section 10A (the title to which becomes “Modification of remedies for breach of statutory condition where bailee not consumer”), in subsection (1), for “the bailee does not deal as consumer” substitute “the contract is not a consumer contract under which the bailee is the consumer”.
- 25 In section 11(1) (exclusion of implied terms, etc.), for “the 1977 Act” substitute “the 2005 Act”.
- 26 In section 11D (implied terms about quality or fitness in contract for transfer of goods in Scotland), in subsections (3A) and (3C), after “consumer contract” insert “and the transferee is the consumer”.
- 27 In section 11F (remedies for breach of contract in Scotland), omit subsection (3).
- 28 In section 11J (implied terms about quality or fitness in contract for hire of goods in Scotland), in subsections (3A) and (3C), after “consumer contract” insert “and the person to whom the goods are hired is the consumer”.
- 29 In section 11L(1) (exclusion of implied terms, etc. in Scotland), for “the 1977 Act” substitute “the 2005 Act”.
- 30 In section 11M (additional rights of transferee in consumer cases), for subsection (1)(a) substitute –
- “(a) there is a consumer contract under which the transferee is the consumer,”.
- 31 In section 16(1) (exclusion of implied terms, etc.), for “the 1977 Act” substitute “the 2005 Act”.
- 32 In section 18 (general interpretation) –

- (a) in subsection (1), at the appropriate place insert—
  - ““consumer contract” and, in relation to a consumer contract, “the consumer” have the same meaning as in section 26 of the 2005 Act;”, and
- (b) for subsection (4) substitute—
  - “(4) For those purposes, if the transferor wishes to rely on a contract for the transfer of goods not being a consumer contract under which the transferee is the consumer, it is for the transferor to prove that it is not.
  - (5) Subsection (4) also applies in relation to a contract for the hire of goods; and for that purpose—
    - (a) “transferor” includes the bailor or supplier, and
    - (b) “transferee” includes the bailee or person to whom the goods are hired.

- 33 In section 19 (interpretation: references to Acts)—
- (a) omit the definition of “the 1977 Act” and the word “and” immediately following it, and
  - (b) at the end, insert “; and  
“the 2005 Act” means the Unfair Contract Terms Act 2005”.

*Merchant Shipping Act 1995 (c. 21)*

- 34 In section 184 of the Merchant Shipping Act 1995 (c. 21) (Orders in Council relating to carriage within the British Islands), omit subsection (2).

*Arbitration Act 1996 (c. 23)*

- 35 The Arbitration Act 1996 (c. 23) is amended as follows.
- 36 In section 89 (the cross-heading immediately above which becomes “Consumer and small business arbitration agreements” and the title to which becomes “Application of the Unfair Contract Terms Act 2005”)—
- (a) for subsections (1) and (2) substitute—
    - “(1) Sections 90 and 91 extend the application of sections 4 and 11 of the 2005 Act (detrimental terms in consumer and small business contracts) in relation to a term which constitutes an arbitration agreement.
    - (2) For that purpose—
      - “the 2005 Act” means the Unfair Contract Terms Act 2005, and
      - “arbitration agreement” means an agreement to submit to arbitration present or future disputes or differences (whether or not contractual).”, and
  - (b) in subsection (3), for “Those sections” substitute “Sections 90 and 91”.

- 37 For section 90 substitute—

**“90 Application where consumer is a legal person**

Section 4 of the 2005 Act applies where the consumer is a legal person as it applies where the consumer is a natural person.”.

- 38 In section 91(1) (arbitration agreement unfair where modest amount sought) for “the Regulations” substitute “sections 4 and 11 of the 2005 Act”.

*Late Payment of Commercial Debts (Interest) Act 1998 (c. 20)*

- 39 In section 14 of the Late Payment of Commercial Debts (Interest) Act 1998 (c. 20) (postponement of date for payment of contract price) in subsection (2), for “Sections 3(2)(b) and 17(1)(b) of the Unfair Contract Terms Act 1977” substitute “Section 9 of the Unfair Contract Terms Act 2005”.

*Contracts (Rights of Third Parties) Act 1999 (c. 31)*

- 40 In section 7(2) of the Contracts (Rights of Third Parties) Act 1999 (c. 31) (disapplication of restriction on exclusion of liability for negligence) for “Section 2(2) of the Unfair Contract Terms Act 1977” substitute “Section 1(2) of the Unfair Contract Terms Act 2005”.

SCHEDULE 6

Section 34(2)

REPEALS AND REVOCATIONS

PART 1

REPEALS

<i>Reference</i>	<i>Extent of repeal</i>
Supply of Goods (Implied Terms) Act 1973 (c. 13)	Section 10(8). Section 11A(4).
Unfair Contract Terms Act 1977 (c. 50)	The whole Act.
Sale of Goods Act 1979 (c. 54)	In Schedule 2, paragraphs 19 to 22.
Supply of Goods and Services Act 1982 (c. 29)	Section 11B(6). Section 11D(10). Section 11F(3). Section 11J(10). Section 11M(5). Section 17(2) and (3). In section 19, the definition of “the 1977 Act” and the word “and” immediately following it.
Occupiers’ Liability Act 1984 (c. 3)	Section 2.
Copyright, Designs and Patents Act 1988 (c. 48)	In Schedule 7, paragraph 24.
Contracts (Applicable Law) Act 1990 (c. 36)	In Schedule 4, paragraph 4.
Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 (c. 40)	Section 68.
Trade Marks Act 1994 (c. 26)	In Schedule 4, in paragraph 1(2), the reference to the Unfair Contract Terms Act 1977.
Sale and Supply of Goods Act 1994 (c. 35)	In Schedule 2, paragraph 5(9)(a)(i) and (c).
Merchant Shipping Act 1995 (c. 21)	Section 184(2).

## PART 2

## REVOCATIONS

<i>Reference</i>	<i>Extent of revocation</i>
Occupiers' Liability (Northern Ireland) Order 1987 (SI 1987/1280 (NI 15))	Article 4.
Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083)	The whole Regulations.
Unfair Terms in Consumer Contracts (Amendment) Regulations 2001 (SI 2001/1186)	The whole Regulations.
Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649)	Article 583.
Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002/3045)	Regulation 14.
Enterprise Act 2002 (Part 9 Restrictions on Disclosure of Information (Amendment and Specification) Order 2003 (SI 2003/1400)	In Schedule 4, the reference to the Unfair Terms in Consumer Contracts Regulations 1999.
Enterprise Act 2002 (Part 8 Domestic Infringements) Order 2003 (SI 2003/1593)	In the Schedule, the reference to the Unfair Contract Terms Act 1977.
Communications Act 2003 (Consequential Amendments No 2) Order 2003 (SI 2003/3182)	Article 2.

