

The Unfair Terms in Consumer Contracts Regulations

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On 1 July 1995 the *Unfair Terms in Consumer Contracts Regulations 1994* came into force in the UK. Implementing EC Directive 93/13/EEC, these Regulations now exist alongside current legislation in this area. The Regulations are intended to improve the level of consumer protection against unfair terms. As a result, the Regulations have forced UK businesses to review many forms of standard contracts and their dealings with their customers. The aim of this paper is to provide a brief outline of the Regulations.

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Summary

The *Unfair Terms in Consumer Contracts Regulations 1994* [the "Regulations"] prohibit the inclusion of unfair terms in standard form contracts. The Regulations apply (with certain limited exceptions) to any contract made between a person acting in the course of a business and a consumer. They apply to any contract term which has not been individually negotiated.

Under the Regulations a consumer is not bound by an unfair standard term in a contract with a seller or supplier. The Regulations also give the Director General of Fair Trading new powers to prevent the continued use of unfair standard terms by businesses in consumer contracts and to prevent anyone recommending such terms.

A general background to the Regulations is set out in Part I of the paper. The Regulations implement EC Directive 93/13/EEC, adopted on 5 April 1993, on "Unfair Terms in Consumer Contracts". The Regulations only came into force after a lengthy consultation process.

Part II of the paper interprets the main provisions of the Regulations.

The aim of the Regulations is also to prevent the continued use of unfair terms and to provide an effective mechanism to this effect. Methods of enforcement and remedies for breach of the Regulations are set out in full in Part III.

Part IV provides a brief outline of the scope of the Regulations. In particular, it addresses how the Regulations affect consumer contracts relating to insurance, banking and financial services.

The Regulations add to, and do not replace, existing protection for consumers, particularly that provided under the *Unfair Contract Terms Act 1977* ["UCTA 1977"]. Therefore, Part V of this paper briefly considers the relative scope and cover of UCTA 1977 and the new Regulations.

The final section of this paper, Part VI, considers the workings and effect of the Regulations in their first year.

Abbreviations

The 'Regulations'	<i>Unfair Terms in Consumer Contracts Regulations 1994</i>
UCTA 1977	<i>Unfair Contract Terms Act 1977</i>
DTI	Department of Trade and Industry
OFT	Office of Fair Trading
Director General	Director General of Fair Trading
The 'Unit'	The Unfair Contract Terms Unit, the Office of Fair Trading
CML	Council of Mortgage Lenders
ABTA	Association of British Travel Agents

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I Background to the new Regulations

The Council of the European Communities adopted a Directive on 5 April 1993 aimed at limiting the use of unfair terms in consumer contracts.¹ The Department of Trade and Industry (DTI) published a consultation document on the implementation of the Directive in October 1993.² In total, eighty-seven substantive responses were received. The response was such that the DTI decided to make some changes to the proposed Regulations, and a further consultation document was issued in September 1994.³

The Regulations⁴ were enacted in substantially the same form as the draft contained in the Further Consultation Document. The Regulations came into force on 1 July 1995. Welcoming the initiative in December 1994, Consumer Affairs Minister Earl Ferrers said:

"This is an important step forward in consumer protection. These Regulations will introduce for the first time a general concept of fairness into consumer contract law in the UK. However, whilst I do not believe that any business which deals fairly with its customers has anything to fear from the Regulations, I recognise that many in the business community feel they need more time to review their contracts. We have therefore decided that the Regulations will not come into effect until 1 July 1995".⁵

In brief, the main effect of the Regulations is to prohibit the inclusion of unfair terms in standard form contracts. The Regulations apply, with certain exceptions, to any term in a contract concluded between a seller of goods or supplier of services on the one hand, and a consumer on the other, where the term in question has not been individually negotiated.⁶

For the purposes of the Regulations, a "consumer" is any individual (not a company or a firm) acting outside the course of business.⁷ So the Regulations potentially cover all contracts entered into by private persons as consumers. They do not apply to contracts between those acting for business purposes (such as small traders and larger businesses); nor do they apply to contracts solely between private persons none of whom is acting in the course of business. It should also be noted that the Regulations do not apply to contracts other than for the sale or supply of goods or the supply of services.

It may be difficult in some cases to decide whether or not a person is a consumer, that is, acting for purposes which are outside his business. The Regulations make no provision for the burden of proof on this issue. For example, a sole trader entering into a contract for

¹ Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, OJ No. L95, 21.04.93, p.29

² Department of Trade and Industry, *"Implementation Of The EC Directive On Unfair Terms In Consumer Contracts (93/13/EEC) - A Consultation Document"*, October 1993

³ Department of Trade and Industry, *"Implementation Of The EC Directive On Unfair Terms In Consumer Contracts (93/13/EEC) - A Further Consultation Document"*, September 1994

⁴ SI 1994 No. 3159. The primary legislation is section 2(2) of the *European Communities Act 1972*

⁵ Department of Trade and Industry press notice, *"The Unfair Terms In Consumer Contracts Regulations 1994"*, 16 December 1994

⁶ Regulation 3(1)

⁷ Regulation 2(1)

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purposes connected with his business, but which are not central to that business, or where the purposes of the transaction are partly personal would be a borderline case. Obviously, it will be necessary for the courts to examine the facts of each case in detail in order to determine whether a person is or is not a consumer.

