

# The Impact of Adopting a Duty to Trade Fairly

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## SECTION ONE

### THE IMPACT OF ADOPTING A DUTY TO TRADE FAIRLY

#### I Introduction

1.1 Over the last twenty years or so, the EC has adopted a series of Directives designed to give consumers an adequate level of protection wherever they deal with businesses in the single market. Each Directive has its own particular regulatory target. These targets include particular instances of sharp practice (misleading advertising)<sup>1</sup>, particular modes of sale (doorstep selling, distance selling)<sup>2</sup>, particular types of product or service (package travel, timeshare, credit)<sup>3</sup>, particular types of contractual term (unfair terms)<sup>4</sup>, and particular schemes of redress (sales and guarantees)<sup>5</sup>. In some cases, the regulatory focus is on the processes by which consumers are brought into a transaction, in other cases it is on the substance of the transaction. As a set, these Directives might be argued to have a dual objective, in part economic, in part ethical.<sup>6</sup>

1.2 The economic objective, regularly flagged up in the Commission's documentation, is to encourage traders (particularly SMEs) and consumers alike to treat the market as a genuinely single market. This means that, so far as possible, any impediments or inhibitions associated with (historic) borders within the market must be removed. Consumers must have the confidence to cross (historic) borders; and traders must not be deterred from trading across (historic) borders because of uncertainty about

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<sup>1</sup> Directive 84/450/EEC (misleading advertising).

<sup>2</sup> Directive 85/377/EEC (doorstop selling); Directive 97/7/EC (distance contracts).

<sup>3</sup> Directive 90/314/EEC (package travel); Directive 94/47/EC (timeshare); Directive 87/102/EEC as amended (consumer credit).

<sup>4</sup> Directive 93/13/EEC (unfair terms).

<sup>5</sup> Directive 99/44/EC (sale of consumer goods and associated guarantees).

<sup>6</sup> Compare Norbert Reich, "From Contract to Trade Practices Law: Protection of Consumers' Economic Interests by the EC" in Thomas Wilhelmsson (ed), *Perspectives of Critical Contract Law* (Aldershot: Dartmouth, 1993) 55.

the applicable regulatory regime (insofar as it bears on the protection of consumer customers).

1.3 The ethical objective almost speaks for itself: programmes of consumer protection serve the ethical purpose of protecting the legitimate interests of consumers. Each of the Directives makes a distinctive contribution to this objective by shielding consumers against transactional practices, processes and provisions that infringe their legitimate interests.

1.4 For the purposes of this Report, it is the ethical objective, in conjunction with the series of Directives, that is the more important. The thought is that the architecture of this body of regulation is incomplete. As we have said, thus far, the EC has protected what it judges to be the legitimate interests of consumers by putting in place a range of prohibitions and duties to be observed by businesses, each Directive prescribing its own bespoke requirements. What has not yet been legislated explicitly is an overarching general duty that, on the one hand, systematises the particular Directive-prescribed duties and, on the other hand, connects the legal requirements more closely to the ethical objective.

1.5 Most ambitiously, such an overarching general duty would cover the complete set of particular Directive-prescribed duties (it would be fully overarching). Less ambitiously, the general duty would overarch only part of this set (it would be partially overarching). In this latter event, however, one might expect there to be subsequent pressure to extend the range of the general duty and complete the regulatory architecture.

1.6 If the general duty, whether fully or partially overarching, were treated as strictly co-extensive with the particular Directive-prescribed duties that it covered, then the adoption of the general duty would make no difference at all to the substance of the regulatory requirement. In practice, there might be some slight difference in the way in which consumer complaints were articulated or processed but the regulatory burden on business would not be increased by the adoption of such a general duty—provided, to repeat, that the general duty was co-extensive with the particular Directive-prescribed duties to which it related. Characteristically, however, the thinking behind proposals for general duties of this kind is not limited to tidying-up the particular duties. As we have said, an overarching general duty would connect the regulatory set to its background ethical objective. What this signifies is that the general duty would have the flexibility to extend beyond the requirements legislated by particular Directives; and that this flexibility would be available to be used where the background ethical objective so required. In other words, if the raft of consumer-protection Directives was judged to have unsatisfactory limits or gaps, there would be recourse to the general duty to deal with the problem (in this sense, as some might put it, the general duty would function as a safety-net). So understood, the general duty would not be co-extensive with particular Directive-prescribed duties; potentially it would add to the regulatory burden on business; and it

would do so by reference to a background objective (the ethical objective of protecting the legitimate interests of consumers) the application of which might not be totally predictable.

1.7 Whether the general duty was fully or only partially overarching, there are any number of ways in which it might be formulated. For example, the legal requirement might copy out the ethical objective by placing businesses under a duty to respect the legitimate interests of their consumer customers; or it might require businesses to act in accordance with the principle of good faith and fair dealing (which may or may not be elaborated in terms of respecting the legitimate interests of consumers); or it might require businesses to trade fairly or in accordance with reasonable (consumer) expectations, or to eschew unfair commercial practices, or the like. During the drafting of the duty, considerable significance may be attached to the particular choice of doctrinal expression. For example, it may be argued that a general duty drafted (positively) as a requirement to trade fairly or reasonably is more onerous or less certain than one drafted (negatively) as a prohibition on unfair or unreasonable trading. However, if the general duty is to have the required flexibility, the particular doctrinal expression employed is unlikely to freeze the regulatory regime.

1.8 To appreciate why the general duty will be expected to play a dynamic role in the regime, two factors need to be borne in mind. First, the way in which the community interprets the background ethical objective (particularly the way in which it understands the idea of “legitimate interests”) may well change over time. If the legal requirements are to stay connected to the current understanding of the ethical objective, the general duty must have the capacity to adapt. Secondly, trading practices do not stand still. The development of e-commerce, for instance, has introduced a quite new way of doing business. The ethical objective applies whether consumers are dealing in electronic or traditional non-electronic environments (or a mixture of the two). The law has to be sufficiently flexible to ensure that consumers are properly protected when new technologies and new tricks of the trade evolve. Again, it falls to the general duty to secure the legitimate interests of consumers.

1.9 It is against this background that we should view the recently published proposal for an Unfair Commercial Practices Directive (UCPD).<sup>7</sup> Article 5.1 of the proposed Directive sets out its focal general duty by prohibiting unfair commercial practices. Under Article 5.2, a commercial practice is to be treated as unfair if (i) it is contrary to the requirements of professional diligence (that is, if a trader fails to exercise the special skill and care “commensurate with the requirements of normal market practice towards consumers in his field of activity in the internal market”<sup>8</sup>) and (ii) (put simply) it

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<sup>7</sup> COM (2003) 356 final, Brussels, 18.6.2003 (proposal for a Directive concerning unfair business-to-consumer commercial practices in the internal market).

<sup>8</sup> As defined by Article 2(j).

materially distorts (or is likely to so distort) the economic behaviour of consumers. The UCPD particularly targets commercial practices that are misleading or aggressive and, over and above the specification of the general tests (in Articles 6-9), it identifies a number of misleading and aggressive practices which are unfair in all circumstances.<sup>9</sup> The strategy of the UCPD, therefore, is to combine a black-list with a background general duty against unfair commercial practices, particularly relating to misleading and aggressive practices. Although the draft Directive applies to unfair commercial practices both before and after a transaction in relation to a product,<sup>10</sup> it is of limited scope, Article 3.2 providing that it is “without prejudice to the rules on the validity, formation or effect of a contract.”

1.10 Although the salient features of this newly proposed Directive will be summarised in the final section of this Report, our purpose is not, as such, to offer a commentary on this particular proposal from the EC putting forward a general duty (against unfair commercial practices) in this particular form with its scope limited in a particular way. Rather, our purpose is to consider, proactively as it were, the impact that a general duty to trade fairly (or a general prohibition on unfair trading practices) would have on the consumer law of contract (and whether, in practice, its effect could be confined to consumer contracts). The extent to which this is a hypothetical scenario is difficult to say. The proposed Directive, for example, purports to have no direct impact on the general law of contract and, of course, it applies only to business-to-consumer transactions. Whether the Directive, as finally agreed, will survive with these particulars no one can know. Even if it does survive in a carefully circumscribed form, it might nevertheless be seen as a step towards an overarching general duty of the kind sketched above. If this proves to be the case, the hypothetical would move closer to the actual and there would be a more pressing reason to consider how such a duty might impact on the English law of contract (moreover, this would be so regardless of whether the duty was enforced *ex casu* by individual consumer claimants, or through an agency such as the OFT, or both).

## II The Structure of the Report

1.11 The Report is in seven principal sections.

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<sup>9</sup> See Article 5.4 and Annex 1. Misleading commercial practices that are black-listed by the Annex *include* bait advertising, bait and switch promotions, advertorials, and pyramid schemes, while aggressive commercial practices *include* creating the impression that a consumer is not free to leave the premises until the contract is signed, hounding a consumer at home, making persistent and unwanted solicitations, inertia selling, and so on.

<sup>10</sup> See Article 3.1.

1.12 In Section Two, we employ a “convergence” approach to consider whether, and why, the protection offered to consumers under the current regime of English law might be extended by the adoption of a general standard of fair trading (and, concomitantly, whether the adoption of such a general duty would add significantly to suppliers’ obligations in dealing with consumers).

1.13 This leads, in Section Three, to an examination of where we might find a gap between the regulation of procedural and substantive fairness currently found in English contract law and the requirements of fairness that a general standard of fair trading would introduce.

1.14 In Section Four, we summarise the main arguments relied on in the ongoing debate as to whether English contract law should incorporate an overarching standard of good faith. To a considerable extent, the protagonists in this debate accept that, for better or worse, good faith now has a foothold in consumer contracts and so the focus tends to be on good faith in commercial contracting. For two reasons, however, the contours of this debate are relevant for our purposes. First, the arguments canvassed in the context of commercial dealing assist in understanding the implications of adopting a general fair trading requirement in relation to consumer contracting. Secondly, if there is a risk that a fair trading duty adopted for consumer contracts might spread to commercial contracts, we should be aware of whether this would be a positive, negative, or neutral development in the law.

1.15 One of the principal objections to general standards such as good faith and fair dealing is that they threaten the values of certainty, predictability and consistency to which English contract law is classically committed. In Section Five, we consider (i) how far the fair dealing obligations currently located in English law have jeopardised these values and (ii) how the administration of discretionary doctrines (such as the reasonableness requirement under the Unfair Contract Terms Act, 1977) have been operationalised to maintain an adequate level of calculability.

1.16 In Section Six, we consider how great a risk there is that a fair trading standard designed for consumer transactions might spread to commercial transactions. And, to the extent that there is such a risk, we discuss how it might be contained.

1.17 Section Seven is written on the assumption that the fair trading Directive (in fact, like the proposed UCPD as presently drafted) would be in the form of a maximum harmonisation measure. This raises the question of whether there would then be a risk of under-regulating, leaving consumers exposed to trading practices that unfairly threaten their legitimate interests.

1.18 Finally, in Section Eight, we summarise the salient features of the proposed UCPD, considering briefly whether the implementation of the Directive as a further (unconsolidated) layer of regulation will give rise to problems of doctrinal density and practical uncertainty in relation to this field of English law.

### **III Summary of Main Points**

1.19 Our principal conclusions are as follows.

1.20 In making judgments about the practical impact of adopting a general requirement of fair trading, it is doctrinal form and doctrinal substance that are more important than doctrinal expression. In contrast to its European counterparts, English contract law (i) favours specific provisions to general clauses (i.e. as a matter of doctrinal form) and (ii) its default values are those of self-reliance and individualism rather than mutuality and co-operativism (i.e. as a matter of doctrinal substance). Accordingly, it is to be expected that the implementation of an EC prescribed general duty of fair trading would not only commit English law to a doctrinal form that it does not favour, it would almost certainly be loaded with doctrinal substance that pushed domestic law away from its favoured values.

1.21 The significance of implementing an EC-prescribed general duty of fair trading, intended to function as a dynamic doctrinal element, would be far from negligible. Although doctrinal form is ultimately less important than doctrinal substance, the former is important (see 2.17-2.21 below).

1.22 The significance of implementing such a general duty carrying substantive doctrine drawn from Europe is that it would put to the test just how far modern English doctrinal thinking concerning fair dealing (procedural and substantive) in consumer contracts has moved away from classical market-individualism towards the values of mutuality and co-operativism.

1.23 Procedural fairness turns on whether the consumer has made an unforced choice and whether the choice was properly informed. Both these focal issues invite responses that draw on underlying default values running from individualism and self-reliance to mutuality and co-operativism. In our assessment, English law is not strikingly out of line with European law on these issues (it sees the issues in pretty much similar terms and responds in a similar sort of way). However, if there is a gap between English consumer contract law and its European counterparts, it is in relation to the requirement to disclose.

1.24 Substantive unfairness is used very loosely in English contract law, often sliding into the idea of substantive unreasonableness. It seems to have a triple purpose: (i) to flag up the need for an inquiry into procedural fair dealing in the particular case (here the substance of the term sets up a rebuttable presumption of procedural unfairness); (ii) to operate as an irrebutable presumption of procedural unfairness; and (iii) to regulate wholly unreasonable terms (independent of procedural fairness or unfairness). In our judgment, it is not obvious that the introduction of a general duty of fair trading would find English law lacking in relation to its willingness to resort to the idea of substantive unfairness.

1.25 A claim concerning fairness in contract can arise *ex casu* or by way of pre-emptive challenge. So far as pre-emptive challenge is concerned, enforcers and adjudicators must operate with a model of a representative or average consumer. The English judicial view seems to be in line with ECJ jurisprudence; this is not a particularly protective position; and, although the proposed UCPD copies in this jurisprudence, it may be significant that there are more protective benchmarks in play elsewhere in Europe.

1.26 The limited incorporation of good faith in the English consumer law of contract has not been noticeably problematic. On this basis, we might suppose that English law can adjust to general standards of fair dealing. Nevertheless, those who advocate that English law should adopt principles of this kind must overcome the fundamental objection that this is liable to misfire until agreement is reached about whose (or which) standards are to serve as the reference point for fairness or unfairness.

1.27 In response to this objection, the principal options seem to be: (i) the standards of fair dealing recognised by the community of which the contractors are most proximately a part; and (ii) the standards of fair dealing and co-operation that would be prescribed by the best (i.e. most defensible) moral theory. In the context of business-to-business dealing, the former option is workable and has its attractions. However, in the present context of business-to-consumer contracts, neither option is compelling. Those who participate in consumer transactions in the single market do not form an ideal “community”; and the jurisprudence of the EC, even if an expression of best European practice, is scarcely an essay in moral theory. If a general duty to trade fairly is adopted, and if it is to have real prospects of acceptance, then it must be operationalised in a way that is sensitive to both best European co-operative standards as well as local practice and expectation in the consumer marketplace.

1.28 If we view a general duty to trade fairly in this light, there is no reason to reject the idea out of hand. It introduces a dynamic element into the law coupled with a tendency towards co-operative standards. This might not be where English contract law started but it is in line with the direction in which our consumer law of contract has been moving for some considerable time.

1.29 Even if the adoption of a general duty to trade fairly would be running with the grain of modern consumer law, there might be concerns that it would operate as a loose cannon (jeopardising the values of predictability and consistency) and that it would be difficult to keep it cabined and confined within consumer law.

1.30 With regard to the first of these concerns, where English contract law has previously developed broad general discretions (for example, as in the Unfair Contract Terms Act, 1977), it has sought to give some direction to their application by formulating operative guidelines. To some extent, measures of this kind, which are designed to encourage consistent and calculable application of general discretions, could be adopted to reduce concerns about the unpredictability of a general duty to trade fairly. Certainly, with a general duty hedged in this way, fears that it would function as a loose cannon are unwarranted. However, insofar as the role of the general duty is to give the law some flexibility and capacity for evolution, there is a limit to how far it can be pegged down.

1.31 With regard to the second concern, the scope of the general duty could be drafted in such a way that it provides quite explicitly that it applies only to consumer contracts. There are now plenty of precedents for drafting regulations in such a sector-specific way and there is no reason to think that doctrinal limits of this kind would not be respected. To this extent, the duty to trade fairly could be doctrinally ring-fenced. However, what cannot be guaranteed is that the co-operative spirit or sense of a duty to trade fairly would not extend elsewhere in contract law. In fact, for some time, the commercial law of contract has shown some sensitivity to the practical realities of “relational” dealing where the contractors’ businesses are to some extent integrated and where the parties reasonably expect a more accommodating and co-operative approach from their trading partners. Thus, if a general duty to trade fairly with consumers exerted some influence in the commercial sector (in the regulation of business-to-business dealings) this would not involve a radical change of approach.

1.32 If the proposed UCPD were to be adopted and implemented in its present (maximum harmonisation form), there would be several causes for concern. First, although the general effect of the Directive might be (marginally) to increase the level of consumer protection (as against the level set currently by English law), it would be unfortunate if it prevented English law from developing a more protective standard. Secondly, it would also be unfortunate if the evolutionary potential of the general duty was limited by the maximum harmonisation form. Thirdly, although the UCPD purports to be without prejudice to local law on the validity, formation or effect of a contract, some overlapping (e.g. with the common law doctrines of misrepresentation and duress) seems inevitable. To prune and tidy up such a thicket of doctrine would be a major exercise, but it would be essential if the law was not to remain confusing and uncertain.

1.33 Finally, we suggest that, if the general prohibition in the proposed UCPD were to be read as a requirement of good faith, this need not be a cause for concern. The English law of consumer contracts already operates relatively unproblematically with a good faith doctrine; some standard form contractors freely choose to incorporate such a principle; and, although English commercial law does not explicitly have such a general principle, the modern tendency towards the protection of reasonable expectations coupled with the contextual interpretation of commercial contracts gives effect to a good faith requirement by another name.<sup>11</sup>

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<sup>11</sup> See *The Law of Contract* (Butterworths Common Law Series) 2<sup>nd</sup> ed (London: Butterworths, 2003), Ch. 1.

## **SECTION TWO**

### **THE POSSIBILITY OF CONVERGENCE**

#### **I Introduction**

2.1 The purpose of this Report is to consider, in a proactive spirit, the impact that a general duty to trade fairly would have on the English law of contract (primarily with regard to consumer transactions).

2.2 For the purposes of this Chapter, therefore, we assume that, in order to comply with EC law, it would be necessary for English law to adopt a new standard, one explicitly requiring fair trading with consumers. On this assumption, the questions that we are seeking to address are of the following kind. Has the development of the modern English law of contract taken us to the point where there is already, in effect, a general duty to trade fairly? Would the adoption of such a general duty in consumer contracts make any difference to the balance of rights and responsibilities already supported by the law? If so, would it significantly add to the business supplier's burdens? How far is there convergence between (a) English law as it is and (b) English law as it would be were it to be modified by the incorporation of a duty to trade fairly?

2.3 Ideally, in order to answer such questions, especially the question of convergence, we need the two key variables, English law as it is and English law as it would be, to be stabilised. Whilst we can stabilise the former, it is impossible in advance of having further and better particulars concerning the substance of a duty to trade fairly to stabilise the latter.<sup>1</sup> In other words, we are asking how English contract law as it is might diverge from English contract law as it might become, with the latter being an as yet under-determined regime that includes a general duty to trade fairly.

2.4 In this Section, we will suggest that, although the principal features of a regime of contract law are found in its doctrinal form, doctrinal expression, and doctrinal substance, for the purposes of convergence, doctrinal form and doctrinal substance—especially the latter—are the key factors. In other words, we will suggest that the particular doctrinal expression favoured by a legal regime is relatively unimportant; what matters is whether

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<sup>1</sup> The proposed UCPD gives quite detailed guidance as to misleading and aggressive commercial practices. However, as we explained in 1.10 above, this Report is not a direct response to this particular proposal.

general duties have a dynamic (obligation-creating) function and, crucially, whether the doctrinal substance is informed by classical values of self-reliance and individualism or by modern values of mutuality and co-operativism. In the final analysis, it will be argued, the reason why a general duty of fair trading might add to existing obligations in English law is because the fair trading obligation signifies a further shift from classical to modern substantive doctrine.

2.5 Our discussion is in five parts as follows: in part II, we clarify the ideas of convergence, divergence and identity between legal regimes; in part III, we identify doctrinal form, doctrinal expression, and doctrinal substance as possible points for comparative reference between legal regimes; and, in parts IV, V, and VI, we discuss the significance of each of these three reference points for a convergence study.

## **II Convergence, Divergence, and Identity**

2.6 The English law of contract makes various provisions for fair trading. Some of these provisions originate in domestic case-law and legislation; others originate in requirements adopted by EC law. However, English law does not, *as such*, place business contractors who deal with consumers under an explicit duty to trade fairly. It follows that, if a consumer believes that a business supplier has acted unfairly in making or performing a particular contract or that the terms of the contract are unfair (in themselves or in their application), then the consumer's complaint will not be recognised if it is pleaded directly in terms of breach of a duty to trade fairly. Instead, the claim will have to be framed in a way that is recognised by English contract law, specifically by those parts of the doctrinal body that are designed to regulate fair dealing.

2.7 This being so, the question is whether there is a significant gap between the position currently given by the fair dealing doctrines of English contract law and the position that would obtain were an explicit duty of fair trading to be adopted. In other words, how close a convergence is there between English law as it is (without a duty to trade fairly) and English law as it might be (that is, modified by the incorporation of an explicit duty to trade fairly)? We should not be altogether dismissive of the possibility of quite a high degree of convergence, for it is clear from comparative studies that, even where legal regimes present very different doctrinal features, they may generate very similar outcomes to materially similar disputes.<sup>2</sup> Conversely, common doctrinal labels

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<sup>2</sup> See, e.g., Reinhard Zimmermann and Simon Whittaker (eds), *Good Faith in European Contract Law* (Cambridge: Cambridge University Press, 2000).

may belie substantive doctrinal differences that lead to divergent rather than convergent outcomes.<sup>3</sup>

2.8 It should be emphasised that judgments (positive or negative) as to convergence between two regimes of contract law are independent of judgments as to their doctrinal identity (or difference). Whereas the reference point for judgments as to convergence is the outcome indicated by the legal regime for a claim based on a particular set of facts, the reference points for doctrinal identity are ones of doctrinal form, expression and substance. To judge that there is convergence in a particular case, one is simply judging that each regime would be expected to generate essentially the same outcome (paradigmatically, by way of adjudication, but also parasitically by way of settlement and the like).

2.9 Where two regimes of contract law have comprehensive identity of doctrinal form, expression and substance, then they also have convergence. Without such comprehensive identity, convergence cannot be guaranteed. However, as we have said, it is clear that, notwithstanding differences in terms of doctrinal identity, regimes are capable of achieving a significant degree of convergence. It is also clear that, although a lack of identity as to doctrinal form and expression is not unimportant, the principal driver in relation to outcomes—and, hence, the principal driver for the purposes of convergence judgments—is doctrinal substance (reflecting the underlying ethic of the particular regime).<sup>4</sup>

2.10 We need to speak to each of these three elements—doctrinal form, doctrinal expression, and doctrinal substance. However, if doctrinal substance is the key driver then we can already say that the degree of convergence between English contract law as it is (without a duty to trade fairly) and English contract law modified by the incorporation of an explicit duty to trade fairly will hinge largely on the doctrinal substance implicated in these two regimes.

### **III Doctrinal Form, Doctrinal Expression, and Doctrinal Substance**

2.11 The characteristics of a body of contract doctrine can be represented by reference to doctrinal form, doctrinal expression, and/or doctrinal substance.

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<sup>3</sup> Cf Hans Micklitz's report to the Commission, *Study on the Feasibility of a General Legislative Framework on Fair Trading*, <http://europa.eu.int/comm/consumers>.

<sup>4</sup> Roger Brownsword, "Individualism, Cooperativism and an Ethic for European Contract Law" (2001) 64 MLR 628.

2.12 By “doctrinal form” we mean whether doctrine is presented in terms of general standards or principles or whether the preferred form is more specific, more rule-like. To require business contractors to “trade fairly” with consumer customers is to employ a general standard; to impose a 14-day cooling off period where business contractors sell on consumer customers’ doorsteps, is to prescribe at a much more specific level.

2.13 By “doctrinal expression”, we mean the particular form of words chosen for a doctrinal idea. Instead of requiring business contractors to “trade fairly” with consumer customers, the same idea might be expressed as a requirement for business traders to act in “good faith” or in accordance with a rule of “reasonableness”; or, following the preferred negative formulation of the proposed UCPD, the requirement might be expressed as a prohibition on unfair commercial practices or businesses might be enjoined to avoid acting “unconscionably”, and so on.

2.14 By “doctrinal substance”, we mean the idea lying behind the particular doctrinal form and expression. A particular idea might be presented in more than one doctrinal form and, as we have just said, the same idea might be given more than one doctrinal expression. For example, the idea that consumers should not be unfairly surprised by the “small print” of a transaction might be translated into a general duty or a specific set of rules designed to bring home the terms of the contract to the consumer; and, where the chosen doctrinal form is that of a general duty, the relevant duty might be expressed through a requirement of good faith or reasonable notice, as much as through a duty to trade fairly. Conversely, we should *not* assume that where the same doctrinal form and/or expression is used identical outcomes will be produced—it is only where there is identity of doctrinal substance that we can safely assume identity of outcome.

#### **IV Doctrinal Form**

2.15 As legal argument has become more attentive to the features of contract law regimes found elsewhere in the common law world and in civilian Europe, it has become apparent that the English law of contract displays a marked preference for relatively specific doctrines, such doctrines having a reasonably clear scope and operating on the basis of well-defined criteria. No doubt, this preference reflects the importance attached to doctrinal calculability and predictability.<sup>5</sup> Despite this, it is also evident that English law has the doctrinal resources to enable it to arrive in many instances at broadly similar results to those that would be reached by legal regimes employing more general and more flexible doctrines.

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<sup>5</sup> For the strength of this preference, see e.g. Lord Hoffmann’s speech for the Privy Council in *Union Eagle v Golden Achievement* [1997] 2 All ER 215 which we discuss below at 4.10.

2.16 A good example of this kind of convergence is the well-known case of *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*<sup>6</sup>. There, the question was whether the claimant picture library was entitled to rely on the contractual provision that set the rate for late return of material borrowed from the library. The fairness of the library's reliance on the provision was an issue because the rate set was significantly higher than that found in comparable contracts. In principle, a regime of contract law might permit such a provision to be challenged as unfair on either procedural or substantive grounds: if the challenge were procedural in nature, the focus would be on the fairness of the processes leading up to the formation of the contract; if the challenge were substantive in nature, the focus would be on the reasonableness of the rates (whether judged by reference to a band of rates set by comparable contracts or by some independent measure of reasonableness). In *Interfoto*, the challenge hinged on the procedural question of whether the library had taken reasonable steps to put the borrowers on notice that, if the materials were returned late, the specified rates would apply. Although the doctrine of "reasonable notice" of terms is fairly elastic, it points to a relatively specific requirement of fair dealing. This is to be contrasted with all-encompassing standards of good faith and fair dealing of the kind found in the civil codes of many other European legal regimes. Remarking on this contrast, in a much-quoted passage, Sir Thomas Bingham said:

In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other...; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as "playing fair," "coming clean" or "putting one's cards face upwards on the table." It is in essence a principle of fair and open dealing....

English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.<sup>7</sup>

Where these piecemeal doctrinal solutions lead to common outcomes we have convergence. We might surmise, therefore, that where there has been unfair dealing it matters little whether the victim's interests are protected by a specific doctrine (holding that the library had not given reasonable notice) or by a general overarching principle (holding that the library had not acted in good faith). However, it would be a mistake to

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<sup>6</sup> [1989] QB 433.

<sup>7</sup> [1989] QB 433, 439.

think that the form (or pitch) of doctrine is entirely neutral and can be left without more to local preference.

2.17 The reason why the form of doctrine can make a difference in practice is prefigured by our observation that, whereas more specific doctrines tend towards calculability, more general doctrines tend towards flexibility. In practice, these tendencies may be manifested in the following ways.

First, in a legal regime that relies on, and is restricted to, an array of specific doctrines, there are problems for both claimants and adjudicators.

For claimants, the difficulty is that, if the particular claim cannot readily be brought within the ambit of one of the recognised doctrines (or causes of action), it is liable to be struck out. This, of course, is not uniquely a problem for consumer claimants or contractors—for instance, the difficulties facing claimants who wish to allege a violation of privacy are notorious.

For judges, too, the rigidity and specificity of doctrine can be problematic. If the merits of the claim are strong, judges who do not respond in a way that reflects the justice of the claim are liable to be criticised; and the law will be accused of being an ass. However, in order to respond positively, some doctrinal innovation is required, whether by extension of existing doctrine or by creation of new doctrine. Whichever remedial approach is adopted, the decision is likely to be greeted with the complaint that “hard cases make bad law”.

2.18 By contrast, if a legal regime relies on an overarching general standard, or a mix of such a standard in conjunction with more specific doctrines, it is very much easier for litigants to bring forward novel claims (or defences), and for judges to handle such points. Quite simply, the general standard serves as a fall-back. However, there are some drawbacks. In particular, if the general standard can be pressed into service whenever the merits seem to justify it, critics will complain that the regime is inherently unpredictable. Moreover, where a legal system has traditionally operated with specific doctrines, the reception of a general standard can cause some uncertainty about whether claims should be handled under the settled specific doctrines or under the new general standard—such was the experience, for example, in Israel when a principle of good faith was adopted.<sup>8</sup>

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<sup>8</sup> See, Nili Cohen, “Good Faith in Bargaining and Principles of Contract Law” (1989) 9 *Tel Aviv University Studies in Law* 249; and para 4.14 below.

2.19 Secondly, the greater the flexibility that the doctrinal form incorporates, the easier it will be to respond to meritorious claims without seeming to do violence to doctrine. Even rules that are quite specific can have some flexibility built into them (any rule that hinges on reasonableness will have such flexibility); but the more a legal regime prefers specific rules the more likely it is to operate such in-built flexibility in a cautious and incremental way.

2.20 The price to be paid for specific calculable rules was vividly highlighted in the notorious case of *L'Estrange v F Graucob Ltd.*<sup>9</sup> In this case, the Court of Appeal reluctantly applied the rule that, in the absence of fraud, misrepresentation, coercion, or the like, a party's signature on a contract indicates assent to its terms. The reason for the court's reluctance was twofold: first, the contract (the Sales Agreement) was very poorly presented on brown paper with the terms in minute print; and, secondly, the purchaser was a small businesswoman (a café proprietor) who had signed the document without appreciating the risks that the agreement purported to place upon her (essentially, that it was entirely her problem if the product, a cigarette vending machine, did not work). As Raphael Powell pointed out in a seminal lecture some twenty years later,<sup>10</sup> in a legal regime operating with an overriding requirement of good faith in negotiation, it would be possible to act on such concerns about lack of transparency and exploitation of vulnerability—and, indeed, there have been very similar cases in other jurisdictions where a general clause has been invoked to save the day.<sup>11</sup>

2.21 Thirdly, it might also be noted that, in other jurisdictions, general clauses can serve as gateways through which public law human rights provisions can enter into the private law of contract.<sup>12</sup> Following the enactment of the Human Rights Act 1998, it is unclear how far the Convention rights impinge (horizontally) on disputes between private contracting parties, as it remains a moot point whether any such impingement would be desirable or not, whether parties would be permitted to contract out (for example, where an employer wishes to restrict an employee's freedom of expression by imposing a confidentiality clause), and so on. Such questions, however, take us away from the main business of this Report.

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<sup>9</sup> [1934] 2 KB 394.

<sup>10</sup> Raphael Powell, "Good Faith in Contracts" (1956) 9 *Current Legal Problems* 16.

<sup>11</sup> See, *Tilden Rent-A-Car v Clendenning* (1978) 83 DLR (3d) 400, 18 OR (2d) 601.

<sup>12</sup> See, e.g., Andreas Heldrich and Gebhard M Rehm, "Importing Constitutional Values through Blanket Clauses", in Daniel Friedmann and Daphne Barak-Erez (eds), *Human Rights in Private Law* (Oxford: Hart Publishing, 2001) 113.

## V Doctrinal Expression

2.22 Every regime of contract law will operate with its own conception of fair dealing. However, each regime will express its own conception in its own distinctive way. As we have seen already, in many civilian systems, “good faith” is the chosen expression while, in others, the burden is carried by “abuse of right”. In North America, too, good faith is widely used but, in Australia, the challenge to unfair dealing has been mounted on the back of the doctrine of unconscionability.<sup>13</sup> Insofar as English law expresses a general requirement of fair dealing it is in terms of contractors acting reasonably. However, given the English preference for specific rules, this idea is expressed through a variety of rules rather than in one overarching requirement that contractors should act reasonably in forming, performing, and pursuing remedies under their contracts. In this larger picture, reasonableness sometimes operates as a default position supplementing the expressed intentions of the contractors, at other times as a limiting principle.

2.23 The way in which reasonableness operates as a supplementary principle is nicely illustrated by Buckley LJ in *Gillespie Bros. v Roy Bowles Transport Lt.*<sup>14</sup> Thus:

It is not in my view the function of a court of construction to fashion a contract in such a way as to produce a result which the court considers that it would have been fair or reasonable for the parties to have intended. The court must attempt to discover what they did in fact intend. In choosing between two or more equally available interpretations of the language used it is of course right that the court should consider which will be likely to produce the more reasonable result, for the parties are more likely to have intended this than a less reasonable result.<sup>15</sup>

According to Lord Denning MR, however, some judges have seen their function in more active terms, hiding behind the traditional language of construction and intention to displace the ordinary reading of contractual provisions in favour of reasonable terms. Thus:

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<sup>13</sup> See, e.g., David Harland, “Unconscionable and Unfair Contracts: An Australian Perspective” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999), 243.

<sup>14</sup> [1973] QB 400.

<sup>15</sup> *Ibid.*, at 421.