# **APPENDIX B**

## **THE UNFAIR CONTRACT TERMS ACT 1977**

An Act to impose further limits on the extent to which under the law of England and Wales and Northern Ireland civil liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms and otherwise, and under the law of Scotland civil liability can be avoided by means of contract terms.

### **PART I**

#### **AMENDMENT OF LAW FOR ENGLAND AND WALES AND NORTHERN IRELAND**

##### **Introductory**

##### **1 Scope of Part I**

- (1) For the purposes of this Part of this Act, “negligence” means the breach –
  - (a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;
  - (b) of any common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty);
  - (c) of the common duty of care imposed by the Occupiers’ Liability Act 1957 or the Occupiers’ Liability Act (Northern Ireland) 1957.
- (2) This Part of this Act is subject to Part III; and in relation to contracts, the operation of sections 2 to 4 and 7 is subject to the exceptions made by Schedule 1.
- (3) In the case of both contract and tort, sections 2 to 7 apply (except where the contrary is stated in section 6(4)) only to business liability, that is liability for breach of obligations or duties arising –
  - (a) from things done or to be done by a person in the course of a business (whether his own business or another’s); or
  - (b) from the occupation of premises used for business purposes of the occupier;and references to liability are to be read accordingly but liability of an occupier of premises for breach of an obligation or duty towards a person obtaining access to the premises for recreational or educational purposes, being liability for loss or damage suffered by reason of the dangerous state of the premises, is not a business liability of the occupier unless granting that person such access for the purposes concerned falls within the business purposes of the occupier.
- (4) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the breach was inadvertent or intentional, or whether liability for it arises directly or vicariously.

##### **Avoidance of liability for negligence, breach of contract, etc**

##### **2 Negligence liability**

- (1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.
- (2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.

- (3) Where a contract term or notice purports to exclude or restrict liability for negligence a person's agreement to or awareness of it is not of itself to be taken as indicating his voluntary acceptance of any risk.

### **3 Liability arising in contract**

- (1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.
- (2) As against that party, the other cannot by reference to any contract term –
- (a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or
  - (b) claim to be entitled –
    - (i) to render a contractual performance substantially different from that which was reasonably expected of him, or
    - (ii) in respect of the whole or any part of his contractual obligation, to render no performance at all,
- except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.

### **4 Unreasonable indemnity clauses**

- (1) A person dealing as consumer cannot by reference to any contract term be made to indemnify another person (whether a party to the contract or not) in respect of liability that may be incurred by the other for negligence or breach of contract, except in so far as the contract term satisfies the requirement of reasonableness.
- (2) This section applies whether the liability in question –
- (a) is directly that of the person to be indemnified or is incurred by him vicariously;
  - (b) is to the person dealing as consumer or to someone else.

### **Liability arising from sale or supply of goods**

#### **5 "Guarantee" of consumer goods**

- (1) In the case of goods of a type ordinarily supplied for private use or consumption, where loss or damage –
- (a) arises from the goods proving defective while in consumer use; and
  - (b) results from the negligence of a person concerned in the manufacture or distribution of the goods,
- liability for the loss or damage cannot be excluded or restricted by reference to any contract term or notice contained in or operating by reference to a guarantee of the goods.
- (2) For these purposes –
- (a) goods are to be regarded as "in consumer use" when a person is using them, or has them in his possession for use, otherwise than exclusively for the purposes of a business; and
  - (b) anything in writing is a guarantee if it contains or purports to contain some promise or assurance (however worded or presented) that defects will be made good by complete or partial replacement, or by repair, monetary compensation or otherwise.
- (3) This section does not apply as between the parties to a contract under or in pursuance of which possession or ownership of the goods passed.

## **6 Sale and hire-purchase**

- (1) Liability for breach of the obligations arising from –
  - (a) section 12 of the Sale of Goods Act 1979 (seller's implied undertakings as to title, etc);
  - (b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (the corresponding thing in relation to hire-purchase),cannot be excluded or restricted by reference to any contract term.
- (2) As against a person dealing as consumer, liability for breach of the obligations arising from –
  - (a) section 13, 14 or 15 of the 1979 Act (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);
  - (b) section 9, 10 or 11 of the 1973 Act (the corresponding things in relation to hire-purchase),cannot be excluded or restricted by reference to any contract term.
- (3) As against a person dealing otherwise than as consumer, the liability specified in subsection (2) above can be excluded or restricted by reference to a contract term, but only in so far as the term satisfies the requirement of reasonableness.
- (4) The liabilities referred to in this section are not only the business liabilities defined by section 1(3), but include those arising under any contract of sale of goods or hire-purchase agreement.

## **7 Miscellaneous contracts under which goods pass**

- (1) Where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods or hire-purchase, subsections (2) to (4) below apply as regards the effect (if any) to be given to contract terms excluding or restricting liability for breach of obligation arising by implication of law from the nature of the contract.
- (2) As against a person dealing as consumer, liability in respect of the goods' correspondence with description or sample, or their quality or fitness for any particular purpose, cannot be excluded or restricted by reference to any such term.
- (3) As against a person dealing otherwise than as consumer, that liability can be excluded or restricted by reference to such a term, but only in so far as the term satisfies the requirement of reasonableness.
- (3A) Liability for breach of the obligations arising under section 2 of the Supply of Goods and Services Act 1982 (implied terms about title etc in certain contracts for the transfer of the property in goods) cannot be excluded or restricted by reference to any such term.
- (4) Liability in respect of –
  - (a) the right to transfer ownership of the goods, or give possession; or
  - (b) the assurance of quiet possession to a person taking goods in pursuance of the contract,cannot (in a case to which subsection (3A) above does not apply) be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness.

- (5) This section does not apply in the case of goods passing on a redemption of trading stamps within the Trading Stamps Act 1964 or the Trading Stamps Act (Northern Ireland) 1965.

## **8 Misrepresentation**

This section substitutes the Misrepresentation Act 1967, s 3 and the Misrepresentation Act (Northern Ireland) 1967, s 3.

