IMPROVING THE LAW ON UNFAIRNESS

In five years on the statute book, the Unfair Terms in Consumer Contracts Regulations 1994, S.I. 1994/3159, generated great interest and very little case law. Their first consideration by an appellate court came in *Director General of Fair Trading* v. *First National Bank plc* [2000] 1 All E.R. (Comm.) 371. And while these proceedings were on their way to the Court of Appeal, the Regulations were repealed and replaced by the Unfair Terms in Consumer Contracts Regulations 1999, S.I. 1999/2083. Both developments are of considerable interest.

Director General of Fair Trading v. *First National Bank plc*

First National is among the largest providers of Consumer Credit Act loans in the United Kingdom. Clause 8 of the Bank's standard lending conditions made provision for the Bank's remedies in the event of the borrower's default.

> If the repayment instalment is not paid in full by that [due] date, FNB will be entitled to demand payment of the balance on the Customer's account and interest then outstanding ... Interest on the amount which becomes payable shall be charged in accordance with Condition 3, at the rate stated in paragraph D ... until payment after as well as before any judgment (such obligation to be independent of and not to merge with the judgment).

The Bank admitted that clause 8 had potential to cause hardship, but claimed that it is a common provision which must be read in the light of the statutory protection conferred on borrowers by the Consumer Credit Act 1974. Should the lender issue enforcement proceedings, section 129 of the Act empowers the court to grant the borrower a "time order", extending the repayment schedule by a system of instalments. Section 136 confers an additional power to protect the borrower by amending the credit agreement to vary the rate of contractual interest payable on the instalments.

The Director General took issue with clause 8, and used his powers under regulation 8(2) of the 1994 Regulations to seek an injunction preventing its future use. He argued that consumers were left unaware of their statutory protection. The bank would obtain judgment and a time order would be granted, but the borrower would not be informed of his right to seek a variation of the interest rate under section 136. Thus borrowers were unfairly exposed to large and unexpected liability for interest.

The Director General failed before Evans-Lombe J. ([2000] 1 W.L.R. 98), but succeeded on appeal. The Court of Appeal held that the term was unfair and agreed to hear further argument on

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the form of relief to be granted after the parties had had an opportunity to consider the judgment. The case was decided on the basis of the 1994 Regulations, as the 1999 Regulations only entered into force on 1 October 1999, too late to apply to the present dispute. The Court of Appeal was asked to consider both the scope and the effect of the 1994 Regulations.

On the first issue, the Bank relied upon regulation 3(2)(*b*) to argue that clause 8 fell outside the court's scope of review, in that it "concerned the adequacy of the ... remuneration as against the ... services ... supplied". The argument was rejected. "Adequacy" must refer to the extent, not the existence, of remuneration. Clause 8 was not caught by regulation 3(*2*)(*b*) because it established only the Bank's right to contractual interest upon default; it did not define the rate of interest that the Bank had contracted for as remuneration for its services.

Having determined the applicability of the Regulations, their Lordships then considered the unfairness of clause 8. Under regulation 4(1): "'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". Evans-Lombe J. had taken a three-stage analysis to this question, asking whether the term was "inherently", "procedurally" or "substantively" unfair. The Court of Appeal was "not persuaded that the judge was correct in his approach", and took a very different tack.

First, their Lordships remarked that the question of unfairness must be evaluated solely by reference to the terms of the Regulations, and the introduction of external concepts such as "inherent unfairness" is not a legitimate practice. With respect, this must be right. The Regulations provide clear conceptual tools for the definition of unfairness, and the introduction of other language would seem both unnecessary and confusing.

Instead, Peter Gibson L.J. identified three indicia of unfairness from the Regulations themselves: absence of good faith; significant imbalance in the parties' rights and obligations under the contract; and detriment to the consumer.