What is the justification for the courts...departing from the ordinary meaning of the words? If you examine all the cases, you will...find that at bottom it is because the clause...is unreasonable, or is being applied unreasonably in the circumstances of the particular case. The judges have, then, time after time, sanctioned a departure from the ordinary meaning. They have done it under the guise of “construing” the clause. They assume that the party cannot have intended anything so unreasonable. So they construe the clause “strictly”. They cut down the ordinary meaning of the words and reduce them to reasonable proportions. They use all their skill and art to this end.<sup>16</sup>

On this view, without saying as much, the courts are using reasonableness as a limiting principle.

2.24 Where reasonableness operates as a supplementary principle (a fortiori, where it operates as a limiting principle: see below), what is the reference point for this standard? To paraphrase Lord Wilberforce’s sceptical remarks in *L Schuler AG v Wickman Machine Tool Sales Ltd*,<sup>17</sup> who is the ubiquitous reasonable man? And, if the reasonable man is a business man, does he adopt the standards of English or German business people? In principle, there are two ways in which such a supplementary standard might be regarded.

2.25 One approach, reflected in Buckley LJ’s remarks in *Gillespie*, as well as in Steyn J’s reasoning in *Mosvolds Rederi A/S v Food Corporation of India*,<sup>18</sup> has the following three features: (i) that the court should proceed on the basis that the contracting parties are reasonable people; (ii) that reasonable contractors are more likely to have intended that disputes concerning their agreement should have reasonable rather than unreasonable results; and (iii) that the standards of reasonableness applied by the court are to be the standards of reasonableness accepted by the contractors themselves.

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<sup>16</sup> Ibid., at 415. Cf Simon Brown LJ in *Lancashire County Council v Municipal Mutual Insurance Ltd*. [1996] 3 All ER 545, 552: “The principles governing the construction of commercial contracts are not in doubt: the more unreasonable the result of a given construction, the readier should the court be to adopt some less obvious construction of the words.”

<sup>17</sup> [1974] AC 235, 263.

<sup>18</sup> [1986] 2 Lloyd’s Rep 68.

The other approach is that, the intentions of the contractors having run out, judicial standards of reasonableness should take over as the basis for decision. So, for example, where the doctrine of frustration is based on what the parties, as fair and reasonable contractors, would have agreed upon had they made express provision for the (unforeseen, unanticipated, or unprovided-for) contingency, the law is getting very close to operating with a free-standing doctrine of reasonableness. Indeed, as Lord Radcliffe remarked in *Davis Contractors Ltd v Fareham UDC*,<sup>19</sup> once frustration is so understood, there is some considerable distance between contract doctrine and the parties' intentions, such that:

By this time it might seem that the parties themselves have become so far disembodied spirits that their actual persons should be allowed to rest in peace. In their place there rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself.<sup>20</sup>

In other words, this latter view presupposes a clean break between the understanding of the contracting parties (once their intentions are exhausted) and the fall-back principle of reasonableness.

2.26 Although neither approach places reasonableness in competition with explicit contractual intention, the difference between reasonableness relative to the contracting parties' own lights (as in the former approach) and reasonableness relative to the judges' own lights (as in the latter approach) is doubly important. At one level, if judges are acting according to their own lights, there is a question about the legitimacy of their decisions; at another level, judicial decision-making becomes less calculable (at any rate, to the parties and their advisers) if judges are guided by their own standards of reasonableness.

2.27 As we turn to consider the function of reasonableness as a limiting principle, the significance of the distinction between the two approaches to reasonableness needs to be emphasised. Quite simply, where a court is guided by the express language of the agreement (as evidence of the parties' intentions) in conjunction with the contracting parties' own standards of reasonableness, this can be understood as a concerted attempt to give effect to the parties' reasonable expectations. In other words, where the court follows such an approach, there is no tension between intention and reasonableness—in

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<sup>19</sup> [1956] AC 696.

<sup>20</sup> *Ibid.*, at p. 728.

both its aspects, the inquiry is dedicated to keeping faith with the parties' own understanding of their obligations. However, where judges rely on their own standards of reasonableness, the parties are no longer in control of their rights and obligations.

2.28 As an explicit limiting principle, reasonableness is to be seen right across the doctrinal landscape. The rules of formation are in various ways qualified by the principle of reasonableness—for example, if terms are to be incorporated by notice, the notice given must be reasonable;<sup>21</sup> the classical posting rules will hold good only so long as they do not produce unreasonable results;<sup>22</sup> reliance in and around the formation of a contract will be protected where it is reasonable;<sup>23</sup> the objective test presupposes some standpoint involving reasonableness, and so on. Where a term is grey-listed under the Unfair Contract Terms Act 1977, it will be valid only if, as section 11(1) provides, it was “a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.” Similarly, covenants in restraint of trade are enforceable only insofar as they satisfy the *Nordenfelt* tests of reasonableness.<sup>24</sup> Under the doctrine of promissory estoppel, binding adjustments to contracts may not require detrimental reliance by the promisee, but they certainly require reasonable reliance.<sup>25</sup> A party pleading economic duress must show that there was no reasonable alternative other than to accede to the demands made, and steps of avoidance must be taken within a reasonable time.<sup>26</sup> Judicial

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<sup>21</sup> Originally, *Parker v South Eastern Railway Co* (1877) 2 CPD 416, as refined in *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163, and *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433. See, too, *AEG (UK) Ltd v Logic Resource Ltd* [1995] CCH Commercial Law Reports 265; and Robert Bradgate, “Unreasonable Standard Terms” (1997) 60 MLR 582.

<sup>22</sup> See e.g., *Holwell Securities Ltd v Hughes* [1974] 1 All ER 161.

<sup>23</sup> See e.g., *Errington v Errington and Woods* [1952] 1 KB 290; *Blackpool and Fylde Aero Club Ltd v Blackpool Borough Council* [1990] 3 All ER 25; and the use of collateral contracts to protect reasonable reliance on pre-contractual representations. Generally, on the protection of pre-contractual reliance, see John N. Adams and Roger Brownsword, *Key Issues in Contract* (London, Butterworths, 1995) 115-121.

<sup>24</sup> See *Nordenfelt v Maxim Nordenfelt* [1894] AC 535.

<sup>25</sup> Seminally, see *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130.

<sup>26</sup> See *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd: The Atlantic Baron* [1979] QB 705.

recourse to reasonable men abounds in disputes involving implied terms and frustration.<sup>27</sup> Even (some might say, especially) in relation to the exercise of remedies, the innocent party's rights are qualified by considerations of reasonableness—for example, reasonable steps in mitigation are required, and under section 4 of the Sale and Supply of Goods Act 1994 a commercial buyer's right to withdraw for breach of a statutory implied term is lost if “the breach is so slight that it would be unreasonable...to reject.”

2.29 The English predilection for “reasonableness” shines through even where EC law is being implemented. For example, in the recent Sale and Supply of Goods to Consumers Regulations<sup>28</sup> (implementing Directive 99/44/EC), the idea that the consumer's remedy should not be disproportionate is tied to what would be unreasonable. Briefly, where the goods do not conform to the contract of sale, in the sense that they are not of satisfactory quality (which itself turns on the standard that a reasonable person would regard as satisfactory in the circumstances), the consumer purchaser has two layers of remedies. The first layer is to seek repair or replacement of the goods. Where such remedies are not appropriate, a second layer becomes available; in such a case, the consumer's remedy is to seek a reduction of the price or rescission of the contract. Regulation 5 provides that this second layer of remedies comes into play inter alia where repair or replacement is disproportionate. And, what makes one remedy disproportionate in relation to another is if it imposes costs on the seller which are “unreasonable” taking into account such matters as the value of the goods if they had conformed, the significance of the lack of conformity, and the relative inconvenience to the buyer.<sup>29</sup>

2.30 In some of the cases mentioned, the limiting principle is expressed as a matter of what is reasonable, in others in terms of what is unreasonable. Whether or not the particular choice of expression signifies substantively will vary from case to case. For example, in the recent Court of Appeal decision in *Paragon Finance plc v Nash*,<sup>30</sup> the court accepted that there was an arguable case for an implied term to the effect that the finance company mortgagee would not exercise its discretion to vary the interest rate applicable to mortgagor customers unreasonably. This, however, placed only a marginal

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<sup>27</sup> On implied terms, see M. Furmston (ed), *The Law of Contract* (Butterworths Common Law Series) (London, Butterworths, 1999) 60-62 and para 2.30 below; and, on frustration, see para. 2.25 above.

<sup>28</sup> SI 2002 No 3045.

<sup>29</sup> See inserted section 48B(3) and (4).

<sup>30</sup> [2001] EWCA Civ 1466.

limitation on the mortgagee, leaving it free to exercise its commercial judgment in the context of its entire business and financial circumstances. Thus:

It is one thing to imply a term that a lender will not exercise his discretion in a way that no reasonable lender, acting reasonably would do. It is unlikely that a lender who was acting in that way would not also be acting either dishonestly, for an improper purpose, capriciously or arbitrarily. It is another matter to imply a term that the lender would not impose unreasonable rates....Such an implied term [i.e., of the former kind] is necessary in order to give effect to the reasonable expectations of the parties.<sup>31</sup>

The important point about this is not so much whether the limit is couched in terms of what mortgagors might reasonably expect, or what would be unreasonable for mortgagees to do. The question is how far the court is prepared to imply a term that restricts self-interested action by the mortgagee at the expense of the mortgagor—and this goes to the heart of the question of doctrinal substance.

## **VI Doctrinal Substance**

2.31 By far and away the most important feature of any regime of contract law is the set of values that informs its substantive doctrine. Broadly speaking, the substantive content of doctrine (in whatever form, general or specific, and however expressed) will reflect the local valuation of self-reliance and individualism as against mutuality and co-operativism. The more that mutuality and co-operativism are valued, the thicker the concept of fair dealing and the greater the demand that the interests of fellow contractors should be respected.

2.32 Characteristically, regimes of contract law that are predicated on the values of self-reliance and individualism will interpret a requirement of fair trading (or fair dealing, or fairness in contract) as a matter of fair procedure. The baseline is that no one should be coerced into a contract and nor should fraud be tolerated. When the classical model of English contract law organised itself around the slogan that “a free contract is a fair contract”, it signalled that its regulatory interventions in the name of fair contracting would not go beyond these minimal procedural rules.

2.33 Although the principles of freedom of contract and sanctity of contract have by no means lost all influence in English law (particularly where commercial contractors, each

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<sup>31</sup> Dyson LJ at paras 41-42.

with substantial bargaining power and with access to legal advice, are the parties to the dispute), in two important respects, the modern law has moved on from the minimalist position adopted by the classical law.

2.34 First, modern law no longer treats free trading as sufficient. To qualify as fair, a contract must satisfy procedural requirements relating to both freedom and information, and substantive standards of fairness and reasonableness. Sometimes, substantive restrictions may be imposed as an indirect way of enforcing the procedural requirements—for example, if it seems inherently unlikely that a contractor would *freely* bargain away some entitlement, the law may treat the entitlement as non-negotiable (not because it holds that bargaining away the entitlement would be intrinsically unfair but because it judges that this substantive restriction is a more effective way of enforcing the procedural requirement than asking directly whether the negotiation was freely undertaken). In some instances, however, a substantive restriction may be imposed because a particular kind of term is thought to be unfair—or, at any rate, it is thought that it would be unfair to permit a contractor to rely on the term in the circumstances of the particular case.

2.35 Secondly, in modern legal regimes, consumer contracts are treated differently from business contracts, with consumer contractors enjoying a higher level of protection against unfair dealing and unfair terms. This bifurcation of contract law, with business-to-business contracts being treated differently from business-to-consumer contracts, was already evident in English law before the European Community launched its programme of consumer protection. However, without any question, the impact of the stream of Directives (from 1985 onwards) aimed at harmonising the rights of consumers wherever they deal in the single market has been to underline the tailored nature of this part of the legal regime.

2.36 Each of these developments in the modern law reflects some movement in doctrinal substance. And, whether we are looking at the recognition of substantive fairness or the special protection of consumer contractors, the movement indicated is away from the values of self-reliance and individualism towards those of mutuality and co-operativism. However, this is not the same thing as saying that the modern law has transformed itself from a classical model predicated on the values of self-reliance and individualism to a regime predicated on the values of mutuality and co-operativism. Modern regimes of contract law may have moved some way along this value spectrum but each legal system will strike its own balance between these underlying values. For example, with regard to procedural fairness, there may be general acceptance of the need for transparency but very different views about how far disclosure is required; and, similarly, with regard to substantive fairness, there may be general acceptance of the need for balance but very different views about how far this allows for the regulation of the contractual price or price-sensitive terms.

## Summary

2.37 Although convergence studies are problematic where a comparison is being made between under-determined legal regimes, we know that relative to the two most important dimensions of any contract regime—namely, those of doctrinal form and doctrinal substance—English law tends to privilege different values to those favoured by European counterparts. First, as a matter of doctrinal form, English contract law prefers specific provisions to general clauses; and, secondly, as a matter of doctrinal substance, the default values of English contract law are those of self-reliance and individualism rather than mutuality and co-operativism.

2.38 Accordingly, we can predict with a degree of confidence that the implementation of an EC prescribed general duty of fair trading would not only commit English law to a doctrinal form that it does not favour, it would almost certainly be loaded with doctrinal substance that pushed domestic law away from its favoured values.

The significance of implementing an EC-prescribed general duty of fair trading, intended to function as a dynamic doctrinal element, would be far from negligible. Although doctrinal form is ultimately less important than doctrinal substance, the former is important for the reasons that we have given (2.17-2.21).

The significance of implementing such a general duty carrying substantive doctrine drawn from Europe is that, even though the English law of consumer contracts has moved away from the classical market-individualist values of contract law, it is not clear how far its consumer-welfarist orientation embraces the values of mutuality and co-operativism. Bearing in mind that any fair trading initiative from the EC would also have single market objectives, and thus be concerned that consumers should be confident in all parts of the market, there would be an added pressure to move towards a co-operative default position.

2.39 Before we can speculate about where such pressure would most be felt, we need to consider how far English already pursues fair trading objectives through its doctrines that are designed to promote procedural and substantive fairness in consumer transactions. This is the subject of the next Section.

## SECTION THREE

### PROCEDURAL AND SUBSTANTIVE FAIRNESS

#### I Introduction

3.1 In this Section, we consider whether English contract law already offers consumers a level of protection that would be equivalent to that presupposed by a fair trading requirement. This calls for some discussion of the position taken by English law in relation to both procedural and substantive fairness—as it were, fair contracting processes and fair contractual provisions.

3.2 Our discussion is in three principal parts. In part II, we make some general remarks about the way in which English law views questions of contractual fairness; in part III, we focus on procedural fairness (encompassing questions of freedom of choice and informed choice); and, in part IV, we turn to substantive fairness.

3.3 Broadly speaking, our conclusions are that a fair trading Directive could seek to import an approach that is more informed by the values of mutuality and co-operation; and that, although the English consumer law of contract has moved a long way towards co-operativism, there is still some way to go.

#### II Questions of Fairness in English Contract Law

3.4 Modern regimes of consumer contract law, including English contract law, operate on the basis that transactions may be challenged for their unfairness both as a matter of procedure and as a matter of substance. In practice, such challenges will be made *ex casu* by particular consumer contractors in relation to a particular transaction or pre-emptively by the relevant bodies (principally the Director General of Fair Trading) acting under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR, replacing the 1994 Regulations).

3.5 A consumer contractor is unlikely to challenge a contractual term *ex casu* unless it is perceived to be substantively unfair and materially to the detriment of the consumer. Such a challenge may be articulated purely as a substantive issue (independent of any alleged procedural unfairness) or the substantive unfairness may be argued to originate in some procedural unfairness. For example, in *Thornton v Shoe Lane Parking*,<sup>1</sup> the

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<sup>1</sup> [1971] 2 QB 163.

claimant sought to challenge notices at the defendant's car park that purported to exclude the car park's liability for negligence. The reason why the claimant was moved to do this was because he had been injured while using the car park and the notices stood in the way of his claim for compensation. This challenge might have been presented as a matter of substantive fairness—no matter what, such provisions were unfair and unreasonable; or as a matter of procedural unfairness—as in the *Interfoto* case (above), car-park users were not given fair warning that they parked on these terms. Once the Unfair Contract Terms Act 1977 (UCTA) was in force, the law invited a substantive challenge in a case such as that of Thornton; because, quite simply, section 2(1) of the Act provides that there can be no reliance on contractual terms or notices that purport to exclude or restrict liability for negligence where that negligence has led to death or personal injury. However, prior to UCTA, unless a challenge could be made substantively in the guise of an argument about intention and construction (see *Gillespie* above) the law channelled challenges to procedural matters. Thus, the burden of Mr Thornton's challenge was that the process by which he had been brought into the transaction was unfair in that he was not given timely and proportionate notice of the onerous terms on which the car park proposed to contract.

3.6 With regard to pre-emptive challenges under the UTCCR, there is now a wealth of reported out-of-court practice and just one leading in-court case, *Director General of Fair Trading v First National Bank plc*.<sup>2</sup>

3.7 So far as the out-of-court jurisprudence is concerned, the Bulletins issued by the OFT show that the Unfair Contract Terms Unit within the Office is acting against both procedural and substantive unfairness.<sup>3</sup> Generally, OFT intervention is triggered by the employment of standard form provisions that are on the grey list set out in Schedule 2 of the UTCCR. In some instances, the offending provisions are deleted and withdrawn by the standard form contractor, apparently indicating agreement that such terms are substantively unfair; or, if not deleted, the terms are trimmed, indicating again that, to the extent of the trimming, it is accepted that the term is substantively unfair. In other instances, the offending provisions are merely made more transparent, seemingly indicating that there is no substantive unfairness provided that the criteria of procedural fairness are observed.

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<sup>2</sup> [2001] UKHL 52.

<sup>3</sup> For an overview, see Susan Bright, "Winning the Battle Against Unfair Contract Terms" (2000) 20 *Legal Studies* 331.

3.8 With regard to the in-court jurisprudence, the *First National Bank* case, gives us the most authoritative judicial interpretation of the “good faith” requirement under the UTCCR. Briefly, under regulation 5(1) of the UTCCR, a contractual term that has not been individually negotiated is to be regarded as unfair if “contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.” In the *First National Bank* case, the DGFT, having been unable to reach agreement with the Bank concerning a particular standard form provision in its loan agreement, sought an injunction to restrain further use of the term. In seeking this relief, the DGFT believed that he was acting to protect a significant number of borrowers who had been unfairly caught out by the term in question. Although it was the 1994 version of the UTCCR that governed this particular dispute, the guidance given by their Lordships as to the meaning of good faith, and the span of potential unfairness, is equally applicable to the current version of the Regulations. The key judgments are given by Lord Bingham and Lord Steyn, both of whom have previously lent their support to reception of the idea of good faith or a doctrinal analogue.<sup>4</sup>

3.9 Giving the leading judgment, Lord Bingham says:

The requirement of good faith in this context is one of fair and open dealing. Openness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the customer’s necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or [the like]. Good faith in this context is not an artificial or technical concept; nor, since Lord Mansfield was its champion, is it a concept wholly unfamiliar to British lawyers. It looks to good standards of commercial morality and practice. [Regulation 5(1) of the UTCCR] lays down a composite test, covering both the making and the substance of the contract, and must be applied bearing clearly in mind the objective which the regulations are designed to promote [i.e. improving the functioning of the single market and protecting consumers in that market].<sup>5</sup>

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<sup>4</sup> See, especially, The Hon Johan Steyn, “The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?” [1991] *Denning LJ* 131; and Johan Steyn, “Contract Law: Fulfilling the Reasonable Expectations of Honest Men” (1997) 113 *Law Quarterly Review* 433.

<sup>5</sup> [2001] UKHL 52, para 17.

Most of what Lord Bingham says echoes the procedural focus of his remarks in the *Interfoto* case. However, he does say, quite explicitly, that the test is a composite one, applying to both the making and the substance of the transaction.

3.10 Lord Steyn, having followed Lord Bingham's lead by saying that good faith imports a requirement of fair and open dealing, nevertheless underlines the importance of substantive unfairness, saying that "[a]ny purely procedural or even predominantly procedural interpretation of the requirement of good faith must be rejected."<sup>6</sup> The reason why matters of substance are crucial is twofold. First, as Lord Steyn quite correctly points out, in a pre-emptive challenge such as that in the *First National Bank* case, where the dispute lies between the regulator and the standard form contractor, "there is not a direct *lis* between the consumer and the other contracting party."<sup>7</sup> In fact, there is no consumer as such, nor a specific transaction. In consequence, the regulations can only be applied sensibly "by taking into account the effects of contemplated or typical relationships between the contracting parties. Inevitably, the primary focus of such a pre-emptive challenge is on issues of substantive fairness."<sup>8</sup> Secondly, the grey list, a landmark of the UTCCR, is a check-list for arguably unfair provisions. Or, to put this slightly differently, the idea of "significant imbalance" in the general test of fairness signals a concern with substantive matters.

3.11 There is more to be said about the *First National Bank* case. However, it suffices for the present to say that there is already solid support in English law for the proposition that, in principle, a general duty of fair trading or the like would apply not only to procedural matters, to how the contract was made, but also to matters of substantive fairness. Our next step, therefore, is to take a harder look at what English law requires in the way of procedural fairness before asking the same question about substantive fairness.

### III Procedural Fairness

3.12 If business contractors are required to deal fairly with consumers, this means that the way in which the former bring the consumer into the contract must respect the latter's legitimate interests. What sort of interests might this cover?

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<sup>6</sup> Para 36.

<sup>7</sup> Para 33.

<sup>8</sup> *Ibid.*

3.13 If we start with the widely accepted idea that contracts are predicated on the free and informed consent of the parties, then two important groups of interests relate to (i) the consumer's freedom (the contract should represent an unforced choice) and (ii) the information made available to the consumer. In each case, a regime of contract law committed to fair dealing must place business contractors under duties that relate to the protected interests. How far the particular regime will be prepared to go will depend on its substantive values. The more that the regime is guided by the values of mutuality and co-operativism, the more that business contractors will be expected to attend to the interests of consumers.

### *Freedom (coercion and undue influence)*

3.14 Characteristically, regimes of contract law are committed to the principle that a transaction should not be treated as binding unless it represents the unforced choice of the parties. However, the question of what counts as an unforced choice is notoriously problematic.<sup>9</sup> In the non-contractual context of patients making unforced choices as to their treatment, theorists conceive of a spectrum running from wholly unforced choice to wholly forced choice with a point on the spectrum representing a substantially unforced choice.<sup>10</sup> Obviously, there is plenty of room for argument about where this point lies and what its significance is. When this kind of model is returned to the context of a marketplace transaction, its application is no easier.<sup>11</sup>

3.15 As we have said, the operation of a regime of contract law draws very heavily on its guiding values. In the case of the requirement of unforced choice (or substantially unforced choice), where the default values are those of self-reliance and individualism, the demands of procedural fairness will protect consumers against the most egregious examples of forced choice; but, in a regime informed by such values, there will be a reluctance to move away from this end of the spectrum. By contrast, where the default values are those of mutuality and co-operativism, procedural fairness will be much more focused on the paradigm of an unforced choice and a substantially unforced choice will be an approximation to this ideally fair situation.

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<sup>9</sup> Seminally, see Duncan Kennedy, "Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power" (1982) 41 *Maryland LR* 563.

<sup>10</sup> See, Ruth Faden and Tom Beauchamp, *A History and Theory of Informed Consent* (New York: Oxford University Press, 1986).

<sup>11</sup> Cf Articles 8 and 9 (and Annex 1) of the proposed UCPD in which *aggressive* commercial practices are related to harassment, coercion and undue influence.

3.16 If we start at the forced choice end of the spectrum, the clearest case of procedural unfairness is the contract made at gun point. A minimally protective regime would disallow direct physical coercion of this kind but, beyond that point, the values of self-reliance and individualism would militate against protective intervention. However, once these values weaken, as they have done in modern regimes of contract law, we start moving towards the unforced choice end of the spectrum and, in so doing, impose a more demanding standard for this aspect of procedural fair dealing. By way of illustration, we can indicate some of the steps that might be taken in this movement away from the minimal position.

First, under the rubric of a doctrine of duress or coercion of the will, a transaction is treated as procedurally unfair if the consumer's will is overborne by threats not only to the person *but also by threats to property*. This position may be extended by treating threats to third parties as if they were threats to the consumer personally.

Secondly, under the rubric of the doctrine of undue influence, a transaction is treated as procedurally unfair if the choice made by the consumer is not autonomously made.<sup>12</sup> Although most cases in this category will involve some improper conduct by the business contractor under whose undue influence the consumer is drawn into the transaction, this is not inevitably the case. (There is an important three-party variation on this theme. Business contractor A deals with consumer B in a context in which A will appreciate that there is a risk that B is acting under the influence of C. Failure by A to double-check that B is acting free of C's influence will result in the transaction between A and B being treated as procedurally unfair).<sup>13</sup>

Thirdly, under an extended version of the doctrine of duress, a transaction is treated as procedurally unfair if, even though the consumer's will is not overborne, nevertheless the choice to enter the contract is made as a result of improper pressure (which may or may not include harassment). This doctrine may or may not require the consumer to be placed in a position where there is no reasonable alternative but to submit to the pressure applied.

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<sup>12</sup> English law has found it difficult to give a crisp definition of "undue influence". By contrast, Article 2(1) of the proposed UCPD defines "undue influence" as the exploitation of "a position of power to apply pressure, without using physical force, in a way which significantly limits the consumer's ability to make an informed decision."

<sup>13</sup> See a run of cases from *Lloyds Bank Ltd v Bundy* [1975] QB 326 to *Royal Bank of Scotland v Etridge* (No 2) [2001] 4 All ER 449.

Fourthly, the extended doctrine of duress is further extended to include improper economic pressure. In English law, this critical move was made in *The Atlantic Baron*<sup>14</sup> where a shipyard demanded increased payment (to cover itself against the unanticipated devaluation of the contract currency) otherwise, so it threatened, it would not perform its part of the bargain. It was recognised by the court that this pressure was improper, that it constituted economic duress and that, in principle, it gave the client the opportunity to avoid the (forced) agreement to pay the additional sum. Since that time, as in *The Atlantic Baron*, the leading cases have centred on pressure applied for renegotiation in *commercial* contracts (typically, suppliers demanding to be paid more for the agreed contractual performance). However, the jurisprudence associated with the doctrine is still under-developed; and, in particular, it remains unclear, beyond the obvious paradigms, how improper or illegitimate economic pressure is to be distinguished from acceptable commercial pressure. In principle, economic duress might be pleaded, too, by *consumers*. In the current state of English law, it is hard to imagine such a plea succeeding where it amounts to a complaint that a supplier has driven a hard bargain but where the latter's conduct falls short of being unconscionable. On the other hand, there is no reason why economic duress should not be available to consumer contractors (just like their commercial counterparts) who are improperly pressurised into a renegotiation of the contract—although, where a supplier in a consumer contract can fall back on express provisions permitting upward price adjustment, questions of fairness are unlikely to concern the nature of the choice (forced or unforced) made by the consumer; instead, the focal questions will be whether the consumer received fair warning of the term and/or whether the term is substantively fair.

Fifthly, the doctrines shielding consumers against improper pressure are extended to cover improper incentives and inducements.<sup>15</sup>

Sixthly, a transaction is treated as procedurally unfair if the supplier presents the terms of the contract to the consumer on a take-it-or-leave-it basis, without offering any alternative deal. Additionally, no alternative deal is available elsewhere. This is a one-contract supplier in a one-contract market. Here, so far as the decision to contract is concerned, the consumer's will is not overborne and nor is there any pressure (improper or otherwise) on the part of the business contractor. The lack of choice concerns the terms of the chosen contract.

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<sup>14</sup> *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd* [1979] QB 705.

<sup>15</sup> What might be counted as improper pressure in relation to inducements and incentives? According to para 71 of the Explanatory Memorandum accompanying the proposed UCPD, the average consumer's choice will not be distorted by the offer of a free cup of coffee at a car sales site or by free transport to an out-of-town retail park. However, what would we make of an offer to re-schedule a consumer's debt repayments provided that further purchases were made (which would not otherwise be made)? On the concept of the "average consumer", see para 3.23 et seq below.

Seventhly, a transaction is treated as procedurally unfair if the supplier presents the terms of the contract to the consumer on a take-it-or-leave-it basis, without offering any alternative deal. This holds irrespective of whether alternative deals are available elsewhere.

By the time that we get to the sixth and seventh steps, we have moved a long way from the power plays that underlie the earlier instances of forced choice. By this stage, it is the structural imbalance of power that is doing all the work; there is no need for the business contractor to apply pressure because the consumer simply lacks any bargaining strength (other than walking away from the deal altogether).

3.17 The extent to which English law has taken these steps is apparent from the general acceptance of the idea that there is a problem about consumers lacking any bargaining power against standard form contractors. Indeed, nowadays, such an observation would be regarded as trite. What is less trite is the claim that, on closer analysis, much of the problem here resides in a shifting understanding of the requirement of unforced choice as a matter of procedural fairness.

3.18 In this context, it is worth noting the Law Commission's recent attempt to be more explicit about consumer bargaining strength as a factor bearing on judgments of fairness.<sup>16</sup> According to the Commission, the following matters are the ones that count:<sup>17</sup>

- (a) whether the transaction was an unusual one for either of the parties,
- (b) whether the party adversely affected by the term was offered a choice over the term,
- (c) whether he had an opportunity to seek a more favourable term,
- (d) whether he had an opportunity to enter into a similar contract with other persons but without that term,
- (e) whether there were alternative means by which his requirements could have been met,
- (f) whether it was reasonable, given his abilities, for him to have taken advantage of any offer, opportunity or alternative mentioned in sub-paragraphs (b) to (e).

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<sup>16</sup> Law Commission, *Unfair Terms in Contracts* (LCCP No 166) (London, 2002).

<sup>17</sup> *Ibid.*, Appendix B, Schedule 1, para 4.

As we have said, the modern law has moved on a long way from classical contract thinking. In the light of consideration (f), we can see just how far modern thinking is prepared to go. Consumers who might have found more favourable terms in the market (in the single market in future) will nevertheless be allowed to plead procedural unfairness if it is judged unreasonable to expect such searches to be made.

### ***Information***

3.19 Even if the consumer makes an unforced choice to enter a particular transaction, there will still be procedural unfairness if the consumer's choice is not properly informed, that is, if the consumer's interest in relevant knowledge and understanding is not respected and protected. As with the concept of an unforced choice, we can imagine a spectrum running from fully informed choice to wholly uninformed choice, with the notion of a substantially informed choice somewhere along the way.<sup>18</sup> Once again, the way in which these ideas are operationalised depends on the default values of the particular regime.

3.20 If we start at the uninformed choice end of the spectrum, the clearest possible case of procedural unfairness is where the consumer has been drawn into the transaction by fraud. In the minimally protective regime, beyond fraud, the consumer is left to rely on her own resources. However, as modern regimes of contract law step away from this position to impose a thicker conception of procedural fairness, they rely on the values of mutuality and co-operativism to progressively shift the informational risk and responsibility from consumer to supplier. By way of illustration, we can once again indicate some of the steps that might be taken in this movement away from the minimal position.

First, a transaction is treated as procedurally unfair if the consumer's agreement has been induced by *non-fraudulent* misrepresentations.<sup>19</sup> Until the Misrepresentation Act, 1967, it was notoriously difficult for the victims of non-fraudulent misrepresentations to secure adequate redress. By so placing much of the risk of honest but false representations on

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<sup>18</sup> Cf Articles 6 and 7 (and Annex 1) of the proposed UCPD in which the idea of *misleading* commercial practices is elaborated.

<sup>19</sup> In English law, a misrepresentation is conceived of as a representation which purports to be a statement of fact (not of intention or mere opinion or law) but which is actually untrue. To be operative, the misrepresentation must be of such a nature as to be capable of inducing the misrepresentee to enter into the contract with the misrepresenter. Generally, see *The Law of Contract* (Butterworths Common Law Series) 2<sup>nd</sup> ed (London: Butterworths, 2003) Ch. 4.

representees, the pre-1967 law failed to reflect the difference between careless and careful representations. The 1967 Act, following parallel developments in tort law, remedied this situation by providing for the award of damages where a misrepresentation, although believed by the misrepresenter to be true, is made without reasonable grounds for such a belief. In this way, the balance of risk in relation to *non-fraudulent* misrepresentations was adjusted and fine-tuned: whereas consumers who are induced to contract by negligent misrepresentations may seek to avoid the contract and claim damages, those who are induced by non-negligent (strictly innocent) misrepresentations are left only with the fragile option of avoidance.

Secondly, where a transaction is made on a business contractor's standard terms and conditions, it will be treated as procedurally unfair unless reasonable steps have been taken to alert the consumer to the existence of such terms and conditions. In respect of unsigned contracts, English law adopted this position under the rule of "reasonable notice" in the late nineteenth century.<sup>20</sup>

Thirdly, extending the doctrine of reasonable notice, it is not sufficient to alert the consumer to the existence of standard terms and conditions. The reasonableness of the notice is measured by the nature of the particular term that the business supplier seeks to rely on. The more unusual or onerous the term, the more prominent and explicit the notice required. This strengthening of the reasonable notice rule was introduced in English law in *Thornton* and it was followed in *Interfoto*.

Fourthly, a transaction is treated as procedurally unfair if the consumer has entered the agreement in ignorance of some "material fact". Material facts are those to which the business contractor has privileged access and which he judges the consumer would consider to be relevant to the transaction.

Fifthly, the material facts rule is extended to require disclosure of information which the business contractor has but to which he has no special or privileged access. In this light, we might point out that Article 7.1 of the proposed UCPD provides that a commercial practice shall be regarded as misleading where, all things considered, it "omits material information that the average consumer needs, according to the context, to take an informed transactional decision and thereby causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise."

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<sup>20</sup> See *Parker v South Eastern Rly Co* (1877) 2 CPD 416.

Sixthly, the material facts rule is further extended to encompass information which the particular consumer contractor would wish to have even if the business supplier is, in good faith, unaware of this customer's informational requirements.