Under the Regulations, a seller or supplier means any person or organisation providing goods or services in the course of business.⁸ The term "business" covers any trade or profession, and also the activities of governmental and other public bodies.

The Regulations apply only to standard terms; they do not apply to contractual terms which have been individually negotiated. Regulation 3(3) defines a term that has not been individually negotiated between a consumer and a seller or supplier in the following way:

"For the purposes of these Regulations, a term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has not been able to influence the substance of the term".

The Regulations clearly apply to the kind of standard terms contained in standard form contracts. Such terms do not have to be in writing, but typically they are found in the "conditions of business" printed in small print on the back of order forms, brochures, quotations and so on, and to most standard form banking and insurance documentation.

The fact that one specific term in a contract may have been the subject of individual negotiation will not prevent the Regulations from applying to the remainder of the contract.⁹ It is clear, however, that the more a consumer has been able to influence terms in a contract, the less likely it is that the Regulations will apply. This said, the burden of proof is on the seller or supplier to show that a particular term has been individually negotiated.¹⁰

⁸ Regulation 2(1)

⁹ Regulation 3(4)

¹⁰ Regulation 3(5)

II Interpreting the Regulations

The Regulations are reprinted in full in Appendix A to this paper.

The Regulations apply where contractual terms have not been individually negotiated. The Regulations' basic principles are that:¹¹

- in a contract between a seller or supplier and a consumer, a term will not be binding on the consumer if it is "unfair";
- a seller or supplier must ensure that any written term is expressed in "plain, intelligible language", and if there is any doubt about its meaning, the interpretation of a term most favourable to the consumer is to prevail.

A. Terms which may be unfair

The basic effect of the Regulations is to introduce into English Law the general concept of fairness. If a contractual term within the scope of the Regulations is considered by a court to be unfair, that term will not be binding on the consumer.

Under Regulation 4(1) an unfair term is one which "contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer".

Regulation 4(2) states:

"An assessment of the unfair nature of a term shall be made taking into account the nature of the goods or services for which the contract was concluded and referring, as at the time of the conclusion of the contract, to all 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".

The burden of proof is on the consumer to show that the term is unfair according to this test.

However, in assessing whether a term is fair, the court is required to take into account not only the literal meaning of the term itself but also the nature of the goods or services concerned, referring, as at the time the contract was made, to all the circumstances. Relevant circumstances would include all the other terms of the contract and the terms of any other contract on which the contract in question is dependent. In effect, the Regulations require the court to "assess the situation in the round" and to adopt a "commonsense approach to the issue of fairness".¹²

¹¹ Office of Fair Trading briefing, "*Unfair Standard Terms*", July 1995

¹² Alison Padfield, "The Impact on English contract Law of the EC Directive on Unfair Terms in Consumer Contracts", 5 *Journal of International Banking Law* [1995]

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Paragraph 1 of **Schedule 3** to the Regulations contains an illustrative list of seventeen types of standard contract terms which may be regarded as unfair, and hence automatically causing a significant imbalance to the detriment of the consumer. For example, a term which has the effect of enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided may, according to Schedule 3, be regarded as unfair. More importantly, terms which have the effect of excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier, may also be unfair under the Regulations. Contractual terms listed in Schedule 3 as possible examples of unfair terms include:

- a. no liability for death and injury
- b. no liability for breaches of contract
- c. right not to provide services
- d. retention of pre-payments
- e. penalty clauses
- f. general opt-out clauses
- g. right to terminate without notice
- h. automatic renewal clauses
- i. hidden terms
- j. general variation clauses
- k. right to change what is supplied
- l. right to increase the price
- m. right of final decision in contractual disputes
- n. entire agreement clauses and formality requirements
- o. unequal obligations
- p. right to assign without consent
- q. restrictions on legal remedies

Many of the terms described in Schedule 3 and which are deemed to be unfair are those which result in a consumer being forced to accept greater contractual risks or more onerous liabilities than the business party to the contract. However, two points should be noted:

(i) the list is illustrative, and it is made clear in the body of the Regulations¹³ that it is non-exhaustive. The fact that a term does not figure in the list does not create any presumption that it is therefore fair;

(ii) the list is of terms which may be regarded as unfair. The appearance of a term in the list does not automatically mean that it is unfair. The fairness or otherwise of a term must always be judged against the criteria outlined in Section 2, regardless of whether or not it appears in Schedule 3.

It is also worth noting that certain of the terms are already blacklisted by UK legislation. For example, term (a) [above] which deals with excluding liability for death or personal injury is automatically void under section 2(1) of the *Unfair Contract Terms Act 1977* where negligence is the cause of liability. Since the EC Directive specifically allows Member States to retain or adopt more stringent measures if they wish, the relevant legislation in these areas will take precedence over the Regulations.

B. The requirement of good faith

Central to the test of fairness under the Regulations, is a requirement of "good faith".