Good faith is, of course, a civilian concept which derives from the German Standard Contract Terms Act. Referring to academic analysis, Peter Gibson L.J. noted that the concept encompasses both procedural and substantive aspects. "Terms", he said, "must be reasonably transparent and should not operate to defeat the reasonable expectations of the consumer". Clause 8 of the Bank's agreement failed this test. The provision for post-judgment contractual interest in clause 8 was so powerful, and would be so

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surprising to the average consumer, that it should be brought clearly to the borrower's attention. Expressed in this way, the concept of good faith is strikingly similar to the rule proposed over forty years ago by Denning L.J. in *Spurling* v. *Bradshaw* [1956] 1 W.L.R. 461, where he said: "Some clauses which I have seen would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient". The doctrine of good faith may not be entirely alien to English law, after all.

The Court had less to say on the question of significant imbalance. This is perhaps to be regretted, as the concept of significant imbalance was specifically included alongside good faith by the draftsmen of EC Directive 93/13 (upon which the Regulations are based), and adds much to the understanding of unfairness. Significant imbalance directs attention to the balance of advantage within the contract: whether the business derives illegitimate benefit to the prejudice of the consumer. It is a generalising concept, requiring an examination of the typical transaction (here, a typical Consumer Credit Act loan agreement) to see whether the disputed agreement fits the norm. Imbalance is central to the civilian approach to unfairness, and of particular importance in England, where the common law method tends to focus attention inwards on precedent and argument by analogy. "Unfairness" involves the recognition of broader considerations.

Finally, the concept of detriment required little exposition, either in the abstract or in its application to the instant facts.

The judgment of the Court of Appeal is certainly to be welcomed. It focuses proper attention on the wording of the Regulations, and re-establishes the purity of analysis that was undermined by the introduction of peripheral terminology at first instance. Greater attention might have been paid to the consideration of significant imbalance, but this is just a minor gripe about a judgment that displays admirable sensitivity to civil law concepts.

The Unfair Terms in Consumer Contracts Regulations 1999

While the 1994 Regulations were enacted to implement the European Council Directive on Unfair Terms in Consumer Contracts (93/13/E.E.C.), differences in structure, wording and content left some doubt whether this purpose had been fully achieved. The 1999 Regulations set out to transcribe the Directive more accurately.

The most significant feature of the 1999 Regulations is that they reproduce almost exactly the wording of the Directive. This results

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in some important substantive changes from the 1994 version. First, Schedule 1 (which was never contained in Directive 93/13) has been removed to give the Regulations a significantly broader scope. Contracts relating to employment, succession, family law and the internal constitution of companies, which were formerly exempt from consideration under this schedule, are now subject to the Regulations.

Secondly, the new Regulations make changes to the definition of an "unfair term", as the relevant sections of the 1994 Regulations have been replaced by provisions cut directly from Directive 93/13. In particular, the new Regulations omit Schedule 2, which had been inserted by the English draftsmen to offer guidance on the definition of good faith. This change is warmly welcome. The subtle analysis of their Lordships in the *First National* case, without any reference to Schedule 2, demonstrates that courts are well able to tackle the concept without the aid of formalistic criteria. Moreover, the civil law approach to good faith is defined by generalisation, and excessive definition was specifically avoided in the Directive, which offers only a "grey list" of prima facie unfair terms. It is to be hoped that the more expansive wording of the new Regulations will encourage a global approach to the definition of unfairness that sits more easily with the civil law origins of Directive 93/13.

Important procedural changes have also been made. Directive 93/13 requires Member States to provide "adequate and effective means ... to prevent the continued use of unfair terms", and it was generally thought that the scheme of supervision by the Director General of Fair Trading set up under the 1994 Regulations failed to meet this obligation. Therefore, the new Regulations extend the Director's authority to confer greater powers of investigation and public information. Importantly, these powers have also been made available to a wide range of "qualifying bodies", including public regulators and the Consumers' Association. Qualifying bodies may now seek injunctions against unfair terms in the public interest, and it is hoped that this decentralisation will encourage more effective supervision from a wider range of litigants.

The new Regulations are to be welcomed as they now implement the spirit and detail of this Directive into English law. Some concerns remain over the effectiveness of injunctions as a means to control unfair terms. However, the new Regulations certainly go a long way towards providing "adequate and effective means" for the protection of consumers.

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