

## HT 2018-09

### Tackling unfair contract terms

#### Introduction

The unfair terms provisions of the Consumer Rights Act 2015 (CRA) protect consumers against unfair terms in contracts and notices. Whilst the Competition and Markets Authority (CMA) has the leadership role in overseeing the rights of consumers in the UK, the FCA has powers to challenge unfair terms in financial services consumer contracts. Financial services consumer contracts are likely to include insurance brokers' terms of business agreements and insurance policy documents as well as the terms and conditions of banks and other financial firms.

The CRA superseded the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) from 1 October 2015, implementing EU Council Directive 93/13/ECC on unfair terms in consumer contracts. In addition to unfair terms, the CRA addresses consumer issues such as what should happen when goods are faulty and what happens when a business is acting in a way which isn't competitive. It also gives consumers certain basic rights when they enter into contracts for services. In summary, those rights are as follows.

- The service must be performed with reasonable care and skill
- If no price for the service has been agreed, a reasonable price only is payable
- If no time for performance has been agreed, the service must be performed within a reasonable time

#### FCA oversight of unfair terms

The part of the FCA Handbook that contains information on how the FCA exercises its powers in relation to unfair terms is the Unfair Contract Terms and Consumer Notices Regulatory Guide (UNFCOG). These powers enable the FCA to obtain an undertaking from a firm that it will amend or remove an unfair contract term from its consumer contracts. An undertaking was given by BISL, for example, to change the cancellation terms under its policies. Their contract terms allowed the firm to cancel a policy and either refund or keep the premium, depending on the circumstances, which, in the opinion of the FCA needed to be explained more fully.

The regulator can also apply to a court for an injunction to prevent a firm from using or enforcing a term against its customers.

In addition to its powers under the CRA (and under the previous UTCCRs for older contracts) the FCA can take action under the Financial Services and Markets Act 2000 (FSMA) on the basis of a breach of the FCA's Principles for Businesses, specifically:

- Principle 6, which requires a firm to 'pay due regard to the interests of its customers and treat them fairly'
- Principle 7, which requires a firm to 'pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading'

These Principles apply both to the way contract terms are drafted and also to how contract terms are used by firms in practice.

The FCA has set out five key messages for firms to focus on when drafting consumer contracts:

- Firms should take into account consumers' legitimate interests in relation to contracts
- Fairness is not contrary to the prudent management of the business, but part of it
- Focusing on narrow technical arguments to justify a contract term that, in fact, may be unfair, risks future challenge

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- The fact that a term does not resemble any of the indicatively unfair terms listed under the legislation may not, in itself, remove the risk of unfairness. Firms need to assess whether a term is fair as a whole and in the context of the particular product or service
- Firms should take into account developments in legislation and relevant case law

Where unfair terms come to the regulator's attention, and considers that firms have been relying upon such terms to the detriment of customers, the FCA will challenge firms accordingly.

### **What is a consumer contract?**

The CRA defines a consumer contract as one between a "trader" and a "consumer". A "consumer", for the purposes of the CRA is an individual (a natural person rather than a legally incorporated organisation such as a company) who is acting for purposes wholly or mainly outside his or her trade, business, craft or profession - which would allow consideration of transactions that are entered into for a mixture of personal and business. The term "trader" is broadly defined as a legal person (which includes both natural and legal persons such as companies) acting for purposes relating to that person's trade, business, craft or profession. The definition of "trader" also includes those acting in a trader's name or on a trader's behalf, such as a trader's employees or agents. In the context of insurance, insurance companies, insurance intermediaries and their appointed representatives would be "traders".

### **What is an unfair term or notice?**

Terms of consumer contracts or consumer notices are unfair if, contrary to the requirement of good faith, they cause a significant imbalance in the parties' rights and obligations to the detriment of the consumer. A term or notice that is unfair is not legally binding on consumers. This does not prevent consumers from relying on it if they wish.

