

Title: Unfair Terms in Consumer Contracts Lead department or agency: Law Commission Other departments or agencies: Scottish Law Commission	Impact Assessment (IA)		
	Date: July 2012		
	Stage: Consultation		
	Source of intervention: Domestic		
	Type of measure: Legislation		
Contact for enquiries: Donna Birthwright 020 3334 0282			
Summary: Intervention and Options			IA No: LAWCOM0024

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, One-Out?	Measure qualifies as
£million	N/Q	N/Q	Yes	zero net cost

What is the problem under consideration? Why is government intervention necessary?
 Unfair terms law is contained in two different pieces of legislation: a 1977 Act and 1999 Regulations which implement a European directive. This “double-banking” leads to overlapping law, which is complex and unclear. It exposes businesses to legal, prudential, operational, and reputational risks, and adds to their administrative burden. Applying the law is an intricate exercise, requiring sophisticated legal advice, increasing enforcement costs.
 Government intervention is needed to consolidate and clarify the law.

What are the policy objectives and the intended effects?
 The policy objective is consolidation and clarification of the law on unfair terms. The intended effects include:
 1. **Lower risks for businesses**, produced by more certainty in the law.
 2. **Increased consumer confidence and competition**. If consumers know what they are paying and what they are getting in return, they are able to participate in the market with confidence and exercise consumer choice.
 3. **Reduced enforcement costs**. Under the current state of the law, enforcement bodies must rely on sophisticated legal advice and face litigation risks.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
Option 1: Do nothing. This option would leave the law as it is, with all its uncertainties. Businesses would remain exposed to the risk of litigation and disputes, which may mean that they are not able to enforce contract terms. Legal uncertainty also increases regulatory costs as applying the law requires sophisticated legal resources.
Option 2: Consolidation of the law and clarification of the exemption. This option would consolidate the law on unfair terms as recommended in the Law Commissions’ 2005 Report on unfair terms. It would also clarify the law on the Regulation 6(2) exemption in the Unfair Terms in Consumer Contracts Regulations 1999, in response to stakeholders’ concerns that the law in this area is difficult to apply in practice, and open to competing interpretations.

Will the policy be reviewed? The Law Commission does not implement legislation. Review is a matter for the implementing department. If applicable, set review date: N/A

Does implementation go beyond minimum EU requirements?			We are consulting on this issue. See text at page 5.		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			Traded: N/A	Non-traded: N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.
 Signed by the Responsible Commissioner: _____ *David Hertzell* _____ Date: _____

Summary: Analysis & Evidence

Policy Option 2

Description: Update the business insured's duty of disclosure to reflect the reciprocal nature of information exchange.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: optional	High: optional	Best Estimate:

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	optional	optional	optional
High	optional	optional	optional
Best Estimate	optional	optional	optional

Description and scale of key monetised costs by 'main affected groups'

We propose clarification, not major change in the law. Businesses and enforcers will bear minimal one-off familiarisation costs, and businesses may need to review their standard terms. Additional costs should be minimal as responsible businesses operate staff training programmes which include training on their terms and consumer relations. Businesses are already obliged to keep their terms under review to ensure legal compliance. Similarly, enforcers already operate training programmes on unfair terms law.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	optional	optional	optional
High	optional	optional	optional
Best Estimate	optional	optional	optional

Description and scale of key monetised benefits by 'main affected groups'

Businesses will benefit from simpler dispute handling; they will find it simpler to draft standard terms; the risk of expensive and uncertain litigation will be reduced; and there will be increased sales resulting from increased consumer confidence / spending. For the public sector, simpler law would reduce enforcement costs because it will be easier to explain the law to consumers and traders, and resolve cases.

Other key non-monetised benefits by 'main affected groups'

The reforms would deter traders from using unfair terms that lead to consumer non-financial detriment. Consumers would find it easier to resolve disputes, saving time and experiencing less stress.

Key assumptions/sensitivities/risks

Discount rate (%)

We anticipate a reduction of unfair terms which will reduce the number of complaints. Consumers are very reluctant to take disputes to court, preferring to reach a resolution by negotiation. Clearer law will help achieve that. We, therefore, doubt there will be any significant increase in court cases brought by consumers. Similarly, we do not anticipate a significant increase in court cases instigated by enforcers, as most cases are resolved by negotiation rather than formal action. Clearer law should lead to swifter resolution without court action.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO? Yes/No	Measure qualifies as IN/OUT/Zero net cost
Costs:	Benefits:	Net:		

Evidence Base (for summary sheets)

Introduction

- 1.1 This Impact Assessment is published alongside the Law Commission and Scottish Law Commission's (the Law Commissions) Issues Paper on Unfair Terms in Consumer Contracts. In our Issues Paper, we ask whether consultees still agree with the recommendations we made in our 2005 Report on Unfair Terms in Contracts;¹ and we make new recommendations with regard to the Regulation 6(2) exemption in the Unfair Terms in Consumer Contracts Regulations 1999.² We do not consider misleading and aggressive sales products or the Consumer Protection from Unfair Trading Regulations 2008³ (CPRs) which are the subject of a separate report.⁴

Removing double-banking

- 1.2 In 2005, the Law Commissions noted that the law on unfair terms was inconsistent and unduly complicated, because it was subject to two separate legal regimes: the Unfair Contract Terms Act 1977 (UCTA) sets out the traditional UK approach, while the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) implement the Unfair Terms Directive 1993. It is an example of double-banking.⁵ The two regimes have different scopes of application, to some extent they overlap, they have different effects, and use different concepts and terminology. This leads to an unnecessary administrative burden on businesses, as traders need to understand and apply the two regimes to their standard form contracts.
- 1.3 A report in 2008 by the University of East Anglia identified overly-complex legislation as a key weakness in UK consumer law.⁶ In addition, the Davidson Review reported on the negative effects of double-banking upon businesses and consumers, and found that it "makes the law more complex and difficult to use."⁷ Removing double-banking is part of the Government's Red Tape Challenge, which aims to reduce the overall burden of regulation.
- 1.4 We recommended reform to consolidate the law and published a draft Bill, combining the UTCCR and UCTA. Although the previous Government accepted the report in principle, so far the report has not been implemented. This consultation reviews the 2005 recommendations and asks whether they continue to have public support.

