KEY POINTS

- A recent Issues Paper from the Law Commission and Scottish Law Commission affirms their 2005 recommendations that the legislation implementing the Unfair Terms Directive in the UK should be reformulated to make it more accessible.
- It is debatable whether the proposed reformulation of the fairness test would correctly reflect the meaning of the Directive.
- Re-writing the "core terms exemption" in the way proposed may not be compatible with the Directive.
- The proposed legislation would absorb the Unfair Contract Terms Act 1977 in its application to consumer contracts, leading to some "rounding up" of consumer protection.

Feature

Author Malcolm Waters QC

Implementing the Unfair Terms Directive in accessible language: an impossible challenge?

INTRODUCTION

In their joint Issues Paper, "*Unfair Terms in Consumer Contracts: a new approach?*", 25 July 2012, the Law Commission and the Scottish Law Commission set out proposals for simplifying and rationalising the law on unfair terms in contracts between businesses and consumers (B2C contracts).

BACKGROUND

The Law Commissions previously considered the reform of the law on unfair terms in their 2005 Report, "*Unfair Terms in Contracts*", Law Com No 292; Scot Law Com No 199 (the 2005 Report).

The recommendations in the 2005 Report were accepted in principle by the previous Government, but have not so far been implemented. Since then, the judgments of the UK Supreme Court in the test case on unarranged overdraft charges, *Office of Fair Trading v Abbey National plc and others* [2009] UKSC 6; [2010] 1 A.C. 696, have given detailed consideration to the so-called "core terms exemption" in Art 4(2) of the Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts (the Directive), as implemented in the UK by Reg 6(2) of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).

The present Government now intends to update the law on unfair terms as part of its planned Consumer Rights Bill, which is expected to be introduced in the 2013–14 Parliamentary session.

Against that background, the Government asked the Law Commissions in May 2012:

- to review and update the recommendations in their 2005 Report so far as they affect B2C contracts; and
- to examine the Art 4(2) exemption and advise the Department for Business, Innovation and Skills (BIS) on how best to implement the exemption, bearing in mind the UK's minimum harmonisation obligations under the Directive.

The Issues Paper set out the Law Commissions' views on these two topics and invited consultees to respond by 25 October 2012 to a range of questions listed in the Paper. Following the consultation, the Law Commissions intend to publish an Advice to BIS in the spring of 2013.

REVIEW OF THE 2005 REPORT

The 2005 Report recommended combining the Unfair Contract Terms Act 1977 (UCTA) and the UTCCR into one coherent piece of legislation, "rounding up" in favour of the consumer where the two regimes differ. While the UCTA and the UTCCR overlap and seek to achieve similar outcomes in relation to B2C contracts, the task of combining them is made difficult by the fact that the UCTA is a tightly drafted piece of UK domestic legislation, whereas the UTCCR generally follow the looser language and more nebulous concepts used in the Directive.

Having reviewed the recommendations in the 2005 Report for the purposes of the Issues Paper, the Law Commissions concluded that they remained appropriate and saw no need to re-open them, other than in the area of the "core terms exemption" where new recommendations are made. The Issues Paper did, however, summarise the earlier recommendations and asked whether there were any areas where they needed updating.

One of the areas highlighted was the previous recommendation that the Directive should not be "copied out" into UK law, but should be rewritten in a clearer, more accessible way. The merits of this proposal are less obvious than they may at first sight appear. It is true that some of the language of the UTCCR may be alien to UK lawyers. It is also true that the European Court of Justice (ECJ) has emphasised the need for national implementing legislation to be clear.

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

Moreover, to the extent that the language of the Directive remains unfamiliar to UK lawyers, it could be argued that its "foreignness" is a salutary reminder that some of the key concepts employed in the Directive have no direct counterpart in UK law. For example, Art 3(1) of the Directive (whose wording is copied out in Reg 5(1) of the UTCCR) characterises a term as unfair if, contrary to the requirement of

good faith, it cause a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer. The Law Commissions' proposed re-write of this provision would state that, if a term of a B2C contract is detrimental to the consumer, the business cannot rely on the term unless the term is "fair and reasonable", taking into account: (i) the extent to which it is transparent; and (ii) the substance and effect of the term and the circumstances existing at the time it was agreed. It is by no means clear that the Directive's twin concepts of "significant imbalance" and "good faith" have the same meaning as the "fair and reasonable" test proposed by the Law Commissions – albeit that the application of the test would be guided by a list of ten factors relating to the substance and effect of the term, some of which reflect provisions in the Directive that shed light on the meaning of Art 3(1).

