

The material below appears as “Unfairness of Bank Charges” in [2008] 124 *Law Quarterly Review* 561-568.

12.4.6 Non-core terms under UTCCR

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At stake in *The Office of Fair Trading v Abbey National Plc and 7 Others* [2008] EWHC 875 (Comm) is the future ability of banks to generate income (estimated at £3.5bn a year) from charges levied against customers’ current accounts when customers overdraw without permission. If such charges (“unpaid item fees”, “guaranteed paid item fees”, “paid item fees”, and “overdraft excess charges”) are invalid under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), banks will collectively be liable for immense sums in restitution (tens of thousands of claims are on hold pending the outcome of this test case). Banks would also have to find new ways of financing their current account services with knock-on effects for all customers.

This is the first stage of the test case brought by seven banks and one building society (providers of 90 percent of UK’s current accounts) and the Office of Fair Trading. The issue is whether these charges come within the common law rule against penalties or within the UTCCR’s fairness requirement. If so, the next stage would determine whether the charges are actually penal or unfair and so invalid and unenforceable. Andrew Smith J held that:

- (i) The penalty rule does not apply since the relevant charges are payable on an event other than breach of contract. This deprives businesses, unprotected by the UTCCR, of their major ground for restitution.
- (ii) The bank charges are subject to the UTCCR; the exemption under Regulation 6(2)(b) is inapplicable because although the charges are (largely) in “plain intelligible language”, they are not core terms in the sense of the price paid “in exchange for a service”.
- (iii) It would be inappropriate to grant a declaration stating that the charges would only be unfair under Regulation 5(1) if the banks acted unfairly regarding the procedure by which the charges were agreed.

12.4.6.1 The requirement of 'plain intelligible language'

Regulation 6(2) makes “plain intelligible language” the first condition of exemption from review under the UTCCR. Mindful of the consumer protection objective, Andrew Smith J in *Office of Fair Trading v Abbey National Plc and 7 Others* [2008] EWHC 875 (Comm) lays down two helpful markers. First, he lists among the relevant considerations: the parties’ previous contractual dealings and any non-contractual leaflets and brochures given to consumers at or before contract formation (contrast *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912 which makes the parties’ previous negotiation inadmissible in contractual interpretation). Second, his Lordship sets a very high standard for plainness and intelligibility. Absence of ambiguity is not enough, nor that the challenged term is expressed as clearly as is reasonably possible; the typical consumer should be able to understand “the actual words used ...[and] how the terms affect the parties” rights and obligations” (at [103] and [121]).

On the other hand, sellers and suppliers need not advise consumers about the proposed contract, nor provide all the information necessary to their deliberations: an omission in the contract is only relevant if it “renders unclear or unintelligible what is expressed in them” (at [99]). On a “sensible”, “practical and moderate approach”, the consumer “is entitled to understand essentially the type of charges which his bank is entitled to levy, the circumstances in which it is entitled to levy them and for how much he will be liable” (at [119]). Beyond that the consumer cannot necessarily predict whether he will incur bank charges since that may depend on several variables outside his knowledge and control. The criteria for authorizing unarranged overdrafts and the order for processing a customer’s payment instructions are wholly within the banks’ discretion, subject only to the bar against acting arbitrarily, capriciously or in bad faith; the timing of deductions depend on when payees present the consumer’s instructions for payment. On the facts, the banks’ charges were in plain intelligible language except in relatively minor respects in respect of four of the banks.

Requiring “plain intelligible language” is a very limited solution to the problem of unfairness in consumer contracts. The assumption of the European Court of Justice that the “typical” or “average consumer” is “reasonably well informed and reasonably observant and circumspect” and will “read and seek to understand the contractual terms in the light of information, advice or explanations in non-contractual material” before entering a contract (at [89] and [95]), is wildly optimistic. In *Thornton v Shoe Lane Parking Limited* [1971] 2 QB 163 Lord Denning described this paradigm as “a fiction. No customer in a thousand ever read the conditions” (at 169) and Megaw L.J. anticipated the likely indignation of service providers if customers actually tried to read and understand them (at 173). Lord Reid explained why: it is pointless reading if you are unlikely to understand, get a definitive explanation or be able to negotiate disagreeable terms (*Suisse Atlantique Société d’Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361, 406).

Thus, the high transaction cost of comprehension renders consumers “rationally ignorant” when confronted with lengthy and complicated standard form contracts (whether or not in plain intelligible language). This explains why the UTCCR goes beyond requiring clear language to providing substantive protection from unfairness. But, since even “rationally ignorant” consumers enter contracts with knowledge of its “gist” or core terms, these core terms are exempted from review for unfairness if they are expressed in plain intelligible language.

12.4.6.2 Non-‘core’ terms

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Exempted core terms

Regulation 6(2) states:

“In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-

(a) to the definition of the main subject matter of the contract, or

(b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.”