The fourth, fifth and sixth steps put an increasing burden of disclosure on the business contractor. Moreover, this is not simply a matter of putting some effort and resource into ensuring that one's standard terms are properly brought home to the customer, we are moving into the area of sharing price-sensitive information. Although English thinking has come a long way in relation to ensuring that the consumer understands the terms of the contract, there is a reluctance to make any concession to the principle that parties may legitimately bargain with price-sensitive cards close to their chest.

3.21 The Law Commission's recent work on unfair terms is again indicative of the seriousness with which the informational dimension of procedural fairness is taken.<sup>21</sup> According to the Commission, the following matters are relevant to the knowledge and understanding of consumers contractors:<sup>22</sup>

- (a) any previous course of dealing between the parties,
- (b) whether the party adversely affected knew of the term,
- (c) whether he understood the meaning and implications of the term,
- (d) what other persons in a similar position to him would normally expect in the case of a similar transaction,
- (e) the complexity of the transaction,
- (f) the information given to him before or when the contract was made,
- (g) whether the contract was transparent,
- (h) the way that the contract was explained to him,
- (i) whether he had a reasonable opportunity to absorb any information given,
- (j) whether he took professional advice, or it was reasonable to expect that he should have taken such advice,
- (k) whether he had a realistic opportunity to cancel the contract without charge.

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<sup>21</sup> Law Commission, *Unfair Terms in Contracts* (LCCP No 166) (London, 2002).

<sup>22</sup> *Ibid.*, Appendix B, Schedule 1, para 3(1).

Clearly, if these criteria had applied in a case such as *L'Estrange v Graucob*, we would find quite a gap between the requirements of procedural fairness and the way in which the contract was actually made. However, *L'Estrange* is not a consumer case and a better test is the *First National Bank* case.

3.22 The essence of the complaint in the *First National Bank* case was that borrowers who fell into arrears might not appreciate that interest at the contractual rate would continue to accrue on the outstanding sum quite independently of amounts to be paid under any judgment against them obtained by the bank. In order to bring home the contractual position to defaulting borrowers, the bank sent a standard letter saying that, whilst borrowers need only pay the amounts ordered by the court, interest continued to accrue and, thus, it was in the borrower's interest to increase their repayments "otherwise a much greater balance than the judgment debt may quickly build up." Nevertheless, if procedural fairness demands that borrowers should fully understand the extent of their potential exposure at the time of contracting, the DGFT was not satisfied that the bank's processes passed muster.

3.23 Had the House of Lords sought to apply something akin to the Law Commission's proposed check-list, the difficulty flagged up by Lord Steyn would have been apparent at once. Whereas the Commission's criteria are drafted for an *ex casu* challenge, the House in the *First National Bank* case was dealing with a pre-emptive challenge. In such a case, the court must explicitly or implicitly operate with a representative or average consumer. This raises the question: what are the characteristics of the representative or average consumer?

3.24 Strictly speaking, the representative consumer is not necessarily the same as the average consumer. Whereas a protective court might hypothesise a particularly vulnerable consumer as the representative model, the average consumer, qua the median, will be taken to be neither particularly vulnerable nor particularly capable (relative to the range of the reference group).

3.25 In the ECJ's jurisprudence, it is settled that the average consumer is to be assumed to be "reasonably well-informed and reasonably observant and circumspect"<sup>23</sup>. So, for example, in the well-known Mars case,<sup>24</sup> where it was argued that consumers

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<sup>23</sup> See, Case C-210/96, *Gut Springheide GmbH v Oberkreisdirektor des Kreises Steinfurt* (1998) ECR I-4657 (para 37). In so holding, the ECJ echoed the views of Advocate General Mischo who proposed that, for the purposes of evaluating the potentially misleading nature of promotional material, it should be the reaction of the informed consumer, not that of the casual consumer, that should constitute the benchmark. This characterisation of the average consumer is copied into the proposed UCPD by Article 2(b).

<sup>24</sup> *Verein gegen Unwesen in Handel und Gewerbe v Mars GmbH*, C-470/93 [1995] ECR I-1923.

might be misled by a “+10%” marker on Mars ice-cream bars, the ECJ did not accept that the average consumer would be fooled by the fact that the “+10%” promotional marking took up nearly 25% of the bar. According to the court:

Reasonably circumspect consumers may be deemed to know that there is not necessarily a link between the size of the publicity markings relating to an increase in a product’s quantity and the size of that increase.<sup>25</sup>

In taking this approach, the ECJ followed the Opinion of Advocate General Léger that “consumers showing normal care” would make no automatic connection between the size of the promotional marking and the size of the increase and that “a careful consumer” would be prepared for an element of promotional exaggeration—in other words, that the average consumer is reasonably streetwise.<sup>26</sup> Should the member state suspect that its consumers, or a relevant group thereof, fall below this standard, the jurisprudence allows for further inquiries to be made.

3.26 Although this is the settled view of the ECJ, not all member states accept this benchmark. In particular, in both Belgium and Germany, there are decisions that take a more protective line. Thus, in the Saint Brice case, the Belgian Cour de Cassation adopted the “least attentive” consumer as the standard<sup>27</sup>; and, in the Scanner advertising case, the Bundesgerichtshof has recently taken a similar approach by equating the “average consumer” with the “casual observer” in certain situations.<sup>28</sup> Despite the potentially confusing terminology (see 3.24 above), we can say that where a court has to employ a representative consumer as a benchmark, it has a range of competence, skill and attentiveness by reference to which this ideal-type can be specified. In the ECJ, a median approach is taken; but in the Belgian and German decisions, we can see a more protective standard being set. In this light, how does the approach of the House of Lords in the *First National Bank* case look?

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<sup>25</sup> Para 25.

<sup>26</sup> Para 53.

<sup>27</sup> Judgment of 12 October, 2000.

<sup>28</sup> Judgment of 20 December, 2001: I ZR 215/98.

As we have observed, the House, without always saying so explicitly, speaks to the meaning of good faith and its application to consumers in two frameworks: one context is that of the *ex casu* challenge where there is an actual consumer; the other is that of the pre-emptive challenge where the court must be guided by a benchmark consumer. Thus, when Lord Bingham says that good faith precludes taking advantage of the customer's necessity, indigence, lack of experience, and so on, this places a requirement on the supplier relative to the particular customer with whom he is dealing; in other words, fair trading standards vary from case to case depending on the competence, vulnerability and circumstances of the individual consumer. However, in a pre-emptive challenge, where there are many unidentified consumers rather than one identified consumer, the court must work with a representative consumer. In taking as its benchmark a reasonably competent consumer, one able to understand that interest continues to accrue, and one who will be sufficiently well informed to seek judicial relief for which statutory powers do provide but which is not automatically invoked, the House seems to be pretty much in line with the ECJ's standard. However, this is quite a skilled consumer and one who, in practice, probably has access to legal advice; for its one thing to appreciate that there is not necessarily a link between the size of promotional markings on a Mars bar and any increase in the size of the bar itself, quite another to appreciate that repayment of a debt as per a court order will not necessarily clear the debt.

What emerges from the *First National Bank* case is that the English House of Lords, if not the DGFT, sets the general threshold for consumer protection somewhere in the middle and that this is in line with ECJ thinking. To those who argue that this does not sufficiently protect more vulnerable consumer contractors, the House of Lords can respond that such special circumstances will be regulated by good faith in an *ex casu* challenge by the particular victim of unfair dealing.

3.27 Finally, it should be said that, if we take as our representative consumer one who is reasonably circumspect and generally able to look after his own interests in the marketplace, it is easy to think that an ethic of self-reliance is not altogether inappropriate. And, although English law seems to be fairly close to EC thinking on the characteristics of the representative consumer, there is no doubt that, in general, it diverges from other European regimes when it comes to requiring the disclosure of price sensitive information. Each legal system will make some exceptions for disclosure; but, as Hugh Collins has said:

At the extreme, in France, it has been suggested that the exceptions now amount to a general principle requiring disclosure, which nearly obliterates the general rule against disclosure....In other legal systems, especially those influenced by Germany..., the exceptions where disclosure is required are often conceived as part of a broader duty to bargain in good faith....In the common law world, the exceptions remain fragmentary, partly built upon established doctrines such as

misrepresentation and implied terms, and partly derived from specific statutory provisions.<sup>29</sup>

So, to give a standard example, if a consumer were to contract with a business contractor for a house clearance, and if the latter realised that some of the items to be cleared were of considerable value, we would not expect English law to require disclosure of this information. In other words, English law would not treat the house-clearer's self-interested silence as a breach of principles of fair dealing. Such a scenario can be adjusted in many ways and, sometimes, small variations might be highly material legally speaking (depending, for instance, on such matters as whether the business contractor has special knowledge, whether the consumer was explicitly relying on the expertise of the business buyer-cum-valuer (and whether the business contractor appreciated this, or should as a reasonable contractor have done so), whether it would have been reasonably easy for the consumer to discover the real value of the goods, whether the consumer was being unreasonably dependent on others, and so on). However, the impression gleaned from comparative studies is that civilian regimes of contract law in Europe would be much readier to give the lay (consumer) vendor relief against a sale at undervalue.<sup>30</sup>

#### IV Substantive Fairness

3.28 Classically, the common law exerted (and continues to exert) a degree of control over the content of contracts. For example, there were (and still are) public policy restrictions of various kinds and penalties were (and still are) not enforced. However, whether it would be appropriate to describe such control as being exercised on the grounds of substantive *unfairness* is questionable—"unreasonableness" perhaps, but not "unfairness".

3.29 It is rather easier to relate the substantive control exercised by way of contractual construction to a conception of fairness. As we have pointed out already,<sup>31</sup> the courts

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<sup>29</sup> Hugh Collins, "Disclosure of Information and Welfarism" in Roger Brownsword, Geraint Howells, and Thomas Wilhelmsson (eds), *Welfarism in Contract Law* (Aldershot: Dartmouth, 1994) 97, at 109.

<sup>30</sup> See, e.g., Reinhard Zimmermann and Simon Whittaker (eds), *Good Faith in European Contract Law* (Cambridge: Cambridge University Press, 2000), especially hypothetical number 2 (at 208-235); and Hein Kötz, "Towards a European Civil Code: The Duty of Good Faith" in Peter Cane and Jane Stapleton (eds.) *The Law of Obligations: Essays in Celebration of John Fleming* (Oxford, Clarendon Press, 1998) 243, 254-256. The famous case of *Smith v Hughes* (1871) LR 6 QB 597 is, of course, the locus classicus of the English preference for informational economy (albeit in the setting of a business-to-business sale).

<sup>31</sup> See para 2.23 above.

became practised in construing contracts in a way that produced reasonable results. This was usually justified in terms of giving effect to the parties' intentions. However, it could have been justified as an exercise in *procedural* fairness. The argument would have been that the contract was so favourable to one of the parties that it was inherently unlikely that the other (especially a consumer contractor) could have freely agreed to such terms or have done so on an informed basis. In other words, so-called substantive unfairness flagged up an assumed procedural defect. With the benefit of hindsight, we can see that this was a rare tangle of confusion and obfuscation: the courts, seeking to maintain the rhetoric of freedom of contract, claimed to be enforcing the contractual intention (when it was pretty clear that the parties did not have a common intention); commentators saw this as intervention for the sake of substantive fairness (when it was not clear what would amount to independent substantive unfairness); and if the best account characterised this as intervention because of procedural unfairness, the courts of construction made no direct inquiry into the processes by which the contract had been formed.

3.30 With the enactment of the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations (now) 1999 (UTCCR), it is generally accepted that substantive unfairness is legislatively controlled. The question is: what does such unfairness amount to? In response, we might detect something of a paradox. On the one hand, UCTA has no clear conception of substantive unfairness; yet, it decrees that some terms in consumer contracts cannot be relied on, which is just what we would expect if a term was (independently) substantively unfair. On the other hand, the UTCCR has, in its idea of significant imbalance (or contractual asymmetry), quite a plausible conception of substantive unfairness; yet it does not decree that this suffices to preclude reliance on the terms that are covered by this conception, which is not what we would expect if a term was (independently) substantively unfair—indeed, one might think that the scheme of the UTCCR fits better with a model of procedural unfairness. We need to look more carefully at these legislative schemes.

3.31 Without attempting to offer a comprehensive analysis of UCTA, we can focus on two indicative pairs of provisions and one free-standing provision. First, there is the pair of provisions in section 2 that regulates terms which purport to exclude or restrict liability for negligence. Secondly, there is the pair of provisions in section 6 that regulates terms in sales contracts which purport to exclude or restrict liability for breach of the statutory implied terms (in sections 13-15 of the sales legislation). Thirdly, the free-standing provision is in section 3(2) where, in a consumer or a standard term contract, a term may be challenged as unfair where it purports to authorise a performance that is substantially different from what the consumer reasonably expected.

3.32 The pair of provisions in section 2 are to the following effect.<sup>32</sup> Where negligence has resulted in death or personal injury, an exclusionary or restrictive term cannot be relied on; where negligence results in damage to property or some other kind of loss (economic loss), reliance on an exclusionary or restrictive term is permissible provided that it was a reasonable term to include in the contract. What this seems to presuppose is that it is never fair to exclude or restrict liability for negligence leading to death or personal injury, or that it is so unlikely that such a term could have been fairly agreed upon that it can be black-listed. Yet, the same cannot be said about terms purporting to exclude liability for negligence leading to some other kind of loss or damage. In this latter case, reliance on the term is only disallowed if the party seeking to rely is unable to persuade the court that the term was a fair and reasonable one to include in the contract. Further to the guidelines in UCTA, and the jurisprudence developed by the courts, the criteria that determine this matter are largely procedural in nature.<sup>33</sup> Accordingly, we can make sense of these provisions if we view them as indirect enforcement of standards of procedural fairness but it remains unclear what is independently substantively unfair about the exclusion or restriction of liability for negligence where death or personal injury has resulted.

3.33 The pair of provisions in section 6 distinguishes between consumer contracts (where there can be no reliance on terms purporting to exclude or restrict liability in relation to the statutory implied terms) and business contracts (where reliance is permitted provided that the seller can satisfy the court that the term was a fair and reasonable one to include in the contract).<sup>34</sup> What do we make of this? Unlike the contrast in section 2, the difference in section 6 cannot turn on the substance of the exclusion or restriction—the content of the controlled term is identical; the difference is that, in one case, it is relied on against a consumer buyer and, in the other case against a business buyer. Thus, this looks very much like a procedurally inspired provision. The underlying thinking is that it is easier to black-list such terms in consumer contracts than to inquire as to the fairness of the process by which the consumer was brought into the contract—because in the overwhelming majority of cases, the consumer will not have been treated fairly.<sup>35</sup> In business contracts, however, there is a much more realistic

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<sup>32</sup> See sections 2(1) and 2(2).

<sup>33</sup> The most important criteria relate to the relative bargaining strength of the parties, their knowledge and the choices available to the party who has “accepted” the term in question. See discussion in John N. Adams and Roger Brownsword, *Key Issues in Contract* (London: Butterworths, 1995) Ch. 8.

<sup>34</sup> See sections 6(2) and 6(3).

<sup>35</sup> Cf para. 2.34 above.

prospect of the transaction having been negotiated in a way that meets the standards of procedural fairness and so it would be wrong to exclude this possibility by black-listing. Instead, a case-by-case approach is appropriate.

3.34 Thirdly, there is an interesting free-standing provision in section 3(2)(b)(i). The control in section 3 applies to consumer contracts or to contracts made on a party's written standard terms of business. The particular sub-section covers terms which purport to authorise a business contractor "to render a contractual performance substantially different from that which was reasonably expected of him." There is not much jurisprudence on the interpretation of this sub-section. Potentially, it could be extremely flexible and protective of consumer interests. However, in *Paragon Finance plc v Nash*,<sup>36</sup> the Court of Appeal restricted the potential application of the provision by reading "contractual performance" as encompassing only the contractual obligations. Hence, the exercise of contractual powers or discretion in a way that a consumer did not reasonably expect could not be challenged under this sub-section. For our purposes, however, the interest in this sub-section lies elsewhere.

3.35 Basically, the idea of what the consumer reasonably expected could be implemented in one of two ways. One way would be to treat a term allowing for a radically different kind of performance as suspect relative to criteria of procedural fairness. Accordingly, before such a term could be relied on, it would be necessary to establish that the contract was fairly negotiated, that the term was transparent and so on. The other way would be follow Lord Denning's famous strategy of covering up the suspect term to ask what, *without the term*, was the general purpose of the contract. Any attempt to deviate from the main purpose of the contract, so identified, would be disallowed. Again, this could be tracked back to a concern about procedural fair dealing: disallowing the provision without further inquiry would be the right result in most cases and would anyway act as a disincentive to other business contractors who might otherwise try this on. Or, this might be explained as a case where a term of this kind was genuinely, and independently, regarded as substantively unfair.

3.36 Before we go on to the UTCCR, we should take stock of three key points. First, reliance on a term with a suspect content (loosely speaking, an "unfair" term) may be disallowed for three different reasons: (i) because, on further inquiry, it is seen to be the outcome of procedurally unfair dealing; (ii) because, without further inquiry, it is treated as more likely than not to have been the outcome of procedurally unfair dealing; and (iii) because, irrespective of procedural considerations, it is substantively unacceptable. Secondly, even though the rhetoric of substantive unfairness is widely used, little attention is explicitly given to these distinctions. Thirdly, there is a paradox of the following kind: where a suspect term is identified by its *substance*, this will usually be an

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<sup>36</sup> [2001] EWCA Civ 1466.

invitation to check for *procedural* fairness; while, where a suspect term is identified by its *form*, this may well be a case of genuine *substantive* unfairness.

3.37 This last point is illustrated quite nicely by the UTCCR. Terms that are grey-listed in the Regulations are indicative examples of provisions that involve a significant imbalance to the detriment of the consumer. As a number of commentators have remarked, many of the indicative examples instantiate a significant imbalance by virtue of their asymmetry: the contract grants some excuse or advantage or option to the business without making a similar concession to the consumer. We might say, therefore, that the UTCCR, unlike UCTA, has a systematic organising conception of the form that a particular species of *substantively* unfair term will take, that is, a term displaying a significant imbalance in a context of asymmetry. However, if we really think that such a term is substantively unfair, the logic is that it should be disallowed irrespective of any procedural considerations. Yet, as we have said, the Regulations do not take this step. Rather, whether in an *ex casu* or pre-emptive context, there has to be an inquiry into good faith, into matters of procedural fair dealing.

3.38 The conclusion that we should draw from this discussion is that, whereas procedural fairness is pretty clearly mapped out, substantive fairness is still something of a puzzle; English law seems to know substantive unfairness when it sees it but it has difficulty in articulating a clear conception that does not reduce back to procedural fairness.

## **Summary**

3.39 English law has gone a long way towards controlling procedural unfairness in consumer contracts. The courts led the way by developing the common law but these measures have been re-inforced by UCTA and the UTCCR. The dual focus of procedural fairness is whether the consumer has made an unforced choice and whether the choice was properly informed. Both these focal issues invite responses that draw on underlying default values running from individualism and self-reliance to mutuality and cooperativism. English law is not strikingly out of line with European law on these issues (it sees the issues in pretty much similar terms and responds in a similar sort of way). However, if there is a gap between English consumer contract law and its European counterparts, it is in relation to the requirement to disclose.

3.40 The idea of substantive unfairness is used very loosely in English contract law, often sliding into the idea of substantive unreasonableness. It seems to have a triple purpose: (i) to flag up the need for an inquiry into procedural fair dealing in the particular case (here the substance of the term sets up a rebuttable presumption of procedural unfairness); (ii) to operate as an irrebutable presumption of procedural unfairness; and

(iii) to regulate wholly unreasonable terms (independent of procedural fairness or unfairness).

3.41 The idea of substantive unfairness, independent of any question of procedural unfairness, is difficult to articulate. We have some models of what such a substantively unfair term might look like—for example, the section 3(2)(b)(i) provision in UCTA and the idea of a significant imbalance in the UTCCR. However, these are models of the *form* of a substantively unfair term. It is not obvious that the introduction of a general duty of fair trading would find English law lacking in relation to its willingness to resort to the idea of substantive unfairness.

3.42 A claim concerning fairness in contract can arise *ex casu* or by way of pre-emptive challenge. So far as pre-emptive challenge is concerned, enforcers and adjudicators must operate with a model of a representative or average consumer. The English judicial view seems to be in line with ECJ jurisprudence; this is not a particularly protective position; and it may be significant that there are more protective benchmarks in play elsewhere in Europe. So far as *ex casu* challenges are concerned, as we have said, disclosure may be the area where current English thinking falls short of the European standard.

## SECTION FOUR

### THE GOOD FAITH DEBATE

#### I Introduction

4.1 In this Section of the Report, we summarise and review the main arguments relied on in the ongoing debate as to whether English law should follow much of the civilian and common law world by incorporating an overarching standard of good faith in contracts.

4.2 With the enactment of the UTCCR, the protagonists in this debate accept that, for better or worse, good faith now has a foothold in consumer contracts. Hence, the debate is at its sharpest where the focus is on good faith in commercial contracting.

4.3 There are a number of reasons why the debate about good faith is relevant for present purposes. First, and most obviously, it is the most clearly formed debate concerning the adoption by English contract law of a general standard that is something akin to fair trading. Secondly, even where the arguments put forward by the protagonists are set in the context of commercial dealing, they assist in understanding the implications of adopting a general fair trading requirement in relation to consumer contracting. Thirdly, if there is a risk that a fair trading duty adopted for consumer contracts might spread to commercial contracts, we should be aware of whether this would be a positive, negative, or neutral development in the law—after all, the eminent comparative jurist, Hein Kötz, has suggested that the adoption of a good faith standard in English contract law would probably do little good, but neither would it do much (if any) harm.<sup>1</sup>

4.4 Our discussion in this Section is in five principal parts. In part II, we rehearse the leading arguments against good faith; in part III, we sketch the position of neutrals; and in part IV, we set out the leading arguments in favour of the adoption of good faith. In part V, we seek to bring these arguments more clearly into focus by engaging them with three competing models of good faith; and, finally, in part VI, we extend this discussion by indicating, briefly, how good faith might be modelled in consumer contracts in a single European marketplace.

4.5 Broadly speaking, our conclusion is that the adoption of a general principle of good faith, similarly the adoption of a general requirement of fair trading, would

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<sup>1</sup> Hein Kötz, “Towards a European Civil Code: The Duty of Good Faith” in Peter Cane and Jane Stapleton (eds.) *The Law of Obligations: Essays in Celebration of John Fleming* (Oxford, Clarendon Press, 1998) 243.

nudge English law closer to a co-operative approach; that, so far as consumers are concerned, this should assist in creating the culture of confidence that is required for full participation in the single market; and that, provided judges took their lead from the standards of fair dealing supported by the single market community, this would facilitate flexible adjudication without being a recipe for chaos and confusion.

## II. The Arguments against Good Faith

4.6 The arguments against adopting a general principle of good faith are well-rehearsed. At least five negative themes are recurrent.<sup>2</sup>

4.7 First, it is objected that a doctrine of good faith, by requiring the parties to take into account the legitimate interests or expectations of one another, cuts against the essentially individualist ethic of English contract law. As Lord Ackner asserted in *Walford v Miles*,<sup>3</sup> the adoption of a requirement of good faith would be incompatible with the adversarial ethic underpinning English contract law. Thus:

[T]he concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations...A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party.<sup>4</sup>

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<sup>2</sup> Cf. e.g., Roger Brownsword, “Positive, Negative, Neutral: the Reception of Good Faith in English Contract Law” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 13, where the five themes in the text are considered. In Reziya Harrison, *Good Faith in Sales* (London, Sweet and Maxwell, 1997) 685-687, four objections are considered: (i) that good faith is a European invention, now glossed with EU bureaucratic thinking; (ii) that regulation of fair dealing is for Parliament rather than the Courts; (iii) that good faith would involve the death of contract as we know it; and (iv) that good faith would make it difficult for commercial people to know where they stand.

<sup>3</sup> [1992] AC 128.

<sup>4</sup> *Ibid.*, at 138. For similar assertion of the adversarial view, see eg, Slade LJ in *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1989] 2 All ER 952, 1013; and May LJ in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd: The Good Luck* [1989] 3 All ER 628, 667.

If contract is narrowly concerned with self-interested dealing, then a doctrine of good faith is a hostage to fortune, encouraging judicial conscience to ameliorate the outcomes of hard-headed commercial dealing.<sup>5</sup>

4.8 Secondly, echoing a point commonly encountered in sceptical North American commentaries, it is said that good faith is a loose cannon in commercial contracts.<sup>6</sup> Whilst everyone agrees that a doctrine of good faith represents some set of restrictions on the pursuit of self-interest, the objection is that it is not clear how far these restrictions go. In other words, good faith presupposes a set of moral standards against which contractors are to be judged, but it is not clear whose (or which) morality this is. Without a clear moral reference point, there is endless uncertainty about a number of critical questions—for example, about whether good faith requires only a clear conscience (subjective good faith) or whether it imports a standard of fair dealing independent of personal conscience (objective good faith);<sup>7</sup> whether good faith applies to all phases of contracting, including pre-contractual conduct; whether good faith regulates only conduct (namely, how the parties conduct themselves during the formation of the contract and, subsequently, how they purport to rely on the contractual terms for performance, termination, and enforcement) or also the content (substance) of contracts (in other words, whether good faith regulates matters of procedure and process or also matters of contractual substance);<sup>8</sup> whether a requirement of good faith adds anything to the regulation of bad faith (that is, whether

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<sup>5</sup> Similar reservations have been expressed in both Australian and Canadian courts. See, *Austotel Property Ltd v Franklins Selfserve Property Ltd* (1989) 16 NSWLR 582, 585 (Kirby P); and the dissenting opinion of Wallace JA in *Re Empress Towers Ltd and Bank of Nova Scotia* 73 DLR (4th) (1991) 400, 409-410.

<sup>6</sup> See eg, Michael G. Bridge, “Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?” (1984) 9 *Canadian Journal of Business Law* 385; Clayton P. Gillette, “Limitations on the Obligation of Good Faith” (1981) *Duke LJ* 619; Mark Snyderman, “What’s So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending” (1988) 55 *University of Chicago Law Review* 1335.

<sup>7</sup> Seminally, cf E. Allan Farnsworth, “Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code” (1962-3) 30 *University of Chicago Law Review* 666; and for reflections on the distinction between a subjective and an objective standard of good faith, see “The Concept of Good Faith in American Law” (Centro di Studi e Ricerche di Dritto Comparato e Straniere, Saggi, Conferenze E Seminari 3, Rome, April 1993).

<sup>8</sup> Cf e.g., South African Law Commission, *Unreasonable Stipulations in Contracts and the Rectification of Contracts* (Working Paper 54, Project 47, 1994), in which the concept of good faith is viewed as a doctrinal resource regulating unfair contract terms (although, subsequently, in Discussion Paper 65 (1996) the Commission substituted the standard of unconscionability for that of good faith). See Dale Hutchison, “Good Faith in the South African Law of Contract” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 213.

good faith simply comprises so many instances of bad faith);<sup>9</sup> whether good faith imposes both negative and positive requirements (covering, say, non-exploitation, non-opportunism, non-shirking as well as positive co-operation, support, and assistance); and so on.

4.9 Closely related to the second concern (which, essentially, is about an undesirable lack of calculability), there is a third concern, namely that a doctrine of good faith would call for difficult inquiries into contractors' states of mind. Often the literature on good faith emphasises that the question of whether a contractor has acted in good faith hinges on the contractor's reasons for action.<sup>10</sup> This is not to be confused with matters of subjective honesty, but it does involve speculating about a contractor's reasons. For example, in a case such as *Walford v Miles* (and, similarly, the *Regalian Properties* case<sup>11</sup>), where a party closes a deal with a third party or breaks off negotiations, how might a court decide whether this is because it suits their economic interests to do so or because they simply could not close the bargaining distance between themselves and the other party? Motives are sometimes mixed, such that unravelling a party's real reasons would involve a whole host of problems.<sup>12</sup>

4.10 Fourthly, if good faith regulates matters of substance in a broad sense (including the remedial regime) (which it seems to do once we view it as a kind of implied term for co-operation),<sup>13</sup> then this impinges on the autonomy of the contracting parties. Accordingly, even if the sceptics allow (if only for the sake of argument) that good faith may legitimately regulate the process of contracting, to ensure that agreement is genuine, they will argue that, once good faith trespasses on

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<sup>9</sup> As argued by Robert S. Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968) 54 *Virginia Law Review* 195.

<sup>10</sup> See eg, Steven J. Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith" (1980-81) 94 *Harvard Law Review* 369.

<sup>11</sup> *Regalian Properties plc v London Dockland Development Corpn* [1995] 1 All ER 1005; but cf *Sabemo Property Ltd v North Sydney Municipal Council* [1977] 2 NSWLR 880.

<sup>12</sup> Cf S.M. Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 JCL 55, esp. at 63-64. In addition to raising a query about the workability of a good faith-driven inquiry into motives, Waddams sees a potential perversity in such an approach. Thus, Waddams suggests that a party seeking to terminate for late payment "would presumably be advised to think very hard, while writing the crucial letter [of termination], about the evils of unpunctuality, and to think not at all about the balance sheet disclosing the unprofitable nature of the contract" (at 63).

<sup>13</sup> Seminally, see E. Allan Farnsworth, "Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code" (1962-3) 30 *University of Chicago Law Review* 666; and see, too, J.F. Burrows, "Contractual Co-operation and the Implied Term" (1968) 31 MLR 390.

substance, it restricts the autonomy of the parties and it is inconsistent with the fundamental philosophy of freedom of contract, with the idea that contract law should set a calculable framework for self-regulation by the parties.

If we combine the thought that good faith imports an uncertain discretion with the thought that good faith challenges the autonomy of contracting parties, we have powerful reasons to be sceptical about the wisdom of adopting such a doctrine. Thus, in the Privy Council decision in *Union Eagle Ltd v Golden Achievement Ltd*,<sup>14</sup> we see these ideas combining to resist the “beguiling heresy” that the court has an unfettered discretion to relieve against the express terms of a contract where enforcement would be “unconscionable” (for present purposes, instead of “unconscionable”, read “contrary to good faith”).<sup>15</sup> In the *Union Eagle* case, the contract was for the purchase of a flat on Hong Kong Island. In accordance with the contract, the purchaser paid a 10% deposit to the vendor’s solicitors as stakeholders, and completion was to take place on or before 5.00 pm on September 30, 1991. Clause 12 of the contract provided that, if the purchaser failed to comply with any of the terms of the agreement, then the deposit was to be forfeited and the vendor had the option of rescinding the agreement. The purchaser was ten minutes late in completing on the due date, whereupon the vendor declared that the deposit was forfeited and the contract rescinded. A number of points were taken by the purchaser but the main question was whether the court should invoke its equitable jurisdiction to relieve against this allegedly unconscionable outcome. Lord Hoffmann, speaking for the court, explained why the strict terms of the contract should be adhered to:

The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the courts have rejected such generalisations are founded not merely upon authority...but also upon practical considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be “unconscionable” is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic. The realities of commercial life are that this may cause injustice which cannot be fully compensated by the ultimate decision in the case.<sup>16</sup>

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<sup>14</sup> [1997] 2 All ER 215.

<sup>15</sup> For support for the “beguiling heresy”, see *Shiloh Spinners Ltd v Harding* [1973] AC 691, 726 (Lord Simon); for its rejection, see *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana, The Scaptrade* [1983] 2 AC 694, 700. For reflections on the tendency to reject, see P.S. Atiyah, *Essays on Contract* (Oxford, Clarendon Press, 1988) 370-372.

<sup>16</sup> [1997] 2 All ER 215, 218-219.

Having expressed these general considerations, Lord Hoffmann then qualified his remarks by conceding that “the same need for certainty is not present in all transactions and the difficult cases have involved attempts to define the jurisdiction in a way which will enable justice to be done in appropriate cases without destabilising normal commercial relationships.”<sup>17</sup> However, this was not such a special case. In *Union Eagle*, there were no complicating features, such as the purchaser incurring an excessive penalty for a trivial breach, or of the vendor being unjustly enriched, or of the vendor having misled the purchaser.<sup>18</sup> The simple fact was that the purchaser was late in completing; to build an argument on the basis that the purchaser was only “slightly late” would be to encourage litigation about “how late is too late”;<sup>19</sup> and, as the plight of the vendor in the present case illustrated all too clearly, litigation can sterilise the property leaving the owner uncertain for a period of years whether or not he is entitled to resell. Accordingly, the Privy Council determined that, in cases of this kind, far from indulging the purchaser’s trivial breach, it was appropriate to restate quite firmly that equity would not intervene.

4.11 The final thread in the sceptical negative view is that a general doctrine of good faith goes wrong in failing to recognise that contracting contexts are not all alike. If contract law is to be sensitive to context, it cannot be right to apply a doctrine of good faith irrespective of context. As Michael Bridge has said:

It is a fair reproach to English contract law that it unthinkingly treats the rules and principles of commodity sales, time and voyage charterparties and so on as though they could be applied without modification in very different contractual settings. Good faith theorists should avoid making the same sort of mistake. In my view, what is needed is an informed treatment of different areas of commercial contract and market activity.<sup>20</sup>

Bridge goes on to argue that it would be wholly inappropriate to introduce a doctrine of good faith into the commodities markets, where dealing is intrinsically competitive and where opportunistic behaviour is to be expected. This is not to say that, even in

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<sup>17</sup> Ibid., at 219.

<sup>18</sup> Complications of this kind troubled the Australian courts in *Legione v Hateley* (1983) 152 CLR 406, and *Stern v McArthur* (1988) 165 CLR 489.

<sup>19</sup> [1997] 2 All ER 215, 222.

<sup>20</sup> Michael Bridge, “Good Faith in Commercial Contracts” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 139, 147.

the commodities markets, good faith is totally rejected. However, insofar as notions of good faith are accepted, they are taken up in the standard terms of the trade and this, Bridge argues, is the way that the market best deals with new questions of fair dealing.