### **Other provisions about contracts**

## **9 Effect of breach**

- (1) Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.
- (2) Where on a breach the contract is nevertheless affirmed by a party entitled to treat it as repudiated, this does not of itself exclude the requirement of reasonableness in relation to any contract term.

## **10 Evasion by means of secondary contract**

A person is not bound by any contract term prejudicing or taking away rights of his which arise under, or in connection with the performance of, another contract, so far as those rights extend to the enforcement of another's liability which this Part of this Act prevents that other from excluding or restricting.

### **Explanatory provisions**

## **11 The "reasonableness" test**

- (1) In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have been a fair and reasonable one to be included 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.
- (2) In determining for the purposes of section 6 or 7 above whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection does not prevent the court or arbitrator from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.
- (3) In relation to a notice (not being a notice having contractual effect), the requirement of reasonableness under this Act is that it should be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen.
- (4) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this or any other Act) whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular (but without prejudice to subsection (2) above in the case of contract terms) to –
- (a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and
  - (b) how far it was open to him to cover himself by insurance.
- (5) It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.

## **12 “Dealing as consumer”**

- (1) A party to a contract “deals as consumer” in relation to another party if –
  - (a) he neither makes the contract in the course of a business nor holds himself out as doing so; and
  - (b) the other party does make the contract in the course of a business; and
  - (c) in the case of a contract governed by the law of sale of goods or hire-purchase, or by section 7 of this Act, the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.
- (1A) But if the first party mentioned in subsection (1) is an individual paragraph (c) of that subsection must be ignored.
- (2) But the buyer is not in any circumstances to be regarded as dealing as consumer –
  - (a) if he is an individual and the goods are second hand goods sold at public auction at which individuals have the opportunity of attending the sale in person;
  - (b) if he is not an individual and the goods are sold by auction or by competitive tender.
- (3) Subject to this, it is for those claiming that a party does not deal as consumer to show that he does not.

## **13 Varieties of exemption clause**

- (1) To the extent that this Part of this Act prevents the exclusion or restriction of any liability it also prevents –
  - (a) making the liability or its enforcement subject to restrictive or onerous conditions;
  - (b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;
  - (c) excluding or restricting rules of evidence or procedure;and (to that extent) sections 2 and 5 to 7 also prevent excluding or restricting liability by reference to terms and notices which exclude or restrict the relevant obligation or duty.
- (2) But an agreement in writing to submit present or future differences to arbitration is not to be treated under this Part of this Act as excluding or restricting any liability.

## **14 Interpretation of Part I**

In this Part of this Act –

“business” includes a profession and the activities of any government department or local or public authority;

“goods” has the same meaning as in the Sale of Goods Act 1979;

“hire-purchase agreement” has the same meaning as in the Consumer Credit Act 1974;

“negligence” has the meaning given by section 1(1);

“notice” includes an announcement, whether or not in writing, and any other communication or pretended communication; and

“personal injury” includes any disease and any impairment of physical or mental condition.

## **PART II**

### **AMENDMENT OF LAW FOR SCOTLAND**

#### **15 Scope of Part II**

- (1) This Part of this Act applies only to contracts, is subject to Part III of this Act and does not affect the validity of any discharge or indemnity given by a person in consideration of the receipt by him of compensation in settlement of any claim which he has.
- (2) Subject to subsection (3) below, sections 16 to 18 of this Act apply to any contract only to the extent that the contract –
  - (a) relates to the transfer of the ownership or possession of goods from one person to another (with or without work having been done on them);
  - (b) constitutes a contract of service or apprenticeship;
  - (c) relates to services of whatever kind, including (without prejudice to the foregoing generality) carriage, deposit and pledge, care and custody, mandate, agency, loan and services relating to the use of land;
  - (d) relates to the liability of an occupier of land to persons entering upon or using that land;
  - (e) relates to a grant of any right or permission to enter upon or use land not amounting to an estate or interest in the land.
- (3) Notwithstanding anything in subsection (2) above, sections 16 to 18 –
  - (a) do not apply to any contract to the extent that the contract –
    - (i) is a contract of insurance (including a contract to pay an annuity on human life);
    - (ii) relates to the formation, constitution or dissolution of any body corporate or unincorporated association or partnership;
  - (b) apply to –
    - a contract of marine salvage or towage;
    - a charter party of a ship or hovercraft;
    - a contract for the carriage of goods by ship or hovercraft; or,
    - a contract to which subsection (4) below relates,only to the extent that –
    - (i) both parties deal or hold themselves out as dealing in the course of a business (and then only in so far as the contract purports to exclude or restrict liability for breach of duty in respect of death or personal injury);  
or
    - (ii) the contract is a consumer contract (and then only in favour of the consumer).
- (4) This subsection relates to a contract in pursuance of which goods are carried by ship or hovercraft and which either –
  - (a) specifies ship or hovercraft as the means of carriage over part of the journey to be covered; or
  - (b) makes no provision as to the means of carriage and does not exclude ship or hovercraft as that means,in so far as the contract operates for and in relation to the carriage of the goods by that means.

## **16 Liability for breach of duty**

- (1) Subject to subsection (1A) below, where a term of a contract, or a provision of a notice given to persons generally or to particular persons, 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 of the occupier, that term or provision –
  - (a) shall be void in any case where such exclusion or restriction is in respect of death or personal injury;
  - (b) shall, in any other case, have no effect if it was not fair and reasonable to incorporate the term in the contract or, as the case may be, if it is not fair and reasonable to allow reliance on the provision.
- (1A) Nothing in paragraph (b) of subsection (1) above shall be taken as implying that a provision of a notice has effect in circumstances where, apart from that paragraph, it would not have effect.
- (2) Subsection (1)(a) above does not affect the validity of any discharge and indemnity given by a person, on or in connection with an award to him of compensation for pneumoconiosis attributable to employment in the coal industry, in respect of any further claim arising from his contracting that disease.
- (3) Where under subsection (1) above a term of a contract or a provision of a notice is void or has no effect, the fact that a person agreed to, or was aware of, the term or provision shall not of itself be sufficient evidence that he knowingly and voluntarily assumed any risk.