Clarifying the effect of the exemption for main subject matter and price

- 1.5 We have now been asked to address one issue of particular concern to stakeholders: namely which terms should be exempt from the fairness review because they relate to the main subject matter of the contract or the price/quality relation. This exemption is based on article 4(2) of the Unfair Terms Directive and has been implemented in Regulation 6(2) of the UTCCR.

¹ Unfair Terms in Contracts (2005) Law Com No 292, Scot Law Com No 199.

² SI 1999 No 2083.

³ SI 2008 No 1277.

⁴ Consumer Redress for Misleading and Aggressive Practices (2012) Law Com No 332; Scot Law Com No 226.

⁵ Double-banking is failing to streamline the overlap between existing legislation in force in the UK and new EU sourced legislation.

⁶ BERR (2008). Benchmarking the performance of the UK framework supporting consumer empowerment through comparison against relevant international comparator countries (<http://www.bis.gov.uk/files/file50027.pdf>).

⁷ <http://www.bis.gov.uk/files/file44583.pdf>. Davidson Review, *Final Report* (November 2006).

- 1.6 This issue came to prominence during the litigation over bank charges, culminating in the 2009 Supreme Court decision: *Office of Fair Trading v Abbey National plc.*⁸ The issue before the court was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms within the meaning of article 4(2). The uncertainty of the law on this issue is illustrated by the fact that the High Court and Court of Appeal found that the terms were not exempt, though the Supreme Court found that they were.
- 1.7 The Law Commission and Scottish Law Commission have been asked to review the law on this issue, taking account of the purpose of the Directive, UK litigation, decisions of the Court of Justice of the European Union (CJEU) and the approach of other Member States. This legal review is discussed in detail in Parts 4 to 7 of the Issues Paper.
- 1.8 The Law Commissions have concluded that the law in this area is fundamentally uncertain. The Supreme Court decision can be interpreted in several ways, and the courts could use it to justify a variety of approaches. Furthermore, it may well be overturned by a decision of the CJEU. The Commissions note that the German Federal Supreme Court (*Bundesgerichtshof – BGH*) has taken a very different approach, and has consistently assessed ancillary bank charges for fairness.⁹
- 1.9 The fact that the banks ultimately succeeded before the Supreme Court may lull traders into a false sense of security, encouraging them to rely on hidden charges for their income stream. As the FSA has highlighted, this exposes the businesses to four types of risks:
- (1) The **legal risk** of not being able to enforce a particular contract term because it has been deemed to be unfair. This includes the possibility of an expensive court case, with uncertain outcomes;
 - (2) The **prudential risk** of terms being unenforceable. Once a firm is committed to a certain charging structure, it faces costs should that charging be found to be invalid. In the bank charges litigation, this was a major risk as the banks had raised £2.56 billion from unauthorised overdraft charges in 2006;
 - (3) The **operational risk** of spending management time in redrafting contract terms and providing consumers with new contracts;
 - (4) The **reputational risk** of consumers not trusting firms and therefore not wanting to do business with them.¹⁰
- 1.10 These risks are particularly acute for traders that operate on the basis of long-term service contracts, such as utilities companies, telephone or internet service providers.
- 1.11 The uncertainty of the law also disadvantages smaller traders, who do not have access to sophisticated legal resources, and would not be prepared to take the risk of litigation. Businesses need greater certainty in the law so that they can develop terms and conditions and business models which comply with the law, as if they are wrong the risks they face are significant and potentially expensive.

⁸ [2009] UKSC 6, [2010] 1 AC 696.

⁹ See Appendix A to our Issues Paper.

¹⁰ FSA: Fairness of terms in consumer contracts: a visible factor in firms treating their customers fairly. June 2008.

Policy options on the exemption

- 1.12 The Issues Paper therefore considers how to frame the exemption so as to give maximum clarity to businesses about which terms are exempt from review, and which are least likely to be overturned by the CJEU. This has not been an easy task, as the issue is subject to several constraints. The Unfair Terms Directive is a minimum harmonisation measure, which means that the UK must implement it, and must not implement it in a way which provides less protection to consumers.
- 1.13 This leaves two options:
- (1) **Option 1: do nothing.** This would leave the current law, in which the implementing regulation merely copies out the words of the Directive. The Law Commissions consider that this would lead to unacceptable uncertainty. The words are extremely difficult to understand; the guidance given by the UK courts is ambiguous; and the Supreme Court interpretation may be overturned by the CJEU.
 - (2) **Option 2: rewrite the exemption in a clearer way.** The preferred option is to rewrite the exemption contained in the Directive in a way which replicates the underlying idea, but which uses different language. Under European law, this is permissible if the implementing legislation provides for additional consumer protection (rather than less protection). It is not the intention of the proposals to increase consumer protection in a substantive way, but the re-written exemption may increase protection at a technical level.
- 1.14 At present, the exemption for price terms states that the assessment for fairness shall not relate “to the adequacy of the price or remuneration, as against the goods or services supplied in exchange”. The Law Commissions are consulting on whether this should be re-written to state that a price term is excluded from review provided that it is transparent and prominent. We ask if these terms should be defined as follows:
- (1) *Price* means a monetary obligation;
 - (2) *Transparent* means expressed in plain intelligible language, legible and readily available to the consumer; and
 - (3) *Prominent* means that it was presented in a way that a reasonably well-informed, reasonably observant and circumspect consumer would be aware of the term.
- 1.15 Similarly, the Law Commissions propose that a term relating to the main subject matter of the contract should only be exempt from review if it is transparent and prominent.
- 1.16 This emphasis on transparency and prominence is based on the underlying purpose of the Unfair Terms Directive, which is to enhance competition. Consumers can make rational decisions about the prices of which they are aware. Consumers are unaware of charges that are buried in small print and, therefore, competition does not work to drive down their level. Rather, competition is undermined as traders maintain artificially low headline prices, and rely on hidden charges to generate their income stream.