The fairness test starts by asking whether the wording used tilts the rights and responsibilities between the customer and the trader too much in favour of the trader taking into consideration the subject matter of the contract, how a term relates to other terms in the contract and all the circumstances at the time the term was agreed. Schedule 2 of the CRA illustrates the meaning of unfairness by listing various types of terms which may be regarded as unfair in the "grey-list".

Certain terms and notices are black-listed by legislation as unsuitable for use with consumers in any circumstances. These terms can be challenged on that basis, without needing to prove that they fail the fairness test.

### **Grey-listed terms and notices**

The "grey-list", covers terms which may cause or allow one or more of the following common problems:

- Consumers being denied full redress if things go wrong
- Consumers being tied into the contract beyond what they would normally expect
- The trader not having to perform their obligation
- Consumers unfairly losing prepayments, if the contract is ended
- The trader arbitrarily varying the terms after they have been agreed, for instance, so as to supply a different product, raise the price or reduce consumer rights
- The trader determining the price or subject matter of the contract after the consumer is bound by it
- Consumers being subject to disproportionate financial sanctions

Items on the grey-list include:

- Exclusion and limitation clauses such as exclusion of liability for poor service; delay or failure to perform contractual obligations
- Retention of prepayments on consumer cancellation
- Disproportionate termination fees

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- Unequal cancellation rights
- Trader's right to cancel without refund
- Trader's right to cancel without notice
- Excessive notice periods for consumer cancellation
- Binding consumers to hidden terms
- Trader's right to vary terms generally

### **Black-listed terms and notices**

The CRA makes certain contract terms legally ineffective; i.e. not binding on or enforceable by the trader against the consumer – in a number of specific situations. The CMA refers to these terms or notices as 'black-listed'.

Black-listing makes the following terms automatically unenforceable and so there is no need to apply the fairness test:

- Terms or notices that restrict liability for death or personal injury resulting from negligence
- Terms that have the effect that the consumer bears the burden of proof regarding compliance by a distance supplier, or an intermediary, with an obligation under law implementing the Distance Marketing of Financial Services Directive 2002.69
- Contract terms seeking to exclude or restrict statutory rights

Black-listing also prevents terms being used to take away the protection that the CRA gives. A term of the contract is blacklisted to the extent that it would:

- exclude the trader's liability for failing to carry out the service with reasonable care and skill, or for failing to act in compliance with information about the trader or service which is binding on the trader under the Act
- exclude or restrict any available remedy for breach of any of the rights under the CRA or make a remedy more difficult for the consumer to enforce
- restrict the amount of compensation a trader can be required to pay for breach of any of the statutory rights to less than the price the consumer is required to pay under the contract.

### **Exemptions to the fairness test**

The main exemption is commonly called 'the core exemption' and relates to terms that specify the main subject matter of the contract or set the price – provided they are transparent and prominent. This exemption provides that a term may not be assessed for fairness to the extent that:

- it specifies the main subject matter of the contract; or
- the fairness assessment would be of the appropriateness of the price payable under the contract, by comparison with the goods, digital content or services supplied

A term which specifies the main subject matter of the contract or sets the quality/price can benefit from the exemption only if it is both transparent and prominent. If such terms are not prominent and transparent, the exemption does not apply and they are fully assessable for fairness.

The fairness test does not apply, also, where wording is covered by legal provision; e.g. required by legislation. This exemption is referred to as the 'mandatory statutory or regulatory' exemption. It is not an absolute exemption – its application is subject to terms being transparent and prominent.

### **Transparency of a term or notice**

It is a separate and distinct requirement of the CRA that a written term of a consumer contract or a consumer notice is transparent. This specific transparency requirement sits alongside and reinforces, the more general obligation, embodied in the requirement of good faith, of fair and open dealing in the use of contract terms.

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The primary requirement of transparency is that a term should be intelligible to consumers. This means that written terms and notices need to be expressed in plain and intelligible language and be legible. The customer's obligations and rights should be set out fully, and in a way that is not only comprehensible but puts them into a position where they can understand their practical significance. Failing the transparency test alone, independently of the fairness test, does not make a term unenforceable against an individual consumer in the same way as a finding of unfairness. But there is a requirement that, if a term or notice has more than one possible meaning, and so is ambiguous, it should be given the meaning that is most favourable to the consumer.