The scope of these exempt “core” terms (i.e. “main subject matter” or “price or remuneration”) reflects the balance struck between consumer protection (which necessitates narrow exemptions) and contractual freedom (which precludes quality or price control). It mirrors the problematic distinction between “exemption” and “duty-defining” clauses under the Unfair Contract Terms Act 1977. Analogously, while it is arguable that all terms are part of the “main subject matter” or “price or remuneration” of the contract, such a wide exemption would clearly thwart consumer protection. In *Office of Fair Trading v Abbey National Plc and 7 Others* [2008] EWHC 875 (Comm) Andrew Smith J adopts a disjunctive rather than conjunctive interpretation of Regulation 6(2), so that the scope of the price/quality ratio exemption under 6(2)(b) is not, in principle, restricted by reference to the contract’s main subject matter under 6(2)(a). However, in practice, he reaches the same result as would be reached by a conjunctive approach: the bank charges are not payments for the overall price of essential services and so are not exempted by Regulation 6(2)(b). His Lordship’s reasoning - based on the consumer’s reasonable interpretation and the objective correlation between charge and service exchanged - is a master class in the teleological interpretation of law of EU origin.

The starting point is that Regulation 6(2)(b) cannot exempt “all terms that related in some way to a price or remuneration... otherwise there would be a ‘gaping hole in the system’” (at [351]). Regulation 6(2)(b) implies its own limit, only exempting price terms that relate to the parties’ “essential bargain”, and not to “ancillary”, “incidental” or “peripheral” payments such as price escalation or default clauses. The banks’ argument that the charges were for the “whole package” of their services was rejected for inconsistency with the natural use of language, the typical customer’s understanding and the banks’ own description of “free-if-in-credit”.

The banks’ alternative argument, that the charges are for “specific services” supplied when consumers request credit beyond their existing facility, was also rejected. Since the essential characteristics of a current account include banks paying on customers’ instructions, banks provide no essential service when they process, but refuse to pay on,

a consumer's instruction (at best, this service is "ancillary to and incidental to the service of paying in accordance with the mandate" (at [370])). Even if banks do pay out, Regulation 6(2)(b) still does not apply because the charges are not in exchange for that service but are "levied because the services are supplied in particular circumstances" (at [406]). Although extra administration is involved for banks, this is neither explained to consumers nor presented as the exchange for the charges. This conclusion is reinforced by the contingent and discretionary nature of the charges and the lack of correlation between the amount charged on the one hand, and whether an unarranged overdraft is authorized and, if so, the amount or duration of the overdraft, on the other. Moreover, even if the charges were accepted as payments for unarranged overdrafts, "they are only part of the price or remuneration" (banks also derive income from consumers' credit balances and interest payments on overdrafts), and not to "the essential element of exchange" or the "overall price" that is the hallmark of exempt price terms (at [400], [406], [414]).

12.6.3.2 The unfairness test under UTCCR

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Good faith

The next stage of *Office of Fair Trading v Abbey National Plc and 7 Others* [2008] EWHC 875 (Comm) will determine whether the bank charges are actually unfair. Regulation 5(1) states: "A contractual term which has not been individually negotiated shall 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 anticipation of this determination, the banks sought a declaration that a term could only be unfair if "the bank has not dealt fairly and openly with its customers as regarding the process by which the relevant charges were agreed" (relying on *Director-General of Fair Trading v First National Bank* [2001] 1 AC 481 and *Bryen & Langley Ltd v Boston* [2005] EWCA Civ 973). Andrew Smith J refused to grant this declaration "in abstract terms" (at [447]) noting the difficulty of fully defining good faith and the impropriety

of prematurely restricting “a concept which is to be given an autonomous interpretation in light of the recitals to the Directive...[and which has] different connotations in the law of different member states” (at [441]). Lord Millett had cautioned “against looking for a single test for what constitutes unfairness” (*First National Bank*, at [54]). Moreover, there is “debate as to quite what would be covered” by the expression “procedural defects in the negotiating process” (at [441]). For example, the reference in Recital 16 to “the strength of the bargaining position of the parties” in assessing good faith “is not obviously about the “procedure” or the “process” whereby the contract was made” (at [441]). Analogously, Lord Bingham’s judgment in *First National Bank*, on which the banks rely, explicitly links “good faith” to procedural unfairness, but, his Lordship’s description of it incorporates clear non-procedural elements (at [17], emphasis added):

Appropriate prominence should be given to *terms which might operate disadvantageously* to the customer...the supplier should not, whether deliberately *or unconsciously*, take advantage of the consumer’s necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, [and] *weak bargaining position*.

On this basis, the banks’ use of “plain intelligible language” would not, alone, be conclusive of good faith nor bar a finding of unfairness at the next stage. In *Bryen & Langley* the crux was simply the identity of the party putting forward the standard terms apparently unfair towards the consumer. If it is the consumer (e.g. on the advice of professionals in large scale transactions, as in *Bryen & Langley*) the terms are not unfair. But, if it is the seller or service provider without drawing the client’s attention to it, there is unfairness (as in *Picardi v Cuniberti* [2003] BLR 485). “Unfair surprise”, is often said to be the procedural gist of contravention of good faith under Regulation 5(1). But, the ready analogy is the “ticket cases” where the procedures required to ensure the enforceability of unsigned documents depends on the seriousness of substantive detriment to the consumer (recall the “red hand” rule *J Spurling Ltd v Bradshaw* [1956] 1 WLR 461). Surprises are only a worry if they are substantively harmful.