Prior to the implementation of the Regulations, there was no requirement of 'good faith' under the general English law of contract (although in particular areas of English law, such as trusts, partnership and insurance, a duty of good faith is found).

Schedule 2 to the Regulations contains a list of some of the issues which should be considered when making an assessment of good faith. The most important issues to be considered are:

- the relative bargaining strengths of the consumer and the business;
- whether the consumer had an inducement to agree to a particular term;
- whether the goods or services were sold or supplied to the special order of the consumer; and
- the extent to which the seller or supplier has dealt fairly and equitably with the consumer.

¹³ Regulation 4(4)

Where a consumer has been given a genuine choice on whether to agree to a term, fully understanding what it entailed, and agreed to it freely without having to be pressurised in any way, a supplier would have some basis for claiming to have acted in good faith. However, a supplier might not be able to establish good faith simply by proving that he had disclosed contract terms in full and provided sufficient explanation for them to be understood.

C. The requirement for plain and intelligible language

Regulation 6 states simply that in any standard form contract:

"a seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language, and if there is doubt about the meaning of a written term, the interpretation most favourable to the consumer shall prevail".

Although there is no separate sanction for failure to comply with this provision, whether or not a term is expressed in plain, intelligible language is relevant in assessing whether a term is unfair.

Where the basic terms of a contract are not clearly expressed, the whole contract may be open to attack by a consumer. Any doubts about the meaning of a written term are to be resolved in favour of the consumer. It should be pointed out that this is in sharp contrast to the position which prevails under the common law, which is that, with certain limited exceptions, a party who signs a contract is bound by it, whether or not he or she read and understood it before signing.¹⁴

D. Exclusions

Schedule 1 to the Regulations contains a list of specialised contracts and particular terms which are excluded from the scope of the Regulations. The Regulations do not apply to:

- any contract relating to employment;
- any contract relating to succession rights (inheritance, for instance);
- any contract relating to rights under family law (such as maintenance payments);
- any contract relating to the incorporation and organisation of companies or partnerships; and,
- any term incorporated in order to comply with or which reflects
 - (i) statutory or regulatory provisions of the United Kingdom; or

¹⁴ Alison Padfield, "The Impact On English Contract Law Of The EC Directive On Unfair Terms", 5 *Journal of International Banking Law* [1995]

(ii) the provisions or principles of international conventions to which the Member States of the Community are party.

In addition, two important types of standard terms (ie. known as "core terms") are also excluded from the Regulations. Regulation 3(2) states:

"In so far as it is in plain, intelligible language, no assessment shall be made of the fairness of any term which-

(a) defines the main subject matter of the contract, or

(b) concerns the adequacy of the price or remuneration, as against the goods or services sold or supplied".

In other words, terms which define the main subject matter of the contract or which set the price to be paid for it are excluded from the test of fairness but this exemption applies only to the term in question, not to the remainder of the contract. While these so-called "core provisions" will not be addressed for fairness, they will remain factors which can be taken into account in assessing the fairness of other terms.

It should also be emphasised that, for the exemption to apply the term in question must be in plain, intelligible language, and to the extent that it is not, it may be open to challenge under Regulation 6.¹⁵

¹⁵ See Section II (C) of this Research Paper

III Remedies and enforcement

Under the Regulations, the effect of a finding that a term is unfair is that it shall not be binding on the consumer.¹⁶ The aim of the Regulations is also to prevent the continued use of unfair terms and to provide an adequate and effective mechanism to this effect.

Regulation 8 requires the Director General of Fair Trading [the "Director General"] to consider any complaint that a contract term drawn up for general use is unfair. The Director General is under a duty to consider any complaint unless it appears "frivolous or vexatious".¹⁷ If he decides that a particular standard term is unfair, he can accept appropriate undertakings offered by the business concerned. It may, for example, give an undertaking to stop using such a term altogether, or to revise its standard terms in order to avoid the perceived unfairness.

If no undertaking is given to withdraw or amend a term, the Director General can seek a High Court injunction (or in Scotland, a Court of Session interdict) to prevent the continued use of that term or a term having like effect in contracts drawn up for general use. He may also seek a temporary injunction or interdict to prevent the use of the term until the case can be fully argued in court. The Director General has a duty to give reasons for his decision to apply (or not to apply) for an injunction.

Welcoming these new powers, Jeffrey Preston, then Director General, said:

"I welcome these new powers which will help to prevent unfair terms from appearing in the small print of consumer contracts. This will be an important advance in consumer protection.

....The Regulations give me considerable scope in dealing with problems which arise, and in most cases it should be possible to resolve matters quickly without resort to court action. But I will not hesitate to seek an injunction from the courts if this becomes necessary.

