Preliminary Paper No 11

"UNFAIR" CONTRACTS

A discussion paper

The Law Commission welcomes your comments on the discussion paper and seeks your response to the questions raised.

These should be forwarded to:

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PREFACE

This paper discusses the complex and controversial issue of "unfair" or "unconscionable" or "oppressive" contracts, outlining the present state of the law as well as possibilities for changes to that law through legislation. The paper was prepared with the valuable assistance of Jim Cameron, a former member of the Law Commission, and represents the end of an initial stage of preliminary consultation. It is designed to help the Law Commission gather information and opinion on this topic.

In general terms, a contract is a legally enforceable bargain made voluntarily by two or more parties. Contracts provide the basis for commercial activity and for much of our domestic and social activities. A general freedom to enter into such bargains as parties consider it in their own interest to make is a feature of our law and our society. On the other hand, there are contractual situations where the parties are so unequal, or one party has acted unconscionably towards or oppressed or exploited another, in which the law may give greater weight to protection than freedom. This paper is concerned with the question of what rules should be used to define those situations and how far (if at all) such contracts should be enforceable at law.

The paper has three substantial parts to it. Chapter I reviews the present state of the law and perceived problems with it. Chapter II considers the scope for legislative intervention with particular reference to a detailed scheme which might provide some statutory guidance on many of the issues which arise in this area. Thirdly, the Appendices describe existing New Zealand legislation affecting this topic as well as statutory provisions in the United States of America, Australia, the United Kingdom and West Germany.

Those particularly pressed for time may gain a fair appreciation of the essence of this paper by reading the short sections on "The involvement of the Law Commission" (pp 3-5), "Disadvantages of the present law" (pp 24-27), Possible legislative changes" (pp 28-30), "Introduction to scheme" (pp 30-31), "Scheme in full" (pp 51-56) and the list of questions (pp 57-58).

The Law Commission is not committed to the detailed scheme discussed in Chapter II nor to any form of legislative intervention in this area. The Commission is aware of economics of law arguments which favour minimal court involvement in what may be seen as private contractual arrangements (cf, Epstein, "Unconscionability: A Critical Reappraisal" (1975) 18 Journal of Law and Economics 293). Our consultation to date leaves us in little doubt that proposals for reform in this area will attract a wide range

of responses. So the scheme is advanced on the basis that it may assist in identifying the issues and the range of remedies which are relevant to legislative law reform in this area.

In addition to encouraging comment on the issues raised in this paper (summarised in the list of questions on pp 57-58), the Law Commission would particularly welcome information about the working of the present law, examples of unfair transactions where the law seems to offer no remedy, and types of contractual terms thought to be especially objectionable.

The Law Commission will consider the next stage in this project in the light of the written submissions received. At this stage, it seems likely that a series of workshops and seminars focussing on some of the critical issues would be valuable before any consideration is given to the question of final recommendations.

Submissions should be forwarded to:

The Director
Law Commission
P O Box 2590
Wellington

by Friday, 30 November 1990. Inquiries can be directed to Penelope Stevenson, tel: (04) 733-453.

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PRESENT LAW AND PERCEIVED PROBLEMS

1 Is there need for statutory reform or restatement of the law that applies to contracts between persons whose bargaining power is clearly unequal, where there is an element of unfairness or exploitation? If reform is justified, what should its nature and scope be?

2 The range and importance of contracts in all modern societies are very great. In New Zealand alone, many thousands of contracts are made daily. They are not only a basic part of business, commercial and economic life generally, but they also affect many aspects usually thought of as more personal. Buying or renting a house, travelling to work or on holiday, buying goods and services, borrowing money or depositing it in a bank, guaranteeing someone else's debt, insuring life or property, joining a superannuation scheme, agreeing on the division of property if a marriage breaks up, even through to making funeral arrangements - all involve the making of contracts. Freedom to contract, and the expectation that promises contained in contracts will be kept (or if not, can be enforced by the courts), are at the heart of our economic system.

3 The law of contract therefore needs to be clear, predictable and practical. People should be free to fashion whatever arrangements suit them. It is not the Law Commission's view that the law should protect adults from the consequences of their imprudence or impetuosity. Equally, however, the law ought to be seen as just and fair. Any law that affects the validity and enforceability of contractual agreements can have far-reaching consequences. Changes should not be made lightly. However, if changes are required in the interests of justice, they ought to be made without hesitation.