Three further points can be made against the necessity of procedural unfairness under Regulation 5(1). First, the very ability of “qualifying bodies” to apply for injunctions against

the *future use* of specific terms means that “the primary focus of such a pre-emptive challenge is on issues of substantive unfairness” (Lord Steyn *First National Bank* at [33]). Logically, the issue must be determined without reference to any procedural unfairness that has occurred or might occur. Moreover, once an injunction is granted, the term (and terms with like effect) is prohibited irrespective of the procedural safeguards surrounding its acceptance. It is the term, as opposed to the negotiating process, which must be in bad faith.

Second, only one of the 17 indicatively unfair terms listed in Schedule 2 of the UTCCR focuses on procedural unfairness (para 1(i)). The other 16 highlight substantive unfairness. The latter must, at least presumptively, contravene good faith in the Recital 16 sense of failing to deal “fairly and equitably” with the consumer “whose legitimate interests [the seller or supplier] has to take into account”. These can be understood in terms of the consumers’ interest to: his reasonable expectations (paras 1 (f), (g), (j), (k), (m) make indicatively unfair terms giving the trader disproportionate discretion in performance), to adequate redress (paras 1 (a), (b), (o), (q)), and to avoid unreasonable burdens (paras 1 (d), (e), (h), (l)). In *First National Bank* Lord Steyn concludes that the Schedule 2 terms “convincingly demonstrate that the argument of the bank that good faith is predominantly concerned with procedural defects in negotiating procedures cannot be sustained. Any purely procedural or even predominantly procedural interpretation of the requirement of good faith must be rejected” (at [36]).

Finally, the reasoning that the UTCCR is aimed at procedural (not substantive) unfairness because clear intelligible core terms are exempted by Regulation 6(2) is not sustainable. First, Recital 19 makes clear that while core terms are not directly challengeable, the fairness of any other term can be challenged in the light of the core terms. Second, given that the contract continues to bind the parties “if it is capable of continuing in existence without the unfair term” (Regulation 8(2)), the exemption of core terms can be explained not only in terms of preserving scope for freedom of contract, but also to avoid the whole contract collapsing for want of core terms. Short of the power to vary unfair contracts, substantive unfairness is best remedied, not by effectively vitiating contracts and depriving consumers of desired goods or services, but by allowing consumers to enforce their

contracts, free of the offending terms that produced the original significant and objectionable imbalance.

All this judgment says is that bank charges can be assessed for unfairness. Whether they are actually unfair is the next question. A significant plank of the banks' argument must be a defence of their composite and integrated charging structure: the relevant bank charges bear no relationship to the cost of administering credit requests which exceed existing facilities, but are designed to support the personal current accounts service as a whole with free banking for those in credit. On this point, the judge's observation is absolutely critical: "the Directive and the 1999 Regulations are concerned with the fairness of the individual contract between the seller or supplier and a particular consumer and are not directly concerned with whether seller or supplier treats fairly consumers as a body" (at [415]). Good faith and significant imbalance "to the detriment of the consumer" under Regulation 5(1) must be judged on the micro-level of the individual; fairness at the macro-level, in the sense that Banks may not be over-profiting overall, is strictly irrelevant.

In 2006 the banks received £2.5 billion from charges on an average daily unarranged overdraft balance of £0.6 billion, for which interest is additionally payable. These charges impose on the 7% to 20% of customers (varying with the bank) who pay them, the disproportionate burden of financing the personal current accounts service of 100% of customers. They evidence not only "significant imbalance", but also contravention of "good faith" in the Recital 16 sense of failing to take account of these consumers' "legitimate interest" in avoiding unreasonable burdens.

The banks' charging structure reverses the usual pattern of cross subsidisation by delivering free banking services to those with the most financial competence or resources at the expense of those with the least. The alternative of "user pays" -charging all customers monthly or annual fees, perhaps coupled with charges for specific transactions – will doubtlessly be unpopular with those currently receiving free banking, but it is hardly objectionable to link charges more directly with the services provided. The greater transparency yielded is precisely what confers immunity from review for unfairness under Regulation 6(2).

12.6.3.1 The tests of reasonableness under UCTA

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In *Regis (UK Ltd v Epcot Solutions Ltd* [2008] EWCA Civ 361 a standard term in a contract for the supply of serviced office accommodation excluded any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss. The exclusion of liability was reasonable under the Unfair Contract Terms Act 1977 because:

- (i) E could still sue for the defective air-conditioning by reference to the diminution in value of the services promised (the rent which E would have saved if the offices had not been air-conditioned or had only been partially air-conditioned). R and reasonably limited this liability to 125 per cent of the fees or £50,000, whichever was higher.
- (ii) The exclusion should not be interpreted as covering liability for fraud or wilful, reckless, or malicious damage and so unreasonable under UCTA.
- (iii) There was no inequality of bargaining power. R advised its customers to protect themselves by insurance for business losses and it was generally more economical for the person suffering the loss to take out insurance.