### Variation of terms

Firms might legitimately need to make changes to their contracts in certain circumstances; for instance, where new regulatory requirements or where they have a justifiable reason for altering their pricing. However, firms should always consider whether a variation is necessary or appropriate for a contract before including it.

Following the introduction of the CRA and in light of a number of rulings in the EU Court of Justice, the regulator is currently consulting on proposed guidance regarding the way firms draft and review variations in terms; the main considerations being:

- The validity of the reason(s) for varying a term
- The transparency of the variation term
- Provision for notice in the variation term
- Provision for freedom to exit the contract should a consumer not wish to accept the variation

A large proportion of the contract terms which are referred to the FCA give firms the right to vary contracts without obtaining consent from consumers. Consumers may typically be given notice of any proposed changes and may be able to exit their contracts if they do not want to accept the change. The draft guidance is intended to enhance firms' understanding of how the law on unfair terms operates in the context of variation terms, in particular with regard to unilateral variations and the reasons firms put forward to justify a price increase.

The FCA recognises the potential benefits of fair variation terms to both firms and consumers but where the FCA considers a variation term in a contract to be unfair or lacking in transparency, it may take action to prevent the firm from relying on that term.

### Summary

In general, the CRA requirements reflect the FCA's principles of "treating customers fairly" and "clear, fair and not misleading communications", but they also mirror the product disclosure rules in ICOBS inasmuch that terms should be drafted "to ensure that consumers are put into a position where they can make an informed choice whether or not to enter into the contract".

The FCA has provided a number of **examples of good practice** in relation to consumer contracts, such as:

- Frequent reviews of all consumer contracts for fairness and to ensure they comply with the CRA
- Assessing contracts as part of regular product reviews throughout the product lifecycle to ensure the firm can demonstrate it is treating customers fairly
- Reviewing FCA publications including undertakings obtained by the FCA about terms in consumer contracts
- Monitoring updates about the fair treatment of customers, legislative changes and guidance from trade associations
- Using management information on complaints received about unfair terms to identify potentially unfair or unclear contract terms and making appropriate changes
- Improving staff training to ensure staff meet the standards set out in product literature, including contracts

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On the other hand, **examples of poor practice** might include internally-focused reviews of consumer contracts based on 'what looks fair', without consideration of external legal or regulatory information, and contracts containing out-of-date material.

In general, firms should always set out a customer's obligations and rights in a clear and comprehensible way, so that the consumer is able to see how they relate to each other, and can foresee and evaluate, at the time of conclusion of the contract, the consequences they may have in the future.

Where complex and technical issues have to be covered, particular care should be taken. It should not be assumed that the consumer understands the detail of how a particular transaction or market operates. Sufficient information should be given (for example, in accompanying literature) to ensure that the consumer understands both the words used and the practical implications of any unavoidably difficult terms and their relationship with his or her other rights and obligations.

In a nutshell, the consumer needs to have a proper understanding of the contract for all sensible and practical purposes.

## Further information on unfair terms

*The Competition and Markets Authority (CMA) guidance:*

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/450440/Unfair Terms Main Guidance.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/450440/Unfair_Terms_Main_Guidance.pdf)

*Consumer Rights Act:* <http://www.legislation.gov.uk/ukpga/2015/15/contents/enacted>

*Government guidance for businesses:* <https://www.gov.uk/guidance/unfair-terms-explained-for-businesses-full-guide>

*Government Guidance on writing fair contracts: guidance for businesses:*

<https://www.gov.uk/government/collections/writing-fair-contracts-guidance-for-businesses>

*FCA webpages on unfair terms including a list of undertakings:* <https://www.fca.org.uk/firms/unfair-contract-terms>

*FCA consultation on variation terms:* <https://www.fca.org.uk/publication/guidance-consultation/gc18-02.pdf>

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