## **17 Control of unreasonable exemptions in consumer or standard form contracts**

- (1) Any term of a contract which is a consumer contract or a standard form contract shall have no effect for the purpose of enabling a party to the contract –
  - (a) who is in breach of a contractual obligation, to exclude or restrict any liability of his to the consumer or customer in respect of the breach;
  - (b) in respect of a contractual obligation, to render no performance, or to render a performance substantially different from that which the consumer or customer reasonably expected from the contract;if it was not fair and reasonable to incorporate the term in the contract.
- (2) In this section “customer” means a party to a standard form contract who deals on the basis of written standard terms of business of the other party to the contract who himself deals in the course of a business.

## **18 Unreasonable indemnity clauses in consumer contracts**

- (1) Any term of a contract which is a consumer contract shall have no effect for the purpose of making the consumer indemnify another person (whether a party to the contract or not) in respect of liability which that other person may incur as a result of breach of duty or breach of contract, if it was not fair and reasonable to incorporate the term in the contract.
- (2) In this section “liability” means liability arising in the course of any business or from the occupation of any premises used for business purposes of the occupier.

## **19 “Guarantee” of consumer goods**

- (1) This section applies to a guarantee –

- (a) in relation to goods which are of a type ordinarily supplied for private use or consumption; and
  - (b) which is not a guarantee given by one party to the other party to a contract under or in pursuance of which the ownership or possession of the goods to which the guarantee relates is transferred.
- (2) A term of a guarantee to which this section applies shall be void in so far as it purports to exclude or restrict liability for loss or damage (including death or personal injury) –
- (a) arising from the goods proving defective while –
    - (i) in use otherwise than exclusively for the purposes of a business; or
    - (ii) in the possession of a person for such use; and
  - (b) resulting from the breach of duty of a person concerned in the manufacture or distribution of the goods.
- (3) For the purposes of this section, any document is a guarantee if it contains or purports to contain some promise or assurance (however worded or presented) that defects will be made good by complete or partial replacement, or by repair, monetary compensation or otherwise.

## **20 Obligations implied by law in sale and hire-purchase contracts**

- (1) Any term of a contract which purports to exclude or restrict liability for breach of the obligations arising from –
- (a) section 12 of the Sale of Goods Act 1979 (seller's implied undertakings as to title etc.);
  - (b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (implied terms as to title in hire-purchase agreements),
- shall be void.
- (2) Any term of a contract which purports to exclude or restrict liability for breach of the obligations arising from –
- (a) section 13, 14 or 15 of the said Act of 1979 (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);
  - (b) section 9, 10 or 11 of the said Act of 1973 (the corresponding provisions in relation to hire-purchase),
- shall –
- (i) in the case of a consumer contract, be void against the consumer;
  - (ii) in any other case, have no effect if it was not fair and reasonable to incorporate the term in the contract.

## **21 Obligations implied by law in other contracts for the supply of goods**

- (1) Any term of a contract to which this section applies purporting to exclude or restrict liability for breach of an obligation –
- (a) such as is referred to in subsection (3)(a) below –
    - (i) in the case of a consumer contract, shall be void against the consumer, and
    - (ii) in any other case, shall have no effect if it was not fair and reasonable to incorporate the term in the contract;
  - (b) such as is referred to in subsection (3)(b) below, shall have no effect if it was not fair and reasonable to incorporate the term in the contract.

- (2) This section applies to any contract to the extent that it relates to any such matter as is referred to in section 15(2)(a) of this Act, but does not apply to –
  - (a) a contract of sale of goods or a hire-purchase agreement; or
  - (b) a charterparty of a ship or hovercraft unless it is a consumer contract (and then only in favour of the consumer).
- (3) An obligation referred to in this subsection is an obligation incurred under a contract in the course of a business and arising by implication of law from the nature of the contract which relates –
  - (a) to the correspondence of goods with description or sample, or to the quality or fitness of goods for any particular purpose; or
  - (b) to any right to transfer ownership or possession of goods, or to the enjoyment of quiet possession of goods.
- (3A) Notwithstanding anything in the foregoing provisions of this section, any term of a contract which purports to exclude or restrict liability for breach of the obligations arising under section 11B of the Supply of Goods and Services Act 1982 (implied terms about title, freedom from encumbrances and quiet possession in certain contracts for the transfer of property in goods) shall be void.<sup>1</sup>
- (4) Nothing in this section applies to the supply of goods on a redemption of trading stamps within the Trading Stamps Act 1964.

## **22 Consequence of breach**

For the avoidance of doubt, where any provision of this Part of this Act requires that the incorporation of a term in a contract must be fair and reasonable for that term to have effect –

- (a) if that requirement is satisfied, the term may be given effect to notwithstanding that the contract has been terminated in consequence of breach of that contract;
- (b) for the term to be given effect to, that requirement must be satisfied even where a party who is entitled to rescind the contract elects not to rescind it.

## **23 Evasion by means of secondary contract**

Any term of any contract shall be void which purports to exclude or restrict, or has the effect of excluding or restricting –

- (a) the exercise, by a party to any other contract, of any right or remedy which arises in respect of that other contract in consequence of breach of duty, or of obligation, liability for which could not by virtue of the provisions of this Part of this Act be excluded or restricted by a term of that other contract;

<sup>1</sup> Section 21(3A) does not appear in a number of the published versions of UCTA, but it is in force. The background to the provision is as follows.

Schedule 1 to the Sale and Supply of Goods Act 1994 inserted a new Part 1A into the Supply of Goods and Services Act 1982, to deal with the supply of goods in Scotland.

Section 11B(6) of Part 1A itself inserted a new subsection (3A) into section 21 of UCTA, to provide a Scottish equivalent of section 7(3) of that Act. In effect, section 11B(6) made an insertion within an insertion.

The new Part 1A came into force (as did the whole of the 1994 Act) on 3 January 1995, as a result of section 8(2) of the 1994 Act, and remains in force.

- (b) the application of the provisions of this Part of this Act in respect of that or any other contract.