TERMINOLOGY

4 The principal theme of this paper is the contract whereby one party is said to be the victim of oppression, harshness or exploitation by the other party. Contracts of this kind are often called "unconscionable". The term is well understood by most lawyers. It has the advantage of describing the way in which judges approach disputes in questions of this kind. The question is not whether someone was foolish to make a contract containing particular terms, or whether they got a poor bargain. Rather, the courts look at the other party's behaviour in bringing about the contract: would it be contrary to

conscience to allow him or her to enforce it?

5 "Unconscionability" is, however, sometimes seen as a separate concept, and sometimes as overlapping or embracing other well-known grounds for not enforcing contracts - undue influence, duress, estoppel, breach of a fiduciary duty, and so on. A thread of unconscionability, in the wider sense, runs through all these doctrines. The term is also often used legally outside the realm of contracts - for instance as the basis for deciding that someone holds property as a constructive trustee.

6 Often there is an implication of moral delinquency about the word "unconscionable". This is not always so, however. It was described in a case decided in the United States under the Uniform Commercial Code, *Williams v Walker-Thomas Furniture Co*, 350 F 2d 445, 2 UCC 955 (1965) in this way:

> Unconscionability has generally been recognised to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favourable to the other party.

7 The need to avoid words that can be used emotionally becomes particularly important if an attempt is made to deal with clauses in standard contracts. Without doubt, many such clauses are drawn up to suit the interests of the economically dominant party. They may be unconscionable in the sense used in the American case just quoted. However, many people would see it as going too far to suggest that all those who propound such clauses are guilty of moral fault. The more common criticism is that these standard clauses may constitute an abuse of power and be unfair in the sense of being unreasonable and unnecessary to safeguard genuine interests, and that they negate any true consent by the other party.

8 Even in a more traditional context, the choice of a word such as "unfair" rather than "unconscionable" has some express judicial approval in New Zealand. *Riki v Codd* (1980) 1 NZCPR 242 concerned leases granted to a farmer on most advantageous terms to him by four Maori. In deciding that the leases should be cancelled, Hardie Boys J said, in referring to an earlier case (*K v K* [1976] 2 NZLR 31):

> There was thus what [the Judge] described as an "unfair bargain" - a phrase which recalls the words of Kay J in *Fry v Lane* ... and which I think expresses the true purpose of the inquiry more accurately for present day purposes than the traditional phrase "unconscionable bargain" which

gives the appearance at least of setting the standard too high.

9 "Unfair" has also been used in this context by the Privy Council in the leading New Zealand unconscionability case, *Hart v O'Connor* [1985] 1 NZLR 159, [1985] AC 1000.

10 The Law Commission thinks that "unfair" is a more accurate term to describe the sort of contracts and terms in contracts it is concerned with here.

11 It must be stressed, however, that unfairness for the purpose of this paper means more than just inequality of bargaining power or unevenness of result. There must, additionally, be something that is contrary to accepted standards of good conduct in dealings with others.

THE INVOLVEMENT OF THE LAW COMMISSION

12 At a Law Commission seminar on contract law developments, held in May 1988, the law relating to unconscionable contracts was mentioned as one topic possibly needing attention. The Commission decided to take it up, ahead of other possible reforms, for these principal reasons:

- Contractual unfairness is a subject to which the courts have given increasing attention. During the last 10 or 15 years the courts in New Zealand - and also in Australia, Canada and England - have given a number of important judgments. These judgments have given prominence to the doctrine of unconscionable contracts and developed the law in a way that is not altogether clear.

- There has been a good deal of legislation on the subject of contractual unfairness in recent years. This is linked immediately to the consumer movement, but is linked more broadly to a sense that social justice has a role even in the marketplace. In New Zealand, legislation to deal with abuses arising from inequality of bargaining power has mostly been piecemeal, reactive and often narrow. Much legislation which prohibits particular terms in contracts, or provides that its benefits shall not be diminished by contractual agreement, has a common underlying element. That element is the desire to prevent unfairness.

- The topic has arisen in several other

projects of the Law Commission. In its work on limitation of time as a defence in civil proceedings, on securities over personal property (that is, property other than land) and on arbitration, the Commission has had to consider whether certain terms ought to be outlawed; eg, those which provide an extremely short limitation period for bringing an action or imposing arbitration to settle disputes. Indeed, one instance of this last matter is dealt with in the Insurance Law Reform Act 1977. However, it may be better to approach the issue more broadly - if only because the complete prohibition of what might often be a perfectly sensible term to meet a few bad cases savours of legislative over-reaction. Outright prohibition of particular terms may be an inefficient way of safeguarding against a danger.