- 1.17 To bring further clarity, the paper also proposes that the exclusion from review should not relate to price escalation clauses, early termination charges and default charges. These are the charges which are most commonly assessed by enforcement bodies. Examples of these terms are also listed in the annex to the Directive as being terms which “may be unfair”.
- 1.18 The proposal that price escalation clauses, early termination charges and default charges may be assessed for fairness draws on the underlying principle behind the examples set out in the annex. It may go further than a strict reading of the Directive would show was absolutely necessary. The Law Commissions have formed the view, however, that the CJEU is unlikely to interpret the Directive in a strict way. Rather the CJEU is likely to take a purposive approach, drawing on the principle behind the examples given in the annex.
- 1.19 Businesses should not find it difficult to ensure that price escalation clauses, early termination charges and default charges are broadly fair. The main cost to businesses arises not from complying with the law but from not complying. At present, there is a risk that businesses will misunderstand the law in this area, by using hidden charges to cross-subsidise the headline price. If that charging structure is then over-turned by the courts, the costs in terms of legal, prudential, operational and reputational risk could be considerable. The proposal is designed to reduce the risk of such a misunderstanding.

Policy objectives and intended effects

- 1.20 The policy objectives are consolidation and clarification of the law on unfair terms. The intended effects are three-fold, as follows:
- (1) **Lower risks and costs for businesses.** Traders will have the required certainty and clarity to enable them to avoid using unfair and hidden terms, thereby reducing the risk of litigation and the incidence of disputes. There will be swifter and cheaper resolution of disputes about terms. In addition the administrative burden of regulations will be reduced as the law is consolidated;
 - (2) **Consumer confidence and increased competition.** Consumers will know what the price and the main subject matter of the contract is, that is what they are paying and what they are getting in return; and be able to participate in the market place with confidence. They will make better choices because they will be able to compare deals offered by different traders. This will produce a more efficient market environment and increase competition;
 - (3) **Reduced enforcement costs.** Clarification will make enforcement and application of the law easier. Enforcement bodies currently rely primarily on informal rather than formal enforcement methods. That is, they achieve compliance with the law by explaining the law and reaching agreement with traders about how terms should be amended. Our proposals should make this process quicker and simpler.
- 1.21 Below we start by explaining the problem which unfair terms legislation is designed to address. We then explain the effect of our proposals, discussing who will be affected, and the costs and benefits.

What is the problem which unfair terms legislation addresses?

The problem with standard form consumer contracts

- 1.22 Consumers enter into multiple standard term contracts each year, covering many aspects of their lives. Whilst they are heavily reliant on the goods and services provided through standard form contracts, few consumers read the contracts in detail. In most cases, they enter into these contracts without legal advice. This means that consumers can be taken by surprise by hidden terms, which leads to disputes and dissatisfaction. They expect traders to make money on the main elements of the deal; not to make their profit from terms hidden in the small print.
- 1.23 Consumers tend to focus on headline elements such as price.¹¹ A recent YouGov survey showed that most consumers do not read contracts thoroughly before purchase: 65% give contracts a quick skim read or pick out the main points; an additional 10% do not read contracts at all. The main reason given for not reading contracts is that the terms and conditions were standard. Consumers may trust the company or think that they are protected by the law, or they may think that as they cannot do anything about the terms it is not worth the time and trouble of reading them.

Standard form contracts and information asymmetry

- 1.24 Standard terms enable the parties to make complex contracts with the minimum of time or trouble, and can be good for competition by making shopping simpler. They save the expense of many individual negotiations, thereby reducing transaction costs. The time saving frees consumers to put effort into comparing offers, which gives firms an incentive to offer low prices and good service.
- 1.25 Hidden contract terms, however, can undermine competition by making it harder to compare traders' deals,¹² and consumer confidence is threatened. This is illustrated by the OFT's market study on consumer contracts:

Where there are several aspects to a product or service being provided, competition can become focused on one particular aspect, most often the headline price. In these cases there is a risk that fierce competition on that single headline aspect pushes firms to recover costs, or restrict services, through less visible contract terms. For competition to work well for consumers, value on the headline aspects must not be undermined by unfavourable conditions in the small print.

If consumers are confident that the small print will be broadly consistent with their expectations, they can focus on shopping around for best value on the main elements of a deal. If, on the other hand, consumers fear that the small print contains nasty surprises, they will divert effort into scrutinising terms and conditions or be reluctant to buy at all. Transaction costs will be higher, and trust in markets will be undermined.¹³

¹¹ OFT1312, p 17.

¹² OFT1312, p 35.

¹³ OFT1312, p 5.

- 1.26 In summary, if consumers do not have to worry about the small print, they will generate competition by focusing on the main elements of the deal. Competition is undermined, however, where unexpected charges are hidden in small terms.
- 1.27 The problem has been analysed as one of information asymmetry. Traders do not compete on small print terms because consumers do not know about them. This led to the paradox identified by the influential economist Professor Peter Diamond in 1971. If no consumers read the small print, a firm cannot attract custom by offering efficient contracts, and if all firms offer the same terms, it is not worth any consumer spending time to discover this.¹⁴ The result is that the position can easily be reached where even in a competitive environment all providers offer standard terms which are unfavourable to consumers; and where this position is reached, it becomes entrenched. Traders have more to gain by offering low headline prices than in offering fair terms.
- 1.28 The problem is similar to that identified by Professor Akerlof in his Nobel prize winning essay on the “market for lemons”.¹⁵ In the US, a “lemon” is a second hand car which looks adequate but proves defective. Akerlof explained that without legal protection, poor quality cars would drive out the good. The owners of good cars would not be paid an adequate price, and would withdraw their cars from the market. As better cars are withdrawn, the average quality would fall. This would lead to a reduction in price, leading more and more owners to withdraw. The same analysis can be applied to hidden contract terms. Information asymmetry leads to a race to the bottom.¹⁶