#### **24 The “reasonableness” test**

- (1) In determining for the purposes of this Part of this Act whether it was fair and reasonable to incorporate a term in a contract, regard shall be had only to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties to the contract at the time the contract was made.
- (2) In determining for the purposes of section 20 or 21 of this Act whether it was fair and reasonable to incorporate a term in a contract, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection shall not prevent a court or arbiter from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.
- (2A) In determining for the purposes of this Part of this Act whether it is fair and reasonable to allow reliance on a provision of a notice (not being a notice having contractual effect), regard shall be had to all the circumstances obtaining when the liability arose or (but for the provision) would have arisen.
- (3) Where a term in a contract or a provision of a notice purports to restrict liability to a specified sum of money, and the question arises for the purposes of this Part of this Act whether it was fair and reasonable to incorporate the term in the contract or whether it is fair and reasonable to allow reliance on the provision, then, without prejudice to subsection (2) above in the case of a term in a contract, regard shall be had in particular to –
- (a) the resources which the party seeking to rely on that term or provision could expect to be available to him for the purpose of meeting the liability should it arise;
  - (b) how far it was open to that party to cover himself by insurance.
- (4) The onus of proving that it was fair and reasonable to incorporate a term in a contract or that it is fair and reasonable to allow reliance on a provision of a notice shall lie on the party so contending.

#### **25 Interpretation of Part II**

- (1) In this Part of this Act –
- “breach of duty” means the breach –
    - (a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;
    - (b) of any common law duty to take reasonable care or exercise reasonable skill;
    - (c) of the duty of reasonable care imposed by section 2(1) of the Occupiers’ Liability (Scotland) Act 1960;
  - “business” includes a profession and the activities of any government department or local or public authority;
  - “consumer” has the meaning assigned to that expression in the definition in this section of “consumer contract”;
  - “consumer contract” means subject to subsections (1A) and (1B) below a contract (not being a contract of sale by auction or competitive tender) in which –

- (a) one party to the contract deals, and the other party to the contract (“the consumer”) does not deal or hold himself out as dealing, in the course of a business, and
- (b) in the case of a contract such as is mentioned in section 15(2)(a) of this Act, the goods are of a type ordinarily supplied for private use or consumption;

and for the purposes of this Part of this Act the onus of proving that a contract is not to be regarded as a consumer contract shall lie on the party so contending;

“goods” has the same meaning as in the Sale of Goods Act 1979;

“hire-purchase agreement” has the same meaning as in section 189(1) of the Consumer Credit Act 1974;

“notice” includes an announcement, whether or not in writing, and any other communication or pretended communication;

“personal injury” includes any disease and any impairment of physical or mental condition.

(1A) Where the consumer is an individual, paragraph (b) in the definition of “consumer contract” in subsection (1) must be disregarded.

(1B) The expression of “consumer contract” does not include a contract in which –

- (a) the buyer is an individual and the goods are second hand goods sold by public auction at which individuals have the opportunity of attending in person; or
- (b) the buyer is not an individual and the goods are sold by auction or competitive tender.

(2) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the act or omission giving rise to that breach was inadvertent or intentional, or whether liability for it arises directly or vicariously.

(3) In this Part of this Act, any reference to excluding or restricting any liability includes–

- (a) making the liability or its enforcement subject to any restrictive or onerous conditions;
- (b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;
- (c) excluding or restricting any rule of evidence or procedure;
- (d) . . .<sup>2</sup>

but does not include an agreement to submit any question to arbitration.

(4) . . .<sup>3</sup>

(5) In sections 15 and 16 and 19 to 21 of this Act, any reference to excluding or restricting liability for breach of an obligation or duty shall include a reference to excluding or restricting the obligation or duty itself.

<sup>2</sup> Repealed by the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990, ss 68(5)(b), (6), 74(2), Sch 9.

<sup>3</sup> Repealed by the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 ss 68(5)(b), (6), 74(2), Sch 9.

## **PART III**

### **PROVISIONS APPLYING TO WHOLE OF UNITED KINGDOM**

#### **Miscellaneous**

#### **26 International supply contracts**

- (1) The limits imposed by this Act on the extent to which a person may exclude or restrict liability by reference to a contract term do not apply to liability arising under such a contract as is described in subsection (3) below.
- (2) The terms of such a contract are not subject to any requirement of reasonableness under section 3 or 4: and nothing in Part II of this Act shall require the incorporation of the terms of such a contract to be fair and reasonable for them to have effect.
- (3) Subject to subsection (4), that description of contract is one whose characteristics are the following –
  - (a) either it is a contract of sale of goods or it is one under or in pursuance of which the possession or ownership of goods passes; and
  - (b) it is made by parties whose places of business (or, if they have none, habitual residences) are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom).
- (4) A contract falls within subsection (3) above only if either –
  - (a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from the territory of one State to the territory of another; or
  - (b) the acts constituting the offer and acceptance have been done in the territories of different States; or
  - (c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

#### **27 Choice of law clauses**

- (1) Where the law applicable to a contract is the law of any part of the United Kingdom only by choice of the parties (and apart from that choice would be the law of some country outside the United Kingdom) sections 2 to 7 and 16 to 21 of this Act do not operate as part of the law applicable to the contract.
- (2) This Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside the United Kingdom, where (either or both) –
  - (a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act; or
  - (b) in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf.
- (3) In the application of subsection (2) above to Scotland, for paragraph (b) there shall be substituted –
  - “(b) the contract is a consumer contract as defined in Part II of this Act, and the consumer at the date when the contract was made was habitually resident in the United Kingdom, and the essential steps necessary for the

making of the contract were taken there, whether by him or by others on his behalf.”.

## **28 Temporary provision for sea carriage of passengers**

(1) This section applies to a contract for carriage by sea of a passenger or of a passenger and his luggage where the provisions of the Athens Convention (with or without modification) do not have, in relation to the contract, the force of law in the United Kingdom.

(2) In a case where –

(a) the contract is not made in the United Kingdom, and

(b) neither the place of departure nor the place of destination under it is in the United Kingdom,

a person is not precluded by this Act from excluding or restricting liability for loss or damage, being loss or damage for which the provisions of the Convention would, if they had the force of law in relation to the contract, impose liability on him.

(3) In any other case, a person is not precluded by this Act from excluding or restricting liability for that loss or damage –

(a) in so far as the exclusion or restriction would have been effective in that case had the provisions of the Convention had the force of law in relation to the contract; or

(b) in such circumstances and to such extent as may be prescribed, by reference to a prescribed term of the contract.

(4) For the purposes of subsection (3)(a), the values which shall be taken to be the official values in the United Kingdom of the amounts (expressed in gold francs) by reference to which liability under the provisions of the Convention is limited shall be such amounts in sterling as the Secretary of State may from time to time by order made by statutory instrument specify.