One effect of the new Regulations will be that an unfair term is not binding on the consumer. This will enable consumers themselves to challenge or resist enforcement of such terms by traders".¹⁸

In practice, the Director General's responsibilities are handled on a day-to-day basis by a group set-up within the Office of Fair Trading [the "OFT"], and known as the "Unfair Contract Terms Unit". It is intended that individual consumers who find that their concluded contracts may contain unfair terms will have the full range of normal civil law remedies available to them. According to the DTI¹⁹, it is **not** intended that the Director General will exercise his powers to obtain a direct civil law remedy in the case of a particular aggrieved consumer, rather that he will act in the more general interests of consumers and competitors

¹⁶ Regulation 5(1)

¹⁷ Regulation 8(1)

¹⁸ Office of Fair Trading press notice, "*Fair terms in consumer contract - new powers come into effect*", 30 June 1995

¹⁹ Department of Trade and Industry Guidance Notes, "*The Unfair Terms In Consumer Contracts Regulations 1994*", July 1994

to ensure that unfair terms do not, once identified, continue in use. The Director General also has power under Regulation 8(7) to arrange for the dissemination of advice and information as to the operation of the Regulations.

If a contractual term is found to be unfair and, therefore, unenforceable, the remainder of the contract will not be affected, provided that it is capable of continuing in existence without the unfair term. If so much of the contract is tainted by unfairness that it becomes incapable of continuing in existence, the Regulations provide that the contract shall cease to bind the parties.²⁰

²⁰ Regulation 5(2)

IV The scope of the Regulations

A. Conflict of laws

The provisions of the Regulations apply regardless of any contract term which applies or seeks to apply the law of a state outside the EC if the contract "has a close connection with the territory of the Member States".²¹

In effect, Regulation 7 is designed to prevent any 'improper' avoidance of the Regulations.

B. The effect of the Regulations

1. On Consumer Contracts

A consumer is not bound by an unfair standard term in a contract with a business. What this means in practice depends on the nature of the term. For instance, a business would not be able to rely on a term that unfairly sought to make a consumer pay more than the originally agreed price if it went to court to try to enforce the extra payment. Similarly, a term which purports to say that customers have no right to compensation for (say) poor workmanship, may be deemed to be unfair and a consumer could still sue a business for damages.

The fact that a business cannot enforce an unfair term against a consumer does not mean that the rest of the contract falls away, so long as it is capable of continuing to exist without that term.

For the individual consumer, the Regulations simply mean that the business cannot enforce terms that are unfair against him or her. They provide no criminal penalty for the use of any unfair term. So the Regulations are relevant only where the consumer is in dispute with the business over a contract, and the dispute could go, or has gone, to court.

Although the Director General of Fair Trading has certain powers under the Regulations, he cannot help any individual consumer in a private dispute by seeking compensation or other redress for problems experienced in the past. He can only step in to protect consumers in general by seeking to prevent the continued use of any particular unfair term in the future.

The Regulations have obvious application to standard contracts relating to consumers in the commercial world.

²¹ Regulation 7

2. The effect of the Regulations on insurance contracts

The Regulations apply to insurance contracts which were specifically excluded from the ambit of previous consumer protection legislation.²² The application of the Regulations to the insurance industry has been discussed at length in the consultative process.

It is probably because it is the first time that any consumer legislation regulating contract terms has extended to the insurance field that there has been a great deal of commentary on the impact of the Regulations in the insurance press. It is likely that the Regulations will have the greatest impact on household, motor vehicle and life insurance policies, since those are the types of insurance commonly entered into by consumers. The main points of particular interest to insurers are summarised below:

- In practice, the Regulations will only apply to direct insurance with individuals. This has some results which might not, at first glance, be expected. For example, the Regulations will not apply to a commercial motor fleet policy, even though such policies may well cover private individuals driving for social, domestic and pleasure purposes, because "consumer" means a person who, in making the contract, is acting for purposes outside his business.
- Any term which:
 - (a) defines the main subject matter of the contract; or
 - (b) concerns the adequacy of the price or remuneration, is not to be assessed for fairness, provided it is in plain, intelligible language.

The clauses of an insurance contract which define, or circumscribe, the peril insured and the insurers' liability have been cited as a typical example of clauses which will come within this exception. The extent of the risk is something which is taken into account in fixing the premium, and so such terms will be within this exception.

However, it should be noted that the fairness of these clauses **can** still be considered if they are not in plain, intelligible language. Further, if there is any doubt about the interpretation of such clauses, the most favourable interpretation to the insured is to prevail. It is, therefore, sensible for the insurer to make sure that any exceptions are clearly referred to in the clauses themselves, and not hidden away at the back of the policy somewhere.

It should also be noted that one of the factors expressly to be taken into account in assessing the fairness of a term is the other terms of the contract. Therefore, the

²² Note. Insurance contracts are wholly exempted from the scope of the *Unfair Contract Terms Act 1977* under Schedule 1 paragraph 1(a)

clauses relating to the ambit of the risk may themselves be relevant for assessing the fairness of other terms, even if their own fairness is not itself susceptible to scrutiny.

- The concept of "good faith" is a new concept in English consumer law. It remains to be seen how the courts will interpret it. They may have regard to the principle of *uberrimae fides* (ie. 'the utmost good faith') which has long been observed by the parties to contracts of insurance. However, the concept of "good faith" under the Regulations is certainly not identical to the principle of *uberrimae fides* in insurance contracts. For example, whereas a breach of the duty of *uberrimae fides* may render an entire insurance contract void from policy inception, an insurance contract will survive the striking down of a term for unfairness under the Regulations, provided it is capable of continuing in existence without the offending term.
- As outlined above, Schedule 3 to the Regulations sets out a list of examples of clauses which **may** be unfair. Although effectively no more than guidance, Schedule 3 gives a helpful illustration of potential areas of concern. None of these relate specifically to insurance contracts, but those which may be relevant in the insurance context include the following:

(a) Terms which "irrevocably bind...the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract". This may tend to discourage the practice of supplying the policy wording after the inception of the policy, at least where the insured is not simply renewing a policy on similar terms to a previous one.