The history of the legislation

- 1.29 In light of the problems identified with standard form contracts, the legislature stepped in, passing the Unfair Contract Terms Act in 1977. In 1993, this was supplemented by the Unfair Terms Directive 1993 (UTD), which is implemented through the UTCCR.¹⁷
- 1.30 The UTD exempts terms in plain intelligible language relating to the main subject matter and the price. The thinking behind this exemption is to distinguish between terms which consumers know about (and which are subject to competition) and terms which they do not know about. Professors Brandner and Ulmer published an article in 1991, which influenced the text of the exemption. The article stated that “the protection of consumers against unfair contract terms is to contribute to the balance of the parties’ rights and obligations”, and this should be achieved by “improving the transparency in this area”. They continued:

The requirement of transparency is directed against terms which may *conceal* the principal obligations or the price and thus make it difficult for the consumer to obtain an overview of the market and to make what would (relatively speaking) be the best choice in a given solution. The improvement of information helps the market mechanisms to prevent any imbalance between the parties’ rights and obligations.¹⁸

¹⁴ P Diamond, “A model of price adjustment” (1971) 3(2) *Journal of Economic Theory* 156. For discussion, see M Armstrong and J Vickers, “Consumer Protection and Contingent Charges” (2012) *Journal of Economic Literature* 50:2, 477-493 at p 489.

¹⁵ G Akerlof, “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism” (1970) 84 *Quarterly Journal of Economics* 488.

¹⁶ See Michael Schillig, “Directive 93/13 and the “price term exemption”: a comparative analysis in the light of the “market for lemons rationale” (2011) *International & Comparative Law Quarterly* 933 at p 936.

¹⁷ The Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994 No 3159) came into force on 1 July 1995. The 1994 Regulations were reproduced with some limited changes in the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999 No 2083). Summarise changes or refer to current law section.

¹⁸ Hans Brandner and Peter Ulmer, “The Community Directive on Unfair Terms in Consumer Contracts: some critical remarks on the proposal submitted by the EC Commission” *Common Market Law Review* (1991) 28 647- 662 at p 656.

- 1.31 This legislation remains an important way of regulating the consumer market place, but it needs to offer traders more certainty. The proposals focus more explicitly on the transparency and prominence of the term. This is designed to improve competition and bring more certainty to traders.

The problems caused by lack of competition

- 1.32 In the current economic climate, where the popularity of price comparison websites is rising, there is pressure upon traders to compete on low headline prices, whilst earning their profits through hidden terms. This leads to competition being undermined as consumers do not know at the outset what the true price is, and cannot compare deals.

- 1.33 This also reduces consumer confidence. The role of consumer confidence in generating growth has become part of government policy:

The Government believes that people buying goods and services should be empowered to make wise decisions about what and how they purchase. ... Empowered consumers are more confident to buy new or different products and services and demand choice, thereby stimulating competition and innovation from traders as well as high standards of consumer care. In turn, this drives greater productivity and economic growth.¹⁹

- 1.34 In OFT research, 20% of people said they had experienced a problem with at least one consumer contract in a one year period.²⁰ In 80% of those cases, the problem came as a surprise, such as terms relating to: cancellation; renewal and discount periods; unexpected charges; and unfair interpretation of terms and conditions.²¹

- 1.35 Apart from causing consumer detriment, consumer disputes and dissatisfaction are time consuming for traders to deal with. Furthermore, if disputes are not resolved promptly consumer confidence and spending are undermined.

- 1.36 Consumer confidence generates consumer spending which is a major part of the UK economy. Consumer spending represents approximately 60% of the UK's gross domestic product. UK consumer spending increased from approximately £600 billion in 2000 to over £850 billion in 2011.²² In comparison to other EU Member States, the UK's consumer expenditure is above average. A report from the European statistics source "Eurostat" shows that UK consumers spend more than the average European.²³

- 1.37 Competition also improves innovation in the form of new products, services, and production processes as firms strive against their competitors. Research analysing the impact of the EU single market programme found that increases in competition raised the levels of innovation; and higher levels of innovation led in turn to higher productivity growth.²⁴

¹⁹ Government Response to the Consultation on Institutional Reform (April 2012), para 8.

²⁰ OFT1312, p 17.

²¹ Above, p 21.

²² Office for National Statistics: <http://www.ons.gov.uk/ons/rel/consumer-trends/consumer-trends/q1-2012/stb-consumer-trends-q1-2012.html>.

²³ Eurostat Yearbook 2011: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/CH_01_2011/EN/CH_01_2011-EN.PDF, pages 36 and 54.

²⁴ Griffith, R. et al. (2006), 'Product Market Reform and Innovation in the EU', Institute for Fiscal Studies.

The effect of the legislation

- 1.38 Controls on the use of unfair terms in standard form contracts have been an important way of regulating the consumer market place for the last twenty years. Many examples can be found where enforcement action to remove unfair terms has had a positive impact in promoting consumer confidence, competition and growth. Below we consider examples drawn from the mobile phone market, estate agency contracts and approved code schemes.