4.12 To sum up, the case against the adoption of a general principle of good faith is that English contract law is premised on adversarial self-interested dealing (rather than other-regarding good faith dealing); that good faith is a vague idea, threatening to import an uncertain discretion into English law; that the implementation of a good faith doctrine would call for difficult inquiries into contracting parties' reasons in particular cases; that good faith represents a challenge to the autonomy of contracting parties; and, that a general doctrine cannot be appropriate when contracting contexts vary so much—in particular, harking back to the first objection, a general doctrine of good faith would make little sense in those contracting contexts in which the participants regulate their dealings in a way that openly tolerates opportunism.

### III Neutrality and scepticism

4.13 As we have seen, in the *Interfoto* case, Sir Thomas Bingham, having noted that many legal systems employ a doctrine of good faith to regulate fair dealing in contract, observed that English law has arrived at much the same position by developing “piecemeal solutions in response to demonstrated problems of unfairness.”<sup>21</sup> Such remarks might be read as encouraging a pragmatic neutrality towards good faith.<sup>22</sup> According to this view, whilst there is nothing intrinsically objectionable about a good faith doctrine, English law has its own doctrinal tools for achieving the results that are achieved via a good faith doctrine in other jurisdictions.<sup>23</sup> Moreover, Sir Thomas's relatively sanguine assessment seems to be vindicated by both the approach and the outcome of *Interfoto* where, in the context of a commercial contract, the English doctrine of “reasonable notice” was manipulated to disallow a standard term that had not been adequately disclosed—up to a point at least, English piecemeal solutions seem to be as effective as single principle good faith solutions.

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<sup>21</sup> [1989] QB 433, at p. 439.

<sup>22</sup> Cf. Roger Brownsword, “Two Concepts of Good Faith” (1994) 7 JCL 197.

<sup>23</sup> The English doctrine of frustration is a standard example in this context. Cf Werner F. Ebka and Bettina M Steinhauer, “The Doctrine of Good Faith in German Contract Law”, in Jack Beatson and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (Oxford, Clarendon Press, 1995) 171, and Werner Lorenz, “Contract Modification as a Result of Change of Circumstances” *ibid*, 357. For evidence of convergent solutions, arrived at by a variety of doctrinal routes, see Reinhard Zimmermann and Simon Whittaker (eds), *Good Faith in European Contract Law* (Cambridge: Cambridge University Press, 2000).

4.14 The paradigm of neutrality holds: (i) that there is a strict equivalence between a general doctrine of good faith and the piecemeal provisions of English law that regulate fair dealing (we can call this “the equivalence thesis”); and (ii) that it makes no difference whether English law operates with a general doctrine or with piecemeal provisions (we can call this “the indifference thesis”). Once we differentiate between the equivalence and the indifference theses, and once we distinguish between holding these theses in the abstract as against in the context of a going legal system, it becomes apparent that the neutral view has a strong bias to slide towards the negative view.

One way in which this bias will reveal itself is if we imagine a neutral, who accepts both the equivalence and the indifference theses *in the abstract*, but who is now asked whether it would be sensible to replace the English piecemeal approach with a general doctrine of good faith. Clearly, since (*ex hypothesi*) nothing is to be gained by replacing one approach with the other, the neutral must take a negative view on this practical question (unless, for some bizarre reason, incurring transaction costs is judged to be a good thing).

Suppose, though, the proposal is not to replace the English piecemeal approach with a general doctrine of good faith, but to supplement the former with the latter so that they would exist alongside one another in English law. What would the neutral say to this? Again, the neutral would have good reason to take the negative view. If, as the neutral believes, there is a strict equivalence between the piecemeal approach (involving such specific doctrines as economic duress, promissory estoppel, misrepresentation, mistake, frustration, and the like) and a general doctrine of good faith, it seems a needless duplication to supplement the former with the latter. Worse, the neutral might fear that specific doctrines, with well-defined functions, are liable to become clouded once a general background standard is in play, for lawyers might be uncertain not only about whether they should found themselves on the traditional doctrines or the new general standard<sup>24</sup> but also about where the boundaries of the traditional doctrines now lie.<sup>25</sup>

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<sup>24</sup> Cf Nili Cohen, “Good Faith in Bargaining and Principles of Contract Law” (1989) 9 *Tel Aviv University Studies in Law* 249.

<sup>25</sup> Similar difficulties might be experienced in a legal system where a broad doctrine of unconscionability pre-dates the adoption of a doctrine of good faith. See, e.g., the extended analysis of good faith in Gummow J’s judgment in *Service Station Association v Berg Bennett* (1993) 117 ALR 393, 401-407. In this case, the applicants pleaded *inter alia* that that it was an implied term of the parties’ agreement that “the respondent was obliged to act in good faith toward the applicant.” Gummow J rejected this ground of the application, being unwilling to take what was seen as “a major step” (407), requiring “a leap of faith” (406), when this was not required by authority. Significantly, though, the applicants’ pleadings relied, too, on section 52A of the Trade Practices Act 1974, which deals with unconscionable conduct. For some reflections on the relationship between good faith and unconscionability where the doctrines are assumed *not* to be equivalent, see S.M. Waddams, “Good Faith, Unconscionability and Reasonable Expectations” (1995) 9 JCL 55, esp. at 60-61.

4.15 Thus far, we have assumed, so to speak, a fully committed neutral (holding both the equivalence and the indifference theses in the abstract). Consider, now, the case of a half-committed neutral. Perhaps the clearest example of such a view is that of the neutral who holds to the equivalence thesis but who rejects the indifference thesis by contending that specific rules are to be preferred to general exhortations to act in good faith.<sup>26</sup> On this view, the piecemeal provisions of English law, provided that they are sufficiently clear and precise, are to be preferred to an open-ended good faith provision (even if the outcomes, when litigated, would be convergent). Whether we ask such a neutral about the wisdom of adopting a general principle of good faith either in the abstract or in the context of a going legal system, a negative view will be taken.<sup>27</sup>

4.16 In principle, then, the ostensibly neutral view covers a number of possible positions. In practice, however, where the adoption of good faith is being considered in the context of a legal system that already has a variety of resources for dealing with unfairness in contract, neutrality will lean towards the negative view. It follows that English neutrals, even those who fully accept the equivalence and indifference theses, will tend to oppose the incorporation of a general doctrine of good faith.

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<sup>26</sup> Cf S.M. Waddams, "Pre-Contractual Duties of Disclosure" in Peter Cane and Jane Stapleton (eds.) *Essays for Patrick Atiyah* (Oxford, Clarendon Press, 1991) 237, at 253-4. Waddams suggests that, whilst there are, at first sight, attractions in embracing broad concepts such as good faith and fair dealing, this does not always produce expected results. Experience indicates that:

What is needed is a set of rules sufficiently in conformity with the community sense of morality not to produce results perceived as outrageous, while at the same time preserving sufficient content to be workable and reasonably inexpensive of regular application, and maintaining a fair degree of security of property transfers.

In the light of this, Waddams concludes that, rather than espousing a general good faith doctrine, a "more effective way of producing honest behaviour is likely to be the adoption of specific rules that, in particular contexts, make honesty the best policy." Taking this view, English pragmatism would seem a sound approach. But cf. Thomas Wilhelmsson, "Good Faith and the Duty of Disclosure in Commercial Contracting" in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 165.

<sup>27</sup> If the half-committed neutral favours tailored rules rather than general principles, such a neutral also favours the use of familiar rather than unfamiliar language (even if the languages are equivalent). We can detect such reasoning in the way in which the general test of unfairness in the EC Directive on Unfair Terms in Consumer Contracts was first negotiated at EU level and then "translated" into English law. See further M. Tenreiro, "The Community Directive on Unfair Terms and National Legal Systems" (1995) 3 *European Review of Private Law* 273; and Roger Brownsword, Geraint Howells, and Thomas Wilhelmsson, "Between Market and Welfare: Some Reflections on Article 3 of the EC Directive on Unfair Terms in Consumer Contracts" in Chris Willett (ed), *Aspects of Fairness in Contract* (London, Blackstone, 1996) 25, 47-48.

#### IV The Arguments in Favour of Good Faith

4.17 In his seminal paper, Raphael Powell argued that the adoption of a good faith doctrine would be beneficial in that it would enable the English courts to avoid having “to resort to contortions or subterfuges in order to give effect to their sense of the justice of the case.”<sup>28</sup> Moreover, citing *L’Estrange v Graucob Ltd*<sup>29</sup> and implicitly rejecting a neutral view, Powell argued that a good faith doctrine would sometimes be a more powerful and effective resource than the favoured English tools for dealing with perceived unfairness. Until quite recently, support for such a positive view was definitely confined to a minority of English contract lawyers.<sup>30</sup> However, there are indications of growing support amongst academic lawyers<sup>31</sup> and at least four arguments can be advanced in favour of good faith as follows.

4.18 First, to the extent that English law already tries to regulate bad faith dealing, it may be argued that it would be more rational to address the problem directly (rather than indirectly) and openly (rather than covertly) by adopting a general principle of good faith. This is Powell’s first line of argument and it is a familiar theme in the North American literature advocating adoption of good faith. Robert Summers, for example, maintains that

[without a principle of good faith, a judge] might, in a particular case, be unable to do justice at all, or he might be able to do it only at the cost of fictionalizing existing legal concepts and rules, thereby snarling up the law for future cases. In begetting snarl, fiction may introduce inequity, unclarity or

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<sup>28</sup> Raphael Powell, “Good Faith in Contracts” (1956) 9 *Current Legal Problems* 16, 26.

<sup>29</sup> [1934] 2 KB 394.

<sup>30</sup> But cf The Hon Johan Steyn, “The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?” [1991] *Denning LJ* 131; Hugh Collins, “Good Faith in European Contract Law” (1994) *OJLS* 229, and *The Law of Contract* 3rd ed (London, Butterworths, 1997) passim; John N. Adams and Roger Brownsword, *Key Issues in Contract* (London, Butterworths, 1995), Ch. 7; and Roger Brownsword, “‘Good Faith in Contracts’ Revisited” (1996) 49 *Current Legal Problems* 111.

<sup>31</sup> See, e.g., a number of the contributions to Angelo Forte (ed), *Good Faith in Contract and Property Law* (Oxford: Hart, 1999), especially Ewan McKendrick, “Good Faith: A Matter of Principle?” *ibid.*, at 39.

unpredictability. In addition, fiction can divert analytical focus or even cast aspersions on an innocent party.<sup>32</sup>

Powell's example of "snarl" (as Summers calls it) in the law happens to be in the field of implied terms.<sup>33</sup> However, it could equally well have been in some other area of contract law—abusive (or opportunistic) termination, for example, is another fertile area.<sup>34</sup> Whatever the example, the point is the same: that the law should be transparent and that a doctrine of good faith assists the law to achieve this ideal.

4.19 Secondly, in the absence of a doctrine of good faith, it may be argued—as Powell contended in relation to English law, and as Summers says (above) with reference to US law—that the law of contract is ill-equipped to achieve fair results, on occasion leaving judges "unable to do justice at all." This particular argument in favour of good faith can be developed in several ways. For example, if we imagine good faith as an umbrella principle,<sup>35</sup> covering, unifying, and filling the gaps between a range of specific doctrines designed to secure fair dealing, then in hard cases (of the kind that supposedly make bad law) judges could appeal to the umbrella principle to justify a one-off decision, or to adumbrate some new principle of fairness, or to extend the range of an already recognised principle (for example, extending the range of equitable estoppel into pre-contractual dealings, or extending the principle of duress to some forms of economic pressure, and so on). So equipped, judges in the *appeal courts*, would have no need *covertly* to stretch and manipulate existing resources; and they would have no excuse for handing down patently unfair decisions. Moreover, in the *trial courts*, judges who might otherwise bow to the pressure of precedent, would have the opportunity to avoid declaring that hard cases simply yield hard decisions. With good faith openly adopted as a foundational doctrine, there

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<sup>32</sup> Robert S. Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968) 54 *Virginia Law Review* 195, 198-199. To similar effect, see eg, Charles L. Knapp, "Enforcing the Contract to Bargain" (1969) 44 *New York University Law Review*, 673, 727; Robert S. Summers, "The General Duty of Good Faith—Its Recognition and Conceptualization" (1982) 67 *Cornell Law Review* 810, 812; and (in Australia) Priestley J.A. in *Renard Constructions (ME) Property Ltd. v. Minister for Public Works* (1992) 26 NSWLR 234, 266.

<sup>33</sup> The case in point is *Ingham v Emes* [1955] 2 All ER 740. For discussion, see Roger Brownsword, "'Good Faith in Contracts' Revisited" (1996) 49 *Current Legal Problems* 111, 116-117.

<sup>34</sup> Cf Roger Brownsword, "Retrieving Reasons, Retrieving Rationality? A New Look at the Right to Withdraw for Breach of Contract" (1992) 5 JCL 83.

<sup>35</sup> Cf Dale Hutchison, "Good Faith in South African Contract Law", in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 213.

would be no need for *sub rosa* adjudication; and both trial judges and appeal courts would have the legal support that they require.

4.20 Thirdly, turning on its head one of the negative arguments against a general principle of good faith, it might be argued that, with such a principle, the courts are better equipped to respond to the varying expectations encountered in the many different contracting contexts—and, in particular, it might be argued that the courts are better able to detect co-operative dealing where it is taking place.<sup>36</sup> Thus, the argument runs, if English contract law adopted a doctrine of good faith, it would pose questions of contractual interpretation and implication in a context, not only of background standards of fair dealing, but more immediately of the concrete expectations of the parties. Such concrete expectations would be based as much on the way that the parties related to one another (whether they dealt with one another in an adversarial or non-adversarial manner) as on the express provisions of the agreement. As a result, English law would recover the ability to give effect to the spirit of the deal in a way that prioritised the parties' own expectations.<sup>37</sup>

This third argument in favour of good faith might be put more directly in terms of the protection of reasonable expectation. Indeed, Lord Steyn has recently couched the argument in precisely this way, taking as his starting point the idea that the principal task for the modern law of contract is to protect the contractors' reasonable expectations.<sup>38</sup> Having outlined the revisionist nature of such a general principle in relation to questions of formation, privity, and the like, Lord Steyn turns to criticise the narrow approach in *Walford v Miles*, claiming that a good faith principle is perfectly practical and workable. However, he continues:

I have no heroic suggestion for the introduction of a general duty of good faith in our contract law. It is not necessary. As long as our courts always respect the reasonable expectations of parties our contract law can satisfactorily be left to develop in accordance with its own pragmatic traditions. And where in specific contexts duties of good faith are imposed on parties our legal system

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<sup>36</sup> Cf Roger Brownsword, "Contract Law, Co-operation, and Good Faith: the Movement from Static to Dynamic Market-Individualism" in Simon Deakin and Jonathan Michie (eds.) *Contracts, Co-operation and Competition: Inter-Disciplinary Perspectives*, (Oxford, Oxford University Press, 1997) 255; and, generally, see the critique of the inflexible doctrines of classical contract law in Nagla Nassar, *Sanctity of Contracts Revisited* (Dordrecht, Martinus Nijhoff, 1995).

<sup>37</sup> See, e.g., the approach of the courts in cases such as *Philips Electronique Grand Public SA v. British Sky Broadcasting Ltd.*; *Philips International BV v. British Satellite Broadcasting Ltd* [1995] EMLR 472 and *Timeload Ltd v British Telecommunications plc* [1995] EMLR 459. But cf *Total Gas Marketing Ltd v Arco British Ltd* [1998] 2 Lloyd's Rep 209.

<sup>38</sup> Johan Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 *Law Quarterly Review* 433.

can readily accommodate such a well tried notion. After all, there is not a world of difference between the objective requirement of good faith and the reasonable expectations of parties.<sup>39</sup>

Although this might be mistaken for the neutral view, it is in fact a quite different position. Lord Steyn's (implicit) premise is that there is no equivalence between the traditional piecemeal approach of English law and a general requirement of good faith. Having rejected the equivalence thesis, his argument is that we should adopt what is in effect a general duty of good faith but that this can be cast in the more familiar form of a general principle that the reasonable expectations of the parties should be respected (and, to this extent, we can be indifferent about our doctrinal terminology, that is, about matters of doctrinal expression).<sup>40</sup> In other words, an overriding principle of reasonable expectation serves the same purpose as a general principle of good faith. The language might be different but the idea is the same.<sup>41</sup>

4.21 Finally, it is arguable that the beneficial effects of a good faith doctrine go beyond (reactive) dispute-settlement, for a good faith contractual environment has the potential to give contracting parties greater security and, thus, greater flexibility about the ways in which they are prepared to do business. In a society without any kind of contract law dealing will tend to be very defensive—present (and simultaneous) exchange will be the order of the day, credit being extended only to those who are already known and trusted. Whilst English law goes some way towards meeting the concerns of defensive contractors and, to some extent, liberates practice, it falls short of what is required if the potential synergies of co-operation are to be fully exploited.

Now, the general difficulty facing parties who contract for future performance is that they cannot be sure (i) how market conditions will change (in particular, whether market prices will rise or fall) and (ii) how the other party will act. In relation to the

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<sup>39</sup> Ibid., at p. 439.

<sup>40</sup> See Section Two above.

<sup>41</sup> But cf. S. M. Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 JCL 55, 58-59 for the view that, although "[g]ood faith, unconscionability and reasonable expectations are concepts that sound somewhat similar...good faith is related in very different ways to each of the other two concepts mentioned." Put simply, Waddams' critique of good faith involves (i) contrasting subjective good faith with objective reasonable expectation (such that good faith sometimes seems to detract from fairness) and (ii) comparing objective good faith with objective reasonable expectation (such that good faith seems to add nothing to existing standards of fairness). Thus, speaking of the *Interfoto* case, Waddams says: "If the court recognises that reasonable notice of the clause must be given, and that the clause must be fair and reasonable, a principle of good faith is not needed, and to rest the result on good faith might suggest the additional need for the defendant to establish misconduct or bad motive on the plaintiff's part" (at 61).

latter difficulty, the most defensive assumption is to proceed on the basis that the other side will act in whatever way seems to advance its own immediate interests (that is, as a so-called “straightforward maximiser”).<sup>42</sup> Such a defensive assumption, however, sometimes obstructs our ability to optimise our own interests. Thus, in the standard example of the Prisoner’s Dilemma,<sup>43</sup> A assumes that B will act as a straightforward maximiser (and *vice versa*), as a result of which A and B each avoid the worst possible outcome but fail to achieve the best available outcome. Had A assumed that B would act co-operatively (and *vice versa*), A and B could have relied on one another so as to produce the best available (joint) outcome. Why, then, does A not make such an assumption? Quite simply, A will not make such an assumption unless he is confident that B is to be trusted or, failing this, A has security against the risk that will eventuate should B prove to be an opportunist.

The present argument for good faith is that the same considerations apply in contract. The more that contract doctrine provides a security against the risks of opportunism and exploitation to which co-operative dealing exposes a contractor, the more willing (other things being equal) contractors will be to deal in a way that optimises their interests (even though they are thereby exposed to risk). Thus, as good faith finds a place in the law, and as the contractual environment becomes more congenial to trust and risk-taking, it is possible that these reciprocal influences will work together to promote ever more co-operative thinking in both legal doctrine and contracting practice.

4.22 In sum, there are four strands in the positive view of good faith. A good faith doctrine allows problems of bad faith to be addressed in a clean and direct fashion; it enables judges at all levels to deal in a coherent and an effective manner with cases of unfair dealing; it can bring the law much more closely into alignment with the protection of reasonable expectations (which, it must be recognised, vary from one contracting situation to another); and it can contribute to a culture of trust and co-operation that enhances the autonomy of contractors and that, on a larger scale, is an important feature of successful economies.<sup>44</sup>

4.23 To these four strands, a fifth might be added. It is now commonly said that the adoption of a good faith principle would bring English contract law into line with other European legal regimes as well as with the provisions that are being drafted into model restatements of European contract law. For two reasons, this does not greatly

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<sup>42</sup> See David Gauthier, *Morals by Agreement* (Oxford, Clarendon Press, 1986).

<sup>43</sup> See e.g., David Gauthier, *Morals by Agreement* (Oxford, Clarendon Press, 1986) 79-82.

<sup>44</sup> See eg Alessandro Arrighetti, Reinhard Bachmann, and Simon Deakin, “Contract Law, Social Norms and Inter-Firm Cooperation” (1997) 21 *Cambridge Journal of Economics* 171; and Brendan Burchell and Frank Wilkinson, “Trust, Business Relationships and the Contractual Environment” (1997) 21 *Cambridge Journal of Economics* 217.

assist our understanding of the issues. First, in the present context, we are assuming that something akin to good faith, possibly in the guise of a fair trading principle, will be imported into English law—this is the premise on which this Report is written. Secondly, and more importantly, adopting the doctrinal expression, “good faith”, does not close the matter: as we have been at pains to emphasise, it is the substance that goes with the doctrinal expression that is crucial. In other words, we only really move into line with European regimes of contract law if we embrace their default values.

## V Three Models of Good Faith

4.24 What are we to make of the arguments for and against adopting a general doctrine of good faith? This rather depends on which model of good faith we have in mind; for, essentially, there are three such models, each of which needs to be made explicit before either the negative or the positive arguments can be evaluated. The first model, “a good faith requirement” as we can call it, simply acts on the standards of fair dealing that are already recognised in a particular contracting context. These standards may or may not yet have crystallised into express terms commonly used, but they nevertheless represent the informal expectations of those who deal in the particular market.<sup>45</sup> The second model, “a good faith regime” as we may term it,<sup>46</sup> acts on the standards of fair dealing that are dictated by a critical morality of mutuality and co-operation. Unlike the first model of good faith, this second model does not track recognised standards (although it may sometimes coincide with them) but, instead, tries to make the market in the sense of prescribing the co-operative ground rules. The third model of good faith is what Michael Bridge evocatively calls “visceral justice”.<sup>47</sup> Here, judges react impressionistically to the merits of a situation

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<sup>45</sup> Cf section 205 of the *Restatement (2d) of Contracts*, which provides for a requirement of good faith in the performance and enforcement of contracts. The linking of the good faith requirement to commercial expectations is made clear by the Official Comment to the Restatement. Thus:

The phrase “good faith” is used in a variety of contexts and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving “bad faith” because they violate community standards of decency, fairness or reasonableness.

See, too, Nagla Nassar, *Sanctity of Contracts Revisited* (Dordrecht, Martinus Nijhoff, 1995) e.g., at pp. 167-168, and 239-242.

<sup>46</sup> Cf Nili Cohen, “Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate” in Jack Beatson and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (Oxford, Clarendon Press, 1995) 25.

<sup>47</sup> Michael Bridge, “Good Faith in Commercial Contracts” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 139.

and dispose of cases accordingly—all in the name of good faith. Unlike either the first or the second models of good faith, this third model is judicial licence.

4.25 On the face of it, judicial licence has little to recommend it; thus, the third model of good faith does not merit serious consideration. It follows that the only plausible choices are between the status quo and the first or second models of good faith. In this light we can reconsider the sceptical arguments, not with a view to cashing the positive case, but simply to observe where such arguments register against the adoption of a good faith requirement or a good faith regime.

4.26 To adopt a *good faith requirement* would be to make a relatively modest adjustment to the status quo. When, in a particular contracting context, the participants have a shared understanding of where the line is drawn between fair and unfair dealing—and, concomitantly, shared expectations about the conduct of fellow contractors—then the law simply adopts this shared view of fair dealing. On occasion, this might involve moving ahead of the standard form terms currently in circulation, but it would scarcely be vanguard law-making. Rather, a court operating with a good faith requirement would aspire simply to follow the shared sense of good faith in the particular contractual setting. Certainly, there would be no question, on this view, of good faith being employed to override clear expectations (such as those perhaps to be found in the Hong Kong property market that provided the background in the *Union Eagle* case); nor would good faith be employed to thicken up the relatively thin sense of fair dealing that one would expect to find in highly competitive contracting contexts.<sup>48</sup>

What, though, would a good faith requirement signify (a) where a particular transaction does not readily fit within an identifiable context or (b) where there is an identifiable context, but there is no shared understanding of fair dealing? In cases of this kind, the law must do its best to construct the backcloth of expectation against which the parties dealt; for, it cannot be emphasised too strongly, that a good faith requirement is dedicated to articulating and respecting the parties' expectations.

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<sup>48</sup> Article 1.106(2) of the Lando Commission's *Principles of European Contract Law* provides that the duty to act in accordance with good faith and fair dealing (in Article 106.1(1)) may not be excluded or limited. Given that the intention of the Commission seems to be to prescribe a good faith requirement, how far does this constrain the parties? If the parties can draw the line between fair and unfair dealing as they wish, good faith is entirely self-regulating—the only restriction is that the parties cannot stipulate that they are not bound by their own standards of fair dealing (whatever those standards are). If, however, the standards of the relevant business community apply, then although the non-excludable duty remains context-sensitive—so that, in some contexts, only a relatively thin regime of fair dealing might be recognised—there might now be a constraint on the parties' freedom to set lower standards of good faith. This depends upon whether the relevant standards of fair dealing allow for the parties to set their own (lower) standards. If they do, the parties remain free to self-regulate (in accordance with the non-excludable background regime); if they do not, the parties are constrained.

Where that backcloth involves a serious conflict of opinion about the requirements of fair dealing, the law must follow the “better” view.<sup>49</sup> Where there is a dominant view, there might well be a presumption in favour of protecting expectations that are reasonable relative to that view; where there is no such view, the law cannot avoid making an invidious choice and tie-breaking rules need to be agreed. This, however, hardly justifies condemning a good faith requirement out of hand.

4.27 The adoption of a *good faith regime* would be an altogether more ambitious, and controversial, move, inviting two lines of objection. First, if the regime is simply presented as one in which the parties should act with good faith towards one another,<sup>50</sup> or should act in a way that evinces loyalty or respect for the legitimate interests of one another, the application of such an idea is likely to be unpredictable—at any rate, this is liable to be so in the absence of a developed background jurisprudence of good faith. Accordingly, if a good faith regime is not to be condemned as too vague and uncertain, it needs to be prescribed in a way that offers contractors clear guidance as to its principal requirements. Secondly, because a good faith regime is not designed to track recognised standards of fair dealing, it invites the objection that it is liable to override the intentions of the contractors. For example, it might be objected that it would be absurd to prescribe a good faith regime for a market as ruthlessly competitive as that in financial derivatives. Insofar as the good faith regime is simply a default position, which contractors can agree to displace (as, say, in commodities and derivatives markets), the objection falls away—and this is largely the response to the problem. However, this assumes that a good faith regime is adopted as a facilitative measure when, to some extent, we might wish to adopt such a regime as a protective measure for the benefit of contractors who might otherwise be exploited. To bite this bullet, we certainly need to say that the good faith regime can only be displaced where there is compelling evidence of mutual agreement; and we might need to go a step further in some contracting contexts, saying that there can be no derogation from good faith.<sup>51</sup>

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<sup>49</sup> Cf. Thomas Wilhelmsson, “Good Faith and the Duty of Disclosure in Commercial Contracting” in Roger Brownsword, Norma J. Hird, and Geraint Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 165, for the distinction between a private autonomy model of good faith and the Nordic moral model of good faith. The former relates closely to a good faith requirement; the latter is closer to a good faith regime. In the former model, the “better” view (as explained in the text hereto) reflects what is accepted and recognised in business practice. In the latter, however, at least in the Nordic model, good faith operates as a pressure to improve standards of fair dealing and, insofar as it taps into recognised standards, the “better” view is the better view relative to the decision-maker’s critical moral perspective.

<sup>50</sup> Eg, as in the Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053).

<sup>51</sup> Again, as eg, in the Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053), in which Regulation 5 provides that the parties may not derogate from the good faith principles in Regulations 3 and 4. And, cf the analysis in Gunther Teubner, “Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences” (1998) 61 MLR 11.

4.28 If it is accepted that good faith as visceral justice is not an option, then where do the sceptical arguments hit home at the real targets? In the case of a *good faith requirement*, it has to be conceded that there might be some uncertainty (where the parties' expectations themselves are unclear, or where the case falls outside any recognised context); and, at various levels, there might be some difficulties of application. For example, there might be problematic inquiries into a party's reasons or motives where the recognised standards of fair dealing make such matters material. The scale of this problem should not be exaggerated, however. If there is a difficulty, it arises only where the setting in which the parties have contracted makes reasons and motives relevant factors—and, with a good faith requirement, such a setting is largely the product of the parties' own custom and practice.<sup>52</sup> As for the (negative) arguments that good faith represents a challenge to the autonomy of the parties and that it does not allow for the heterogeneity of contracting contexts, these objections simply fall wide of the mark. Indeed, the positive view can turn these arguments round to claim that a good faith requirement is designed precisely to respect the autonomy of contractors—good faith, far from being a licence for visceral justice is a necessity if the contractual project is not to be eviscerated<sup>53</sup>—and to do so in a way that is sensitive to the variations found in contracting contexts. In the case of a *good faith regime*, so long as this is simply the default position in contract law, there is no challenge to the parties' autonomy, and there is some allowance for variation from one contracting situation to another. However, under-prescription of such a regime will expose it to the charge of uncertainty; and, if the regime is one from which the parties are not permitted to contract-out, then the negative view strikes home unless the concept of autonomy is given a radical re-interpretation.

Finally, although both a good faith requirement and a good faith regime are less vulnerable to the negative view than that of good faith as visceral justice, does either have any response to the argument that English law should never be guided by anything but an adversarial ethic? The short answer is that this opening gambit on the part of the negative view is less an argument than a declaration of faith. However, if an answer is needed, supporters of good faith can point to the failure of the adversarial view to measure up to the expectations of contractors in non-adversarial contexts, as well as to the body of recent writing that holds that adversarial relations in contract are sometimes inimical to our individual and collective economic well-being.<sup>54</sup>

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<sup>52</sup> To this extent, there is no reason to take issue with Stephen Waddams' remark that few business people would "be inclined to favour a rule that the right to reject should depend on the actual motives of the buyer, a rule that would involve costly enquiries and create incentives to assemble unreliable and self-serving evidence of good motive": see "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 JCL 55, 64.

<sup>53</sup> Cf Nagla Nassar, *Sanctity of Contracts Revisited* (Dordrecht, Martinus Nijhoff, 1995) 241-242.

<sup>54</sup> Generally, see Simon Deakin and Jonathan Michie (eds.) *Contracts, Co-operation and Competition: Inter-Disciplinary Perspectives*, (Oxford, Oxford University Press, 1997).

## VI Modelling Good Faith in European Consumer Contracts

4.29 How are our foregoing remarks to be focused specifically on good faith in *consumer* contracts in Europe? In some ways, the practice of consumer contracting is even more oppositional than the classical model of adversarial business contracting. There is reason to suppose that, in both business and consumer contracting, where there is repeat-dealing and a course of trading, a more co-operative and trusting relationship is likely to develop. However, in a pan European single-market, consumers will enter into many one-shot transactions—these may be price-sensitive consumers who will cross borders aggressively to seek out the best deal, or they may be consumers who routinely cross borders and enter into one-off contracts (for example, as motorists do at petrol-filling stations). Where this is the case, a legal requirement upon business contractors to treat consumers in a co-operative spirit is imposed rather than spontaneously developed within a particular trading community. Should we, then, conceive of a general duty to trade fairly with consumers in the single market as akin to the model of a good faith requirement or as more like a good faith regime?

4.30 A general duty of good faith (or fair trading), understood as a good faith requirement, works best in a setting of genuine community where contractors share the same standards of fair dealing. These standards are integrated into the formal rule framework for the making, performance, and enforcement of contracts. The single market in Europe falls a long way short of this ideal-type. Each member state has its own formal rule framework for the making, performance, and enforcement of contracts; and there is some variation in the accepted standards of fair dealing. On the other hand, the considerable body of jurisprudence associated with the EC's programme of consumer protection is now a recognised ingredient in any attempt to synthesise fair dealing requirements within the member states.

4.31 The base that we are working from, therefore, has the following mix of formal and informal elements:

- A set of formal imposed standards of fair dealing, originating in the central EC institutions, and elaborated in their jurisprudence.
- EC standards of fair dealing as formally implemented in local law together with local jurisprudence.
- Local standards of fair dealing as formally expressed in national law.
- Informal standards of fair dealing accepted by local business communities.

- Informal expectations of fair dealing as understood by local consumers.

To bring these elements together under the rubric of a general duty of fair trading cannot be likened mechanically to the adoption of either a good faith requirement or a good faith regime. On the one hand, there are imposed co-operative standards (akin to a good faith regime); but, on the other hand, there is a patchwork of acceptance of co-operative requirements (akin, where there is a common understanding, to a good faith requirement). It follows that the construction and elaboration of a general duty of fair trading that pulls these elements together will need to be sensitive to both best European co-operative standards as well as local practice and expectation in the consumer marketplace.

4.32 Inevitably, there will be a degree of uncertainty about the scope and application of the ground rules of this constructed practice. However, if in doubt, the injunction must be to err on the co-operative side because (so the economic argument will run) the market needs confident consumers and consumers will not be confident without security. What will create real uncertainty is not adjudication that tries to unpack the logic of these constructed fair dealing standards but which, instead, when in doubt, reverts to classical principles of self-reliance.

## Summary

4.33 The limited incorporation of good faith in the English consumer law of contract has not been noticeably problematic. Certainly, judges seem perfectly happy about handling the idea and the work of the OFT, albeit largely a paper exercise, has not given rise to great anxiety or concern. Nevertheless, those who advocate that English law should adopt fair dealing principles of this kind must overcome the fundamental objection that this is liable to misfire until agreement is reached about whose (or which) standards are to serve as the reference point for such doctrines.<sup>55</sup>

4.34 In response to this objection, the principal options seem to be: (i) the standards of fair dealing recognised by the community of which the contractors are most proximately a part (as in a good faith requirement); and (ii) the standards of fair dealing and co-operation that would be prescribed by the best (i.e. most defensible) moral theory (as in a good faith regime). Neither option is compelling. Those who participate in consumer transactions in the single market do not form an ideal community for the purposes of a good faith requirement; and the jurisprudence of the EC, even if an expression of best European practice, is scarcely an essay in moral theory. If a general duty to trade fairly is adopted, and if it is to have real prospects of acceptance, then it must be operationalised in a way that is sensitive to both best European co-operative standards as well as local practice and expectation in the consumer marketplace

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<sup>55</sup> Cf the issues identified by Thomas Wilhelmsson, note 125 above.