(b) A term "excluding or hindering the consumer's right to take legal action...particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions". Under English law, the extent to which the parties can agree to arbitrators being empowered to disregard legal principles is, of course, limited anyway.

The OFT has a duty, when a complaint is made about the terms of a standard contract, to investigate the complaint and, if appropriate, take action including seeking an injunction against the party recommending such terms. This provision is of general application. It is possible, however, that since it is common for members of the public to complain about the lack of clarity in insurance contracts, policies of insurance may be particularly susceptible to such action where insurers have not thoroughly reviewed and updated their policy wording in the light of the Regulations.

3. The effect of the Regulations on the financial services industry

The Regulations are targeted at standard form terms in a wide range of contracts including:

- consumer credit (including the issue of credit cards);
- mortgage agreements;
- issue of commodity futures and options; and
- investment services contracts.

Since the Regulations do not define the terms "goods" or "services", they have been taken to have a wide meaning and generally to include most types of financial services.

Schedule 3 to the Regulations highlights as potentially unfair, terms which:

- enable the supplier to terminate a contract of indefinite duration without reasonable notice, other than where there are serious grounds for doing so;²³
- enable the supplier to change unilaterally the terms of the contract, without a "valid reason" which is specified in the contract;²⁴ and
- which allow a supplier to increase the price, without giving the consumer the right to cancel the contract where the price rise is disproportionately high.²⁵

However, these provisions do not apply to products or services the price of which is linked to a stock exchange index or financial market rate, including transactions in securities and financial instruments.²⁶ Price indexation clauses are not affected by the provision limiting the use of terms which allow the supplier to increase the price, provided that the method of calculation of price changes is clearly set out in the contract.²⁷

Other specific provisions govern the ability of a supplier of financial services to alter interest rates or other charges: a term allowing the supplier to alter unilaterally the terms of the contract other than for a "valid reason" as specified in the contract is likely to be held to be unfair, unless notice is given.²⁸ Where a valid reason for the alteration exists, notice need not be given in advance, but the consumer must be informed of the change as soon as practicable and given the option of cancelling the contract.²⁹

²³ Schedule 3, paragraph 1(g)

²⁴ Schedule 3, paragraph 1(j)

²⁵ Schedule 3, paragraph 1(i)

²⁶ Schedule 3, paragraph 2(c)

²⁷ Schedule 3, paragraph 2(d)

²⁸ Schedule 3, paragraph 1(j)

²⁹ Schedule 3, paragraph 2(b)

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These provisions are designed to ensure that consumers are informed before entering into an agreement, such as a mortgage, personal loan or investment bond, of the terms and conditions which will apply, and to ensure that variations in those initial terms and conditions are fair and reasonable. The option given to consumers of cancelling contracts where suppliers of financial services attempt to reserve to themselves the right to make changes without a valid reason is likely to have a beneficial effect on the drafting of contracts for financial services and on the behaviour of the suppliers of those services once contracts have been entered into.

4. The effect of the Regulations on the retail banking industry

The implications for the retail banking industry are also substantial. There is no doubt that the Regulations will apply to a vast number of everyday banking agreements including the purchase or sale of:

- mortgages;
- loan agreements;
- foreign currency;
- travellers' cheques;
- international money orders denominated in foreign currency; and ,
- retail banking agreements (including the conditions of use of credit and debit cards).

Such banking agreements are usually in standard form and are therefore within the scope of the Regulations.

It should be pointed out, however, that there is an overlap between the Regulations and the voluntary retail banking code "Good Banking" (a non-statutory provision), which addresses the main terms on which banks should deal with their retail customers.

The Regulations are not clear-cut, so it will be necessary for banks to consider carefully whether the Regulations do and are intended to apply in particular circumstances. Such an analysis may be subject to review by the courts.

C. Compliance Costs

The wide scope of the Regulations means that vast numbers of contracts will be affected. In its "Further Consultation Document"³⁰ the DTI concludes that it is difficult to produce compliance costs estimates for the "typical business" as there are wide differences in the number of standard terms companies may use and in the way these are published. However, the document does give examples of likely compliance costs for a number of organisations, and this information has since been updated.³¹ The British Bankers' Association, for example, estimates that the cost for a large bank to examine its standard terms and conditions, then reprint and circulate them to its branches could be between £500,000 and £1 million in the first instance.³²

The Council of Mortgage Lenders ("CML") estimate non-recurring costs (eg. reviewing contracts, system changes etc) of £10 million for building societies and other mortgage lenders.³³ Recurring annual costs (altering interest rates, reviewing documentation, marketing, consumer complaints etc) are estimated by the CML to be £60 million for building societies and up to £10 million for other lenders.³⁴

The Association of British Travel Agents ("ABTA") estimate that the potential compliance cost to even relatively small companies with a turnover of, perhaps £500,000, could be in excess of £10,000 per company. Large companies may have costs of up to several hundred thousand pounds due to the volume of documentation produced and the number of employees that must be retrained.³⁵

There is little doubt that compliance with the Regulations will require businesses to incur substantial costs, in redrafting their standard form contracts and paying higher insurance fees in anticipation of a potentially wider set of claims.