The mobile phone market: an example

- 1.39 In 1996, the OFT undertook an investigation into the terms used in standard form mobile phone contracts. These included terms relating to the lack of a “cooling off period”, the length of time that consumers were tied into the contract, and the fees payable for disconnecting a service. The OFT were also concerned that mobile phone contracts were not intelligible: they were often too lengthy, not expressed in plain English and contained terms hidden in small print.
- 1.40 As a result of the investigation, the OFT asked nine out of ten of the country’s leading mobile phone suppliers²⁵ to stop using particular terms which it considered to be unfair. In 1997, the OFT had remaining concerns about seven providers.²⁶ Following OFT intervention, these companies introduced revised contracts and agreed not to use or enforce unfair terms.
- 1.41 OFTEL, the industry regulator at the time, supported the OFT’s actions, citing approximately 4,000 complaints and queries per year that it received from customers with mobile phones.²⁷ In 1996, Don Cruickshank, the then Director General of Telecommunications, put forward the argument for early enforcement action:

The mobile telecoms industry has grown rapidly in the past few years. By taking action now over customer concerns, it can help build customer confidence so its continual growth can be assured.²⁸

- 1.42 The mobile phone sector saw rapid growth in the late 1990s.²⁹ It is believed that better regulation, pay-as-you-go options and supermarket deals encouraged competition and growth in the sector.³⁰

²⁵ Orange, Vodafone, Cellnet, Mercury, Astec Communications, British Telecom, The Peoples Phone Company, Motorola Telco and UniqueAir.

²⁶ BT, Call Connections (owned by BT), Unique Air, Motorola Telco, Astec Communications, Peoples Phone and One 2 One.

²⁷ See OFTEL press release “OfTel supports action on ‘unfair’ mobile phone contract terms” available from PR Newswire at <http://www.prnewswire.co.uk/cgi/news/release?id=48309> See also The Independent, “Mobile phone contracts ‘unfair’” (8 June 1996) available at: <http://www.independent.co.uk/news/mobile-phone-contracts-unfair-1335916.html>.

²⁸ OFTEL press release “OfTel supports action on ‘unfair’ mobile phone contract terms” available from PR Newswire at <http://www.prnewswire.co.uk/cgi/news/release?id=48309>.

²⁹ In the third quarter of 1999, the biggest four mobile phone companies (Vodafone, Cellnet, Orange and One 2 One) added 2.7 new UK subscribers BBC News, “Mobile phones – a growth industry” (29 October 1999) available at: http://news.bbc.co.uk/1/hi/business/business_basics/469294.stm.

³⁰ See, for example, BBC News, “Mobile phones – a growth industry” (29 October 1999) available at: http://news.bbc.co.uk/1/hi/business/business_basics/469294.stm.

Estate agents' commissions

- 1.43 In *OFT v Foxtons Ltd*,³¹ the OFT brought proceedings against a well known estate agent claiming that their standard contract with consumer landlords contained unfair terms. The small print included “renewal commissions”, charging a percentage of rent if a tenant introduced by Foxtons renewed their tenancy, even if Foxtons did not negotiate that renewal. Foxtons also included “sale commission” terms, which charged a percentage of the purchase price when a landlord sold a property to a tenant introduced by Foxtons, even if Foxtons did not assist with the sale. These terms were found to be unfair.
- 1.44 The OFT reported that the case has had a positive impact on the awareness and attitudes of traders,³² and consumer empowerment:

The benefits delivered by the Foxtons case comprise direct impacts that arise through Foxtons changing its behaviour, amending their letting terms to the benefit of consumers. Such benefits will continue to accrue in future years. In addition to directly impacting Foxtons terms and charging practices, the case has other indirect impacts, with potential to ... deter similar practices by other letting agents ...³³

The OFT's Consumer Codes Scheme and Approved Trader Schemes

- 1.45 Unfair terms legislation is also an important component of the OFT Consumer Codes Scheme,³⁴ as traders have to show that their standard terms and conditions comply with the UTCCR. In addition, many Trading Standards Services supervise local approved trader schemes, designed to give consumers a reliable way of finding trustworthy local businesses. As part of these schemes, traders are required to show that their standard terms and conditions comply with the UTCCR.
- 1.46 The Government has recently recognised the value of these schemes. It listed the OFT Consumer Codes Scheme and the Approved Trader Schemes run by Trading Standards as two examples of voluntary codes of conduct, and wrote:

Voluntary consumer codes of conduct are an important way to provide protection to consumers and to improve standards of customer service without imposing unnecessary regulatory burdens on business.³⁵

Conclusion

- 1.47 Unfair terms legislation is an important way of regulating the consumer market, and has positive effects in promoting competition and consumer confidence. To work effectively, however, traders must be in a position to find out what charging structures are or are not permitted. If traders think that the law entitles them to rely on default charges (for example) for their primary income stream, and a court finds this to be unfair, the costs to the business can be considerable. It is an area of law where clarity is particularly important.

³¹ [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133.

³² OFT1346, p 36.

³³ OFT1346, p 39.

³⁴ Section 8(2) of the Enterprise Act 2002, gives the OFT the power to approve consumer codes (codes of practice regarding the conduct of traders in the supply of goods and services to consumers), and section 8(3) imposes a duty to specify criteria for approval.

³⁵ BIS Empowering and protecting consumers – the Government response, April 2012.

Our preferred option

We propose two sets of changes:

- 1.48 **Removing double-banking.** In February 2005, the two Law Commissions published a final Report setting out our detailed recommendations, together with a draft Bill. For contracts between a business and a consumer (consumer contracts), the draft Bill combined UCTA and the UTCCR into one coherent regime to cover the whole of the UK, using the same concepts and definitions. We did not intend to make any major policy changes, but where the two regimes differed we “rounded up”, so as to preserve the existing level of consumer protection. We sought to explain the UTD in words which would be more familiar to a UK audience. In our Issues Paper, we ask whether consultees still agree with the recommendations we made.
- 1.49 This reform is intended to reduce administrative burdens on businesses.
- 1.50 **Clarifying the scope of the exemption for price and main subject matter.** This exemption is currently set out in article 4(2) of the Unfair Terms Directive, which has been copied out in Regulation 6(2) of the UTCCR. We propose that a price or main subject matter term should only be exempt from the fairness assessment if it is transparent and prominent.
- 1.51 This reform is designed to reduce the risks to business of misunderstanding the law in this area, while encouraging transparent pricing. This should increase competition and consumer confidence.