(5) In this section, –

(a) the references to excluding or restricting liability include doing any of those things in relation to the liability which are mentioned in section 13 or section 25(3) and (5); and

(b) “the Athens Convention” means the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea, 1974; and

(c) “prescribed” means prescribed by the Secretary of State by regulations made by statutory instrument;

and a statutory instrument containing the regulations shall be subject to annulment in pursuance of a resolution of either House of Parliament.

## **29 Saving for other relevant legislation**

(1) Nothing in this Act removes or restricts the effect of, or prevents reliance upon, any contractual provision which –

(a) is authorised or required by the express terms or necessary implication of an enactment; or

(b) being made with a view to compliance with an international agreement to which the United Kingdom is a party, does not operate more restrictively than is contemplated by the agreement.

(2) A contract term is to be taken –

(a) for the purposes of Part I of this Act, as satisfying the requirement of reasonableness; and

(b) for those of Part II, to have been fair and reasonable to incorporate, if it is incorporated or approved by, or incorporated pursuant to a decision or ruling of, a competent authority acting in the exercise of any statutory jurisdiction or function and is not a term in a contract to which the competent authority is itself a party.

(3) In this section –

“competent authority” means any court, arbitrator or arbiter, government department or public authority;

“enactment” means any legislation (including subordinate legislation) of the United Kingdom or Northern Ireland and any instrument having effect by virtue of such legislation; and

“statutory” means conferred by an enactment.

**30 . . .**<sup>4</sup>

## **General**

### **31 Commencement; amendments; repeals**

(1) This Act comes into force on 1st February 1978.

(2) Nothing in this Act applies to contracts made before the date on which it comes into force; but subject to this, it applies to liability for any loss or damage which is suffered on or after that date.

(3) The enactments specified in Schedule 3 to this Act are amended as there shown.

(4) The enactments specified in Schedule 4 to this Act are repealed to the extent specified in column 3 of that Schedule.

### **32 Citation and extent**

(1) This Act may be cited as the Unfair Contract Terms Act 1977.

(2) Part I of this Act extends to England and Wales and to Northern Ireland; but it does not extend to Scotland.

(3) Part II of this Act extends to Scotland only.

(4) This Part of this Act extends to the whole of the United Kingdom.

## **SCHEDULE 1**

### **SCOPE OF SECTIONS 2 TO 4 AND 7**

1. Sections 2 to 4 of this Act do not extend to –

(a) any contract of insurance (including a contract to pay an annuity on human life);

(b) any contract so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest, whether by extinction, merger, surrender, forfeiture or otherwise;

(c) any contract so far as it relates to the creation or transfer of a right or interest in any patent, trade mark, copyright or design right, registered design, technical or commercial information or other intellectual property, or relates to the termination of any such right or interest;

(d) any contract so far as it relates –

<sup>4</sup> Repealed by the Consumer Safety Act 1978, s 10(1), Sch 3.

- (i) to the formation or dissolution of a company (which means any body corporate or unincorporated association and includes a partnership), or
  - (ii) to its constitution or the rights or obligations of its corporators or members;
  - (e) any contract so far as it relates to the creation or transfer of securities or of any right or interest in securities.
2. Section 2(1) extends to –
- (a) any contract of marine salvage or towage;
  - (b) any charterparty of a ship or hovercraft; and
  - (c) any contract for the carriage of goods by ship or hovercraft;
- but subject to this sections 2 to 4 and 7 do not extend to any such contract except in favour of a person dealing as consumer.
3. Where goods are carried by ship or hovercraft in pursuance of a contract which either –
- (a) specifies that as the means of carriage over part of the journey to be covered, or
  - (b) makes no provision as to the means of carriage and does not exclude that means,
- then sections 2(2), 3 and 4 do not, except in favour of a person dealing as consumer, extend to the contract as it operates for and in relation to the carriage of the goods by that means.
4. Section 2(1) and (2) do not extend to a contract of employment, except in favour of the employee.
5. Section 2(1) does not affect the validity of any discharge and indemnity given by a person, on or in connection with an award to him of compensation for pneumoconiosis attributable to employment in the coal industry, in respect of any further claim arising from his contracting that disease.

## **SCHEDULE 2**

### **“GUIDELINES” FOR APPLICATION OF REASONABLENESS TEST**

The matters to which regard is to be had in particular for the purposes of sections 6(3), 7(3) and (4), 20 and 21 are any of the following which appear to be relevant –

- (a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer’s requirements could have been met;
- (b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;
- (c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
- (d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
- (e) whether the goods were manufactured, processed or adapted to the special order of the customer.

**Schedule 3**  
**Amendment of Enactments**

...

**Schedule 4**  
**Repeals**

...

# APPENDIX C

## THE UNFAIR TERMS IN CONSUMER CONTRACTS REGULATIONS 1999<sup>1</sup>

### SI 1999 No 2083

Whereas the Secretary of State is a Minister designated for the purposes of section 2(2) of the European Communities Act 1972 in relation to measures relating to consumer protection:

Now, the Secretary of State, in exercise of the powers conferred upon him by section 2(2) of that Act, hereby makes the following Regulations:—

#### 1 Citation and commencement

These Regulations may be cited as the Unfair Terms in Consumer Contracts Regulations 1999 and shall come into force on 1st October 1999.

#### 2 Revocation

The Unfair Terms in Consumer Contracts Regulations 1994 are hereby revoked.

#### 3 Interpretation

(1) In these Regulations –

“the Community” means the European Community;

“consumer” means any natural person who, in contracts covered by these Regulations, is acting for purposes which are outside his trade, business or profession;

“court” in relation to England and Wales and Northern Ireland means a county court or the High Court, and in relation to Scotland, the Sheriff or the Court of Session;

“OFT” means the Office of Fair Trading;

“EEA Agreement” means the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 as adjusted by the protocol signed at Brussels on 17th March 1993;

“Member State” means a State which is a contracting party to the EEA Agreement;

“notified” means notified in writing;

“qualifying body” means a person specified in Schedule 1;

“seller or supplier” means any natural or legal person who, in contracts covered by these Regulations, is acting for purposes relating to his trade, business or profession, whether publicly owned or privately owned;

“unfair terms” means the contractual terms referred to in regulation 5.

(1A) The references—

(a) in regulation 4(1) to a seller or supplier, and

(b) in regulation 8(1) to a seller or supplier,

include references to a distance supplier and to an intermediary.