³⁰ Department of Trade and Industry, *Implementation Of The EC Directive On Unfair Terms In Consumer Contracts(93/13/EEC) - A Further Consultation Document*, September 1994

³¹ Department of Trade and Industry, *The Unfair Terms in Consumer Contracts Regulations 1994: Compliance Cost Assessment*, December 1994

³² Ibid page 2

³³ Ibid page 2

³⁴ Ibid page 3

³⁵ Ibid page 4

V How the Regulations relate to existing law on unfair terms

With certain exceptions (for example, where contracts relate to insurance, property transactions and certain financial transactions) most businesses are already subject to the *Unfair Contract Terms Act 1977* [the "*UCTA 1977*"]. The new Regulations are intended to add to, and not replace, existing protection for consumers, particularly that provided under the *UCTA 1977*.

The UK Regulations follow closely the wording of the Council Directive 93/13/EEC on unfair terms in consumer contracts. There has been criticism of the Government in this respect, particularly because the existing regime of the *UCTA 1977* is left in place unaltered. In effect, businesses now have to take account of two differing regimes applying to contract terms, where before there was one. Where a clause is disputed, it will be necessary to determine its validity both against the *UCTA 1977* and against the Regulations.

That said, the extent to which the *UCTA 1977* and the Regulations overlap is, in fact, limited. Although the earlier legislation offers protection that is generally similar to that embodied by the Regulations as regards consumer contracts, it covers a narrower range of types of contract terms. For example:

1. In the main, the *UCTA 1977* deals with exclusion clauses in both consumer and business contracts, whereas the Regulations apply only to terms in contracts with consumers. If, therefore, the clause in question appears in a business contract, only the *UCTA 1977* will be relevant.
2. The *UCTA 1977* can apply to negotiated contracts whereas the Regulations apply only to consumer contracts which have not been individually negotiated.
3. The list of contracts excluded from the respective enactments differs. The *UCTA 1977* deals primarily with exclusion clauses. Contracts relating to insurance, property transactions and certain financial transactions are wholly outside its scope. The Regulations, with certain limited exceptions, apply to all non-negotiated contractual terms in consumer contracts (eg. insurance contracts fall within the regulations).
4. Except where not expressed in plain, intelligible language, the Regulations do not apply to core provisions. In contrast, whether a provision is or is not a core provision is not relevant to the application of the *UCTA 1977*.
5. The Regulations apply a test of "fairness" and "good faith", whereas the *UCTA 1977* applies a different test, that of "reasonableness".
6. Schedule 2 of the Regulations gives a definition of "good faith" and a list of matters to be taken into account in assessing good faith. These matters reflect quite closely the

guidelines for the application of the "reasonableness test" in Schedule 2 of the *UCTA 1977*, but they are by no means identical. For example, the latter refers to "whether the customer knows 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), but this is not included in the Regulations.

7. The Regulations narrowly define a consumer as any living individual acting for purposes outside his business. The definition of someone "dealing as a consumer" under the *UCTA 1977* has been interpreted widely by the courts to include legal persons (such as companies) where they are acting outside the normal course of their business. In effect, under the *UCTA 1977* a company may sometimes be treated as a consumer.

Quoting similar examples to those outlined above, the DTI has stated³⁶ that the effect of the Regulations is to create a regime which is quite distinct and separate from the *UCTA 1977*. However, it has also acknowledged that most of the terms which would be "unfair" under the new Regulations could already be assessed under the 1977 Act. The DTI has stated that in its view, the application of the test of "fairness" in the Regulations and the test of "reasonableness" in the *UCTA 1977* is likely in most cases to lead to broadly similar results.³⁷

The Regulations undoubtedly improve the level of consumer protection throughout the UK. In doing so, they do impose additional burdens on those businesses which deal directly with consumers, requiring them to ensure that their standard form contracts comply with the Regulations. Ultimately, where a clause is disputed, it will be left to the English courts to determine its validity both against the *UCTA 1977* and against the new Regulations and to consider the relationship between the two tests of "fairness" and "reasonableness".

³⁶ Department of Trade and Industry, "*The Unfair Terms in Consumer Contracts Regulations 1994 - Compliance Cost Assessment*", December 1994

³⁷ Ibid

VI The workings and effect of the Regulations in their first year

In May 1996, the OFT published its first bulletin³⁸ on the workings and effect of the Regulations in their first nine months of operation. The bulletin gives guidance on the sorts of terms and conduct which in the OFT's opinion will fall foul of the Regulations and on which the Director General is willing to act. It identified five categories of terms which have most commonly been encountered in complaints. These are:

1. **Entire agreement clauses** which purport to exclude from the contract anything said or promised by a salesman or agent of the company.
2. **Hidden clauses** in which the seller or supplier attempts to bind a consumer to terms which they could not know before entering into a contract.
3. **Penalty clauses** in which, for example, companies are permitted to retain deposits with no counterbalancing penalty for the company if it does not comply with its obligations.
4. **Exclusion clauses** which attempt to exclude liability for every possible eventuality.
5. **Variation clauses** giving the supplier the right to put up prices with no realistic right for the consumer to withdraw without penalty.