Who would be affected by our preferred option?

- 1.52 The main organisations affected would be:

- (1) businesses,
- (2) enforcement bodies; and
- (3) consumers.

- 1.53 Below we consider the costs and benefits to each.

The costs and benefits of the reform to stakeholders

Businesses

Benefits

REDUCING THE RISKS FOR BUSINESSES

- 1.54 An FSA paper on unfair contract terms in standard consumer contracts identifies that the risks to businesses are four-fold:

Firms face significant risks if their consumer contracts contain unfair terms. There is the legal risk of not being able to enforce a particular contract term because it has been deemed to be unfair. Similarly, unfair terms give rise to prudential risks. For example, unfair terms relating to the variation of charges could result in those terms being unenforceable leaving firms exposed to costs. Then there is the operational risk of spending management time in redrafting contract terms and providing consumers with new contracts. Finally, there is the reputational risk of consumers not trusting firms and therefore not wanting to do business with them.³⁶

- 1.55 We consider that the bank charges litigation and the resulting state of the law has heightened those risks, and that our proposals would reduce them.
- 1.56 Regarding the risk of litigation, the OFT say that a High Court UTCCR case taking 12-18 months might cost £100 to £300k in legal fees.³⁷ On this basis, we think it is reasonable to estimate that if a case were appealed to the House of Lords, and therefore took over 2 years, costs might double. With similar costs on both sides, the total cost of litigation would exceed £1million to be borne by the trader and / or the enforcer.
- 1.57 It is very difficult to calculate the benefits of our proposals to businesses. We do not anticipate a clear yearly saving. Instead, the benefit will be in terms of reduced risks: there will be less risk that a firm will face a major challenge to its terms, leading to legal, prudential, operational and reputational costs.
- 1.58 **We invite comments on the costs involved in the following:**
- (1) Legal risks. Is it reasonable to estimate that a major court case may cost a business over £1 million in legal fees?**
 - (2) Prudential risks. Please provide examples of the types of prudential risk and the likely costs a business would face if its charging structure was held to be unfair?**
 - (3) Operational risks. What management time is involved in responding to complaints concerning the fairness of terms?**
 - (4) Reputational risks. What effect does an unfair term challenge have on the reputation of the business?**
- 1.59 **Do consultees agree that these risks would be reduced by the proposed clarification of the exemption?**

REDUCING THE ADMINISTRATIVE BURDEN

- 1.60 Although consumer law is a vital component of consumer confidence, it can impose a significant administrative burden on business. Administrative burdens created by consumer law have been estimated at around £1.25 billion a year.³⁸ With such large figures, even comparably minor improvements can lead to significantly lower overheads for the business world. For example, simplified law will make it easier for businesses to train their staff.

³⁶ FSA: Fairness of terms in consumer contracts: a visible factor in firms treating their customers fairly. June 2008.

³⁷ These figures are not based on a real case; they are notional figures provided by OFT based upon general experience.

³⁸ BERR, *Consumer Law Review: Call for Evidence* (May 2008) pp 8 and 9. These are based on the Better Regulation Executive's database of administrative burdens.

- 1.61 Whilst businesses may see consumer law as a cost, there is evidence that effective dispute resolution, which can be enhanced by clearer law, increases sales. A survey by the OFT found that 70% of consumers who have had their complaint resolved satisfactorily will continue to trade with the same company.³⁹
- 1.62 The Better Regulation Executive identified several important factors in relation to administrative burdens.⁴⁰ One of these is the volume and complexity of regulations. This means that where there is an overlap of law or where the law is complex, as is currently the case, businesses have to turn to professional advisors to explain their businesses' obligations.
- 1.63 **We welcome views from consultees on whether our proposals will reduce the administrative burden on businesses.**

GUIDANCE

- 1.64 Another important factor identified by the Better Regulation Executive is government guidance. It is problematic where guidance is scant, unhelpful, or fails to address the difficult issues. It might be added that a proliferation of advice is unlikely to reduce administrative burdens. At best, it will require more time to read and compare. At worst, it could be contradictory and confuse matters further.
- 1.65 Thus, the type and content of guidance needs careful consideration. It inevitably has to be product and market specific. The rewards, however, are high. Better guidance which enables businesses to ensure self-compliance could save the economy significant amounts of money. 92% of those responding to the Hampton report in 2005 wanted more guidance from regulators.⁴¹
- 1.66 In our Issues Paper, we propose that there should be statutory guidance on the meaning of transparency and prominence. We ask whether stakeholders agree.

THE "RACE TO THE BOTTOM"

- 1.67 Traders, in some sectors, are increasingly pressurised to compete on headline price, whilst achieving their profit through terms which are hidden and /or might fall within the grey area. This has an undesirable effect on the market, because it undermines those traders that want to avoid using hidden terms and terms within the grey area. They find it difficult to compete.
- 1.68 The reforms are intended to dissuade firms from hiding charges in small print, which should be a benefit to honest traders.

³⁹ OFT, *Competition Act and Consumer Rights* (May 2004).

⁴⁰ Better Regulation Executive, *Regulation and Business Advice* (2007) p 9.

⁴¹ P Hampton for HM Treasury, *Reducing administrative burdens: effective inspection and enforcement* (March 2005) p 5.