- The trans-Tasman dimension is also relevant. There has been much talk about whether New Zealand should adopt (or adapt) an amendment made in 1986 to the Australian Trade Practices Act 1974 dealing with unconscionable conduct. Section 52A of the amended Act prohibits a corporation in trade or commerce from engaging in conduct in relation to the supply or possible supply of consumer goods or services that is, in all the circumstances, unconscionable. This is mirrored in State legislation without the reference to corporations (which was necessary in the Commonwealth legislation for constitutional reasons). New Zealand's interest in s 52A arises partly from the Closer Economic Relations (CER) policy of harmonising business law, and partly from the fact that the problems in Australia and New Zealand are similar. (There is rather similar legislation in some of the Canadian provinces as well.)

  Much of the Trade Practices Act 1974 already has a parallel in our Fair Trading Act 1986. Notable is s 9 (the Australian s 52) which creates a remedy for "misleading and deceptive conduct" in trade, a wide phrase that has already produced a substantial body of judicial decisions. The Australian s 52A is at present limited to those goods and services ordinarily acquired for "personal, domestic or household use or consumption".

> For New Zealand to adopt s 52A would itself be a significant step towards a general unfair contracts law, at least for consumer transactions. The question needs to be asked whether this is desirable. If it is desirable in principle, should it be limited as in the present Australian law, and is the Australian approach the best way to go about legislating?

CERTAINTY AND FAIRNESS

13 Any legal system that values both freedom and justice will experience a tension between the two in relation to contracts.

14 How far, in New Zealand in the 1990s, should freedom of contract be limited in order to protect the disadvantaged from exploitation by the strong? Conversely, how far can bargains be unmade by the courts without creating unacceptable uncertainty in commercial, and indeed personal, transactions? If freedom to make bargains is not to be illusory, it must include freedom to make bad bargains. And predictability of result is important. Business people in particular, it is said, need to know where they stand.

15 Most if not all societies recognise as a basic legal and moral principle that promises must be kept. It is a foundation-stone of international law. Business and social life would be unrecognisable without it. Even this principle is not absolute. Some agreements have always been void, or unenforceable, because they infringe some important public interest. This is the foundation of the law about illegal contracts. Likewise, a promise made under threat or coercion is not binding. So the legitimate territory of contract is the freely made promise that does not run foul of any basic public policy.

16 But when *is* a promise to be regarded as freely made? Is the appearance and form of an agreement enough? Or does the notion of the sanctity of the appearance and form of the agreement, which was paramount (though not absolute) in the 19th century, assume an over-simple model - two business people negotiating a deal; people of comparable intelligence and education, both deciding what is to their advantage and agreeing accordingly, taking legal or other expert advice as appropriate?

17 Such cases are of course common enough. However, they are not now typical, if they ever were. In the 1980s the "typical" contract often consists of the acceptance of terms and conditions (perhaps unseen and unknown) drawn up

by a public authority or a large company, or by or on behalf of a trade association, and presented on a take it or leave it basis.

18 The other party may or may not be asked to sign the contract. The need for signature may be presented as "a mere formality". The other party may have little opportunity or time to examine the terms of the contract. The terms are expected to be fair and reasonable. Doubtless they usually are. And these "standard form contracts", which are by no means limited to "consumer" transactions, serve an important if not an essential purpose in modern societies. However, they are a long way from the assumptions that seem to underlie freedom of contract. They are more akin to private legislation than to the traditional contract.

19 As Lord Reid stated:

> In the ordinary way the customer has no time to read them, and if he did read them he would probably not understand them. And if he did understand them and object to any of them, he would generally be told he could take it or leave it. And if he then went to another supplier the result would be the same. Freedom to contract must surely imply some choice or room for bargaining. (*Suisse Atlantique* [1967] 1 AC 361, 406.)

20 Even where the parties genuinely negotiate certain matters, important terms and conditions may be in a standard form. For instance, with a common and very important class of "one-off" transaction, agreements for the sale and purchase of land, the price and the items to be included in the sale are normally bargained for. The majority of the terms of most such agreements are, however, contained in standard form documents prepared by or in conjunction with the Real Estate Institute.

21 It has been argued that classic principles of contract law are altogether irrelevant to these kinds of transaction. At least, the balance between freedom, certainty and fairness now drawn by the law deserves to be reconsidered in this context.

22 Moreover, even if it is possible to negotiate individual contract terms, some people (and some groups of people) are likely to be so much at a disadvantage that their bargaining power is grossly inferior. They are vulnerable to sharp practice and exploitation. How far can their consent be said to be free?

23 So the concept of unfair contracts can be seen as part of a wider family of orthodox contract doctrines that

are concerned with the reality of a party's consent.

