GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: AUGUST 2016

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In the August column, James Ross considers unfair terms in consumer credit agreements.

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UNFAIR TERMS IN CONSUMER CREDIT AGREEMENTS

Introduction

Consumer disputes often involve allegations that a firm's standard contract terms are "unfair". However, "unfairness" is an open-textured concept and it has proved difficult for legislators, regulators and judges to strike the appropriate balance between protecting vulnerable consumers on one hand and respecting the parties' freedom of contract on the other. The field of consumer credit is particularly challenging in this regard because a debtor-creditor relationship is often inherently unequal, at least in terms of the knowledge, financial sophistication and economic circumstances of the parties.

The FCA previously published guidance on unfair contract terms on a *webpage*. However, the FCA guidance was removed in March 2015 following decisions of the Court of Justice of the EU (ECJ) that appeared to be inconsistent with some of the FCA's published views. The FCA's webpage now states "we have no current intention to publish guidance on unfair contract terms".

Consumer credit firms must therefore look to other sources for guidance when drafting standard form contracts. One source of such guidance is the general guidance on unfair terms, dated 31 May 2015, published by the Competition and Markets Authority (CMA) on a *webpage*.

This month's column considers the more specific provisions applicable to consumer credit firms under the Consumer Credit Act 1974 (CCA), the Consumer Rights Act 2015 (CRA) and the FCA's Consumer Credit sourcebook (CONC).

Regulation of unfair terms under the CCA

One obvious way in which a term can be unfair is if it purports to deprive a party of the legal rights and protections which they would otherwise enjoy. The CCA sets out various protections for debtors. A term contained in a regulated credit agreement is void under section 173 of the CCA if, and to the extent that, it is inconsistent with a provision for the protection of the debtor contained in the CCA or subordinate legislation.

The CCA also contains a more specific provision (section 56(3)) that renders a regulated agreement void if, and to the extent that, it purports to provide that a supplier is acting as agent of the debtor or otherwise seeks to relieve the creditor of liability under the deemed agency provisions in section 56 of the CCA. These limited controls over unfair terms tend to cause relatively little difficulty in practice because the statutory sanction is clear: if the term is inconsistent with protections under the CCA, it is automatically void.

However, the CCA also indirectly empowers the court to grant debtors relief from unfair terms by way of the unfair relationships provisions in sections 140A to 140D of the CCA. Section 140A(1) provides that the court may determine that the relationship between the parties is unfair by reason of the terms of the agreement, the way in which the creditor has enforced its rights, or any other thing done (or not done) by, or on behalf of, the creditor.

If the court makes a determination of unfairness under section 140A, it has wide-ranging powers to grant relief under section 140B, including the power to alter the terms of the agreement. Nevertheless, the control of unfair terms under section 140A(1) is somewhat indirect. This is because even if a term is considered unfair, a determination of unfairness can only be made under that section if the court concludes that the resulting relationship between the parties is unfair, having regard to all relevant matters relating to the creditor and the debtor (section 140A(2)). There is therefore a degree of residual uncertainty as to whether the court will make a determination under section 140A and go on to grant relief under section 140B, even if it concludes that a specific term is unfair.

Yet more uncertainty arises because the CCA contains no definition of unfairness in this context. The Supreme Court emphasised, in the case of Plevin v Paragon Finance Ltd [2014] UKSC 61, that each case must be considered on its individual merits, albeit that the court will have regard to any applicable regulatory standards as strong evidence of the commercial behaviour to be expected of a firm, in the interests of fairness. Compliance with such standards may not be sufficient for a firm to avoid a section 140A(1) determination of unfairness, but non-compliance is highly likely to contribute to a determination of unfairness. The key sources of such regulatory standards for consumer credit firms are the CRA and CONC (see *Regulation of unfair terms under the CRA* and *FCA's position on default charges and variation clauses* below).

Regulation of unfair terms under the CRA

Part 2 of the CRA applies to contracts made on, or after, 1 October 2015 and contains provisions that seek to re-implement the Unfair Terms in Consumer Contracts Directive (*93/13/EEC*) (UTCCD) by replacing the Unfair Terms in Consumer Contracts Regulations (*SI 1999/2083*) (UTCCR).

The "grey list" of terms that may be considered unfair, which appears in Schedule 2 to the CRA, has been supplemented compared with the list that appeared in Schedule 2 to the UTCCR (see in particular the examples at paragraphs 1(5), 1(12), and 1(14)). However, it is arguable that the list still does not go far enough when compared with the following recent decisions of the ECJ:

- *Hatosag v Invitel Tavkozlesi Zrt (C-472/10), RWE Vertrieb AG v Verbraucherzentrale (C-92/11).*
- *Kásler v OTP Jelzálogbank ZRT (C-26/13).*
- *Matei v SC Volksbank România SA (C-143/13).*
- *Van Hove v CNP Assurances SA (C-96/14).*

Although firms can therefore look to the CRA grey list as a key source in the context of unfair terms, regard must also be had to the extensive and evolving ECJ jurisprudence.

For more information on unfair contract terms under the CRA, see *Practice note, Consumer Rights Act 2015: unfair contract terms*.

FCA's position on default charges and variation clauses

As set out above, the FCA has withdrawn its general guidance on unfair contract terms. However, limited material is still available in CONC in relation to two important categories of terms that are often challenged for unfairness:

- Variation clauses (see *Variation clauses* below).
- Default charges (see *Default charges* below).

Variation clauses

The ECJ jurisprudence referred to above emphasises that a variation clause may be unfair if it fails to specify clear and valid reasons why a contract may be varied, but there is considerable uncertainty as to what will constitute a valid reason for these purposes. FCA guidance in CONC 6.7.15G states that valid reasons for a firm increasing the rate of interest include:

- (1) Recovering the genuine increased costs of funding the provision of credit under the agreement.
- (2) A change in the risk presented by the customer which justifies the change in the interest rate.

Firms would therefore be well advised to include these reasons (or similar) within their list of reasons as to why the contract may be varied.

Default charges

In relation to default charges, CONC 7.7.5R requires that "a firm must not impose charges on customers in default or arrears difficulties unless the charges are no higher than necessary to cover the reasonable costs of the firm". This implies that if a firm can provide evidence to support the level of its charges as merely covering its reasonable costs on default, such default charges are unlikely to be considered unfair.

Nevertheless, the ECJ jurisprudence must also be considered even in this relatively straightforward area: the recent decision in the case of *Radlinger v Finway (C-377/14)* suggests that the court is required to consider the cumulative effect of all default charges specified in a contract (even those not actually applied by the creditor) when determining whether the terms imposing those charges are unfair.

Considerable uncertainty set to continue

It can be seen from the above brief discussion that the issue of unfair terms is one of the most difficult in consumer credit at the moment. While the relevant provisions of the CCA and the CRA might appear to be relatively straightforward at first glance, they cannot be properly understood without consideration of the extensive and evolving ECJ jurisprudence on unfair terms.

FCA guidance is now very limited, and history has shown that the FCA is liable to reconsider or withdraw its guidance on unfair terms in any event. Whatever the UK's ongoing relationship with the EU following the result of the referendum on 23 June 2016, the only certainty in relation to unfair terms is that this area will remain highly complex for the foreseeable future.