Costs

TRANSITIONAL COSTS FOR BUSINESSES

- 1.69 In 2008, when the CPRs were introduced, the Department for Business, Enterprise and Regulatory Reform (BERR) estimated that businesses would incur one-off familiarisation costs in understanding the CPRs, which could amount to £12 to £27 million.⁴² BERR assumed that between one and two hours of a manager's time would be spent on this function. BERR also assumed those employing more than 50 people may take longer than two hours, and employ legal advisors for this purpose.
- 1.70 The transitional costs for the changes we propose would be less. The costs would only apply to those businesses that use standard term contracts. Even here, the changes would not be significant, as businesses are already obliged to comply with unfair terms law and be familiar with the basic concepts, unlike the CPRs which were new legislation. The changes we propose are to consolidate and clarify existing law, to make it easier to apply. We think that the costs are likely to be low – perhaps between £1 and £2 million.
- 1.71 **We welcome evidence about the likely transitional costs of the proposed reforms. We invite comments on the tentative estimate that the costs to businesses of familiarising themselves with the changes may be in the region of £1 to £2 million.**

ON-GOING COSTS FOR BUSINESSES

- 1.72 Businesses are already obliged to keep their terms and conditions under review. We therefore do not anticipate any significant increase in ongoing costs. There should be fewer terms which fall within the legal grey area where it is unclear whether a term is unfair or not. In fact, we anticipate there should be a reduction in ongoing costs as the law will be easier to apply and disputes should be resolved more swiftly.
- 1.73 We have assumed that the number of initial complaints made to traders about unfair terms will remain fairly static or be reduced, and that disputes will be resolved more quickly without the need to resort to court action. The same considerations apply to enforcement action - we anticipate that the need for formal action will remain static or be reduced.
- 1.74 **Do consultees agree that the reforms would not increase the number of complaints about unfair terms? If not, please give reasons.**

ONE-IN ONE-OUT

- 1.75 Our proposals fall within the scope of the Government's One-in One-out policy,⁴³ because they concern UK regulations which impact on business and civil society organisations, however, we anticipate a zero net cost to business.

⁴² This was based on 770,000 enterprises (an estimate based on the number of retail, hotel and restaurant, automotive, and personal services enterprises), of which about 99% are small businesses (the majority of which employ less than 5 people). Figures have been taken from the Department for Business, Enterprise and Regulatory Reform, *Impact Assessment: The Consumer Protection from Unfair Trading Regulations* (March 2008) p 99.

⁴³ See www.bis.gov.uk/policies/bre/one-in-one-out, for details of the Government's policy.

- 1.76 Whilst our proposals would introduce new legislation to clarify and consolidate the law, we consider that this would not constitute an IN.⁴⁴ Rather we anticipate that there will be two OUTs,⁴⁵ as existing regulations will be removed (rather than two pieces of legislation, there will be one); and a regulation (Regulation 6(2) of the UTCCR) will be recast in order to reduce risks and burdens.

Conclusion

- 1.77 It is very difficult to place a monetary value on the benefits of our proposals to businesses. We consider, however, that the bank charges litigation and the resulting state of the law has heightened legal, prudential, operational and reputational risks to businesses, and that our proposals would reduce them. Simplified law should also result in two other beneficial outcomes for businesses. The first is a reduction in the administrative burden on businesses including quicker dispute resolution and a reduction in the need for businesses to obtain professional advice to explain their legal obligations. The second is that businesses that do not rely on hidden terms, or other terms which fall within the legal grey area, will find it easier to compete in the market place.
- 1.78 Businesses say increased costs to businesses would ultimately be borne by all consumers in the form of increased prices. We think that our preferred option of consolidation and clarification is a balanced package, maintaining consumer protection without increasing costs to businesses.
- 1.79 As we outline in paragraph {1.70}, familiarisation costs should be moderate, and any such costs would be off-set and surpassed by the savings highlighted in paragraphs {1.54} and {1.63}. As for on-going costs, it is likely that enforcers will continue to deal with most cases through negotiation, without legal action. Indeed, we anticipate that clarification of the law should result in an increase in the number of cases settled informally, and swifter resolution, as currently negotiations are prolonged due to complexity. The same considerations apply to consumer disputes, as consumers are generally reluctant to go to court, preferring to resolve disputes by informal agreement.

The public sector: enforcement bodies

How much is currently spent on enforcing unfair terms legislation?

- 1.80 Government policy acknowledges the value of the effective enforcement of consumer legislation in stimulating growth:

Unless the law is enforced effectively, rogue traders can undermine responsible businesses, unfair practices can develop and consumers will lack confidence to exercise choice sensibly and thus drive competition, innovation and growth. Individuals may suffer detriment significantly beyond the cost of their purchase which can in turn lead to social or health problems and a drain on public funds.⁴⁶

⁴⁴ Under the Government's One-In, One –Out (OIOO) policy (www.bis.gov.uk/policies/bre/one-in-one-out) an IN is a regulation whose direct incremental economic cost to business and civil society organisations exceeds its direct incremental economic benefit to business and civil society organisations.

⁴⁵ Under the Government's One-In, One –Out (OIOO) policy an OUT is a deregulatory measure whose direct incremental economic benefit to business and civil society organisations exceeds its direct incremental economic cost to business and civil society organisations.

⁴⁶ Government Response to the Consultation on Institutional Reform (April 2012).

- 1.81 There are 12 enforcement bodies with power to bring challenges under the UTCCR. The main national enforcement bodies in Great Britain are the Office of Fair Trading (OFT); the Financial Services Authority (FSA); the Office of Communications (OFCOM); the Gas and Electricity Markets Authority (OFGEM), the Water Services Regulation Authority (OFWAT), the Rail Regulator, and the Information Commissioner.
- 1.82 Powers are also granted to every weights and measures authority in Great Britain (generally Trading Standards Services), and to the Consumers' Association (Which?).
- 1.83 There are also three Northern Irish bodies: the Director General of Electricity Supply for Northern Ireland, the Director General of Gas for Northern Ireland and the Department of Enterprise, Trade and Investment in Northern Ireland.
- 1.84 Most enforcement is by way of negotiation and out of court settlement. The OFT has pointed out that its success in achieving amendments to potentially unfair terms without litigation in thousands of cases has saved hundreds of millions of pounds in litigation costs.⁴⁷ There are occasional court challenges, however. The Issues Paper discusses three cases heard between 2008 and 2011, involving a total of seven court judgments. Where litigation occurs, it has the potential to be expensive.
- 1.85 It has been difficult to calculate the level of resources spent by these organisations on enforcing unfair terms provisions. Most do not have dedicated teams but carry out unfair terms work alongside other duties. Informal discussions suggest that a very broad estimate of the total cost of enforcement of unfair terms law might be in the region of £4 million per year, and we welcome comments on that figure.