In this first bulletin the OFT also highlights for specific criticism certain types of clauses and practices:

- According to the OFT, illegible print and obscure wording can, by themselves, make terms unenforceable because the Regulations specifically require the consumer to be able to examine all the terms before he is bound.
- The OFT also stresses that even the apparently excluded 'core terms' can be scrutinised under the Regulations if they have not been adequately brought to the consumer's attention prior to conclusion of the contract.

The OFT comments that in the main it is smaller suppliers who have shown least awareness of the Regulations, although this has not prevented some large companies from also falling foul of the Regulations.

In its second bulletin³⁹, published in September 1996, the OFT reviews the first full year of operation of the Regulations. It also gives statistical analysis of complaints received. It reveals that up to 30 June 1996, the Unfair Contract Terms Unit [the "Unit"] had received 817

³⁸ Office of Fair Trading, *Unfair Contract Terms*, Bulletin Issue No. 1, May 1996

³⁹ Office of Fair Trading, *Unfair Contract Terms*, Bulletin Issue No. 2, September 1996

complaints. In roughly one-third of the cases brought to the Unit's attention, action under the Regulations proved to be inappropriate but action was taken in the remaining two-thirds of cases.

The Unit reports that few business sectors seem to be immune from the use of unfair terms. According to the information given in this second bulletin, work in hand for the Unit ranges from consumer agreements for mobile phones and travel contracts, to wheel-clamp removal businesses and monumental masons. It also reports that potentially unfair terms seem to be widely used in home improvement and furnishing businesses and where goods are sold in the home, including double glazing.

Experience in this first year of operation has led the Unit to conclude that:

" ... the use of unfair terms in consumer contracts is widespread and amounts to a serious problem in the United Kingdom. This was contrary to our expectations. Before the Regulations came on stream some commentators had suggested, optimistically, that most businesses would adapt their contracts, without prompting, in order to comply with the Regulations. There would be a few stragglers and perhaps some firms who had been badly advised on the application of the Regulations to their consumer contracts or who had simply not appreciated their wider effects - so there would be some mopping up to do, but little more. It now appears however that awareness of the Regulations, and the implications they have for the way that consumer contracts are drawn up, has spread much more slowly than we had anticipated - particularly among small traders and their legal advisers.

We have been very disturbed to find that unfair terms often conflict not only with the requirements of the Regulations but with consumer protection legislation that has been in place for much longer. Examples include exclusion clauses that are void under the *Unfair Contract Terms Act 1977*, the *Consumer Arbitration Agreement Act 1988*, and others that give rise to offences under the *Consumer Transactions (Restrictions on Statements) Order 1976*."⁴⁰

⁴⁰

Ibid, page 5

VII Further reading

1. Office of Fair Trading , "*Unfair Contract Terms*", Bulletin Issue No.1, May 1996.
2. Office of Fair Trading, "*Unfair Contract Terms*", Bulletin Issue No. 2, September 1996.
3. Department of Trade & Industry Guidance Notes, "*The Unfair Terms in Consumer Contracts Regulations 1994*", July 1995.
4. Richard Lawson, "*Exclusion Clauses and Unfair Contract Terms*", Financial Times Law & Tax, 4th edition, 1995.

Appendix 1

1994 No. 3159

CONSUMER PROTECTION

The Unfair Terms in Consumer Contracts Regulations 1994

<i>Made - - - -</i>	<i>8th December 1994</i>
<i>Laid before Parliament</i>	<i>14th December 1994</i>
<i>Coming into force - -</i>	<i>1st July 1995</i>

Whereas the Secretary of State is a Minister designated^a for the purposes of section 2(2) of the European Communities Act 1972^b 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 and of all other powers enabling him in that behalf hereby makes the following Regulations:-

Citation and commencement

1. These Regulations may be cited as the Unfair Terms in Consumer Contracts Regulations 1994 and shall come into force on 1st July 1995.

Interpretation

2.— (1) In these Regulations—

"business" includes a trade or profession and the activities of any government department or local or public authority;

"the Community" means the European Economic Community and the other States in the European Economic Area;

"consumer" means a natural person who, in making a contract to which these Regulations apply, is acting for purposes which are outside his business;

"court" in relation to England and Wales and Northern Ireland means the High Court, and in relation to Scotland, the Court of Session;

^a (a) S.I. 1993/2661.

^b (b) 1972 c. 68.