4.35 If we view a general duty to trade fairly in this light, there is no reason to reject the idea out of hand. It introduces a dynamic element into the law coupled with a tendency towards co-operative standards. This might not be where English contract law started but it is in line with the direction in which our consumer law of contract has been moving for some considerable time. Indeed, the protection of consumers in English contract law now rests on a range of doctrines that give judges substantial discretion, so much so that one might wonder why we should be so agitated about the adoption of general principles such as good faith. We might, thus, wonder how it is that a modicum of calculability has been retained. How is it that consumers are protected by the law without certainty being altogether sacrificed? This is a question that we take up in the next Section.

## **SECTION FIVE**

### **FAIRNESS, DISCRETION AND CERTAINTY**

#### **I Introduction**

5.1 In English law, whereas procedural fairness (both the freedom and the informational side) is generally regulated by rules that are designed for relative certainty, the modern regulation of substantive fairness (including the proposed UCPD) employs more openly flexible standards. Since all legal regimes seek to balance certainty and flexibility, this invites two questions. First, how does English law introduce some flexibility into its procedural rules? Secondly, how does English law introduce some certainty into its more flexible standards concerning substantive fairness?

5.2 This section will address these questions by considering the tension between general standards (such as good faith or fair dealing) and the classical values of certainty, predictability and consistency which are the cornerstones of English contract law. We will consider to what extent fair dealing obligations, both in respect to procedural and substantive fairness, have sought to resolve this tension.

5.3 We will proceed in the following stages: in part II, we will examine the tension between general standards and the desire to maintain certainty. Part III then considers how English law has traditionally approaches matters of procedural fairness, in particular the question to what extent flexibility is inherent even in this approach. In part IV, we will consider how this is dealt with in the context of the Unfair Contract Terms Act 1977, and the Unfair Terms in Consumer Contracts Regulations 1999.

#### **II Flexibility vs Certainty**

5.4 We have already noted that English law is reluctant to adopt broad flexible standards, preferring instead to develop particular doctrines for specific situations, although in most cases, the ultimate result of applying these are not far removed from those that would obtain were a general standard of fair trading, or “good faith” applied. The dominant objection to accepting broad flexible standards is that these would be too vague and uncertain to assist those who are subject to these standards to organise their dealings in accordance with their requirements.

5.5 However, it is equally recognised that the law needs to avoid becoming too rigid in its rules. It must remain sufficiently flexible to respond to changing needs and situations. It is also recognised that it is impossible to have rules that will deal with every conceivable problem. So despite the law’s reluctance to adopt broad standards, it is recognised that a balance has to be struck between certainty and flexibility to accommodate different circumstances and the need to respond to new developments. The difficulty lies in achieving this balance.

5.6 The obvious advantage of broad flexible standards is that they can cover a vast array of different situations. By adopting a broad standard, whether on its own or in combination with more specific rules, the risk of creating loopholes is minimised. Another reason, and one that is as important, is that flexibility allows for doctrine to

be applied (or disapplied) in accordance with the perceived merits or justice of the particular case.

5.7 In a sense, the advantage of broad standards, i.e., their flexibility, is also a disadvantage. In particular, the ability to adapt to the circumstances of each particular case provokes concerns about certainty and excessive judicial power. Flexible standards become particularised through being applied by those who have been charged with their enforcement (often the courts, but increasingly public bodies such as the Office of Fair Trading). If no, or too little, guidance on the application of such flexible standards is provided, then there is a risk that those who are applying the standard will let their own views influence their decisions to such an extent that the original purpose of the standard is undermined:

“If discretionary powers are too open-ended there is always the risk that their use will be determined by the personal predilections of the adjudicator.”<sup>1</sup>

Goode’s argument is that boundaries for the application of flexible standards, or discretionary powers, need to be set in order to minimise the risk of unpredictability. This may be provided in the legislation itself, but failing that, the judicial response will almost invariably result in the setting of some boundaries:

“No sooner does Parliament confer on the court a new discretionary power, unlimited in terms, than the judges themselves proceed to cut it down by formulating criteria for its exercise.”<sup>2</sup>

There seems to be a desire to harness flexible and open-ended standards to ensure that their application becomes sufficiently predictable to provide certainty, although the courts are aware that some degree of flexibility needs to be retained.

5.8 A further disadvantage of broad flexible standards is that they are ill-suited for forward planning. Thus, a business faced with such a standard may have some idea as to what is and is not acceptable, but may be unsure about a particular activity. It may be argued that the application of such standards by the courts will, in time, provide more comprehensive guidance on the scope of the standard. However, the difficulty with most such standards is that they are designed to accommodate the circumstances that arise in the context of an individual situation. This may make it difficult, if not impossible, to generalise a court’s view in a specific case. Thus, cases may be distinguished on the slenderest of grounds, which results in standards becoming so particularised that they cannot serve as a guide to market behaviour.<sup>3</sup> In addition to the general lack of uniformity of court decisions, it is rare for cases involving consumers to come to court in the first place. There will therefore only be very few cases involving consumers that come before the courts, and the courts will only have a very limited opportunity to develop broad guiding principles for general standards.<sup>4</sup> Collins concludes that “regulation by general standards through particularised adjudication ... is also likely to be ineffective, because it fails to provide determinate

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<sup>1</sup> R.Goode, *Commercial Law in the Next Millenium* (London: Sweet & Maxwell, 1998), p.50.

<sup>2</sup> R.Goode, *Commercial Law in the Next Millenium* (London: Sweet & Maxwell, 1998), p.50.

<sup>3</sup> H.Collins, *Regulating Contracts* (Oxford: Oxford University Press, 1999), p.293.

<sup>4</sup> T.Bourgoignie, “New Patterns Of Consumer Protection Under Warranty Law: Lessons From The U.S. Magnuson-Moss Warranty Act” (1979) 3 *Journal of Consumer Policy* 266, p.268.

standards that can guide participants in the market”<sup>5</sup>. The challenge therefore is to retain some degree of calculability.

5.9 Moreover, the problem of relying on some kind of general standard which might have the potential effect of undermining the parties’ agreement and thereby jeopardising certainty has been referred to by the courts as one reason why the courts are particularly reluctant to exercise a discretion to refuse to enforce contracts on the grounds of unconscionability<sup>6</sup>.

5.10 Having thus reviewed the general arguments for and against broad flexible standards, we now turn to examine the application of flexible fairness standards in English contract law.

### **III Specific Fairness doctrines in English law**

5.11 From our discussion so far, it is apparent that specific fairness doctrines, in any legal regime, will relate to matters of both procedural and substantive fairness. As far as procedural fairness is concerned, the two critical dimensions concern the protection of the parties’ freedom (against coercion) to enter into a transaction, and the integrity of the information based on which they decide which transaction to conclude. In this part, we will comment briefly on two specific fairness doctrines of English contract law, both relating to procedural fairness. The first, misrepresentation, concerns the information dimension; the second, duress, relates to freedom.

5.12 *Prima facie*, the rules relating to both of these doctrines seem relatively certain and geared towards predictability. Thus, they seem to set the groundrules for contracting which is procedurally fair, without creating too much scope for flexibility. However, on closer analysis, it becomes apparent that these doctrines have considerable flexibility built into them, albeit not in the shape of overriding general standards.

#### *Misrepresentation*

5.13 During the discussion leading up to a contract, a supplier may make certain claims about the goods or services he provides in order to encourage the consumer to conclude the contract. Some of these claims may become terms of the contract, and if these subsequently turn out to be untrue, the consumer might have a claim for breach of contract. Others, however, will not be terms but only be regarded as representations. If they are incorrect then a consumer may be able to bring a claim for misrepresentation.

5.14 The basic requirement for a claim in misrepresentation is that the supplier has made a statement of fact which is untrue and which has induced the consumer to enter into the contract. It is significant that the statement is one of *fact* rather than simply one of opinion<sup>7</sup>.

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<sup>5</sup> H.Collins, *Regulating Contracts* (Oxford: Oxford University Press, 1999), p.295.

<sup>6</sup> See Lord Hoffman in *Union Eagle Ltd v Golden Achievement Ltd* [1997] 2 All ER 215. Lord Hoffman conceded that the need for certainty was not present in all situations which opens up the possibility of relying on unconscionability in a consumer context.

<sup>7</sup> E.g. *Esso Petroleum Co Ltd v Mardon* [1976] QB 801.

5.15 A difficult question arises whether silence can amount to a misrepresentation. It seems that failure to volunteer information in the absence of a request for it will not amount to a false statement of fact<sup>8</sup>, whereas an attempt deliberately to conceal information probably will be<sup>9</sup>. Similarly, half-truths<sup>10</sup> and failing to correct information which has changed since the statement was made but before the contract was concluded<sup>11</sup> would also be a false statement of fact.

5.16 However, the mere fact that a statement was false is not enough; it must have induced the consumer to enter into the contract. Thus, reliance is necessary, although there is some confusion as to whether actual reliance has to be shown<sup>12</sup> or whether reliance must have been reasonable<sup>13</sup>. In the absence of reliance on the supplier's statement, there can be no actionable misrepresentation.

5.17 If there is an actionable misrepresentation, then the contract becomes voidable and the consumer is entitled to rescind the contract. The fact that remedies are available if there has been an actionable misrepresentation (the right to rescind a contract or to claim damages) are indicative of the underlying desire to protect procedural fairness, i.e., the recognition that a party should not be tied into a contract which was entered into in reliance on an incorrect fact put forward by the other contracting party. However, the standard remedy for misrepresentation, rescission of the contract, is a discretionary remedy (although now surrounded by settled guidelines).

5.18 As we noted above, the rules have a superficial appearance of certainty and predictability, there is, in fact, a considerable degree of flexibility within each of the elements of misrepresentation. We may take the requirement of a false statement of fact to illustrate the point. The distinction between a statement of opinion and a statement of fact seems to be fairly straightforward. However, it has been held that a statement of opinion can be taken as implying some underlying statement of fact.

5.19 Furthermore, the divergent approaches taken with regard to the question of reliance may, in fact, be further evidence of a flexibility. Thus, the general rule may be that reliance must be reasonable, and provided that it would have been reasonable for a person in the position of the claimant to rely on the misrepresentation, evidence of actual reliance is not required. However, if there is evidence of actual reliance, even where this might not have been reasonable, the misrepresentation may nevertheless be actionable. On this analysis, the reliance factor loses much of its certainty.

### *Duress*

5.20 Duress exists where a consumer is coerced by a supplier to enter into a contract. Such duress may be a threat to the bodily integrity of the consumer, or, in particular circumstances, adversely affect the economic position of a consumer.

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<sup>8</sup> E.g., *Keates v Cadogan* (1851) 10 C.B. 591.

<sup>9</sup> E.g., *Sybron Corp. v Rochem Ltd.* [1984] Ch. 112.

<sup>10</sup> E.g., *Tapp v Lee* (1803) 3 B.&P. 367; *Jewson & Sons Ltd. v Arcos Ltd.* (1933) 47 Ll. L. Rep. 93.

<sup>11</sup> *With v O'Flanagan* [1936] Ch 575.

<sup>12</sup> *Museprime Properties Ltd v Adhill Properties Ltd* [1990] 2 E.G.L.R. 196.

<sup>13</sup> *Pan Atlantic Insurance Co. Ltd. v Pine Top Insurance Co. Ltd.* [1995] 2 AC 501.

5.21 In *The Atlantic Baron*, the possibility of economic duress was accepted for the first time. A situation of economic duress may arise, e.g., where one contracting party, having commenced performance, refuses to continue unless an increased price is paid. An example may illustrate this. C has taken his car to the local garage for repairs. The garage takes the car apart and then tells C that it will have to charge an extra £300 and will not continue the repairs, or put the car back together, unless C agrees. Provided that there is no reasonable alternative available<sup>14</sup>, C might subsequently recover the additional £300 on the grounds that he agreed to the payment under economic duress.

5.22 However, it seems that economic duress will only be accepted where the threat is illegitimate, although it is not entirely clear how significant the relevance of unlawfulness is<sup>15</sup>. Clearly, in the context of a refusal to continue contractual performance, the threat would be illegitimate because, if carried out, it would amount to breach of contract. However, in the absence of a contractual relationship, it may be more difficult to establish economic duress, unless there is a more obvious unlawful threat.

5.23 It may be difficult to distinguish between legitimate commercial pressure on the one hand and illegitimate pressure on the other. It is submitted that in a consumer context, a finding of economic duress might be more readily made than in the context of commercial transactions, where the difference in bargaining power between the parties is likely to be less significant. Irrespective of this, the distinction between legitimate and illegitimate pressure cannot be stabilised. This gives the doctrine of duress an intrinsic flexibility in its application. Indeed, where the question of legitimacy is referred back to the standards of the business community, this is effectively a good faith requirement by another name (see 4.xx).

### **Comment**

5.24 The doctrines of misrepresentation and duress are well-established aspects of English contract law. Both deal with a specific aspect of procedural unfairness. Despite their apparent certainty and predictability, we can see that there is a considerable degree of flexibility in respect of the key rules for each of those doctrines. Having said this, it is nevertheless true to say that these doctrines emphasise certainty over flexibility. Thus, where English law has tackled questions of procedural fairness (on both the freedom and informational side), it has tended to do so in a rule-like manner aiming at calculability. By contrast, modern attempts to regulate substantive fairness seem to favour more open-ended flexible standards. In the following part, we will examine how English law has operationalised such broad standards in dealing with matters of substantive fairness in the context of unfair contract terms.

## **IV Applying Flexible standards in English contract law**

5.25 In this part, we turn to consider what may be regarded as more general fairness principles. The primary example here is unfair contract terms legislation, and specifically the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer

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<sup>14</sup> *Atlas Express v Kafco Ltd.* [1989] 1 All ER 641.

<sup>15</sup> *CTN Cash and Carry Ltd. v Gallagher Ltd.* [1994] 4 All ER 714.

Contracts Regulations 1999. We have already considered the broader context in which these measures operate in section 3.

### ***The Reasonableness Test under the Unfair Contract Terms Act 1977***

5.26 The Unfair Contract Terms Act 1977 renders ineffective terms which seek to exclude or limit liability for death or personal injury caused by negligence (s.2), as well as, in a consumer case, terms which seek to exclude or restrict the implied terms as to quality (s.6 and 7). In a non-consumer transaction, such clauses (i.e., those caught by ss 6 and 7) need to satisfy the requirement of reasonableness. Other terms may also be ineffective but only if they fail to meet the requirement of reasonableness. Thus, s.3 UCTA provides that a contracting party cannot rely on a term to exclude or restrict liability for breach of contract, or claim to be entitled to render a contractual performance substantially different from that which was reasonably expected of him, or no performance at all, unless that term satisfies the reasonableness requirement (see also 3.31 - 3.35 above).

5.27 For present purposes, we are interested in determining how the courts have applied the reasonableness test. We have already observed that this is a flexible and open-ended test. Had UCTA simply introduced a requirement that particular clauses must comply with the requirement of reasonableness, without any further guidance on how reasonableness might be established, it would have created a highly uncertain test.

5.28 However, in order to redress the balance, the Act itself provides guidance on how the reasonableness test is to be applied. Moreover, there is now an extensive body of case law on the application of the reasonableness test available. Section 11 UCTA provides guidance on how the reasonableness test should be applied by a court. According to s.11(1), a term would be reasonable if it is a “fair and reasonable one to be included, having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made”.

5.29 In relation to s.6 and 7, Schedule 2 UCTA provides further “Guidelines” for the application of the reasonableness test. The matters which are particularly relevant in applying the reasonableness test in this context are:

- (i) the relative bargaining strength of the parties, taking into account alternative means by which the customer’s requirements could have been met
- (ii) whether the customer received an inducement to agree to the term, or whether he had the opportunity of entering into a similar contract with other persons but without having to accept a similar term
- (iii) whether the customer knew, or ought reasonably to have known of the existence and extent of the term
- (iv) where the term excludes or restricts relevant liability if some condition was not complied with, whether it was reasonable at the time of contract to expect that compliance would be practicable
- (v) whether goods were manufactured, processed or adapted to the special order of the consumer.

In addition, where the term in question is a limitation clause, regard should be had to

- (a) the resources the person in whose favour the clause operates could expect to have available for the purpose of meeting the liability
- (b) how far it was open to that person to cover himself by insurance.

5.30 The broad reasonableness requirement is therefore at least partly circumscribed by a list of relevant factors which the courts should take into account when assessing whether a particular term meets that requirement. We may note that the detailed list of relevant factors in Schedule 2 should, according to s.11 UCTA, only be taken into account in a non-consumer context in considering whether a term caught by ss.6 or 7 UCTA satisfies the reasonableness test. In other circumstances, the courts are left with comparatively little guidance. In reviewing some of the leading cases under UCTA, we will therefore consider how the courts have applied the reasonableness test, and focus in particular on the significance given to the Schedule 2 criteria, whether the courts have developed additional criteria (as suggested by Goode, above) and to what extent insurance is a relevant factor.

5.31 Before we proceed with our analysis, it should be noted that the case-law under UCTA generally involves commercial, rather than consumer contracts. In the latter context, it may be expected that the courts would generally take a clear pro-consumer stance<sup>16</sup>. Nevertheless, the application of the reasonableness test by the English courts provides a useful study of how the courts might approach a broad flexible standard, and may offer some guidance on how the courts might respond to the introduction of a broad fairness standard into consumer law.

5.32 Two early House of Lords decisions, both commercial cases, are noteworthy for the different attitudes taken in applying the reasonableness test. In *Photo Production Ltd. V Securicor Transport Ltd*<sup>17</sup> a security guard provided by Securicor was responsible for the destruction in a fire of Photo Production's premises. The House of Lords upheld a clause excluding Securicor's liability. By contrast, in *George Mitchell (Chesterhall) v Finney Lock Seeds*<sup>18</sup> the supplier of defective seeds could not rely on a clause limiting their liability to the cost of the seeds provided. Both cases have been the subject of detailed academic scrutiny elsewhere<sup>19</sup>, but we may note here that these two cases are reflective of two different approaches: in *Photo Production*, the House of Lords took a non-interventionist stance, regarding the contract as reflecting the parties' allocation of risk with which the courts should not interfere in commercial transactions. In contrast, *George Mitchell* reflects a neutral approach, leaving each case to be decided on its facts and generally deferring to the trial judge's assessment of reasonableness. There is no consistency in subsequent case law in that some decisions appear to have taken a non-interventionist approach, whereas others

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<sup>16</sup> See J.Adams and R.Brownsword, *Understanding Contract Law*, 3<sup>rd</sup> edition, (London: Sweet & Maxwell, 2000), p.130.

<sup>17</sup> [1980] AC 827.

<sup>18</sup> [1983] AC 803. This case involved the application of the reasonableness test in what was then s.55 of the Sale of Goods Act 1979, which was different in scope than the UCTA reasonableness test.

<sup>19</sup> See in particular, J.N.Adams and R.Brownsword, "The Unfair Contract Terms Act: A Decade of Discretion" (1988) 104 *Law Quarterly Review* 98.

have looked at the particular facts more closely before deciding on whether a particular clause is reasonable, although the latter approach (*George Mitchell*) seems to be more commonly followed.

5.33 The question then arises when the assessment of reasonableness is to be carried out, and to what extent subsequent events may be taken into account. In *George Mitchell*, post-breach conduct (an offer to settle for an amount higher than that set in the contractual limitation clause) was relevant in finding that the clause itself was unreasonable, although that case was decided by applying the pre-UCTA test of asking whether it was fair and reasonable to allow reliance on the clause in all the circumstances of the case. The UCTA test considers whether a particular term was a fair and reasonable one to be *included* in the contract (s.11(1) UCTA). Reliance is therefore not a relevant consideration. Thus, Tomlison J in *Britvic Soft Drinks Ltd v Messer UK Ltd* noted that “it is of course the term which must satisfy the test of reasonableness. The enquiry is not whether, given the circumstances in which reliance is sought to be put upon it, reliance upon the term is reasonable.”<sup>20</sup> In *Stewart Gill Ltd. v Horatio Myer & Co. Ltd.*, the Court of Appeal held that post-formation events were irrelevant to the question of reasonableness, which had “to be determined as at the time when the contract is made and without regard to what particular use one party may subsequently wish to make of it.”<sup>21</sup>

5.34 As we have said, in the legislative scheme of UCTA, the Schedule 2 guidelines are only relevant to terms which seek to exclude or limit liability for a breach of the terms implied into contracts for the sale of supply of goods (as per ss. 6-7 UCTA). Treitel remarked that the

“guidelines no doubt help to reduce the uncertainty to which the requirement of reasonableness gives rise; but the restrictions on their scope are hard to understand”<sup>22</sup>

The courts have shown willing to rely on the Schedule 2 factors in applying the reasonableness test in other contexts. For example, in *Stewart Gill Ltd. v Horatio Myer & Co. Ltd.*<sup>23</sup>, Stuart-Smith LJ noted that “although Schedule 2 does not apply in the present case, the considerations set out there are usually regarded as being of general application to the question of reasonableness”, and in *Zockoll Group Ltd v Mercury Communications Ltd*<sup>24</sup>, Lord Bingham CJ (as he then was), in considering the reasonableness of a term caught by s.3(2) UCTA remarked that “it is also appropriate, although not required by s.11(2) of the Act, to have regard to the guidelines in Sch 2 for application of the reasonableness test”. In so doing, the courts provide some degree of calculability with regard to the application of the reasonableness test.

5.35 In *Smith v Eric Bush*<sup>25</sup>, a case involving an exclusion of liability in negligence by a surveyor, Lord Griffiths considered how the courts should apply the general

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<sup>20</sup> [2002] 1 Lloyd’s Rep 20 at 58.

<sup>21</sup> [1992] Q.B. 600 at 607, *per* Lord Donaldson MR.

<sup>22</sup> Treitel, *The Law of Contract*, 10<sup>th</sup> edition, (London: Sweet & Maxwell), p.237.

<sup>23</sup> [1992] Q.B. 600.

<sup>24</sup> [1999] EMLR 385, CA.

<sup>25</sup> [1990] 1 AC 831.

reasonableness test in s.11(3) UCTA<sup>26</sup>. Having noted that “it is impossible to draw up an exhaustive list of factors that must be taken into account when a judge is faced with this very difficult decision”<sup>27</sup> of applying the reasonableness test, he suggested that some matters should always be considered:

- (i) Were the parties of equal bargaining power?
- (ii) In the case of advice, would it have been reasonably practicable to obtain the advice from an alternative source, taking into account considerations of costs and time?
- (iii) How difficult is the task being undertaken for which liability is excluded (a difficult or dangerous undertaking with a high risk of failure suggesting that an exclusion would more likely be reasonable)?
- (iv) What are the practical consequences of the decision on the question of reasonableness? In this context, the availability of insurance would be significant (see below).

Although phrased differently, criteria (i) and (ii) resemble factors (a) and (b) in Schedule 2, and criterion (iv) emphasises the importance of insurance, which under UCTA itself is strictly speaking only relevant in respect of limitation clauses.

5.36 It is interesting to observe the way the courts have approached the relevance of insurance. According to s.11 UCTA, insurance is a relevant factor in determining whether a clause limiting (rather than excluding) liability is reasonable. For example, it seems unlikely that a clause limiting liability for defects in a contract between a manufacturer and a customer would be reasonable if the manufacturer could have insured against the risk of liability without having to increase the price of his goods to a significant degree<sup>28</sup>. The crucial factor here seems to be the availability of insurance rather than the fact that insurance has been taken out<sup>29</sup>. Thus, in *Photo Production v Securicor*, Photo Production was in a better position to have obtained insurance and therefore the exclusion clause which operated in Securicor’s favour was deemed to be reasonable. Similarly, in *George Mitchell*, it would have been easier for the seed merchants to take out insurance. In *Smith v Eric Bush*, Lord Griffiths emphasised that the availability of insurance is an important relevant consideration:

“There was once a time when it was considered improper even to mention the possible existence of insurance cover in a lawsuit. But those days are long past. Everyone knows that all prudent, professional men carry insurance, and the availability and cost of insurance must be a relevant factor when

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<sup>26</sup> This is the equivalent provision to s.11(1) but applies to non-contractual notices, rather than contract terms.

<sup>27</sup> [1990] 1 AC 831 at 858.

<sup>28</sup> *Salvage Association v CAP Services* [1995] F.S.R. 654.

<sup>29</sup> *Singer (UK) Ltd v Tees & Hartlepool Port Authority* [1988] 2 Lloyd’s Report 164. However, it seems more likely that the clause will be unreasonable where the person in whose favour the clause operates has actually taken out insurance: *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] A.C. 803; cf. Treitel, *The Law of Contract*, 10<sup>th</sup> edition, (London: Sweet & Maxwell), p.237.

considering which of two parties should be required to bear the risk of a loss.”<sup>30</sup>

This suggests that where the party who seeks to rely on an exclusion (or limitation) clause is able to obtain insurance at acceptable cost to cover the risk sought to be excluded, the term (or notice) is likely to be unreasonable. Insurance has therefore become a very significant factor.

5.37 We may complete our brief exegesis by noting the attitude of the appellate courts towards reviewing the trial court’s assessment of reasonableness. Despite the guidelines that have been provided in the Act and developed in the case law, there is a considerable degree of discretion given to the judges in balancing various factors in each individual case; indeed, in order to achieve fairness, such discretion is required. In *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*<sup>31</sup>, it was remarked that in applying the reasonableness test, there is “room for a legitimate difference in judicial opinion”. Therefore, a higher court should not overturn the trial court judge’s assessment “unless satisfied that it proceeded on some erroneous principle or was plainly and obviously wrong”. This attitude reflects the reluctance of the appellate courts to apply the reasonableness test, preferring instead to uphold the findings of the lower courts even where there is a difference of opinion, or, in some cases, referring the matter of application back to the lower courts having considered the relevance of particular factors in assessing the reasonableness of the term in question. Indeed, in *Phillips Products Ltd v T.Hyland and Hampstead Plant Hire Co. Ltd.*<sup>32</sup>, the Court of Appeal emphasised that the decision regarding the reasonableness of a clause in a standard form contract was limited to the facts and that the court’s “conclusion on the particular facts of this case should not be treated as a binding precedent in other cases where similar clauses fall to be considered but the evidence of the surrounding circumstances may be different”<sup>33</sup>. This, of course, means that very little authoritative guidance can be derived from any particular case, at least as far as the reasonableness of a particular clause is concerned.

5.38 In summary, we can see that there is a tension between maintaining the flexibility of the reasonableness standard and the need to ensure a degree of calculability. The unwillingness of the appellate courts to overturn the trial judge, even where there is some degree of disagreement on the application of the reasonableness test, combined with the emphasis on the individuality of each decision, promotes a flexible case-by-case approach, but also introduces uncertainty. This is mitigated by the emphasis on factors which will generally be relevant in applying the reasonableness test, providing some guidance on how a court might deal with this question in a particular case. Considerable emphasis has been placed on the statutory guidelines in Schedule 2 which are applied in a much wider context than envisaged in UCTA itself. We note here that the Law Commission has proposed an even more detailed statutory list of factors as part of its proposed reform of the unfair contract terms legislation<sup>34</sup>. Moreover, as suggested earlier, the courts will consider

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<sup>30</sup> [1990] 1 AC 831 at p.858.

<sup>31</sup> [1983] A.C. 803

<sup>32</sup> [1987] 2 All ER 620.

<sup>33</sup> [1987] 2 All ER 620 at 630, *per* Slade LJ.

<sup>34</sup> Law Commission, *Unfair Terms in Contracts – Consultation Paper 166* (2002), pp.206-7.

carefully whether to interfere in commercial transactions, although they are clearly willing to do so. By contrast, in the context of a consumer transaction, courts are more sensitive to the needs of consumers and will more readily find that a particular clause is unreasonable. However, following the implementation of the EC's Unfair Contract Terms Directive, it seems that UCTA will be of reduced significance in consumer transactions, at least in so far as it does not prohibit particular terms outright (s.2(1), s.6 and s.7).

### ***The Good Faith Requirement in the Unfair Terms in Consumer Contracts Regulations 1999***

5.39 The Unfair Terms in Consumer Contracts Regulations 1999 (implementing EC Directive 93/13) seek to control the fairness of consumer contracts in two ways: (a) unfair terms will not be binding on a consumer and (b) terms must be presented in plain and intelligible language and, if ambiguous, should be interpreted in the consumer's favour.

5.40 The test of "unfairness" under the 1999 Regulations applies only to terms which have not been individually negotiated. A term will be unfair if "contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer." (Regulation 5). In order to assess whether a particular term is unfair, it is necessary to take into account the nature of the goods or services covered by the contract and to consider all the circumstances surrounding the contract. If the term is found to be unfair, it will not be binding on the consumer (Regulation 8).

### ***Enforcement by the Courts***

5.41 The leading case on the application of the Regulations is *Director-General of Fair Trading v First National Bank plc*<sup>35</sup> (decided under the 1994 version of the Regulations, but there is no reason to disregard this case in the context of the 1999 Regulations). The House of Lords held that in order to establish whether a term meets the requirements of good faith, it is necessary to consider both procedural and substantive issues. The procedural aspect of the good faith test requires "openness and fair dealing". As for the substantive aspect, some terms will always create a significant imbalance to the detriment of a consumer and will therefore be inherently unfair.

5.42 Prior to the *First National Bank* case, there were a number of cases in the lower courts. In two of these, both involving contracts for private schools<sup>36</sup>, the judges seemed confused about the scope of the (then 1994) Regulations, which gives rise to some concern about their correct application<sup>37</sup>. A third case, however, seems to be a correct application of the Regulations, in particular of the notion of "good faith". In

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<sup>35</sup> [2002] 1 All ER 97.

<sup>36</sup> *Gosling v Burrard-Lucas*, 4 November 1998, Tunbridge Wells County Court [1999] *Current Law*, January, 197; *Broadwater Manor-School v Davis*, 8 January 1999, Worthing County Court [1999] *Current Law*, May, 208.

<sup>37</sup> See R.Bradgate, "Experience in the United Kingdom" in *The Unfair Terms Directive: Five Years On* (European Commission, 2000).

*Falco Finance Ltd v Gough*<sup>38</sup>, the contract was for a mortgage at a discounted rate. A term provided that if there was a default in repayment, the interest rate would be increased to the full contractual rate and monthly payments would increase considerably. Moreover, in the event of early settlement, the settlement date would be deferred by six months, and interest was also calculated on a flat rate basis at the commencement of the agreement. These terms were held to be unfair. The consumer was encouraged by the reduced interest rate to enter into the mortgage agreement, but the benefit of this was taken away by these terms.

5.43 More recently, the Regulations (still in their 1994 form) were applied by the High Court in *Bankers Insurance Company Ltd v South and Gardner*.<sup>39</sup> The contract in question was a travel insurance policy, and the first issue in that case was whether the exclusion from the policy of accidents caused by the insured whilst in possession of *inter alia* “motorised waterborne craft” applied to the present circumstances. South had seriously injured Gardner with a jet-ski and now sought to rely on the insurance policy. Although the exclusion was a core term and ordinarily excluded from an assessment of fairness, it had been argued that it was not sufficiently clear and precise. Having reviewed the meaning of “craft” both in dictionaries and other documents, Buckley J concluded that the term in question was sufficiently clear and precise, and therefore it was not subject to review. However, two other terms were found to be unfair. The insurance policy contained the requirements, referred to by the judge as “conditions precedent” that the insured had to report in writing as soon as reasonably possible full details of any incident which might result in a claim under the policy and to forward to the insurer immediately upon receipt every writ, summons, legal process or other communication in connection with the claim. Buckley J noted that although non-compliance with these terms could prejudice the insurer’s right of subrogation and chance of recovery, this would not invariably be so. The clauses therefore had the potential of depriving an insured of what he bargained for “simply because the insured has transgressed procedurally” (para 34). The terms in question were therefore unfair for causing a significant imbalance in the parties’ obligations. However, Buckley J also held that “the spirit” of Regulation 5(2)<sup>40</sup> allowed him to regard the terms unfair only to the extent that they denied recovery “whatever the consequences of the breach”. This does not seem to be a correct interpretation of Regulation 5(2), which renders ineffective an unfair term in its entirety, rather than particular consequences of applying that term.

#### *Enforcement by the Office of Fair Trading*

5.44 In addition to invoking the Regulations in the context of a particular dispute, the Office of Fair Trading (OFT), as well as other “qualifying bodies”<sup>41</sup> has been

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<sup>38</sup> [1999] CCLR 16.

<sup>39</sup> [2003] EWHC 380 (QB), 7 March 2003.

<sup>40</sup> Regulation 5(2) of the 1994 Regulations states that “The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term”.

<sup>41</sup> The Data Protection Registrar; the various utilities regulators; every weights and measures authority in Great Britain and the Northern Irish Department of Economic Development are all Part 1 qualifying bodies, which are under a duty to respond to complaints received and have powers to obtain documents and information under Regulation 13 UTCCR 1999. The Consumers’ Association is a Part 2 qualifying body, which is not covered by Regulation 13.

given the power to enforce the Regulations. It does so by approaching traders who use terms in their standard form contracts which generally appear to be unfair and requests that the term be deleted or amended to reduce the potential imbalance of obligations.

5.45 The OFT has been very successful in its work and has dealt with a vast number of complaints. Once a complaint has been received and it is decided to take action, the OFT will seek to negotiate with the trader concerned, providing advice on the Regulations and on how to amend the term in question. If this informal process is unsuccessful, it may be necessary to obtain formal undertakings. The ultimate sanction which the OFT (and other qualifying bodies) could ask for is an injunction preventing the trader from continuing to use the term(s) concerned. To date, the OFT has only taken this course once, in the *First National* case, where it was ultimately unsuccessful. The OFT regularly publishes details of terms it has challenged successfully in its *Unfair Contract Terms* bulletins (21 of which have been published to date).

