



UNFAIR TERMS IN CONTRACTS (LC NO 298; SLC NO 199)

SUMMARY



1. In 2001, the Department of Trade and Industry asked the Law Commission and Scottish Law Commission to rewrite the law of unfair contract terms as a single regime, in a clearer and more accessible style. At the same time we were asked to consider whether to extend the legislation to protect businesses, particularly small businesses.
2. On 24 February we published a final report setting out our detailed recommendations, together with a draft Bill.

THE PROBLEM

3. As the law currently stands, there are two major pieces of legislation dealing with unfair contract terms. The Unfair Contract Terms Act 1977 sets out the traditional UK approach, while the Unfair Terms in Consumer Contracts Regulations 1999 implement the 1993 EU Directive. The two laws contain inconsistent and overlapping provisions, using different language and concepts to produce similar but not identical effects. A law that affects ordinary people in their everyday lives had been made unnecessarily complicated and difficult.
4. The 1977 Act is written in a particularly dense style, which even specialist lawyers find difficult to follow. This is made even more complicated by the fact that the Act contains two Parts: one for England, Wales and Northern Ireland, and one for Scotland. The two Parts produce almost the same effect but use different language to do so. Meanwhile the 1999 Regulations use European concepts that are unfamiliar to UK lawyers. The combination of legislation has led to widespread confusion among consumers, businesses and their advisers.
5. The draft Bill rewrites both laws for the whole of the UK in a way that is much clearer and easier to follow. We have also plugged some gaps in protection.

THE CURRENT LAW: DIFFERENCES BETWEEN THE ACT AND REGULATIONS

6. The 1977 Act extends to a wide range of contracts, including consumer, business, private and employment contracts. However, it only covers a narrow range of terms. It is designed to control exclusion clauses, where one party attempts to exclude or limit their normal liability for negligence or breach of contract, or tries to “render a contractual performance substantially different from that which was reasonably expected”. The 1999 Regulations cover a much wider range of terms, extending to any term other than the main subject matter or the price. However, they only apply to consumer contracts.
7. Under the 1977 Act some terms are automatically ineffective. Under the Regulations, no term is automatically unfair. Instead, they are all subject to a fairness test. However the Regulations permit the Office of Fair Trading (OFT) and other bodies to go to court to prevent unfair terms from being used. These preventive powers have proved to be an important way of regulating the market.
8. The Act and Regulations also differ in their treatment of negotiated clauses; in the way they phrase the fairness test; and in their burden of proof.

CONSUMER CONTRACTS

9. Our aim is to produce a single, unified regime to cover the whole of the UK that preserves the existing level of consumer protection. Where the Act and Regulations differ, we have rounded up rather than rounded down. Thus for consumer contracts, the draft Bill
 - (1) extends to all the terms currently covered by the Regulations (not just exclusion clauses);
 - (2) continues to hold that terms which limit liability for death or personal injury, or which exclude basic undertakings about the quality and fitness of goods are ineffective;
 - (3) includes negotiated clauses as well as standard clauses (as does the 1977 Act). This closes a current loophole by which some businesses can, for example, demand unreasonable deposits by saying that they are prepared to negotiate the amount from 100% to 75%.
 - (4) states that in claims brought by consumers, the burden of proof lies on the business to show that the term is fair. Again this follows the 1977 Act. The business will generally have far greater resources than the consumer so, where the fairness of a term is in issue, it should be required to justify its position. This is not the case in preventive powers, where it will still be up to the OFT or other body to show that the term is unfair.
10. The OFT and other bodies will gain some additional powers to take action against notices. For example, the OFT would be able to demand that a sign in a store car-park saying “no liability is accepted for injury” is taken down. Such signs have long been ineffective in legal terms but organisations continue to use them, presumably in an attempt to discourage people from claiming their rights.

PROTECTING SMALL BUSINESSES

11. The report also recommends improved protection for small businesses. At present, where a business contracts on the other party's standard written terms of business, it may challenge unfair exclusion clauses. This means that the court may review the fairness of a term that excludes or limits liability for negligence or breach of contract, or purports to allow the other party to render a contractual performance substantially different from that which was reasonably expected.
12. We were told that small businesses frequently find themselves signing contracts that contain other unfair terms, which the law does not allow to be challenged. This is especially true where a small farmer, manufacturer or builder supplies a much larger business. The small business may be required to indemnify the larger business for losses that are not their fault, or forfeit deposits, or accept variations of price after the contract has been agreed. They may find that the larger business has reserved the right to terminate a contract at will, or for only a minor default, while the small business is bound more rigorously by the contract.
13. We do not wish to interfere with business contracts that are genuinely negotiated between the parties. However, there is a problem when one party imposes its standard terms on a vulnerable small business. The small business may not understand the term or its consequences; and even if it does understand the term it will often lack the bargaining strength to change it.
14. The draft Bill includes special protection for the smallest and most vulnerable businesses, commonly referred to as "micro businesses". We define these as businesses with nine or fewer staff.
15. Under our proposals, these very small businesses will be able to challenge any standard term of the contract that has not been altered through negotiation, and is not the main subject matter of the contract or the price.
16. However, we do not wish to interfere where contracts are already sufficiently regulated, or where the business is sufficiently sophisticated to look after its interests. We therefore set out a number of exceptions to the new small business protections. We exclude contracts for financial services, contracts over £500,000 and situations where the apparently small business is associated with other businesses, so that overall the group has more than nine employees. We also recommend that the exemptions currently in the 1977 Act should apply to the new controls on small business contracts. These exclude, for example, contracts for land, intellectual property, or security interests or contracts to form or dissolve contracts. Here people will usually seek legal advice.
17. In an ideal world, a well-resourced organisation would use preventive powers to protect small businesses generally, by challenging those that imposed unfair standard terms on them. However, we have not been able to find an organisation with the resources to take on this task. The draft Bill does not presently include preventive powers to be used on behalf of small businesses. However, if resources could be found, this would provide useful protection. Many small businesses told us about unfair terms that could be challenged under the present law, but which are still used because the small business lacks the ability to bring court action.

OTHER CONTRACTS

18. At present, the 1977 Act includes several other types of contract, such as contracts between larger businesses, employment contracts and private sales. Here our aim is to preserve the effect of the current law, while setting it out in a way that is clearer and easier to understand.
19. We do, however, recommend some small reductions in the way that the 1977 Act regulates negotiated contracts between businesses. At present, the Act allows courts to review any term that limits the effect of the implied undertakings in the Sale of Goods Act 1979, which state that goods should match their description or sample, be of satisfactory quality and fit for their purpose. These controls apply to negotiated terms as well as to standard terms. We think it would be very unlikely for a court to find that a clause is unfair when it had been genuinely negotiated between businesses, and we are not aware that any cases have been brought to challenge negotiated terms under these provisions. Under our proposals, businesses will generally be allowed to negotiate to limit contractual liability: the controls will only apply to standard terms.

INTERNATIONAL CONTRACTS AND CHOICE OF LAW

20. Much criticism has been levelled at how the 1977 Act deals with business contracts involving the cross-border sale of goods. Although the avowed aim of section 26 was to exempt export contracts while protecting UK importers, it was drafted in a way that exempted many import contracts and applied the legislation to some exporters. The Draft Bill rewrites this section to exempt only those contracts under which goods are exported or supplied abroad.
21. For consumer contracts, the Draft Bill prevents businesses from using non-UK law if the consumer was living in the UK when the contract was made and took all the steps necessary to conclude the contract there.

Law Commission/Scottish Law Commission
24 February 2005