"Director" means the Director General of Fair Trading;

"EEA Agreement" means the Agreement on the European Economic Area signed at Oporto on 2 May 1992 as adjusted by the protocol signed at Brussels on 17 March 1993^c;

"member State" shall mean a State which is a contracting party to the EEA Agreement but until the EEA Agreement comes into force in relation to Liechtenstein does not include the State of Liechtenstein;

"seller" means a person who sells goods and who, in making a contract to which these Regulations apply, is acting for purposes relating to his business; and

"supplier" means a person who supplies goods or services and who, in making a contract to which these Regulations apply, is acting for purposes relating to his business.

(2) In the application of these Regulations to Scotland for references to an "injunction" or an "interlocutory injunction" there shall be substituted references to an "Interdict" or "interim interdict" respectively.

Terms to which these Regulations apply

3.— (1) Subject to the provisions of Schedule 1, these Regulations apply to any term in a contract concluded between a seller or supplier and a consumer where the said term has not been individually negotiated,

(2) In so far as it is in plain, intelligible language, no assessment shall be made of the fairness of any term which—

(a) defines the main subject matter of the contract, or

(b) concerns the adequacy of the price or remuneration, as against the goods or services sold or supplied.

(3) For the purposes of these Regulations, a term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has not been able to influence the substance of the term.

(4) 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 the contract indicates that it is a pre-formulated standard contract.

^c Protocol 47 and certain Annexes to the EEA Agreement were amended by Decision No. 7/94 of the EEA Joint Committee which came into force on 1 July 1994, (O.J. No. L160, 28.6.1994, p.1). Council Directive 93/13/EEC was added to Annex XIX to the Agreement by Annex 17 to the said Decision No. 7/94.

(5) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.

Unfair terms

4.— (1) In these Regulations, subject to paragraphs (2) and (3) below, "unfair term" means any term which contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

(2) An assessment of the unfair nature of a term shall be made taking into account the nature of the goods or services for which the contract was concluded and referring, as at the time of the conclusion of the contract, to all 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.

(3) In determining whether a term satisfies the requirement of good faith, regard shall be had in particular to the matters specified in Schedule 2 to these Regulations.

(4) Schedule 3 to these Regulations contains an indicative and non-exhaustive list of the terms which may be regarded as unfair.

Consequence of inclusion of unfair terms in contracts

5.— (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.

Construction of written contracts

6. A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language, and if there is doubt about the meaning of a written term, the interpretation most favourable to the consumer shall prevail.

Choice of law clauses

7. 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.

Prevention of continued use of unfair terms

8.— (1) It shall be the duty of the Director to consider any complaint made to him that any contract term drawn up for general use is unfair, unless the complaint appears to the Director to be frivolous or vexatious.

(2) If having considered a complaint about any contract term pursuant to paragraph (1) above the Director considers that the contract term is unfair he may, if he considers it appropriate to do so, bring proceedings for an injunction (in which proceedings he may also apply for an interlocutory injunction) against any person appearing to him to be using or recommending use of such a term in contracts concluded with consumers.

(3) The Director may, if he considers it appropriate to do so, have regard to any undertakings given to him by or on behalf of any person as to the continued use of such a term in contracts concluded with consumers.

(4) The Director shall give reasons for his decision to apply or not to apply, as the case may be, for an injunction in relation to any complaint which these Regulations require him to consider.

(5) The court on an application by the Director may grant an injunction on such terms as it thinks fit.

(6) 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 by any party to the proceedings.

(7) The Director may arrange for the dissemination in such form and manner as he considers appropriate of such information and advice concerning the operation of these Regulations as may appear to him to be expedient to give to the public and to all persons likely to be affected by these Regulations.

Ferrers

Minister of State,

Department of Trade and Industry

8th December 1994

SCHEDULE 1

Regulation 3(1)

**CONTRACTS AND PARTICULAR TERMS EXCLUDED FROM THE SCOPE
OF THESE REGULATIONS**

These Regulations do not apply to—

- (a) any contract relating to employment;
- (b) any contract relating to succession rights;
- (c) any contract relating to rights under family law;
- (d) any contract relating to the incorporation and organisation of companies or partnerships; and
- (e) any term incorporated in order to comply with or which reflects—
 - (i) statutory or regulatory provisions of the United Kingdom; or
 - (ii) the provisions or principles of international conventions to which the member States or the Community are party.

SCHEDULE 2

Regulation 4(3)

ASSESSMENT OF GOOD FAITH

In making an assessment of good faith, regard shall be had in particular to—

- (a) the strength of the bargaining positions of the parties;
- (b) whether the consumer had an inducement to agree to the term;
- (c) whether the goods or services were sold or supplied to the special order of the consumer, and
- (d) the extent to which the seller or supplier has dealt fairly and equitably with the consumer.

SCHEDULE 3

Regulation 4(4)

**INDICATIVE AND ILLUSTRATIVE 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 this desire not to extend the contract is unreasonably early;
 - (i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
 - (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
 - (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
 - (l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
 - (m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;

- (n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
 - (o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
 - (p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
 - (q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.
2. Scope of subparagraphs 1(g), (j) and (1)
- (a) Subparagraph 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) Subparagraph 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.

Subparagraph 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) Subparagraphs 1(g), (j) and (1) do not apply to:
 - transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;

- contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency;
- (d) Subparagraph 1(1) is without hindrance to price indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

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