<sup>1</sup> As amended by the Unfair Terms in Consumer Contracts (Amendment) Regulations 2001, SI 2001 No 1186.

(1B) In paragraph (1A) and regulation 5(6)—

“distance supplier” means—

- (a) a supplier under a distance contract within the meaning of the Financial Services (Distance Marketing) Regulations 2004, or
- (b) a supplier of unsolicited financial services within regulation 15 of those Regulations; and

“intermediary” has the same meaning as in those Regulations.

(2) In the application of these Regulations to Scotland for references to an “injunction” or an “interim injunction” there shall be substituted references to an “interdict” or “interim interdict” respectively.

#### **4 Terms to which these Regulations apply**

- (1) These Regulations apply in relation to unfair terms in contracts concluded between a seller or a supplier and a consumer.
- (2) 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.

#### **5 Unfair terms**

- (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 having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.
- (3) Notwithstanding that a specific term or certain aspects of it in a contract has been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of it indicates that it is a pre-formulated standard contract.
- (4) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.
- (5) Schedule 2 to these Regulations contains an indicative and non-exhaustive list of the terms which may be regarded as unfair.
- (6) Any contractual term providing that a consumer bears the burden of proof in respect of showing whether a distance supplier or an intermediary complied with any or all of the obligations placed upon him resulting from the Directive and any rule or enactment implementing it shall always be regarded as unfair.
- (7) In paragraph (6)—
  - “the Directive means Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC; and

“rule” means a rule made by the Financial Services Authority under the Financial Services and Markets Act 2000 or by a designated professional body within the meaning of section 326(2) of that Act.

## **6 Assessment of unfair terms**

- (1) Without prejudice to regulation 12, 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) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate –
  - (a) to the definition of the main subject matter of the contract, or
  - (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

## **7 Written contracts**

- (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.

## **8 Effect of unfair term**

- (1) An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer.
- (2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term.

## **9 Choice of law clauses**

These Regulations shall apply notwithstanding any contract term which applies or purports to apply the law of a non-Member State, if the contract has a close connection with the territory of the Member States.

## **10 Complaints – consideration by OFT**

- (1) It shall be the duty of the OFT to consider any complaint made to it that any contract term drawn up for general use is unfair, unless –
  - (a) the complaint appears to the OFT to be frivolous or vexatious; or
  - (b) a qualifying body has notified the OFT that it agrees to consider the complaint.
- (2) The OFT shall give reasons for its decision to apply or not to apply, as the case may be, for an injunction under regulation 12 in relation to any complaint which these Regulations require it to consider.
- (3) In deciding whether or not to apply for an injunction in respect of a term which the OFT considers to be unfair, it may, if it considers it appropriate to do so, have regard to any undertakings given to it by or on behalf of any person as to the continued use of such a term in contracts concluded with consumers.

## **11 Complaints – consideration by qualifying bodies**

- (1) If a qualifying body specified in Part One of Schedule 1 notifies the OFT that it agrees to consider a complaint that any contract term drawn up for general use is unfair, it shall be under a duty to consider that complaint.

- (2) Regulation 10(2) and (3) shall apply to a qualifying body which is under a duty to consider a complaint as they apply to the OFT.

## **12 Injunctions to prevent continued use of unfair terms**

- (1) The OFT or, subject to paragraph (2), any qualifying body may apply for an injunction (including an interim injunction) against any person appearing to the OFT or that body to be using, or recommending use of, an unfair term drawn up for general use in contracts concluded with consumers.
- (2) A qualifying body may apply for an injunction only where –
- (a) it has notified the OFT of its intention to apply at least fourteen days before the date on which the application is made, beginning with the date on which the notification was given; or
  - (b) the OFT consents to the application being made within a shorter period.
- (3) The court on an application under this regulation may grant an injunction on such terms as it thinks fit.
- (4) An injunction may relate not only to use of a particular contract term drawn up for general use but to any similar term, or a term having like effect, used or recommended for use by any person.

## **13 Powers of the OFT and qualifying bodies to obtain documents and information**

- (1) The OFT may exercise the power conferred by this regulation for the purpose of –
- (a) facilitating its consideration of a complaint that a contract term drawn up for general use is unfair; or
  - (b) ascertaining whether a person has complied with an undertaking or court order as to the continued use, or recommendation for use, of a term in contracts concluded with consumers.
- (2) A qualifying body specified in Part One of Schedule 1 may exercise the power conferred by this regulation for the purpose of –
- (a) facilitating its consideration of a complaint that a contract term drawn up for general use is unfair; or
  - (b) ascertaining whether a person has complied with –
    - (i) an undertaking given to it or to the court following an application by that body, or
    - (ii) a court order made on an application by that body,as to the continued use, or recommendation for use, of a term in contracts concluded with consumers.
- (3) The OFT may require any person to supply to it, and a qualifying body specified in Part One of Schedule 1 may require any person to supply to it –
- (a) a copy of any document which that person has used or recommended for use, at the time the notice referred to in paragraph (4) below is given, as a pre-formulated standard contract in dealings with consumers;
  - (b) information about the use, or recommendation for use, by that person of that document or any other such document in dealings with consumers.
- (4) The power conferred by this regulation is to be exercised by a notice in writing which may –
- (a) specify the way in which and the time within which it is to be complied with; and

- (b) be varied or revoked by a subsequent notice.
- (5) Nothing in this regulation compels a person to supply any document or information which he would be entitled to refuse to produce or give in civil proceedings before the court.
- (6) If a person makes default in complying with a notice under this regulation, the court may, on the application of the OFT or of the qualifying body, make such order as the court thinks fit for requiring the default to be made good, and any such order may provide that all the costs or expenses of and incidental to the application shall be borne by the person in default or by any officers of a company or other association who are responsible for its default.

#### **14 Notification of undertakings and orders to OFT**

A qualifying body shall notify the OFT –

- (a) of any undertaking given to it by or on behalf of any person as to the continued use of a term which that body considers to be unfair in contracts concluded with consumers;
- (b) of the outcome of any application made by it under regulation 12, and of the terms of any undertaking given to, or order made by, the court;
- (c) of the outcome of any application made by it to enforce a previous order of the court.