Where the Directive employs novel concepts which are likely to be given an autonomous meaning by the ECJ, it may be preferable that the implementing legislation should employ the same language as the Directive, rather than translating it into ostensibly more accessible language, which the courts then have to construe in an unexpected way to bring it back into line with the meaning of the Directive which it is intended to implement.

The Law Commissions' proposed re-write of the so-called "greylist" of indicatively unfair terms in Sch 2 to the UTCCR (which copies out the corresponding list in the Annex to the Directive) gives rise to some similar questions – though here the illustrative nature of the "greylist" avoids the risk that the use of different language will result in the implementing legislation being incompatible with the Directive. To give one example, the reference in para 2(b) of the Sch to the consumer being "free to dissolve the contract" would be re-written to refer to the consumer being able to "cancel the contract, without incurring liability". While that reading may well be correct, there is a rival view (taken, for instance, by the FSA in its January 2012 guidance on unfair contract terms and arguably supported by the decision of the English High Court in *Peabody Trust Governors v Reeve* [2008] EWHC 1432 (Ch) at [45] and [57]) that "freedom to dissolve" means more than an ability to end the contract without incurring legal liability, and that practical barriers to ending the contract may equally result in the consumer not being "free" to dissolve it.

Finally on this aspect of the Issues Paper, it may be noted that the Law Commissions' objective of unifying the UTCCR with the UCTA in relation to B2C contracts would have the result that, in a number of areas, consumers would enjoy greater protection than they currently do under the UTCCR. One example of this is the proposal that, following the approach in the UCTA, the burden of proof should be reversed so that, where an issue about the fairness of a term arises in proceedings brought by a consumer (as opposed to an enforcement body such as the OFT), the business would bear the burden of showing that the term is fair. Another example is the proposal that terms should be assessable for fairness even where they are individually negotiated. While these terms are currently within the UCTA, they are outside the scope of the UTCCR and their inclusion would infringe the principle of individual autonomy which the final text of the Directive was intended to preserve.

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THE NEW PROPOSALS RELATING TO THE ART 4(2) EXEMPTION

Article 4(2) of the Directive is implemented by Reg 6(2) of the UTCCR, which provides:

> "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."

In the *Abbey National* case, the Supreme Court held that Reg 6(2)(b) prevents the assessment of the adequacy (in the sense of the appropriateness or reasonableness) of any monetary price payable for goods or services supplied under the contract. The Supreme Court accepted that the exemption does not apply to charges payable on default, but it rejected the view taken by the Court of Appeal below that a charge will not qualify for the exemption unless it is part of the "essential price" so as to form part of the core bargain between the parties. The Supreme Court accordingly held that the exemption prevented the court from assessing the reasonableness of the amount of the defendant banks' unarranged overdraft charges, notwithstanding that the charges were only payable in contingent circumstances and were not payable by a majority of customers. It is important to note that the Supreme Court did not hold that price terms falling within the exemption were wholly exempt from assessment (the so-called "excluded terms approach"); rather, the judgments proceeded on the basis that the effect of the exemption was merely to exclude any fairness challenge based on the "adequacy" of the charges (the so-called "excluded assessment approach").

Starting from the premise that the Supreme Court's decision is open to different interpretations and has left the law in an uncertain state, the Issues Paper proposes that price terms and terms which define the main subject matter of the contract should be wholly exempt from assessment, provided they are "transparent" and "prominent" and do not appear in the Sch 2 greylist. The requirement for the term to be prominent would mean that it was presented during the sales process in such a way that the average consumer would be aware of it. As the Law Commissions point out, this approach would enable the trader to control the application of the exemption: the trader could ensure that a price term or a term relating to the main subject matter of the contract is exempt from

Biog Box

Malcolm Waters QC is a barrister practising at Radcliffe Chambers, Lincoln's Inn, London. He specialises in the law relating to retail financial services and has a particular interest in the law on unfair terms in consumer contracts.

review by making it prominent.