Benefits to enforcement bodies

- 1.86 Our proposals would result in quicker resolution of cases, and lower enforcement costs. Currently, the application of the law is an intricate and resource-intensive exercise, requiring considerable legal expertise, which is a burden on enforcement bodies, particularly at a time when budgets are being cut.
- 1.87 The main savings would be in legal costs. As discussed above, one major case appealed to the Supreme Court or involving a reference to the CJEU could cost an enforcement body up to £1 million. Even without such a case, there are ongoing costs in legal fees and legal opinions.
- 1.88 **We invite comments on the following tentative estimates:**
- (1) that enforcing unfair terms legislation costs the public purse around £4 million per year.**
 - (2) that the reforms may reduce these costs by around £1 million.**

Costs to enforcement bodies

- 1.89 We do not anticipate significant familiarisation costs for enforcement agencies and consumer advisers because the updated training on unfair terms will simply replace the current training within their training programmes.

⁴⁷ In press release 33/2000. The OFT has challenged thousands of clauses eg OFT Bulletins 21 and 22 list 765 clauses which have been amended or deleted within a six month period.

- 1.90 It is worth noting that we envisage our proposed reforms might be implemented as part of the Government's Consumer Bill package, which is a major review of consumer law, so that special training on the full range of reforms would be beneficial. These costs would need to be included in the Consumer Bill package.

Consumers

The benefits of consumer confidence, empowerment and spending

- 1.91 Hidden and otherwise unfair terms lead to consumer detriment. High levels of consumer detriment have a negative effect on consumer confidence and consumer spending, as consumers become reluctant to spend and have less money to do so. This undermines competition and growth.
- 1.92 As well as financial detriment, consumers also suffer from detriment in ways which are not calculated in financial terms. A considerable amount of personal time can be spent resolving issues which can leave the consumer feeling frustrated and angry.
- 1.93 A Consumer Direct survey, conducted as part of the OFT's consumer contracts market study, found an average of £407 of financial detriment from consumer contract problems.⁴⁸ 78% of those consumers surveyed who had consumer contract problems stated that terms were in dispute between consumer and trader. Unexpected terms and conditions arose in 34% of cases.
- 1.94 A YouGov survey looked at 32 common standard form consumer contracts across a variety of product types. The survey found that 4.8% of purchases in a 12 month period had resulted in a problem or dissatisfaction and, given that consumers generally enter into multiple contracts each year, on average one in five consumers had experienced a problem in a contract entered into in the last 12 months.⁴⁹
- 1.95 We calculate that, on the basis that there are over 50 million consumers in the UK, if one in five experienced a problem with a consumer contract in the first year of the contract, and each problem had a financial detriment of £407, that would represent a total annual detriment of more than £4 billion.⁵⁰ It is important to note, however, that this is likely to be an underestimate of detriment, because the YouGov survey only took account of problems arising within the first year of a contract.
- 1.96 Our proposals would bring benefits to consumers by making disputes easier to resolve, thus shortening the length of disputes and making legal action less likely. In addition, consumers would be clear about the price they are paying and what they are getting in return. This will increase competition, driven by consumers, and consumer confidence and spending.

SPECIFIC IMPACT TESTS

Statutory equalities

- 1.97 We do not think our proposals will have any adverse equality impact on any social group as defined by their race, religion or belief, sexual orientation, gender, age, or disability.

⁴⁸ Above, p 18.

⁴⁹ P 18. Note that 4.8% is probably an underestimate of total problem incidence, as difficulties can develop after the first year of a contract.

⁵⁰ <http://www.ons.gov.uk/ons/rel/consumer-trends/consumer-trends/q1-2012/stb-consumer-trends-q1-2012.html>

Competition

- 1.98 We anticipate that our proposals will enhance competition in the market in two ways. First, they should reduce distortions in the market caused by hidden and otherwise unfair terms; consumers will be able to compare deals. Secondly, consumer confidence and spending will be enhanced because consumers will not need to fear unfair terms.
- 1.99 Consumers tend to focus on headline terms and low headline prices. In some markets, where price comparison websites are prevalent, there is pressure upon traders to compete on the basis of low headline prices, whilst achieving their profit through hidden terms. This leads to consumers being disappointed by surprises, which leads to dissatisfaction and disputes. Consumers will be particularly wary about using new or smaller traders that do not have an established reputation.
- 1.100 We believe, therefore, that implementing our proposals will help foster an environment favourable to entrepreneurialism and enhance competition.

Small firms

- 1.101 As we have described above, the principal benefit for small firms will be the enhancement of competition. However, this is not the sole benefit we foresee for small firms. The opportunity cost involved in dealing with a dispute will often be significantly higher for small firms than for large ones. While larger and more sophisticated firms will have mechanisms in place to deal with customer complaints, smaller firms may not have the staff to handle them. Small firms stand to save more than larger ones if the process of complaint handling can be expedited.
- 1.102 Furthermore, the current state of the law requires considerable specialist legal resources in order to interpret it, which small firms do not have access to.
- 1.103 We do not anticipate that there will be any particular negative effect on small firms beyond moderate familiarisation costs mentioned in paragraphs 1.69 – 1.71 above.

Justice system

- 1.104 As discussed above, we do not consider that the reforms will increase the number of court cases on unfair terms.

Other impacts

- 1.105 We do not consider that the proposals have any impact on greenhouse gas emissions; wider environmental impact; health and well-being; human rights; rural proofing or sustainable development.