5.46 The difficulty for the OFT is that it does not act against the backdrop of a specific consumer complaint, but rather has to proceed on a hypothetical basis. This may make it more difficult to consider whether a particular term is, in fact, unfair. However, in practice, the OFT has generally been able to challenge terms it regards as unfair.

5.47 In 2001, it publishes a guidance document setting out how it approaches the enforcement of the UTCCR 1999.<sup>42</sup> The starting point in assessing whether a term is unfair is to consider what the consumer's position under the contract would be if the term in question were absent. If that term changes what the law regards as a fair balance between consumer and supplier, it is regarded with suspicion.<sup>43</sup> In applying the good faith test, the OFT now takes the lead from the House of Lords decision in the *First National* case (see above).<sup>44</sup>

5.48 Generally, the OFT follows the "grey list" of unfair terms provided in Schedule 2 to the UTCCR, which follow the Annex of the Unfair Contract Terms Directive. In dealing with a particular complaint, the OFT will examine first if the term falls within one of the categories listed there. In addition, the OFT has developed a list of other terms which it considers may be potentially unfair, but which do not fall under one of the headings in Schedule 2. These terms are used in the UK, in particular, but are less common in other Member States and were therefore not included in the Annex to the Directive<sup>45</sup>. These include terms which transfer inappropriate risks to consumers, unfair enforcement powers (such as rights of entry onto the consumer's premises), exclusion of the consumer's right to assign what they have bought to someone else and consumer declarations ("have read and understood" declarations). A third category of challenge is under Regulation 7 UTCCR, requiring terms to be expressed in plain and intelligible language. A significant proportion of

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<sup>42</sup> Office of Fair Trading, *Unfair Contract Terms Guidance*, OFT 311, February 2001.

<sup>43</sup> *Ibid*, p.2.

<sup>44</sup> At the time the *Guidance* was published, the *First National* case had only been heard by the Court of Appeal, although the fundamental approach to good faith put forward by the Court of Appeal is not significantly different from that adopted by the House of Lords.

<sup>45</sup> See *Guidance*, p.41.

the OFT's cases has involved a challenge to the intelligibility of particular terms, irrespective of whether the particular term was also unfair.

5.49 We can therefore see that in enforcing the Regulations, the OFT is trying to maintain some calculability in trying to consider whether a particular term falls within the categories listed in Schedule 2. However, being aware of the flexible nature of the fairness test in the Regulations, it has not limited itself to these categories, and has over time challenged terms which are unfair yet not listed in the schedule. In order not to jeopardise the level of certainty its approach provides, it has published guidance, and continues to publish this through the *Bulletins*, providing details of the terms it regards as unfair. As the OFT's actions are not limited to a particular case, their relevance is broader than cases decided under UCTA (see above), which involve specific contracts and are often restricted to their facts. Yet, some uncertainty remains even for those traders whose terms were changed following OFT intervention, because a court that is asked to consider the fairness of such a term in the context of a specific consumer contract may nevertheless decide that the term is unfair. Moreover, the OFT may reconsider its view of the amended term and require further changes if its assessment of the amended term's fairness changes.

## **V Summary**

5.50 The tension between certainty and flexibility permeates all the fairness rules currently in existence in English law, both in the context of specific doctrines of procedural fairness and the more flexible doctrines of substantive fairness.

5.51 We can see that broad fairness standards are of little concern for the English courts, and the courts have demonstrated their ability to handle these remarkably well. The experience both under UCTA and the UTCCR shows the ability to apply the requirement of "reasonableness" or "unfairness" in a flexible manner, ensuring that cases are generally considered on their particular facts.

5.52 However, despite the willingness to maintain flexibility, the courts have sought to introduce a degree of certainty in putting forward criteria, or guidelines, which should be considered by other courts when applying these fairness standards. Although these are not exhaustive, they nevertheless provide a degree of calculability into an otherwise rather uncertain system.

5.53 This bodes well for the introduction of a wider fairness principle into English law. The courts are willing to recognise that a case might be limited to its particular facts, and that a finding of "unfairness" in the context of one claim will not invariably mean that a similar case will be decided in the same way. However, the courts would undoubtedly seek to provide guiding principles to assist them in applying a broad fairness test.

5.54 The upshot of this discussion is that whilst there can be little doubt that the a broad standard would be applied to a particular case in the way envisaged in the relevant legislation, it may be more difficult to generalise such decisions in order to determine in advance whether particular conduct (as is the case with particular contract terms) would meet the fairness requirement. This may be of concern to some, but then the cornerstones of English consumer law have always been based on broad

standards requiring case-by-case application (UCTA, UTCCR and the terms implied by Sale of Goods Act 1979 and the corresponding remedies<sup>46</sup>)

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<sup>46</sup> See R.Bradgate and C.Twigg-Flesner, *Blackstone's Guide to Consumer Sales and Associated Guarantees* (Oxford: OUP, 2003).

## SECTION SIX

### CONSUMER AND COMMERCIAL TRANSACTIONS

#### I Introduction

6.1 One of the principal concerns, perhaps *the* principal concern about the emergence of a general prohibition on unfair commercial practices, or a general requirement to trade fairly, is that it would have a tendency to destabilise commercial law and commercial transactions. To a large degree the arguments against such a general requirement therefore mirror those against the adoption or recognition of a general requirement of good faith in contractual dealings<sup>1</sup>. First, at least until the development of a significant body of case law interpreting and applying the general requirement there would be uncertainty as to its requirements, which would tend to generate litigation<sup>2</sup>. Second, insofar as a general requirement, whether of good faith or fair trading, is based on or informed by an external moral standard (see the discussion of a 'good faith regime' above) it would, inappropriately, impose a measure of external regulation on commercial dealings.

6.2 As we have noted earlier, English law has generally been sceptical of general principles. Its preference is for the use of more tightly defined, specific doctrinal rules. Sir Thomas Bingham reflected this preference when in the *Interfoto* case he referred to English law's preference for "piecemeal doctrines"<sup>3</sup>. In *Lloyd's Bank Ltd v Bundy*<sup>4</sup> Lord Denning attempted to draw together various doctrinal rules under which the courts have power to intervene in contracts, under the umbrella heading of "inequality of bargaining power". However, in *National Westminster Bank plc v Morgan*<sup>5</sup> the House of Lords denied the existence of any such broad principle as too uncertain. This is not to deny that all the instances of power to intervene identified by Lord Denning involve cases where there is inequality of bargaining power between the parties, but to deny the existence of the broad, overarching principle as a ground for intervention in situations not covered by any of the discrete doctrines.

6.3 In more recent years, perhaps partly as a result of international influences and increased awareness of the approaches of other legal systems, there has been a greater willingness to recognise, if not broad general doctrines, broad principles underpinning English contract law doctrine. Most notably Lord Steyn has on a number of occasions spoken of a general theme running through English contract law of respect for the "reasonable expectations of honest commercial men"<sup>6</sup>. As we have noted already, and

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<sup>1</sup> See 4.3.

<sup>2</sup> See 4.8

<sup>3</sup> [1988] 1 All ER 348 at 352.

<sup>4</sup> [1975] QB 326

<sup>5</sup> [1985] AC 686

<sup>6</sup> See *G. Percy Trentham Ltd v Archital Luxfer Ltd* [1993] 1 Lloyd's Rep 25; *First Energy (UK) Ltd v Hungarian International Bank Ltd*. [1993] 2 Lloyd's Rep 194. See also *Associated Japanese Bank (International) Ltd v Credit du Nord SA* [1988] 3 All ER 902 at 903.

as Lord Steyn himself has observed, there is little apparent difference between this and a principle of "good faith".<sup>7</sup>

6.4 It seems to us, , that a general requirement (not) to trade (un)fairly would have to be anchored to some reference point to give it substance. If the general duty is defined by reference to something like "normal market practice" in the particular trader's field of activity, the general requirement looks to be very much the same as a requirement that contractors respect each other's reasonable expectations or act in "good faith", at least if we adopt a "good faith requirement" which takes its colour and content from the particular market context in which the parties contract<sup>8</sup>. Such a requirement does not seek to raise standards by reference to any external moral framework but, as we have noted earlier, may be said by upholding the parties' reasonable expectations more fully reflect the values of party intention and autonomy.

6.5 In this section we consider the potential impact on *commercial* contract law of adopting a general prohibition on unfair commercial practices in *consumer* transactions. We will suggest that it is probably not possible to restrict the definition of "consumer" transactions so as wholly to exclude all business transactions from the ambit of the general prohibition, and that there is in any case a tendency for concepts developed in relation to consumer contracts to "leak" into the law relating to commercial contracts, and *vice versa*. However, we question whether this is necessarily a serious cause for concern. It is open to question whether English contract law is in fact as certain and predictable as is often claimed, and it seems that the law and the commercial community can tolerate a degree of uncertainty. Moreover, we suggest that many of the trading practices likely to be caught by the proposed general duty would be caught by existing doctrines and principles of English law.

6.6 Our analysis is in five parts, In Part II we consider whether English contract law is as certain and predictable as is sometimes claimed and whether the need for certainty is equally important across all classes of business contract. In Part III we then consider whether it is possible to "fence off" consumer contract law from the general body of contract law so as to minimise the potential for "leakage" from one to the other. In Part IV we consider the tendency for such leakage to occur, in the light, particularly, of the development of certain English law doctrines. In Part V we consider some aspects of a general duty which might tend to encourage and in Part VI some of the factors which might tend to discourage, such "leakage".

## **II Certainty, general principles and English contract law**

6.7 English law's suspicion of broad general doctrines is not shared by other legal systems. Many, including some common law systems, have a general good faith requirement or something similar. In the common law world the United States' Uniform Commercial Code imposes on contractors a general duty to act in good faith<sup>9</sup>, whilst in Australia the courts have developed a general power to intervene in

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<sup>7</sup> Contract Law: Fulfilling the Reasonable Expectations of Honest Men (1997) 113 LQR 433

<sup>8</sup> See 4.24.

<sup>9</sup> UCC s 1-203. See also the *Second Restatement of Contracts*, s 205. Significantly the duty only applies to the performance and breach of the contract, not to its formation.

contracts on the grounds of unconscionability<sup>10</sup>. Similarly both the Lando Principles of European Contract Law<sup>11</sup> and the UNIDROIT Principles of International Commercial Contracts<sup>12</sup> contain a general requirement of good faith. Significantly in the present context, both also contain a number of specific rules which may be said to be particular instances of good faith. The general requirement therefore acts as an overarching, gap-filling mechanism to which resort can be had in situations not covered by the specific rules. Of the two instruments the UNIDROIT principles are particularly significant in the present context since they were drafted with a view to their use for commercial contracts. Insofar as the reason for opposing the introduction into, or recognition in, English law of a general principle of good faith or a requirement to trade fairly is that it would generate uncertainty which would be damaging to commercial activity and/or the reputation of English law, we may question it on two grounds. First, it is open to question whether English contract law is as certain and predictable as is sometimes claimed. Second, we may question whether the business community shares the sceptical view of general principles.

6.8 The claim that English contract law is certain and predictable is often overstated. We have noted already that a thread of reasonableness runs through English contract law<sup>13</sup>. There is in fact a considerable degree of flexibility in English contract law doctrine and the tendency of the modern law has been to replace "bright-line" rules with more flexible - and therefore less predictable - principles. Numerous examples of this tendency can be found throughout the law of contract. An obvious example is the discretion available to the court under the Unfair Contract Terms Act 1977 to hold certain types of exclusion or similar clause unreasonable. The Act does not apply to certain types of commercial contract, including international supply contracts (so that it therefore has no impact on the international commodity trades)<sup>14</sup>, shipping contracts and contracts of insurance<sup>15</sup>. It nevertheless applies to a wide range of commercial contracts, especially those with a purely domestic dimension.

6.9 We could point to other instances with direct relevance to the possible development of a general duty to avoid unfair practices. Thus the ability of the court to classify contract terms as conditions, warranties or innominate terms gives<sup>16</sup> the court a wide discretion to determine the remedial consequences of a breach of contract and, in particular, to restrict opportunistic attempts to escape from contractual obligations on the grounds of alleged breach of contract.

6.10 There are here two layers of uncertainty. First, it cannot be guaranteed even that a term classified by the parties as a condition will be recognised as such by the

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<sup>10</sup> *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447.

<sup>11</sup> Art 1.106.

<sup>12</sup> Art 1.7.

<sup>13</sup> See 2.23 *ff*

<sup>14</sup> UCTA 1977 s 26.

<sup>15</sup> *Ibid* Sch 1.

<sup>16</sup> Following the decision of the Court of Appeal in *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] 2 QB 26, [1962] 1 All ER 474, CA.

court. In *Schuler AG v Wickman Machine Tool Sales Ltd*<sup>17</sup> the House of Lords held that a term classified by the parties in the contract as a "condition" was not in fact a condition in the strict legal sense but was an "innominate" term. The majority of their Lordships was clearly influenced by the feeling that it would be unreasonable to permit the German principal to terminate the contract for one single breach by its English agent, which would have been the consequence of categorising the term in question as a condition. This is apparent especially in the speech of Lord Reid when he observed that

'The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear'<sup>18</sup>.

6.11 Once the term is classified as "innominate" a further discretion comes into play, since the victim of the breach will only be permitted to repudiate his obligations under the contract if the breach "goes to the root of the contract" or is such as to deprive him of substantially the whole of the benefit which it was intended he should obtain from the contract.

6.12 These tests clearly give the court a considerable latitude to determine whether or not to permit repudiation in a particular case and it is clear that, although it is rarely expressly articulated, a significant factor affecting the court's decision will be whether or not it considers that it would be reasonable for the victim to repudiate the contract on the grounds of the breach. Moreover, if *Schuler* shows that the parties cannot escape the court's discretion by classifying terms as "conditions", more recent case law shows that even if the parties expressly state that any breach of contract is to entitle the party not in breach to repudiate the contract, the court may still decide that the contract is not to be interpreted literally. In *Rice v Great Yarmouth BC*<sup>19</sup>, the council had entered into a four year contract for leisure management services. It purported to be entitled to terminate the contract pursuant to an express term which allowed it to terminate the contractor's employment if the contractor committed a breach of any of its contractual obligations. The Court of Appeal held that the clause could not be taken literally and should be interpreted as allowing termination only where the contractor committed a serious breach of its obligations - in effect requiring a breach sufficient to justify termination under the *Hong Kong Fir* test.

6.13 These cases are effectively concerned with the interpretation of the contract and are instances of the so-called "modern" or "purposive" approach to contract interpretation<sup>20</sup>. The point for present purposes is that in these and similar cases the court, although purporting to give effect to the intentions of the parties, is effectively imposing a standard of reasonableness: the contract is not given its literal meaning because the result of so doing would be unreasonable and the parties, as reasonable people, cannot have intended an unreasonable result. It might be contentious to

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<sup>17</sup> [1974] AC 235, [1973] 2 All ER 39, HL.

<sup>18</sup> [1974] AC 235 at 251, [1973] 2 All ER 39 at 45.

<sup>19</sup> (*The Times* 26 July 2000).

<sup>20</sup> *Investors Compensation v West Bromwich BS* [1998] 1 All ER 98

describe such cases as instancing the courts imposing a standard of reasonableness or fairness on the contracting parties but it is not stretching things too far to read them in that way. We might put it differently by saying, echoing the comments of Lord Reid in *Schuler* that if the contract drafter wants to achieve an unreasonable result he is under a duty to make his intention plain in the language of the contract. In effect, therefore, we could re-badge these cases as imposing a sort of disclosure or open-dealing requirement.

6.14 A similar case is *Paragon Finance Ltd v Staunton*<sup>21</sup> in which the Court of Appeal held that a contract term giving one party a discretion to vary the terms of the contract was subject to an implied restriction that the discretion would be exercised "honestly and in good faith" and not arbitrarily, capriciously or for an improper purpose. There are other cases taking a similar line<sup>22</sup>.

6.15 A similar requirement of openness when contracting is apparent in the cases concerned with the so-called "red-hand" rule of incorporation, according to which special steps must be taken to draw attention to a contract term which is unusual or especially onerous in order to incorporate it into the contract. In this line of cases special procedural requirements are imposed where a term is considered substantively unfair. Indeed in the most recent cases on the point the "red hand" rule seems to have metamorphosed into something like a common law reasonableness test<sup>23</sup>.

6.16 This is not intended to be a complete list. Our point, to re-iterate, is that there are already numerous doctrines in English contract law which seem to involve the courts exercising an element of discretionary control over contracts, essentially on the basis of fairness or reasonableness. To those outlined above we might add the rules governing duress and misrepresentation and perhaps the rules governing the power of the courts to imply terms into contracts or to declare a contract frustrated and the doctrine of promissory estoppel. None of these doctrines is ostensibly inconsistent with the principle of freedom of contract. Indeed insofar as the parties to the contract are presumed to be reasonable people these doctrines may be said to uphold freedom of contract and be rooted in the presumed intentions of the parties. However, we are not concerned with the question whether or not the courts are really upholding the parties' intentions but with the question whether as a result English contract law is as certain and predictable as is claimed. Many of these doctrines are inherently unpredictable and yet the uncertainty they engender is not considered an impediment to business and does not seem to have damaged the international standing of English contract law.

6.17 Where commentators have expressed reservations about the dangers of importing into English law a general requirement of fairness, reasonableness or good faith the concern often seems to be about the impact of such a development on particular types of commercial contract. Typically the concern appears to be focused

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<sup>21</sup> [2001] EWCA 1466; [2001] 2 All ER (Comm) 1025.

<sup>22</sup> See eg: *Abu Dhabi National Tanker Co v Product Star Shipping Ltd, The Product Star (No 2)* [1993] 1 Lloyd's Rep 397 (charterparty); *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] EWCA Civ 1047; [2001] 2 All ER (Comm) 299 (reinsurance) and see the cases cited by Mance LJ at paras 62 - 65.

<sup>23</sup> See *AEG (UK) Ltd v Logic Resource Ltd* [1995] CCH CLR 265

on the potential impact on contracts such as those in the international commodity markets, shipping contracts and the like where an ability to make speedy decisions against the background of fluctuating market prices is crucial and where uncertainty may undermine the ability of lawyers to give clear advice allowing traders to make speedy decisions - eg: whether or not to treat a contract as repudiated on the grounds of breach and make a substitute transaction. The point is often, rightly, made that the parties to such contracts often choose English law to govern their contract and bring disputes arising therefrom to London to litigate or arbitrate. Many cases before the Commercial Court in London arise out of such contracts, often with neither party being English. Litigation and arbitration arising from such contracts is therefore a valuable invisible export for the UK.

6.18 It must be said that, insofar as the argument here is that the international trading community chooses English law because it is certain and predictable there is an apparent contradiction here. For if English law is certain and predictable, how is it that there is such a volume of litigation? Parties do not litigate disputes whose outcome is clear. One answer may be that most of these cases turn on disputed issues of fact, where the law itself is clear. An examination of the law reports confirms however that a significant number of the cases which arise are concerned with disputes about the application of law to facts.

6.19 In any case, it is clear that the rules of English law applicable even to such international contracts are often less clear and predictable than is sometimes claimed. To take but two examples, it is clear that terms even in international shipping and commodity contracts can be innominate. The innominate term was first identified in a case concerned with a shipping contract<sup>24</sup> and has been applied to commodity dealings<sup>25</sup>. Moreover, since 1994 it has been the law that under a contract for the sale of goods the buyer cannot reject the goods for breach of one of the statutory implied conditions if the breach is so slight that rejections would be unreasonable<sup>26</sup>. Here is an explicit reasonableness requirement applied to commercial contracts (only) in an area where it is claimed certainty is paramount. Section 15A clearly applies to commodity contracts, yet it does not seem to have had a significant, if any, damaging effect on the attractiveness of English law.

6.20 It is clear that business people do not always share the lawyer's concern for certainty. Many instances can be cited. It is a general rule of the law of contract that an agreement will not be enforced as a contract unless its terms are complete and expressed with sufficient certainty. It is recognised, however, that business people do not always comply with this requirement and for various reasons enter into agreements, intending them to be contractual, which a lawyer might consider incomplete or uncertain. This is recognised by the courts.

‘When two businessmen wish to conclude a bargain but find that on some particular aspect of it they cannot agree, I believe that it is not

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<sup>24</sup> *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] 2 QB 26, [1962] 1 All ER 474, CA.

<sup>25</sup> *Cehave NV v Bremer Handelsgesellschaft mbH, The Hansa Nord* [1976] QB 44

<sup>26</sup> Sale of Goods Act 1979 s 15A

uncommon for them to adopt language of deliberate equivocation, so that the contract may be signed and their main objective achieved. No doubt they console themselves with the thought that all will go well and that the term in question will never come into operation or encounter scrutiny'<sup>27</sup>.

The courts do in fact strive to uphold such agreements. Our point is that uncertainty does not always seem to be regarded as anathema by business people. It may be objected that there is a difference between uncertainty of contractual content and uncertainty of application of the law. However, the result in both cases is the same: the outcome of any dispute, should one arise, cannot be accurately predicted.

6.21 In the same way, whatever the lawyer's objection to "good faith" and similar principles it is not uncommon to find them expressly referred to in contracts. Thus, for instance, long term business agreements often contain so-called hardship clauses, under which the parties agree that if a change of circumstances should make performance of the contract significantly more onerous for one party the parties should meet and attempt in good faith to re-negotiate the contract to achieve a redistribution of the increased burden. Such clauses are probably not enforceable at common law which will not recognise and enforce an agreement to negotiate in good faith<sup>28</sup>. Similarly commercial contracts often contain dispute resolution clauses. It has become common for contractors to adopt structured procedures, the first stage of which may require the parties to attempt to negotiate a settlement of their dispute in good faith. Again there may be doubts about the legal enforceability of such agreements<sup>29</sup>.

6.22 Business may also be prepared to adopt broad standards which the lawyer might categorise as uncertain. A striking example is provided by the Uniform Customs and Practice for Documentary Credits (UCP) issued by the International Chamber of Commerce. The traditional approach of the courts, especially the English courts, to letters of credit is that, perhaps more than any other area of commercial contract law, they require certainty. The key stage of a documentary credit transaction is when the beneficiary of the credit presents the required documents to the bank to receive payment. The modern approach to interpretation of contracts and other commercial documents is flexible and non-technical<sup>30</sup>, but it has been said that this approach has no application to letters of credit<sup>31</sup> and case law requires the documents to strictly comply with the terms of the credit. The UCP, however, relaxes the requirement of strict compliance and states that a bank to which documents are presented shall determine their compliance with the credit "in accordance with

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<sup>27</sup> Per Staughton J in *Chemco Leasing SpA v Redifusion plc* (1985) unreported, quoted by Hirst J in *Kleinwort Benson Ltd v Malaysia Mining Corp* [1988] 1 All ER 714 at 720.

<sup>28</sup> *Walford v Miles* [1992] AC 128, [1992] 1 All ER 453.

<sup>29</sup> See *Halifax Financial Services Ltd v Intuitive Systems Ltd* [1999] 1 All ER Comm 303. Cf *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2002] 2 All ER (Comm) 1041.

<sup>30</sup> See *Investors Compensation Scheme Ltd. v West Bromwich Building Society* [1998] 1 All ER 98

<sup>31</sup> Per Lord Hoffmann in *Mannai Investments Co Ltd v Eagle Star Assurance Co Ltd* [1997] 3 All ER 352 at 380

international standard banking practice." It seems to us that there is little difference between a reference to "international standard banking practice" and a good faith or reasonable expectations standard pegged to current standards of business behaviour in the relevant sector<sup>32</sup>.

### III Ring fencing commercial contracts

6.23 In the preceding section we argued that the claims of certainty made for English law are perhaps sometimes overstated but that the continuing international popularity of English law amongst traders suggests that the international commercial community is perhaps less worried by uncertainty than is often claimed. If we accept, however, that uncertainty in the law relating to commercial transactions is nevertheless undesirable we must ask whether, if a general prohibition on unfair commercial practices, or a general requirement of fair trading, could, if adopted, be confined to consumer transactions.

6.24 First we must ask whether, if a general duty applicable to consumer transactions, were to be adopted it would be possible to devise a watertight definition of "consumer" or "consumer transaction". Domestic experience in this area is not encouraging. In the *R&B Customs Brokers* case<sup>33</sup>, the Court of Appeal held that a limited company could, in certain circumstances, when buying goods be acting not "in the course of a business" and thus be "dealing as a consumer" for the purposes of the Unfair Contract Terms Act. The upshot was that a limited company, albeit a small one and, on the facts of that case, one entering into a transaction for the purchase of a consumer item (a car), was able to take the protection of the strong controls imposed by the UCTA on exclusion clauses in consumer sale contracts.

6.25 A significant feature of the *R&B* decision was that the UCTA draws no distinction between natural and legal persons. There is therefore nothing in the Act to preclude a finding that a limited company is acting as a consumer. The tendency of EC consumer protection legislation is to define consumer more restrictively as a "natural person"<sup>34</sup>. Where this approach is adopted there is therefore no possibility that a limited company could take the protection of the relevant directive.

6.26 This does not however wholly resolve the issue. The restriction of the definition of "consumer" to "natural Persons" means that a limited company could never qualify as a consumer. However, a partnership or sole trader might be able to do so if it could satisfy the other requirements of the definition which require that it/he be acting "for purposes which are outside his trade, business or profession". This seems to suggest that a partnership or sole trader entering into a contract outside its normal line of business might be able to qualify as a consumer. For instance, it can be argued that - to take an example based on the facts of *R&B Customs Brokers* - a partnership buying a car for one of the partners would be acting for purposes which are outside its trade, business or profession, which is not the purchase of cars.

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<sup>32</sup> Although we should note that the ICC has issued guidance to attempt, to some extent, to "codify" international standard banking practice.

<sup>33</sup> *R B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 All ER 847, [1988] 1 WLR 321, CA.

<sup>34</sup> This is the approach adopted in the draft UCPD.

6.27 The point is debatable. Our point is that we cannot, as a result, rule out the possibility that an unincorporated business entering into an unusual contract might be held to be a consumer for certain purposes, with the result that any general "fairness" requirement would, to that extent, be applied to what we might loosely term a business contract.

#### IV "Leakage" from consumer to commercial contract law

6.28 In any case, even if it is possible to draw a clear line between consumer and non-consumer transactions we must consider separately whether there is any risk of "leakage" from consumer to non-consumer contract law. Such leakage may occur even though any new prohibition on unfair commercial practices, or requirement of fair trading, is restricted to consumer transactions as a result of the requirement, or aspects of it, being applied by analogy to non-consumer transactions. Alternatively the courts might take the new directive as indicating an underlying principle in the law and use it as a catalyst for development of a corresponding common law principle.

6.29 Here too experience suggests that there is a real risk that concepts developed in the context of consumer transactions may "leak" into the law applicable to commercial transactions. It may be instructive to consider briefly the history of the development of the law relating to exclusion and similar clauses. Before the introduction of statutory controls on exclusion clauses in the 1970s<sup>35</sup> the courts sought to develop methods to curb what was seen as their abuse, especially in contracts with consumers<sup>36</sup>. Two doctrinal developments are particularly noteworthy. First, the courts developed the concept of "fundamental breach" of contract, a breach so serious that it automatically destroyed the whole basis of the contract and therefore prevented reliance on any exclusion or limitation clause in the contract. Many (but not all) of the early cases in which the doctrine of fundamental breach was applied were concerned with consumer contracts<sup>37</sup> but the doctrine quickly spread and was applied to both consumer and commercial contracts. When applied to commercial contracts the doctrine was open to the objection that it could upset freely agreed commercial agreements as to the allocation of liability, and in the *Suisse Atlantique* case in 1967<sup>38</sup> (a case concerned with a charterparty and therefore what we might term a "pure" commercial contract) the House of Lords sought to rein in the doctrine by asserting that there was no rule of law that an exclusion clause could not exclude liability for fundamental breach but that in each case the scope of the exclusion was a matter of proper construction of the contract. Nevertheless having taken root the doctrine proved difficult to eradicate and it re-emerged in a slightly different form a few years

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<sup>35</sup> Initially in the Supply of Goods (Implied Terms) Act 1973 and then more generally in the Unfair Contract Terms Act 1977.

<sup>36</sup> For a graphic description see the judgment of Lord Denning in the Court of Appeal in *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284 at 296

<sup>37</sup> Eg: *Karsales (Harrow) Ltd v Wallis* [1956] 2 All ER 866; *Yeoman Credit Ltd v Apps* [1962] 2 QB 508; *Astley Trust Ltd v Grimley* [1963] 2 All ER 63; *Charterhouse Credit Co Ltd v Tolly* [1963] 2 QB 683. Cf *J Spurling Ltd v Bradshawi* [1956] 2 All ER 121

<sup>38</sup> *Suisse Atlantique Societe d'Armement Maritime SA v Rotterdamsche Kolen Centrale* [1967] 1 AC 361

later when the Court of Appeal, again in the context of a business-to-business contract held that where a fundamental breach occurred and the party not in breach chose to terminate the contract in response, the effect was that the whole contract, including the exclusion clause, ceased to exist. It was not until the House of Lords' decision in *Photo Productions Ltd v Securicor Transport Ltd* in 1980<sup>39</sup> that the doctrine of fundamental breach was (apparently) laid to rest<sup>40</sup>, and even now there are signs of its vestigial survival.

6.30 The history of the doctrine of fundamental breach illustrates the tenacity, and possible perniciousness, of doctrines once rooted in the common law. Even more instructive for present purposes is the history of the development of another rule originally intended to control the use of exclusion and similar clauses in contracts. This is the so-called "red hand" rule to which we have already referred above. As we have explained earlier the essence of the rule is that if a term is unusual in type or unusually wide it will not be incorporated into the contract by a general reference unless special steps are taken to draw attention to it. It is known as the "red-hand rule" because Lord Denning, in a typically memorable and graphic comment, remarked in one of the earliest cases on the point that in order to give them the required degree of prominence "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."<sup>41</sup>

6.31 The red hand rule can be seen as concerned with the upholding of the parties' reasonable expectations. A contractor to whom a standard form document is proffered may reasonably be expected to know that it is likely to contain contract terms if it is the sort of document which normally does contain such terms. But he will reasonably expect it to contain the sort of terms commonly found in a contract of that particular type. The inclusion of a term of an unusual type or which is unusually wide in scope will be contrary to his reasonable expectations and he therefore cannot be said to have agreed to the term by accepting the document<sup>42</sup>. To put it another way, as we have noted already, the "red hand rule" can be seen as a "good faith" doctrine and Sir Thomas Bingham in the *Interfoto* case identified it as one of the "piecemeal doctrines" by which English law seeks to uphold good faith between contractors<sup>43</sup>.

6.32 The origins of the "red hand rule" can be traced back to judicial dicta in cases decided in the late 19th and early 20th century concerned with exclusion and similar clauses in what would now be termed "consumer" contracts<sup>44</sup>, but in more modern

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<sup>39</sup> [1980] AC 827.

<sup>40</sup> See now UCTA 1977 s 9(2)

<sup>41</sup> *J Spurling Ltd v Bradshaw* [1956] 121 at 125. See also *Thornton v Shoe Lane Parking* [1971] 2 QB 163.

<sup>42</sup> Or, more accurately, since the test of agreement is objective, the profferor of the document cannot reasonably say that he believed that the profferee was agreeing to the unusual term.

<sup>43</sup> [1988] 1 All ER 348 at 352.

<sup>44</sup> See *Parker v South Eastern Railway Co* (1877) 2 CPD 416, per Bramwell LJ at 428; *Hood v Anchor Line (Henderson Bros) Ltd* [1918] AC 837 per Lord Dunedin at 846-7.

cases it has been applied to both consumer and commercial transactions<sup>45</sup> and now seems to be a rule of general application. Nor is it limited to exclusion and limitation clauses. In the *Interfoto* case it was applied to a contract term in a commercial (business-to-business) contract which provided for the payment of default charges for late return of hired photographic transparencies. In effect it now seems to operate, in effect, as a common law test of reasonableness<sup>46</sup> which, not being confined to exclusion clauses, is wider in scope than the statutory reasonableness test under the Unfair Contract Terms Act 1977<sup>47</sup>, and it has been equated with the test of good faith applicable to terms in consumer contracts.<sup>48</sup>

6.33 The doctrine of fundamental breach and the "red hand rule", both developed by the courts as means of controlling what were seen as unreasonable or unfair contract practices, illustrate how concepts developed in the context of consumer contracts can seep over into the law applicable to commercial contracts. (The converse is equally true: in developing the doctrine of fundamental breach the courts drew on a line of earlier cases concerned with contracts for the carriage of goods by sea in which it was held that the if the ship deviated from the agreed route it was no longer able to rely on any exclusion or limitation clauses in the contract.<sup>49</sup>).

6.34 It may be objected that at the time these rules were developed there were no clearly recognised separate categories of "consumer" and "non-consumer" contracts. Today, as a result primarily of statutory developments over the last 30 or so years, there is a much clearer differentiation between the two categories. In particular there is an awareness that there is a growing corpus of European law concerned with the protection of consumers, and it is clear that consumer and commercial contract law are diverging. It may be therefore that it would be easier today than in the past to distinguish between the two and confine rules devised for the protection of consumers to the field of consumer contracts.

6.35 In our view, however, it cannot be guaranteed that novel concepts can be confined to one category or the other in this way. First, as we have noted, the line between consumer and non-consumer transactions is not always clearly or consistently drawn. Second, although there may be a distinction for certain statutory

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<sup>45</sup> See *J Spurling Ltd v Bradshaw* [1956] 2 All ER 121; *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, [1988] 1 All ER 348, CA. *AEG (UK) Ltd v Logic Resource Ltd* [1995] CCH Commercial Law Reports 265 (see Bradgate (1997) 60 MLR 582); *Laceys Footwear (Wholesale) Ltd v Bowler International Freight Ltd* [1997] 2 Lloyd's Rep 367

<sup>46</sup> *J Spurling Ltd v Bradshaw* [1956] 2 All ER 121 per Denning LJ at 125. See also *AEG (UK) Ltd v Logic Resource Ltd* [1995] CCH CLR 265.