A number of points arise out of the Commissions' proposals in this area:

- The contention that the Supreme Court's decision has left the law in an uncertain state seems a little unfair. While the decision has been criticised as giving an unduly literal construction to Reg 6(2)(b), the principle emerging from the judgments seems clear enough: so long as a price term is in plain intelligible language, the court may not assess the reasonableness of any price, even if the price is "ancillary" or "incidental". The Supreme Court's approach is undoubtedly easier to apply in practice than that taken by the Court of Appeal below, which (in Lord Mance's words) would have required a "complex and uncertain value judgment" to determine whether the charges formed part of the "essential bargain", as perceived by the typical consumer.
- Like the Supreme Court's approach, the Law Commissions' proposals would have the attraction of avoiding the need to grapple with the question whether a price is "ancillary" or "incidental". There may be room for argument in individual cases about whether a term satisfies the Law Commissions' proposed tests of transparency and prominence; but the tests are conceptually clear and would have the advantage of being readily applicable to both limbs of the exemption. It is true that the proposals would involve a slight narrowing in the scope of the exemption as compared with the position reached in the *Abbey National* case. But traders can be expected to welcome the degree of control which they would have over the application of the exemption.
- The Law Commissions argue that, if a term is transparent and prominent, a consumer should be aware of it, "which means that it will form part of the 'essential bargain'". This seems odd. Outside the world of celebrity culture, drawing attention to something unimportant is not enough to make it essential. However, this curious appeal to the concept of the "essential bargain" does not mean that the Law Commissions' proposals for reformulating the exemption would produce the same uncertainty as the Court of Appeal's approach in *Abbey National*. Under the Commissions' proposals, the operative test for the application of the exemption would simply be whether the term is transparent and prominent and does not feature in the Sch 2 greylist. Whether or not that is sufficient to make the term part of the "essential bargain" would be irrelevant to the application of the exemption.
- By the time the *Abbey National* case reached the Supreme Court, the banks had accepted that the "excluded assessment approach" was correct; that is to say, they had accepted that, if Reg 6(2)(b) applied to the terms imposing the charges, the effect would not be to render the terms absolutely exempt from any fairness assessment, but merely to exclude any challenge to their fairness based on the "adequacy" of the charges. The Law Commissions were not attracted to this approach, taking the view that it would be artificial for a court to assess the fairness of a price term without taking account of the amount payable. The Issues Paper accordingly recommends that a term which qualifies for the exemption should be wholly excluded from any assessment for fairness. There is considerable practical merit in this proposal. However, the Commissions' support for the "excluded terms approach" involves a departure from the more literal meaning of Art 4(2). As the Commissions recognise, this creates a risk that the ECJ might regard the reformulated exemption as going further than is permitted under Art 4(2), so making it incompatible with the Directive.
- The Issues Paper proposes that it should be stated that the exemption cannot apply to: (i) early termination charges; or (ii) default charges. Taking these charges in turn, the following brief observations may be made:
  - Some early termination charges may be integral to the pricing of the product offered to the consumer. An example is an early repayment charge (ERC) which will become payable under a mortgage if the consumer repays the loan during the period when a special introductory rate (eg a fixed or discounted rate) applies. There is some English authority that an ERC is covered by the exemption (*Smith v Mortgage Express*, unreported, 2 February 2007). Similarly, the FSA has taken the view, following the *Abbey National* case, that the level of an ERC cannot be made the subject of a trader's undertaking under the UTCCR because the charge forms "*part of the price the borrower pays in exchange for the service of being provided with a mortgage which operates at a fixed/discounted rate of interest for a period of time*". This seems right in principle and it is difficult to see why an ERC should not be covered by the Law Commissions' proposed reformulation of the exemption if the term imposing the charge is given the necessary degree of transparency and prominence.
  - The exclusion of true default charges (that is to say, charges payable upon a breach of contract) is uncontroversial. The Law Commissions go on to suggest, however, that terms should also be assessable for fairness "if they have the same effect as a default charge". The suggestion is acceptable if it simply means that charges which are in fact triggered by a breach of contract should be assessable for fairness, despite the contract being drafted in a way which attempts to conceal the nature of the charge by, for example, characterising it as payable for the supply of a service. Some care will, however, be needed to avoid implementing the suggestion in a way which opens the door to arguments of the kind which the OFT advanced, unsuccessfully, in the *Abbey National* case, that the banks' unarranged overdraft charges fell outside the exemption on the basis that, while not in fact payable on default, they were "akin" to default charges because they were payable in "aberrant circumstances". ■