#### **15 Publication, information and advice**

- (1) The OFT shall arrange for the publication in such form and manner as it considers appropriate, of –
  - (a) details of any undertaking or order notified to it under regulation 14;
  - (b) details of any undertaking given to it by or on behalf of any person as to the continued use of a term which the OFT considers to be unfair in contracts concluded with consumers;
  - (c) details of any application made by it under regulation 12, and of the terms of any undertaking given to, or order made by, the court;
  - (d) details of any application made by the OFT to enforce a previous order of the court.
- (2) The OFT shall inform any person on request whether a particular term to which these Regulations apply has been –
  - (a) the subject of an undertaking given to the OFT or notified to it by a qualifying body; or
  - (b) the subject of an order of the court made upon application by it or notified to it by a qualifying body;and shall give that person details of the undertaking or a copy of the order, as the case may be, together with a copy of any amendments which the person giving the undertaking has agreed to make to the term in question.
- (3) The OFT may arrange for the dissemination in such form and manner as it considers appropriate of such information and advice concerning the operation of these Regulations as may appear to it to be expedient to give to the public and to all persons likely to be affected by these Regulations.

#### **16 The functions of the Financial Services Authority**

The functions of the Financial Services Authority under these Regulations shall be treated as functions of the Financial Services Authority under the Financial Services and Markets Act 2000.

## **SCHEDULE 1**

## REGULATION 3

### **Qualifying bodies**

#### *Part One*

- 1 The Information Commissioner.
- 2 The Gas and Electricity Markets Authority.
- 3 The Director General of Electricity Supply for Northern Ireland.
- 4 The Director General of Gas for Northern Ireland.
- 5 The Office of Communications.
- 6 The Director General of Water Services.
- 7 The Office of Rail Regulation.
- 8 Every weights and measures authority in Great Britain.
- 9 The Department of Enterprise, Trade and Investment in Northern Ireland.
- 10 The Financial Services Authority.

#### *Part Two*

- 11 Consumers' Association

## **SCHEDULE 2**

## REGULATION 5(5)

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

#### **1 Terms which have the object or effect of –**

- (a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
- (b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
- (c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
- (d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- (f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- (g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- (h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early;

- (i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
- (l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- (m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;
- (n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
- (o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- (p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
- (q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

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

- (a) Paragraph 1(g) is without hindrance to terms by which a supplier of financial services reserves the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.
- (b) Paragraph 1(j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.  
Paragraph 1(j) is also without hindrance to terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.
- (c) Paragraphs 1(g), (j) and (l) do not apply to:
  - transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;

- contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency.
- (d) Paragraph 1(l) is without hindrance to price indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

# APPENDIX D

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

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

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

Having regard to the proposal from the Commission,<sup>1</sup>

In cooperation with the European Parliament,<sup>2</sup>

Having regard to the opinion of the Economic and Social Committee,<sup>3</sup>

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 policy<sup>4</sup> underlined the importance of safeguarding consumers in the matter of unfair terms of contract; whereas this protection ought to be provided by

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<sup>1</sup> OJ No C 73, 24.3.1992, p 7.

<sup>2</sup> OJ No C 326, 16.12.1991, p 108 and OJ No C 21, 25.1.1993.

<sup>3</sup> OJ No C 159, 17.6.1991, p 34.

<sup>4</sup> 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

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

# **APPENDIX E**

## **LIST OF PERSONS AND ORGANISATIONS WHO RESPONDED TO CONSULTATION**

### **JUDICIARY**

Association of District Judges

Lord Justice Dyson

Sheriffs' Association

### **ACADEMICS**

Law School, University of Aberdeen

Professor Robert Bradgate

Peter Burbridge

Professor Peter Butt

David Capper

Dr John de Lacy

Professor Roger Halson

Professor Brian W Harvey

Professor Ewoud Hondius

Professor Geraint Howells and Dr Christian Twigg-Flesner

Professor Donald B King

Professor Elizabeth MacDonald

Professor John MacLeod

Professor William W McBryde

Professor Hans-W Micklitz

Institute for Commercial Law Studies, University of Sheffield

Professor Gillian Morris

Professor Francis Reynolds

Dr Simon Whittaker

Professor Chris Willett

### **PRACTITIONERS**

Association of Pension Lawyers

Baker & McKenzie

Beale and Company

BMLA (British Maritime Law Association)  
City of London Solicitors Company  
Andrew Clark  
Clifford Chance  
COMBAR (Commercial Bar Association)  
D J Freeman  
ELBA (Employment Law Bar Association)  
Faculty of Advocates  
Freshfields  
Herbert Smith  
David Hoffman  
George Jamieson  
Linklaters  
Martineau Johnson  
Macfarlanes  
David Pollard  
Scottish Law Agents Society

### **INDIVIDUALS**

Paul Dobson  
Jonathan Rush

### **ORGANISATIONS**

Association of Consulting Engineers  
Association of Corporate Treasurers  
Birmingham City Council Trading Standards Section  
British Toy & Hobby Association  
BSSA  
CBI (Confederation of British Industry)  
Construction Confederation  
Construction Industry Council  
Consumer Credit Association  
Consumer Credit Trade Association  
Direct Marketing Association  
Direct Selling Association

Engineering Employers' Federation  
FMLC (Financial Markets Law Committee)  
FOA (Futures and Options Association)  
FSB (Federation of Small Businesses)  
ICAEW (Institute of Chartered Accountants for England and Wales)  
JCT (Joint Contracts Tribunal)  
Law Reform Advisory Committee for Northern Ireland  
LIBA (London Investment Banking Association)  
Nottingham City Centre Retail Association  
Office of Fair Trading  
Periodical Publishers Association  
Plain English Campaign  
retra (Radio, Electrical & Television Retailers' Association)  
Royal Institute of British Architects  
Scottish Advisory Committee on Telecommunications  
Scottish Consumer Council  
Scottish Trading Standards Institute  
Specialist Engineering Contractors' Group  
Specialist Officers Group for Fair Trading of the North of England Trading Standards Group  
Advertising Association  
Information Commissioner  
Law Society of Scotland  
National Consumer Council  
National Consumer Credit Federation  
Newspaper Society  
Royal Institute of Chartered Surveyors  
Trading Standards Institute

## **COMPANIES**

Bassetts the Ironmongers  
BBC  
British Telecommunications  
Crest  
DRKW (Dresdner Kleinwort Wasserstein)

Findaphone

Fujitsu Services

Griffiths & Armour

KPMG LLP

National Grid Transco

Orange Personal Communications Services

Radamec

Shell International Limited