<sup>47</sup> It is also potentially applicable to contracts which are excluded from the scope of UCTA altogether, such as international supply contracts.

<sup>48</sup> See per Brooke LJ in *Laceys Footwear (Wholesale) Ltd v Bowler International Freight Ltd* [1997] 2 Lloyd's Rep 367 at p 385.

<sup>49</sup> Another example of the courts drawing on commercial law principles in a consumer context may be provided by the decision of the House of Lords in *Director-General of Fair Trading v First National Bank* where one of the factors influencing Lord Millett's decision that the clause there in question was not unfair was that similar clauses were commonly included in freely negotiated *commercial* contracts: see [2002] 1 All ER 97 at 118

purposes and often a difference in approach at common law there is no formal distinction between the two categories of contract at common law. Third, we would question whether it is necessarily useful to distinguish simply between "consumer" and "non-consumer" contracts. There is a growing awareness that small and medium sized businesses are often vulnerable to unfair contract practices and are therefore deserving of protection, especially when dealing with larger enterprises. Such thinking can be seen in modern European legislation such as the Commercial Agents Directive<sup>50</sup>, domestic legislation such as the Late Payment of Commercial Debts (Interest) Act 1998 (which was brought into force in stages and originally applied only in favour of small businesses) and can be seen to underpin decisions such as those in *R&B Customs Brokers* and *AEG v Logic Resource*.

6.36 Essentially the case for protecting small businesses is the same as that for protecting consumers: they are generally at a bargaining disadvantage when contracting with a larger business and therefore more likely to contract on unfair terms. There will therefore inevitably be a temptation to take concepts developed for the protection of consumers and extend them for the protection of small businesses. And once the consumer/non-consumer line is breached it is difficult to draw any sort of clear line between different categories of business-to-business contracts. Any distinction based on business size would be impressionistic, imprecise and ad hoc. In short, once the fairness rules are applied to one category of business to business contracts they are potentially applicable to all. It might be that in individual cases they would not be applied because, for instance, it is perceived that on particular facts there is no inequality of bargaining power, or no unfairness, to be corrected, but if our concern is with uncertainty, the mere possibility of controls being applied creates that uncertainty. In short, once the consumer/non-consumer line is crossed the genie is out of the bottle and the problem of uncertainty is live.

6.37 We should not overstate the problem. First, as we have suggested above, experience suggests that commercial law can tolerate a measure of uncertainty and that there is already a greater degree of uncertainty in the law than is sometimes recognised. Second, as we have also noted, it is probably too simplistic to see contract law as divided into consumer and non-consumer contracts. Indeed, for many purposes the needs of small businesses are closer to those of consumers than to those of large business contractors, especially those engaged in commodity and similar trading. Different classes of contractor are likely to have different needs and the relative significance placed on certainty and flexibility in the law may differ from one class of contractor to another. Speaking very generally we may expect that certainty is likely to be more of a priority for large scale commercial contractors such as those engaged in commodity trading, shipping and similar activities.

6.38 We cannot see any way formally to separate off large scale commercial ("mercantile") contracts from other business to business contracts, but experience suggests that the courts may be able to draw such a line; indeed in some cases it seems that the courts draw a clearer line between such mercantile and other contracts than between consumer and non-consumer contracts. Thus it has been held that although contract terms may often be classified as "innominate"<sup>51</sup>, time provisions,

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<sup>50</sup> Council Directive 86/653/EEC.

<sup>51</sup> See above, 6.19.

especially in "mercantile" contracts will normally be classified as conditions because of the importance in such contracts of certainty and the need for contractors to be able to make speedy decisions<sup>52</sup>. However, it is not at all clear what is a "mercantile" contract and how it differs from a "commercial" contract.

## V Factors tending to discourage leakage

6.39 If we were to adopt a general requirement (not) to trade (un)fairly its tendency to leak from consumer into commercial transactions law would depend on a number of factors.

6.40 First, there is probably a better chance of confining the fair trading requirement to a defined sphere of application, in this case consumer contracts, if it is created by statute than by common law. Whilst it is probably impossible ever to draft a totally watertight definition and, as we have observed, any definition of "consumer" is likely to be uncertain at the margin, a statutory definition is likely to be more watertight than a common law one.

6.41 On the other hand even if a statutory rule is not as such applicable in a given situation it may be used by the courts as the basis for the analogous development of the common law. Instructive in this connection are certain comments of Sir Thomas Bingham in the case of *Timeload Ltd v British Telecommunications plc*<sup>53</sup>. The case concerned the proper interpretation of s 3(2)(b) of the Unfair Contract Terms Act 1977, which in certain circumstances applies a test of reasonableness to terms by reference to which a contracting party claims to be entitled "to render a contractual performance substantially different from that which was reasonably expected of him". In *Timeload* BT sought to terminate the contract between themselves and Timeload relying on a clause in the contract which purportedly allowed them to do so. Counsel for BT argued that s 3(2)(b) had no application as the clause in question did not purport to permit BT to render a substandard or partial performance but defined the level of performance the customer was entitled to expect. Sir Thomas indicated that in his view it was at least arguable that s 3(2) was applicable, but continued

"If, however, s 3(2) does not in precise terms cover this case, I do not myself regard that as the end of the matter. ... It seems to me at least arguable that the common law could, if the letter of the statute does not apply, treat the clear intention of the legislature expressed in the statute as a platform for invalidating or restricting the operation of an oppressive clause in a situation of the present, very special, kind"<sup>54</sup>

6.42 A similar approach may underlie the decision in *Paragon Finance Ltd v Staunton*. That case also concerned UCTA s 3(2) and specifically its application to a clause in a credit agreement by which the creditor claimed to be entitled to vary the interest rate payable under the agreement. Section 3(2) clearly applies to clauses under which A purports to be entitled to reduce the level of his performance under his contract with B, but does it apply to a clause by which A purports to be entitled to

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<sup>52</sup> *Bunge Corpn v Tradax SA* [1981] 1 WLR 711 at 716 per Lord Wilberforce

<sup>53</sup> [1995] EMLR 459

<sup>54</sup> At p 468.

demand an increased level of performance from B? The Court of Appeal held that it does not but went on to hold that the term giving the creditor the discretion to vary the interest rate would be subject to an implied limitation that the discretion should not be exercised arbitrarily, capriciously or for an improper purpose, effectively imposing a common law reasonableness restriction on the exercise of the power granted by the contract.

6.43 A second factor tending to influence the tendency of a general fair trading requirement to leak from consumer to commercial contract law will be the mechanism for enforcement of the duty. If such a duty were to be enforceable as a private law right it would be easier to extend its principles into non-consumer contract law. On the other hand if the duty were to be enforced purely by administrative means its tendency to leak through to the non-consumer side would be less (and we note here that the Directive is expressly stated not to be intended to affect the law of contract.)

6.44 On the other hand if a general duty were to be created, even if as a purely administrative measure, it might well be seen as indicating what sort of conduct is and is not socially and commercially acceptable in general terms and therefore be capable of influencing the development of consumer and non-consumer contract law.

6.45 In any case we may doubt whether any general duty created by Directive would be purely administrative. Even if the Directive were not itself to provide for private law enforcement - eg: by an action for damages or rescission of the contract - it seems very likely that Member States would be required to provide an effective remedy which might at the very least require the affected consumer to be given an action for breach of statutory duty.

## **VI Factors tending to encourage leakage**

6.46 Leakage is also more likely to occur if the principles of any general duty are perceived as already immanent in domestic law. We have already considered the debate over the recognition of "good faith" in English contract law. As we have noted the orthodox position is that the imposition of a duty of good faith as between contractors would be inconsistent with the fundamentally individualistic ethic of English contract law<sup>55</sup>. However, we have also noted an increasing willingness amongst the judiciary and commentators to recognise that, at the very least, respect of "good faith" or "reasonable expectations" underlies much of not all of English contract law. To that extent, therefore, the values of a general duty (not) to trade (un)fairly (and, we might add, of the draft UCPD) may be said to be already immanent in domestic contract law<sup>56</sup>.

6.47 Many of the instances of unfair commercial practices likely to be covered by a general duty are practices already prohibited by existing common law doctrines, such as duress, misrepresentation and undue influence. We would anticipate that the

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<sup>55</sup> See 4.7.

<sup>56</sup> The shifting emphasis to a co-operative rather than adversarial ethic is reflected in the Unfair Terms Directive which states in the recitals that the requirement of good faith may be satisfied by the seller or supplier "where he deals fairly and equitably with the other party *whose legitimate interests he has to take into account.*"

adoption of a general duty would be more likely to influence the common law by influencing the development of those existing doctrines than by catalysing the creation of a general good faith or similar requirement. This is particularly likely to be the case if, as discussed above, the consumer were to be given private law rights against the trader engaging in unfair commercial practices -whether for breach of a contractual duty or, indirectly, for breach of statutory duty. If such private law rights were to be provided we would anticipate claims being brought and argued on the dual bases of the general duty and the corresponding common law rule. Thus, for instance, a claim for misrepresentation might be combined with a claim under the general duty that the trader engaged in a misleading practice.

6.48 With this possibility in mind we can identify a number of existing domestic law doctrines which are more or less analogous to the principles of the proposed general duty. On the one hand the existence of these doctrines might reassure us that there is little new in a general duty; on the other hand we might see these doctrines as potential nodes of development where the general duty might influence the development of domestic law. We have observed that a general duty (not) to trade (un)fairly would have a procedural and substantive dimension and that the procedural dimension divides into two aspects, freedom (from coercion and improper pressure) and full and accurate information. There are already existing common law doctrines which can be said to reflect those principles.

6.49 Insofar as the information aspect of the procedural aspect of fairness requires that the consumer not be given misleading information, English law already provides a large measure of protection. Foremost amongst the relevant common law doctrines is the doctrine of misrepresentation. English law generally offers a party who enters into a contract as a result of a false statement a range of remedial options, including the right to rescind the contract and/or claim damages for misrepresentation, or to claim damages or even terminate the contract for breach if the false statement has become a term of the contract. In many cases the contractor will be able to choose between these remedies. Moreover the same principles apply more or less identically to consumer and non-consumer transactions.

6.50 The main limitation of the law of misrepresentation is that it is generally said that English contract law does not recognise a duty of disclosure between contracting parties. Insofar as the informational aspect of procedural fairness requires that the consumer be provided not only with accurate but also with full information, English law may therefore be said to be deficient. However, the "no disclosure requirement" rule is somewhat eroded by a number of exceptions. Thus if a person makes a statement which is initially true he has a duty to correct it if, later, as a result of a change in circumstances, it becomes false<sup>57</sup>. Similarly if a person makes a partial statement which is true in itself but is misleading because of omission of some information, he is "guilty" of misrepresentation<sup>58</sup>. A duty of disclosure is imposed in the case of contracts of insurance, contracts of guarantee and contracts of compromise. Most importantly a duty of disclosure of a sort is effectively imposed in the case of contracts for the sale of goods by s 14(2C) of the Sale of Goods Act 1979.

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<sup>57</sup> *With v O'Flanagan* [1936] Ch 575, [1936] 1 All ER 727, CA; *Spice Girls Ltd v Aprilia World Service* [2002] EWCA Civ 15.

<sup>58</sup> *Dimmock v Hallett* (1866) 2 Ch App 21

Section 14(2) provides that it is an implied condition that the goods delivered will be of satisfactory quality. Section 14(2C) provides however that the buyer cannot claim that the goods are unsatisfactory by reference to any matter brought to his attention before the contract is made. The seller can thus avoid liability for a quality defect in the goods by disclosing it to the buyer. To put it another way, the seller who fails to disclose a defect is strictly liable for it.

6.51 The absence of a general duty of disclosure is further qualified by the ability of the court to construct positive representations of fact out of conduct<sup>59</sup>. Thus although there is no general duty of disclosure many cases of non-disclosure can, by manipulation of these various rules, be conceived of as instances of positive misrepresentation.

6.52 One of the principal arguments against the introduction of a duty of disclosure, especially in commercial contracts, is that it would provide a disincentive for contractors to invest time, effort and financial resources in making their own investigations, whilst depriving the party making disclosure of the benefits of its own investment. In a market context it is also argued that a duty of disclosure would require, for instance, a seller of goods or shares to indicate the price at which similar goods are trading in the market. There may therefore be a case for a wider duty of disclosure in consumer than in non-consumer cases

6.53 If English law does not generally require disclosure of information, it does indirectly impose a requirement of disclosure in relation to the terms of the contract. Thus we may note that the "red hand rule" discussed above effectively imposes a duty of disclosure, broadly analogous to the requirement in art 7, second paragraph, that the trader refrain from providing information in an "unclear, unintelligible, ambiguous or untimely manner".

6.54 The clarity with which contractual terms are communicated is also taken into account under both the Unfair Terms in Consumer Contracts Regulations, 1999 and the Unfair Contract Terms Act, 1977. In relation to the latter noteworthy cases include *The Zinnia*<sup>60</sup> in which the clarity of the language and presentation of an exclusion clause was held to be relevant to the assessment of its reasonableness, and *Stewart Gill v Horatio Meyer*<sup>61</sup> in which the Court of Appeal emphasised the importance of contractors being able to determine at the time of contracting the meaning and scope of terms proffered to them. Both cases concerned commercial contracts.

6.55 In similar vein it is clear that if a contractor presents contract terms in a misleading way he may be precluded at common law from relying upon them to their full effect or at all. The best known example of this principle is the case of *Curtis v Chemical Cleaning and Dying Co*<sup>62</sup> in which a woman took her wedding dress for dry cleaning and was asked to sign a document which stated that the cleaner would not be liable for any damage to the dress. She queried the term and was (wrongly) told that it

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<sup>59</sup> For a recent example see *Spice Girls Ltd v Aprilia World Service* [2002] EWCA Civ 15

<sup>60</sup> [1984] 2 Lloyd's Rep 211.

<sup>61</sup> *Stewart Gill v Horatio Myer Ltd* [1992] QB 600.

<sup>62</sup> [1951] 1 KB 805, [1951] 1 All ER 631, CA

applied only to certain types of damage, including damage to sequins. It was held that the cleaners could not rely on the term to a greater extent than the effect they had represented it to have.

6.56 *Curtis* was a consumer case but the same principle applies to commercial contracts. In *Harvey v Ventilatoren Fabrik Oelde GmbH*<sup>63</sup> a party who presented terms for signature in a misleading fashion was held not to be able to rely on them. The hard-line rule that a party who signs a contract is bound by its terms is therefore substantially qualified. We would anticipate that in a similar way the courts would hold that a party signing a contractual document would not necessarily be bound by an unusual or especially onerous term in the document unless special steps were taken to bring it to his notice<sup>64</sup>.

6.57 The same principle of disclosure of contract terms is apparent in the decision in *Smith v Hughes* where the court held that the seller of goods was under no duty to disclose to the buyer information about the goods, even where he knew that the buyer was mistaken about the nature of the goods, but that the contract would be void if the buyer were mistaken about the *terms* of the contract.

6.58 Insofar as fair trading requires that the consumer be free from coercion and improper pressure the key doctrines are the domestic law rules on duress and undue influence. The doctrine of undue influence mainly protects individual contractors. Its role in commercial contracts is therefore minimal. The modern doctrine of economic duress, on the other hand, was developed in cases arising out of (large scale) commercial contracts<sup>65</sup>. The doctrine does however have its limitations as is indicated by the decision in *CTN Cash and Carry Ltd v Gallaher Ltd*<sup>66</sup> in which it was held that a threat to perform a lawful act in pursuit of a claim bona fide believed to be valid will not ordinarily amount to duress in the context of arm's length commercial dealings so that a threat by a supplier to withhold future supplies from a customer unless the customer accepted the supplier's claim (which subsequently proved to be unfounded) under a separate transaction did not invalidate the customer's acceptance of the claim. Steyn LJ observed that 'it is a mistake for the law to set its sights too highly when the critical inquiry is not whether the conduct is lawful but whether it is morally or socially unacceptable'<sup>67</sup>. On the face of it this might seem to be an area where adoption of a general requirement might lead to further development of English law.

6.59 The *CTN* case effectively involved the exploitation of a superior bargaining position. Such conduct is not always countenanced. Aggressive use of superior bargaining power is taken into account under the Unfair Contract Terms Act, for at

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<sup>63</sup> [1988] BTLR 138. In this case the terms were presented in German with a partial English translation. The profferor was held not to be entitled to rely on a term not included in the translation.

<sup>64</sup> This is already the law in Canada: see *Tilden Rent-A-Car Co v Clendenning* (1978) 83 DLR (3d) 400

<sup>65</sup> See *North Ocean Shipping v Hyundai Construction Co, The Atlantic Baron* [1979] QB 705 (shipbuilding); *Pao On v Yau Liu Long* [1980] AC 614 (share sale).

<sup>66</sup> [1994] 4 All ER 714

<sup>67</sup> [1994] 4 All ER 714 at p 719

least two purposes. Section 3 of the Act applies to certain types of term appearing in (a) a contract between a business and a consumer or (b) a business-to-business contract where one deals on the other's written standard terms. One of the factors relevant to consideration whether terms are "standard" is the willingness of the profferor to negotiate or vary the terms. A business which in dealings with other businesses aggressively relies on its own standard terms and exploits superior bargaining power to do so therefore invites a challenge to the reasonableness of its terms. Balance of bargaining power is then a relevant factor to be considered when making the assessment of reasonableness. Where a business insists on the use of its own standard terms the terms (in so far as they are within the scope of s 3) will be subject to a test of reasonableness and there will be a bias towards finding them unreasonable by virtue of the manner of their imposition, unless they can be justified by reference to other counterbalancing considerations.

## **VII Conclusion**

6.61 Our analysis, and consideration of relevant precedents, leads us to conclude that introduction of a general fair trading duty applicable to consumer contracts is nevertheless likely to have an impact on the law applicable to non-consumer contracts. It is likely to do so in two ways. First, it is unlikely that any definition of consumer can be applied with absolute precision. There is inevitably an element of uncertainty at the margin as to who is and who is not a consumer. To a degree the typical EC law approach, which restricts the category of consumer to "natural persons" is more precise than the domestic law approach in statutes such as the Unfair Contract Terms Act, but even under the typical EC definition there is room for some doubt about the status of unincorporated businesses. There will inevitably be a temptation to stretch the category at the margin to extend protection to businesses - especially small businesses - perceived to be needing or deserving of protection in particular instances.

6.62 In addition there will be a natural tendency for any general fair trading principle to "leak" from consumer transactions into the law applicable to non-consumer transactions simply by its being treated as indicative of underlying social, moral and commercial values. In some cases judges may be tempted to develop the common law by analogy with the general requirement.

6.63 On the other hand we think it unlikely that a general fair trading requirement in consumer transactions would be applied wholesale to commercial transactions. Rather we anticipate that a general duty would tend to influence the development of the law by influencing the development of those existing doctrines, especially common law doctrines, by which English law already upholds fair trading principles.

6.64 Such development is likely to be seen as creating the potential for uncertainty which it is claimed is damaging to commercial law. We would submit however that there is no cause for undue alarm. If as we have suggested the influence of a general duty is more likely to be on the development of existing discrete doctrines the uncertainty created is likely to be manageable. The claims for the certainty of English contract law are, as we have demonstrated, sometimes overstated and evidence suggests that business can tolerate a measure of uncertainty. Indeed a general principle, whether of fair trading, upholding reasonable expectations or good faith, may well be welcome to business people, especially if pegged to relevant business standards, as being more accessible and comprehensible than existing technical legal rules.

6.65 On balance therefore we conclude that although adoption of a general fair trading duty might exert some influence on the development of the commercial law, such influence is likely to be relatively benign and can be tolerated.

## SECTION SEVEN

### CONSEQUENCES OF MAXIMUM HARMONISATION

#### I Introduction

7.1 The European Commission has put forward a proposal for a Framework Directive on unfair commercial practices (“UCPD”). This will be a “maximum harmonisation” measure. This would be a departure from the prevalent approach to harmonisation measures in the field of consumer protection which have hitherto generally been “minimum harmonisation” measures (with the notable exception of Directive 92/59/EEC on General Product Safety (to be replaced with Directive 2001/95/EC from 15 January 2004) and Directive 85/374/EEC on Product Liability).

7.2 The advantage of a “minimum” harmonisation measure is that Member States retain the freedom of maintaining or introducing rules which provide a higher level of consumer protection than required by the relevant directive. However, even in the case of minimum harmonisation measures, Member State freedom is restricted by the rules of the EC Treaty itself, in particular Article 28 EC on the free movement of goods.

7.3 A “maximum” harmonisation measure, on the other hand, takes away this freedom, and Member States cannot in any way alter the standard of protection adopted in a particular directive. The proposal to adopt a “maximum harmonisation” measure therefore raises concerns about the extent to which the directive would regulate trading practices which unfairly threaten consumers’ legitimate interests. Such concerns are two-fold: (a) the Directive might adopt a lower standard than current UK law and thereby create the potential for under-regulation. However, this may not inevitably be a bad thing, because there is some concern about the existing regulatory burden<sup>1</sup>, and some streamlining initiated by the need to implement the UCPD may be beneficial. (b) Alternatively, the UCPD may go further than existing regulation and therefore require an increase in the current regulatory burden.

7.4 This section will examine the potential impact of a maximum harmonisation UCPD. We must issue a *caveat* at the outset. At the time of writing, we were aware of the general thrust which the UCPD might take. However, the legislative process may change significantly the scope of this directive. This makes it difficult to carry out an *ex ante* evaluation of the impact of the UCPD.

7.5 We will proceed as follows: in section II, we will review the nature of harmonisation generally. In section III, we will briefly consider the criteria of minimum harmonisation measures, before turning to maximum harmonisation in section IV. In particular, we will examine the degree of freedom which may be given to Member States to adopt rules which diverge from the harmonised standard. In section V, we turn to the UCPD. We will first identify key variables which the directive might address, and then consider their potential impact on English law.

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<sup>1</sup> The policy behind the Regulatory Reform Act 2001 is to provide a framework to streamline legislation where this would promote a reduction of the regulatory burden imposed on business.

## II The Nature of Harmonisation

7.6 This section will review the key principles of harmonisation by the European Community and consider the degree of freedom left to the Member States by the different types of harmonisation measures.

7.7 A preliminary issue is to examine why harmonisation is necessary at all. The Treaty establishing the European Communities provides that the general objective of the EC is the creation of a single market. The main obstacle in achieving this has been the divergence in the various rules of the Member States affecting all aspects of the internal market. Consequently, it has been necessary to take steps to assimilate these rules to ensure that the operation of the internal market is not restricted and that everyone can participate in the market. The process of harmonisation of Member State rules has been crucial in this regard. However, the European Community does not have an all-encompassing competence to harmonise. It can only adopt legislation in those areas in which the Member States have given competence to the Community to Act. Thus, every measure requires a legal basis in a Treaty Article which provides for the adoption of secondary legislation to pursue a particular goal set out in the Treaty. Almost all consumer protection measures are adopted on the basis of Article 95 (former Article 100a) EC, for example<sup>2</sup>.

7.8 There are two broad types of harmonisation. The one we are concerned with here is known as “positive” harmonisation. Essentially, this means that the EC acts as a re-regulator by introducing a common set of standards across the Community. This may be contrasted with “negative” harmonisation, which is concerned with the removal of existing barriers to the free movement of goods, services, persons and capital by striking down domestic rules which are deemed to constitute such barriers (e.g., under Articles 28, 39, 43 or 49 of the EC Treaty).

7.9 Harmonisation should not be confused with unification. Harmonisation results in the creation of a set of rules common to all the Member States. It may also introduce fundamental concepts which have a particular “European” meaning (such as the notion of ‘good faith’ in the Unfair Contract Terms Directive, or the ‘conformity with the contract’ requirement in the Consumer Sales Directive) into domestic laws. However, Member States retain a considerable degree of discretion in deciding how their national rules should reflect the requirements imposed by a harmonisation measure. In particular, although new concepts may be introduced by a harmonising measure, Member States can generally utilise legal concepts and principles familiar to their legal system when giving effect to a harmonising measure.

7.10 Unification, on the other hand, goes considerably further than harmonisation. Unification would result in the complete replacement of particular aspects of domestic laws with a new set of laws adopted at the European level. The European Commission’s *Communication on European Contract Law*<sup>3</sup> suggested, as one option for the future development of contract law at the European level, the replacement of the contract laws of the Member States with a new uniform “European” law of contract.

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<sup>2</sup> We will return to examine Article 95 in more detail further below.

<sup>3</sup> COM (2001) 398 final.

7.11 Our concern is therefore with positive harmonisation. There are several forms of positive harmonisation, which may be classed according to the degree of freedom left to the Member States to adopt measures which diverge from the harmonised rules, although there is a lack of consensus about how many types of harmonisation there are<sup>4</sup>. For present purposes, we are concerned only with the distinction between the two dominant types of harmonisation, “minimum” and “maximum” harmonisation.

### **III Minimum Harmonisation**

7.12 We first turn to the nature of “minimum” harmonisation. This is a type of harmonisation which has gained in popularity since the Single European Act 1986. As the name suggests, a minimum harmonisation measure will lay down a minimum standard of regulation which all the Member States must follow. It will not be permissible to drop below this minimum standard. However, it is perfectly possible for Member States to go beyond this minimum level and to adopt a higher standard of regulation than the corresponding harmonising measure. This is only limited by the requirements of the EC Treaty, and Article 28 on the free movement of goods, in particular.

7.13 Minimum harmonisation does not remove all of the obstacles created by divergent national rules, but it seeks to reduce these to such an extent that the functioning of the internal market is no longer seriously affected. In effect, however, minimum harmonisation only narrows the freedom of Member States to regulate by mandating a minimum standard which needs to be met. Often, this is the result of a political compromise necessary to ensure that a harmonising measure in a particular area is agreed at all.

7.14 In some cases, the level of regulation in a minimum harmonisation measure is high and the actual freedom given to Member States to adopt higher standards is limited. Generally, however, there will be scope for divergence between the Member States above the level set by the minimum measure. Individuals and businesses are therefore still subjected to different rules throughout the Community. These differences may have the effect of discouraging individuals and businesses from taking advantage of the opportunities offered by the single market<sup>5</sup>.

7.15 A problem with minimum harmonisation therefore is that it does not remove the diversity in the laws and regulations between the Member States, but merely serves to reduce its breadth. Differences do remain, and may continue to pose a

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<sup>4</sup> See Steiner, Woods and Twigg-Flesner, *Steiner and Woods – Textbook on EC Law*, 8<sup>th</sup> edition, (Oxford: Oxford University Press, 2003), chapter 12, and Slot, P.J., “Harmonisation” (1996) 21 *European Law Review* 378-397.

<sup>5</sup> It may be difficult to establish the extent to which Member States can derogate from key aspects of a particular Directive. For example, the Consumer Sales Directive 99/44/EC requires that goods should be in conformity with the contract. There is no such rule in English law, which relies on the terms implied by ss.13-15 of the Sale of Goods Act 1979, as amended. It has been argued that all Member States should be required to introduce a “conformity” requirement and that there is no freedom to derogate from its core ingredients. See Rott, P., “Minimum Harmonisation for the completion of the internal market? – The example of Directive 1999/44/EC”, forthcoming.

barrier to the functioning of the single market<sup>6</sup>. Such problems are less prevalent in the case of maximum harmonisation measures.

#### IV Maximum Harmonisation and Scope for Derogation

7.16 In contrast to a minimum harmonisation measure, a maximum harmonisation measure will set a particular level of regulation from which the Member States may not depart, save in specific circumstances. Member States must ensure that their domestic laws reflect exactly the requirements of a harmonising measure, and may not derogate from this to create a higher level of protection.

7.17 The general principle is that once the Community has legislated in a particular field, Member State competence in this area has been pre-empted. This was clearly established in case 16/83 *Prantl*<sup>7</sup>, where the ECJ held that

“Once rules on the common organisation of the market may be regarded as forming a complete system, the Member States no longer have competence in that field unless Community law provides otherwise.”<sup>8</sup>

7.18 We can see that there are two aspects to the freedom of Member States to derogate from a harmonising measure: first, competence is displaced altogether in the field subject to the maximum harmonisation measure. However, Member State competence is only displaced, or pre-empted, in respect of the field occupied by the harmonising measure. Consequently, aspects which are not within the scope of the harmonising measure are not pre-empted by the Community measure and Member States retain the freedom to regulate such aspects without incurring the risk of liability for failure to comply with EC Law. Secondly, and by way of derogation from the first aspect, to the extent that Community law provides otherwise, derogation is possible. Thus, the harmonising measure itself may permit derogation from the Community standard in specific areas, or the legal basis upon which a measure is adopted may provide for this.

7.19 In order to establish the extent to which Member States may therefore act in an area in which the Community has adopted a maximum harmonisation measure, the first step will have to be to examine the scope of this measure to discover the extent to which Member State competence in the relevant field has been pre-empted. This is essentially a question of construction, or interpretation, of the Community measure concerned<sup>9</sup>. A classic example is case 60/86 *Commission v United Kingdom (Dim-Dip Lights)*<sup>10</sup> which held that Directive 76/756 specified exhaustively the types of lights which could be fitted to cars. Consequently, the UK’s requirement that all new cars should be equipped with dim-dip lights was incompatible with the Directive, despite the fact that dim-dip lights could have contributed to improving road safety. Similarly,

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<sup>6</sup> We do not need to concern us here with the question of reverse discrimination, and to what extent higher national standards may only be applied to products made in the particular Member State, whereas products from other Member States must be allowed onto the market provided that these comply with the requirements of the minimum harmonisation measure.

<sup>7</sup> C-16/83 *Prantl* [1984] ECR 1299.

<sup>8</sup> *Ibid.*, paragraph 6.

<sup>9</sup> See Weatherill, S., “Pre-emption, harmonisation and the distribution of competence to regulate the internal market”, in Barnard, C. and Scott, J., *The Law of the Single European Market – Unpacking the premises* (Oxford: Hart Publishing, 2002), p.52.

<sup>10</sup> [1988] ECR 3921.

in case C-52/00 *Commission v France*<sup>11</sup>, France's decision not to implement the provision in Article 9 of the Product Liability Directive (85/374/EEC<sup>12</sup>) that for liability to arise, the damage caused must exceed €500, on the basis that not to do so would increase consumer protection was held to be incompatible with the Directive.

7.20 *Commission v France* also illustrates the difficulties of construction and interpretation to determine the scope of a maximum harmonisation measure. The Product Liability Directive holds the producer of goods which are defective within the meaning of the Directive strictly liable for personal injury or property damage caused by the defect. "Producer" is defined in Article 3(1). The Directive provides that, without prejudice to the liability of the producer, an importer of goods may be deemed to be a "producer" within the meaning of the Directive (Article 3(2)). Finally, Article 3(3) specifies that each supplier of the product in question shall be treated as its producer where the producer/importer cannot be identified, unless the supplier provides the consumer with details of the producer or importer. A supplier is therefore only affected by the rules in the Directive in narrowly defined circumstances. In *Commission v France*, the question arose to what extent Member States were free to provide for the liability of the *supplier* of defective goods beyond the limited range of circumstances specified in Article 3(3). France had provided that a supplier should be liable in the same way as a producer, having taken the view that Article 3(3) did not pre-empt Member State action as far as the liability of suppliers is concerned<sup>13</sup>. The ECJ disagreed and, in adopting the narrow view that Article 3(3) had pre-empted the right of the Member States to adopt rules on the strict liability of suppliers, held that in doing so, France had violated the Directive. This ruling has given rise to considerable unease among the Member State and has produce a highly unusual response. On 19 December 2002, the Council of the European Union adopted a resolution in which it expressed its disagreement with the ECJ's position and called for the amendment of the Directive to allow Member States the right to choose whether to put the liability of suppliers on the same footing as that of producers under the Directive<sup>14</sup>.

7.21 In the context of the UCPD, the first thing that would need to be considered is its scope, i.e., the extent of the field which has been pre-empted by the UCPD. As this is a matter of interpretation and construction, it may be advisable to ensure both the operative provisions of the UCPD and the recitals are set out in clear terms and are as explicit as possible about the reach of the UCPD.

7.22 Member State competence is preserved in respect of those aspects which fall outside the regulated field. However, even within the field occupied by a maximum harmonisation measure there may be some scope for derogation given to the Member State. This will be the case where the measure itself contains express provisions permitting such derogation. Yet again, the Product Liability Directive provides a good

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<sup>11</sup> [2002] ECR I-3827.

<sup>12</sup> (1985) O.J. L 210/29, 7 August 1985, as amended by Directive 99/34/EC (1999) O.J. L 141/20, 4 June 1999.

<sup>13</sup> This seemed to be in accordance with the views of the Commission and Council, who had issued a joint statement at the time the Directive was adopted to the effect that Member States were free to adopt rules on the liability of intermediaries (see Council Resolution 2003/C 26/02) of 19 December 2002, (2003) O.J. C 26/2, 4 February 2003).

<sup>14</sup> Council Resolution 2003/C 26/02) of 19 December 2002, (2003) O.J. C 26/2, 4 February 2003

example. In its initial form, it contained a number of options, including the possibility for Member States to extend the scope of the Directive to primary agricultural produce (now required following amendment of the Directive in 1999) and to make available the so-called “development risk” defence. Similarly, the Commercial Agents Directive gives Member States the choice to select between the “compensation” and “indemnity” systems.

7.23 Where such options are available, it is possible to derogate from the standard mandated by the harmonising measure, but only to the extent that this is specified. In case C-52/00 *Commission v France*, it had been argued that the various options expressly included in the Product Liability Directive allowed the inference that Member States could derogate from the other provisions of the Directive. This was rejected by the ECJ, which observed that

“The margin of discretion available to the Member States ... is entirely determined by the Directive itself and must be inferred from its wording, purpose and structure.”<sup>15</sup>

7.24 Derogation from a maximum harmonisation measure is therefore only permitted in the circumstances set out in that measure. It is not permissible to depart from the standard adopted in such a measure in any other respect<sup>16</sup>.

7.25 A further possibility for derogation from a maximum harmonisation measure may be offered by the legal basis on which that measure is adopted. As noted previously, all Community measures require a legal basis in a Treaty Article. Consumer protection measures have generally been adopted on the basis of Article 95 EC. This Article provides for the adoption of harmonisation measures which have as their objective the establishment or functioning of the internal market<sup>17</sup>. Many of these measures are minimum harmonisation measures and derogation is therefore permitted to the extent that this raises the degree of protection in the field occupied by the relevant measure.

7.26 However, if the measure is a total harmonisation measure, derogation will only be permitted in the circumstances specified in Article 95. In short, Member States may *retain* national provisions in the field occupied by a harmonisation measure adopted on the basis of Article 95 only on grounds of major needs referred to in Article 30 EC, or relating to the protection of the environment or working environment (Article 95(4)). We can therefore see that derogation is not permitted in order to provide a higher level of consumer protection except to the extent that public health generally might be at risk. The competence of Member States to *adopt new* derogating measures is restricted to the protection of the environment or working environment on grounds specific to that Member State (Article 95(5)). Consumer

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<sup>15</sup> [2002] ECR I-3827, paragraph 16. See also C-183/00 *Sanchez v Medicina Asturiana SA* [2002] ECR I-3901.

<sup>16</sup> We do not consider the question of how to deal with circumstances where another Member State fails to adhere to a Community norm, save to note that it is not permissible to derogate from a harmonising measure in such circumstances by relying on the derogation provision of Article 30 EC (see case C-5/94 *R v MAFF, ex parte Hedley Lomas (Ireland) Ltd* [1996] ECR I-2553).

<sup>17</sup> See Weatherill, n.9 above, and Steiner, Woods and Twigg-Flesner, n.4, above, for a detailed discussion of the scope of Article 95 in the wake of the judgment in C-376/98 *Commission v Germany* (“*Tobacco Advertising*”) [2000] ECR I-8419.

protection therefore cannot be a justification for introducing new measures which conflict with a harmonising measure in the same field, *even where there are specific problems in one Member State*.

7.27 To summarise: a maximum harmonisation measure pre-empts Member State competence to regulate the field occupied by that measure save to the extent that the measure itself provides for derogation in specific areas or the legal basis permits derogation. Member States retain the competence to regulate matters which fall outside the field regulated by the harmonising measure, although there may be practical difficulties in determining the full extent of the “occupied field”.

7.28 One further difficulty with a maximum harmonisation measure can be identified here. It is inevitable that domestic courts will sooner or later be asked to apply the rules introduced by a maximum harmonisation measure. This will entail the domestic court having to interpret particular aspects of such a measure. The more flexible the measure is, the greater will be the risk of different courts adopting different interpretations, which in turn might result in national legal systems drifting apart again. This risk is mitigated, to some extent, through the possibility of referring a preliminary question of interpretation to the European Court of Justice under the Article 234 EC preliminary reference procedure. However, although lower courts are entitled to make such a request, they are not obliged to do so; it is only the final court that may deal with a particular case under the national legal system which is required to refer a question of interpretation to the ECJ<sup>18</sup>.

## **V The Proposed Framework Directive and Maximum Harmonisation**

7.29 We noted earlier that the proposal to adopt the UCPD as a maximum harmonisation measure gives rise to concerns over (a) a risk of under-regulation and (b) the potential for spill-over into non-consumer transactions, and possibly even the law of contract in general.

7.30 It is proposed that the UCPD will be a maximum harmonisation measure; its impact on domestic law depends on a number of variables which we will examine in the remainder of this section. There would only be a very limited scope for the UK to derogate from the provisions of the directive; based on the discussion in the preceding paragraphs, it would only be possible to derogate if the UCPD contained an express option to do so. The overall impact of the UCPD on existing English law would, of course, depend on the scope of the UCPD itself. In section 8, we examine the draft UCPD put forward by the Commission on 18 June 2003. For the purposes of the remainder of this section, we disregard the current proposals and proceed with a hypothetical analysis of the potential impact of the UCPD as a maximum harmonisation measure.

7.31 We can identify a number of variables which will determine the full impact of the UCPD on English law. These are: the nature of the fairness test; the potential impact on contract law, in particular pre-contractual application; whether the fairness test applies to particular transaction or more generally to a trader’s overall behaviour; how the duty should be enforced; and the consequences of a breach of the fairness test. We will expand on these in the following paragraphs, but we can note here that

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<sup>18</sup> For a detailed analysis of the Article 234 procedure, see Steiner, J., Woods, L. and Twigg-Flesner, C., *Steiner and Woods – Textbook on EC Law*, 8<sup>th</sup> edition, (Oxford: Oxford University Press, 2003), chapter 26.

these are not discrete, but to a large extent mutually interdependent, and there is no particular order in which we address these.

### *V.1 The Nature of the Fairness Test*

7.32 Perhaps the most significant aspect of the UCPD will be the nature of the so-called “general clause”, i.e., the provision which will set out the fairness test that will govern consumer transactions. A number of different possibilities have been considered, ranging from a very broad general duty to trade fairly (or in good faith) to the more limited duty not to engage in particular unfair business practices. It is clear that the UCPD will fall somewhere in between these two principles.

7.33 If we assume that the UCPD will introduce a general duty to trade fairly, then its impact on English law could, potentially, be far-reaching. We have already considered this in section 2 of this report. The maximum harmonisation nature of the UCPD would mean that this general duty would replace any existing rules which could be characterised as constituting elements of such a duty. However, the impact on the English consumer law of contract may be less extensive if the proposed duty is phrased in terms of not affecting contract law and/or not being of individualised application. We will deal with these points below.

7.34 It is equally conceivable that the UCPD might do no more than identify particular business practices as unfair and propose how these should be dealt with. In that case, English law would have to be adjusted to ensure that those activities which are deemed unfair by the UCPD are managed accordingly.

7.35 However, in its current draft form, the UCPD combines a general requirement on businesses not to trade unfairly when dealing with consumers, together with more clearly defined specific instances and a binding list of activities which would always be regarded as unfair. This is a scheme which would not be dissimilar to that adopted in Directive 93/13/EEC on Unfair Terms in Consumer Contracts, which provides that terms which, contrary to the requirement of good faith, create a significant imbalance of obligations to the detriment of the consumer, are unfair and not binding on consumers. An indicative (rather than a binding) list of unfair terms is attached to the Directive.

7.36 If this is the direction that is eventually taken, it would still depend on the reach of the UCPD to what extent existing English law would need to be revised in order to comply with the directive. In particular, if the UCPD were not to apply to individual transactions, but rather cover business behaviour more generally, the impact of the directive would be considerably less severe. The same would be true if there was no intention that the UCPD would affect the general rules of contract law.

7.37 Irrespective of the exact shape which the general duty might take, it is possible that the maximum harmonisation nature of the UCPD may, in the medium to long term, give rise to difficulties in adapting to changes in business practice and consumer expectations. We have suggested elsewhere (see section 4) that one of the aspects of a general fairness duty (whichever shape it may take) is that it must allow the law to evolve in accordance with a society’s conception of fairness. This requires some elasticity to allow the scope of the general duty to be adjusted to take account of such developments. In the context of a general clause, such evolution would primarily be achieved through judicial interpretation. However, it is not clear to what extent domestic courts could develop a general clause in the case of a maximum harmonisation measure. There is therefore a danger that the framework introduced by

the UCPD would, over time, fail adequately to protect consumers.<sup>19</sup> It is possible that some evolution will be facilitated through the use of the Article 234 reference procedure, which will enable the ECJ to rule on the scope of the general clause. ECJ judgments in this respect would be binding on all domestic courts. Such difficulties might be less likely if the UCPD were not maximum harmonisation measure.

#### *V.2 Potential Impact on Contract Law, in particular pre-contractual application*

7.38 A second factor which may determine the weight of the UCPD's impact is whether it will require modification of existing contract law doctrines, or whether it leaves contract law unaffected. Our earlier analysis has assumed that there would be some impact on the law of contract, but this would not have to be the sole way forward. It is, for example, possible that the UCPD is imposing a general obligation on business to trade fairly, or not to trade unfairly, which would take the form of a statutory duty (or the European law equivalent).

7.39 If the UCPD does not affect contract law (as indeed it does not in its current draft), then the impact on domestic law might be considerably less severe. It seems that the key measure that would be affected is Part 8 of the Enterprise Act 2002, (which replaces Part III of the Fair Trading Act 1973) which would require some adjusting to incorporate the requirements of the UCPD.

7.40 However, what if the UCPD did affect contract law? In particular, what if this covered pre-contractual aspects, as well as the contractual relationship itself? This could, potentially, result in a full-scale revision of existing contract law principles, to the extent that long-established doctrines would need to be modified, or even replaced altogether, to comply with the requirements of the UCPD. However, as the UCPD will probably focus on business-to-consumer transactions, it would not inevitably be necessary to abandon centuries of established doctrine just to comply with the directive. The existing law of contract, to the extent that it is affected by the UCPD, would be disappplied in the context of transactions which fall within the scope of the directive, but remain in place for all other transactions.

7.41 The draft UCPD issued by the Commission suggests that misleading and aggressive business tactics would be at the centre of the directive. On this basis, if the directive were ultimately intended to affect contract law, it may be necessary to revise the established rules on misrepresentation and duress, to name but two, in order to comply with the UCPD. However, it would be necessary to establish the full scope of the directive to determine whether its requirements differed significantly from the existing set of rules, and it may be the case that few, or even no, changes may be required.

7.42 If the impact on contract does not extend to pre-contractual matters, but is limited to fair dealing in contractual performance, then the impact on contract law, whilst anything but negligible (as demonstrated in sections 2-4), might be less severe, because many established doctrines and principles would remain largely unaffected in the immediate wake of the transposition of the directive. However, it would seem likely that contract law would, over time, undergo a degree of modulation to reflect the greater emphasis on fair dealing which the UCPD might introduce.

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<sup>19</sup> The Q&A press release accompanying the draft UCPD (MEMO/03/135, 18 June 2003) states that the indicative list of unfair practices to be included in the directive (see section 8) can only be updated, amended and reviewed by legislative means.

7.43 Thus, if the current proposal that the UCPD does not affect contract law is retained, its implementation would not be as problematic. In particular, if the general rules of contract remain unchanged, the danger of spill-over (which we considered in the previous section) into non-consumer transactions would be reduced considerably.

### *V.3 Individualised or General Application*

7.44 The impact of the UCPD further depends on whether this is intended to apply to individual consumer transactions, or whether it applies only to the general market behaviour of businesses when dealing with consumers. This question is closely linked with the preceding discussion of the directive's potential impact on the law of contract. If the directive has a direct impact on contract law, it would almost certainly also be of individualised application.

7.45 It is also possible that the UCPD could be both of general and individualised application. This approach could have the most far-reaching consequences for domestic law, potentially affecting the law of contract as well as general regulatory measures adopted in the sphere of consumer protection.

### *V.4 Consequences of breach*

7.46 A further question is what the consequences of a breach of the general duty would be, and whether any particular sanctions would be made available. This matter is closely related with the previous two issues, i.e., the potential impact of the UCPD on the law of contract and the question of individualised application.

7.47 If we assume that the UCPD applies to individual transactions, then it seems likely that a breach of the general duty would affect such transactions. For example, it may be that such transactions are voidable or void. Given this scope, the UCPD would not only affect established contract law doctrines, but also the remedies which are currently made available. Alternatively, specific remedies might be made available for consumers whose transactions were entered into or performed in breach of the duty. We may note here that the draft UCPD is silent on the rights of individual consumers.

7.48 However, if the directive applies to *general* business behaviour, rather than to individual transactions, a breach of the duty should not affect particular transactions. Such transactions may, of course, be impeachable on other grounds. As far as a breach of the general duty is concerned, it seems that the business concerned would be made aware of its failure to act in accordance with the duty, and an appropriate sanction (warning, injunction, fine) be applied.

### *V.5 Enforcement of duty*

7.49 A final consideration is how the duty would be enforced. If the duty is of general application and does not have an immediate effect on the domestic law of contract, then it seems probably that an administrative law enforcement mechanism will be adopted. This would follow a model already established at the European level of giving designated public bodies and other organisations with a legitimate interest in consumer protection the right to take action if a business has failed to comply with the general duty, e.g., by applying to a court for an injunction<sup>20</sup>. This is the scheme currently envisaged in the draft UCPD.

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<sup>20</sup> See Directive 98/27/EC ("Injunctions Directive") and the corresponding provisions in Part 8 of the Enterprise Act 2002. See also Directive 93/13/EEC on Unfair Terms in Consumer Contracts, implemented by the Unfair Terms in Consumer Contracts Regulations 1999.

7.50 If the duty applies to individual transactions (whether in the alternative or in addition to a general application), then the duty would be enforceable by individual consumers affected by a breach taking action to obtain redress.

#### *V.6 Draft UCPD*

7.51 We note here that the draft UCPD reflects the policy decisions that have been made in respect of the variables we have identified above. Some of the potential problems identified above would not materialise if the UCPD were adopted in its current form (see further, section 8). However, during the legislative process, amendments to the scope of the UCPD are likely to be tabled both by Parliament and the Council, and the preceding analysis provides at least some indication of the potential impact of altering one or more of these variables.

### **VII Summary**

7.52 Adopting the proposed UCPD as a maximum harmonisation measure, would mean that the UK government would not be able to deviate from the standard of protection adopted in the directive. In consequence, it would not be permissible to retain existing rules which derogate from the UCPD's general standard, nor would it be possible to introduce new rules which might conflict with the general framework established by the directive.

7.53 The maximum harmonisation nature of the UCPD will almost certainly make it more difficult to adapt the general clause to changing business practices and consumer expectations, as well as society's conception of what is fair or unfair generally.

7.54 It would be necessary to establish the precise scope of the UCPD in order to identify domestic measures which would have to be repealed, or amended, in order to comply with the directive. We have identified a number of factors which may be of relevance in setting the scope of the directive, and the potential impact which the directive might have on UK law as a result.

7.55 If the current proposal to introduce a relatively confined duty not to engage in unfair commercial practices is not altered significantly, then the impact of the UCPD may be relatively insignificant. In particular, it would have little, if any, immediate consequences for the general law of contract. One measure which would almost certainly require some revision is Part 8 of the Enterprise Act, although it may be possible for regulations to be made under section 210(9)<sup>21</sup> and 211(2)<sup>22</sup> of the Act (rather than s.2(2) of the European Communities Act 1972) to implement the UCPD.

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<sup>21</sup> Providing for additions to Schedule 13 of the Enterprise Act 2002, which contains a list of directives covered by the Act.

<sup>22</sup> This subsection empowers the SoS for Trade and Industry to specify what constitutes a domestic infringement. It may be possible to use this provision to introduce regulations which adopt the UCPD standard.

## SECTION EIGHT

### THE DRAFT UCPD – ANALYSIS AND COMMENT

#### I Introduction

8.1 On 18 June 2003, the European Commission presented its *Proposal for a Directive of the European Parliament and Council concerning unfair business-to-consumer commercial practices in the internal market (the unfair commercial practices Directive)* (“UCPD”), together with an explanatory memorandum.

8.2 In this final section, we briefly analyse this draft directive and, based on our findings in the preceding sections, we offer some conclusions on the impact of the UCPD were it to become law in its present format. We also identify existing domestic measures which should, or could, be repealed in order to comply with the requirements of the draft UCPD. Clearly, at this stage, our conclusions are preliminary only; the directive may undergo substantial changes as it makes its way through the legislative process.

#### *Scope of the UCPD*

8.3 Unlike most other consumer protection measures, the UCPD would be a maximum harmonisation measure (see section 7), approximating the laws, regulations and administrative provisions on *unfair commercial practices harming consumers’ economic interests*.(Article 1). It would be adopted on the basis of Article 95, and its primary objective would therefore be to improve the functioning of the internal market. The Explanatory Memorandum to the draft UCPD sets out the obstacles which impede the internal market that have been identified.

8.4 Article 2 provides a detailed list of definitions. “Consumer” is defined as “any natural person who, in commercial practices covered by this Directive, is acting for purposes which are outside his trade, business or profession”. This is the formulation also used, e.g., in the Consumer Guarantees Directive.<sup>1</sup> The phrase “in commercial practices covered by this Directive” sounds odd; indeed, it seems that it is not the “commercial practices” which should be the focus of the definition, but rather the transactions which are entered into as a result of the commercial practice.

In addition, the UCPD defines the concept of “average consumer” as “the consumer who is reasonably well informed and reasonably observant and circumspect”, taking the lead given by numerous judgments by the European Court of Justice. A seller or supplier, also referred to as “trader”, is “any natural or legal person who, in commercial practices covered by this directive, is acting for purposes related to his trade, business of profession”. Finally, “product” is defined to include both goods (including immovable property) and services.

8.5 Article 3 then sets the limits of application of the UCPD. Thus, it is without prejudice to the rules on the validity, formation or effect of a contract. Moreover, it is also without prejudice to the determination and quantification of the types of damage which may be caused by an unfair commercial practice. If there is a conflict between the UCPD and existing EC legislation on consumer protection, the latter prevails.

8.6 Article 4 states that traders are only required to comply with the national provisions in the field of the UCPD in the Member State where they are established.

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<sup>1</sup> Directive 99/44/EC on certain aspects of the sale of consumer goods and associated guarantees (1999) O.J. L 177/12.

Moreover, Member States are not permitted to restrict the free movement of goods or services on the basis of unfair commercial practices. It thereby emphasises that traders are subject to the principles of “home country control” and “mutual recognition”.

#### *Unfair Commercial Practices*

8.7 Article 5(1) contains the so-called general clause, which simply states that “unfair commercial practices are prohibited.” A ‘commercial practice’ is defined in Article 2 as “any act, omission, course of conduct or representation, commercial communication including advertising and marketing, by a trader, directly connected with the promotion, sale or supply of a product to consumers”.

8.8 According to Article 5(2), for a commercial practice to be “unfair”, it must:

- (a) Be contrary to the requirements of professional diligence (defined as “the measure of special skill and care exercised by a trader commensurate with the requirements of normal market practice towards consumers in his field of activity in the internal market”); and
- (b) materially distort (or be likely to do so) the economic behaviour with regard to the product of the average consumer whom it reaches or to whom it is addressed, or of the average member of the group when a commercial practice is specifically directed to a particular group of consumers. “Materially distorting the economic behaviour of consumers” is defined as “using a commercial practice to significantly impair the consumer’s ability to make an informed decision and thereby causing the consumer to take a transactional decision that he would not have taken otherwise.”

8.9 Thus, in order to establish that an unfair commercial practice has been adopted by a trader, it must be established that

- (i) the trader’s action are contrary to the requirements of professional diligence,
- (ii) which affects the average consumer such that
- (iii) his ability to make an informed decision is materially distorted with the effect that
- (iv) the consumer decides to buy goods or services which he would otherwise not have bought, or not bought from the particular trader; or to continue/terminate the commercial relationship with the trader.

8.10 An English lawyer might describe this as an instance of reasonable reliance and change of position which is found in areas such as estoppel, although the parallel between the UCPD and existing English doctrines should not be drawn too readily.

8.11 In addition to this general clause, Article 5(3) specifies that misleading or aggressive practice as defined in the Directive will be regarded as automatically unfair. Annex I of the UCPD contains a list of commercial practices which will always be regarded as unfair (a so-called “black list”).

8.12 According to Article 6, a practice is misleading and therefore caught by the general prohibition if “in any way, including overall presentation, [it] causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise” because it deceives, or is likely to deceive him in relation to:

- Main characteristics of the product (availability, benefits, after-sales service, origin, result of testing etc.)
- Any statement/symbol in relation to direct/indirect sponsorship of the trade or product
- Price, calculation of price, or existing of specific price advantage.
- The need for a service, part, replacement or repair
- The nature, attributes and rights of the trader (or his agent), such as professional qualifications, ownership of IP rights, awards and distinctions etc.
- Claims about the product which the trader cannot substantiate
- The consumers' rights, or the risks he may face.

8.13 Commercial practices are also treated as misleading, where in its factual context and taking account of all its features and circumstances, it causes the consumer to make a transactional decision he would otherwise not have taken, and this involves:

- Marketing of the product, including comparative advertising, which creates confusion with any products, trade marks or names and other distinguishing marks of a competitor
- Non-compliance by the trader with commitments contained in codes of conduct by which the trader has undertaken to be bound where:
  - The commitment is firm and capable of being verified
  - Information specifying the trades to whom the code applies and the content of the code are publicly available;
- Non-compliance given to a public authority to cease an unfair commercial practice under this directive

8.14 Article 7 provides that a commercial practice which, “in its factual context, taking account of all its features and circumstances, omits material information that the average consumer needs according to the context, to take an informed transactional decision” will also be unfair in the same way as misleading actions. This also applies where a “trader hides or provides in an unclear, unintelligible, ambiguous or untimely manner” material information. Article 7(3) further provides that for a misleading omission to occur before a commercial transaction, the trader must have made an invitation to purchase, in which case the following information is regarded as material:

- Main characteristics of the product
- Trading name of trader
- Price inclusive of all taxes, as well as any additional costs such as transport, delivery; where these cannot reasonably be calculated in advance, the fact that additional charges may be payable
- Arrangements for payment, delivery, performance and the complaint handling procedure (if they depart from the requirement of professional diligence)

- Where relevant, the existence of a right of withdrawal or cancellation
- Information requirements in relation to advertising, commercial communication or marketing established by Community law (Article 7(4)), a non-exhaustive list of which is provided in Annex II of the Directive

8.15 Article 8 defines an aggressive commercial practice as one involving harassment, coercion or undue influence which significantly impairs, or is likely to do so, the average consumer's freedom of choice.

8.16 Article 9 specifies that in order to determine whether a commercial practices uses harassment, coercion or undue influence, the following are relevant:

- (a) its timing, nature or persistence
- (b) the use of threatening or abusive language or behaviour
- (c) the use by the trader of any specific misfortune or circumstance of such gravity as to impair the consumer's judgment, of which the trader is aware, to influence the consumer's decision with regard to the product
- (d) any onerous or disproportionate non-contractual barriers established by the trader where a consumer wishes to exercise his rights under the contract (including termination and switching provider)
- (e) any threat to take any action that cannot legally be taken

8.17 Finally, the black list in Annex I provides that the following are automatically to be regarded as unfair commercial practices:

#### **Misleading commercial practices**

- (1) Claiming to be a signatory to a code of conduct when the trader is not.
- (2) Claiming that a code of conduct has an endorsement from a public or other body which it does not have.
- (3) Making an invitation to purchase products at a specified price if there are reasonable grounds for believing that the trader will not be able to offer for supply or to procure another trader to supply, those products or equivalent products at that price for a period that is, and in quantities that are reasonable having regard to the product and price offered (bait advertising).
- (4) Making an invitation to purchase products at a specified price and then:
  - (f) refusing to show the advertised item to consumers, or
  - (g) refusing to take orders for it or deliver it within a reasonable time, or
  - (h) disparaging the product,
  - (i) or demonstrating a defective sample of it
 with the intention of promoting a different product (bait and switch).

- (5) Falsely stating that the product will only be available for a very short time in order to elicit an immediate decision and deprive consumers of sufficient opportunity or time to make an informed choice.
- (6) Undertaking to provide after-sales service to the consumer and then making such service available only in a language other than the one which the trader used in communications with the consumer prior to a transaction without clearly disclosing this to the consumer before the consumer is committed to the transaction.
- (7) Stating that a product can legally be sold when it cannot.
- (8) Using editorial content in the media to promote a product where a trader has paid for the promotion without making that clear in the content. (Advertorial).
- (9) Falsely arguing that the personal security of the consumer or his family is at risk if the consumer does not purchase the product.
- (10) Establishing, operating or promoting a pyramid promotional scheme where a consumer gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other consumers into the scheme rather than from the sale or consumption of products.
- (11) Failing to provide the information stipulated in the Annex of the Regulation on Sales Promotion or providing information which is false, unclear or ambiguous in fulfillment of the requirements in the Annex.
- (12) Using the expression “liquidation sale” or equivalent when the trader is not about to cease trading.

#### **Aggressive commercial practices**

- (1) Creating the impression that the consumer cannot leave the premises until the contract is signed or the payment made.
- (2) Conducting prolonged and/or repeated personal visits to the consumer’s home ignoring the consumer's request to leave.
- (3) Making persistent and unwanted solicitations by telephone, fax, e-mail or other remote media.
- (4) Targeting consumers who have recently suffered a bereavement or serious illness in their family in order to sell a product which bears a direct relationship with the misfortune.
- (5) Requiring a consumer who wishes to claim on an insurance policy to produce documents which could not reasonably be considered relevant as to whether the claim was valid in order to dissuade the consumer from exercising his contractual rights.
- (6) Advertising to children in a way which implies that their acceptance by their peers is dependent on their parents buying them a particular product. This provision is without prejudice to Article 16 of Directive 89/552/EEC on television broadcasting.
- (7) Demanding payment for products supplied by the trader, but which were not solicited by the consumer (inertia selling).

8.18 The remaining provisions deal with the codes of conduct (Article 10), enforcement (Articles 11-13) and amendments to existing EC measures (Article 14-17).

### **Comment and Analysis**

#### *The “Unfairness” standard*

8.19 The preceding paragraphs have described the various instances of the “unfairness” test contained in the draft UCPD. There are common features to these which it might be helpful to identify. In effect, what is required is an action by a trader which goes against the principle of professional diligence, which would cause an average consumer to enter into a contract or deal with the particular trader etc as a result of that action. The sub-division into two categories, misleading and aggressive, together with the black list, provide further guidance on the application of the unfairness standard.

8.20 There may be concern about the potential breadth of Article 5. A number of points can be made about this. First of all, it only acts as a fall-back in case a particular practice is not caught by the specific categories of misleading and aggressive commercial practices, but is nevertheless unfair. This is not dissimilar to the scheme we find in the Unfair Contract Terms Regulations where the (non-binding and non-exhaustive) grey list of unfair terms is the first, and often the only, port of call in considering whether a term is fair. However, where the term at issue does not fall within one of the categories in the grey list, the general test of unfairness has to be applied (as has been done by the OFT on numerous occasions). In a similar vein, if a commercial practice is not clearly misleading or even aggressive, then it may nevertheless be unfair within Article 5. Secondly, it may be argued that the vagueness of the test itself is problematic and the ability of English law to apply it in a particular case is doubtful. However, this too is anything but unusual for English consumer law, and unfair contract terms legislation in particular, where decisions on a case-by-case basis are the norm. And if there is concern about the substantive scope of the test, we may note that it is not that far removed from what we have termed a “good faith” requirement (see 4.26), the introduction of which would in our view not be problematic. It therefore seems to us that the substantive test put forward in the draft UCPD is neither going to be problematic in itself, nor would it be so new a development that English law could not adapt to it.

8.21 The requirement of professional diligence is particularly noteworthy. As noted above, it is defined as “the measure of special skill and care exercised by a trader commensurate with the requirements of normal market practice towards consumers in his field of activity in the internal market”. Put differently (and somewhat more freely), it is necessary to consider if the trader in question has acted with the requisite standard which can be expected of a trader engaged in that particular line of business in the internal market. Although the formulation of the test seems somewhat unusual to an English lawyer, it bears similarities e.g. to the test for the standard of care adopted in the law of torts. It is hoped that this test may be expressed more precisely in the final version of the Directive.

8.22 One aspect raises problems. “Materially distorting the economic behaviour of consumers” is defined as “using a commercial practice to significantly impair the consumer’s ability to make an informed decision and thereby causing the consumer to take a transactional decision that he would not have taken otherwise”. This seems to

be incomplete. We have explained previously that procedural fairness has two dimensions: an unforced choice (freedom) and an informed choice (information). The overall structure of the (un-)fairness provisions of the UCPD maps onto both dimensions rather neatly. Aggressive practices infringe procedural fairness on the freedom side, and misleading practices infringe it on the informational side. The consumer's economic behaviour is materially distorted (rendering the practice unfair) whichever side of procedural fairness is infringed. However, the definition of "material distortion" is defined in a way that speaks only to the informational side. In order to ensure coherence within the UCPD itself, as well as addressing both dimensions of procedural fairness, it is submitted that the definition should be amended by adding the words "free and" before "informed". The revised definition would then be "using a commercial practice to significantly impair the consumer's ability to make a *free and informed* decision and thereby causing the consumer to take a transactional decision that he would not have taken otherwise".

8.23 We can foresee at least one further problem with the UCPD. Although in its current form, the Directive is designed not to affect domestic rules of contract law, there is some overlap in the substance of the UCPD's unfairness test/categories and established common law doctrines (such as misrepresentation, duress and undue influence). There will therefore be some practices which would give a consumer a common law remedy as well as constituting an unfair commercial practice within the directive. Others may be caught either by the common law or the UCPD. It is conceivable that at some stage, a consumer may bring an action both under the common law and for breach of the legislation implementing the UCPD. It is at that point that there is potential for the common law to converge with the Directive, which in turn raises the risk of "leakage" which we examined in section 6. There seems to be no easy solution for avoiding this process of gradual assimilation. We should emphasise that we are not concerned by this possibility as far as consumer transactions are concerned, but just as the development of many doctrines in the context of commercial transactions produces inappropriate result in consumer transactions, the development of the common law in response to a consumer law measure which is of restricted application may give rise to problems.

#### *Potential Amendments to English Law*

8.24 It would be premature to state which existing domestic measures are likely to be affected by the UCPD. Its maximum harmonisation nature may require a more thorough and systematic approach to implementing the directive than is often the case in the context of consumer protection directives which are minimum harmonisation measures. This will not be a bad thing. For businesses, it may result in a reduction in the number of regulations they will have to comply with when dealing with consumers. Furthermore, in one important respect, the UCPD would *improve* the current level of consumer protection in the UK. There has hitherto been no specific means of responding to business behaviour which is unfair yet not against any particular rule of law.

8.25 The maximum harmonisation nature of the UCPD may cause problems if particular practices regarded by a Member State as unfair in all cases are not covered by the black list. If the UCPD is enacted as it is currently drafted, Member States would have to ask the Commission to put forward a proposal to amend the black list in the Annex. This could be a cumbersome and time-consuming process and would not be in the interest of consumers. However, we can see no reason why the UCPD

should adopt so restrictive an approach. An alternative approach could work as follows: if a Member State deemed it necessary to prohibit a particular practice outright, it could submit its proposal to the Commission. This would be examined for its compliance with the UCPD's general prohibition on unfair commercial practices and, provided it is acceptable, the Commission would authorise the Member State to proceed. In effect, that Member State would add the practice at issue to the Annex in the legislation implementing the UCPD. The Commission could then compile a list of authorised domestic additions and publish this in a regular report, or in the Official Journal. If several Member States have prohibited the same practice, an appropriate amendment to the UCPD could be put forward in order to ensure that the operation of the internal market is not unduly affected. Such a procedure would be anything but new; indeed, Article 95 itself contains a so-called "derogation" procedure which could provide the basic framework for the UCPD. A similar approach is also taken in Directive 98/34/EC on the notification of technical standards<sup>2</sup>.

8.26 The UCPD's overall focus on administrative enforcement seems to make both the Trade Descriptions Act 1968 and Part 8 of the Enterprise Act 2002 likely targets for amendment, or even outright repeal. In addition, specific measures such as Part III of the Consumer Protection Act 1987 (pricing) would have to be reviewed. For example, at the very least, Part 8 of the Enterprise Act 2002 would have to be updated to encompass the requirements of the UCPD, both in respect of "domestic" and "community" infringements. It may be possible to introduce regulations under s.211 of the 2002 Act to implement the prohibition on unfair business practices and the specific categories (misleading and aggressive). In addition, a number of existing measures could, or should, be repealed altogether. These include the Unsolicited Goods and Services Act and the Misleading Advertising Regulations.

8.27 It remains unclear at present whether individual consumers could, or indeed should, be able to bring an action against a trader who has engaged in an unfair commercial practice towards them. The UCPD makes it clear that no impact on contract law, and therefore on the contractual relationship between consumer and trader is intended, and contracts themselves remain unaffected by the UCPD. This, of course, would not preclude action under the common law rules on misrepresentation, duress or undue influence, provided that the relevant criteria for relying on those doctrines are made out. However, the UCPD itself does not specify a particular cause of action. It may, however, be possible for a consumer to bring an action against a trader who has committed an unfair commercial practice for breach of statutory duty, provided that it is possible to classify the prohibition on unfair commercial practices as effectively creating a statutory duty on traders not to engage in an unfair commercial practice.

## **Conclusions**

8.28 The UCPD is at an early stage, and it is impossible (and also inappropriate) to put forward any firm conclusions about its potential impact. It constitutes a significant step in the creation of a coherent consumer protection policy for the internal market and it has the potential to raise the overall level of protection.

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<sup>2</sup> Directive 98/34/EC laying down a procedure for the provision of information in the field of technical standards and regulations (1998) O.J.L 204/37.

8.29 There are the usual problems regarding the definition of key concepts in the directive, but it is hoped that these can be ironed out as the draft progresses through the legislative process. Although we have suggested how some of the definitions could be interpreted, it would be preferable if these were phrased more clearly. Perhaps more crucial is the need to amend the definition of “material distortion” to ensure that this is (a) coherent with the overall scheme of the UCPD and (b) an accurate reflection of both dimensions of procedural fairness, i.e., information *and* freedom.

8.30 The maximum harmonisation nature of the UCPD will make its implementation into English law more difficult because of the various practices which fall within its ambit. However, the directive itself would not have as serious an impact as many might fear; many of the practices caught by the general clause are already covered by specific regulations; the unfairness test itself is not going to be a major innovation for English law and its broad flexible nature will equally not cause headaches. However, in order to retain the possibility to respond to problems which may arise in the future, Member States should be given the opportunity to introduce regulations to specify that particular practices which are regarded as unfair in the territory of that Member State are also caught by the general prohibition, having notified the Commission of their intention and having received appropriate clearance from the Commission.