THE HISTORY OF THE LAW

24 The law (and especially that branch of the law known as equity) has always been willing to intervene in what the courts see as unconscionable transactions. As long ago as 1787, in *Evans v Llewellin,* (1787) SC 2 Bro CC 150, 29 ER 1191, where an heir gave up his inheritance for much less than it was worth, the court stated the principle quite broadly (at 1194):

> The cases of infants dealing with guardians, of sons with fathers, all proceed on the same general principle, and establish this, that if the party is in a situation, in which he is not a *free agent,* and is not *equal to protecting himself,* this court will protect him. I do not know that the court has drawn any line in this case, or said thus far we will go and no further, it is sufficient for me to see that the party had not the protection he ought to have had, and therefore the Court will harrow up the agreement. [emphasis original]

25 In 1873, in *Aylesford v Morris* (1873) LR 8 Ch App 484, 491, the Lord Chancellor, Lord Selborne, said:

> ... it is sufficient for the application of the principle, if the parties meet under circumstances as, in the present transaction, to give the stronger party dominion over the weaker ...

26 He granted relief to an expectant heir who became indebted to a moneylender.

27 In *Fry v Lane* (1888) 40 Ch D 312, the court set aside a purchase made from two poor and ignorant men of a future interest in land under a will at a considerable undervalue, and without their having independent legal advice. The Judge quoted from *Wood v Aubrey* 3 Madd 417, 423, where it was said that "a court of equity will inquire whether the parties really did meet on equal terms, and if it be found that the vendor was in distressed circumstances, and that advantage was taken of that distress, it will avoid the contract."

28 The principle of setting aside unfair transactions (using unfair in its active sense) was thus clearly established 100 years ago.

29 Similar principles underlie several long-established doctrines of English contract law, such as *undue influence* and *duress*. Recent decisions of the

courts have extended the notion of duress towards including *economic duress*. Moreover the doctrine known as *estoppel* can be invoked to prevent a person from taking advantage of a situation created by his or her misleading statements or actions. Where one party is regarded as having a *fiduciary duty* towards the other, the breach of that duty may result in a contract being upset.

30 In the 20th century, unconscionability has not been used much in England as an express ground for seeking to overturn contracts; and there were few such cases in New Zealand until recently. However, the courts singled out some types of contract, and some kinds of terms, as requiring to be looked at closely. Thus, as the old cases mentioned above show, money-lending transactions were looked at with some suspicion.

31 Contracts in restraint of trade are one example of the willingness of the courts to intervene in an apparently freely reached agreement. These contracts have always been liable to review by the courts on the public policy ground that freedom of trade ought to be preserved. However, two recent English cases explicitly linked intervention to unfairness. *Schroeder Music Publishing Co Ltd v Macaulay* [1974] 3 All ER 616 was one:

> A young song-writer assigned the copyright in all his works for the next 5 years. The publisher could terminate the agreement at any time on a month's notice. The composer had no similar right. There was no obligation on the publisher to publish any of the works. The contract was the standard one used by the publisher.

32 The House of Lords held that the contract was void. In his judgment (at 623), Lord Diplock made the strong statement that:

> ... the public policy which the court is implementing is ... the protection of those whose bargaining power is weak against being forced by those whose bargaining power is stronger to enter into bargains that are unconscionable .... the question to be answered as respects a contract in restraint of trade of the kind with which this appeal is concerned is: was the bargain fair?

33 However, this was not necessary to the decision, and it seems that the principle he expressed has not been much applied since.

34 Another head under which courts may invalidate onerous and oppressive terms is the doctrine of notice where contracts are subject to sets of printed

conditions. If a particularly onerous term is contained in printed conditions, a party wanting to enforce it must show that it was signed or fairly brought to the other party's attention. If this is not shown, the courts will disregard it. So, in a recent English case:

> An advertising agent had ordered some photos for a presentation to a client. The picture library agreed to send photos which they believed would be useful for the presentation. Attached to the parcel of photos delivered was a delivery note which clearly specified that the relevant photos were to be returned within a period of two weeks. Conditions printed on the back of the note indicated that failure to return the photos within the due date would carry a "fee" of £5 per day for every day that the photos were held beyond the relevant date. Delivery was accepted, the photos were never used, and when eventually returned some weeks later resulted in the agency receiving an invoice for over £3,700. It refused to pay. The Court of Appeal held that the term was not sufficiently brought to the agency's notice and was not part of the contract. (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433.)

35 The courts have also set themselves against what are called "penalty clauses" in contracts. If a contract provides a penalty for its breach, and if that penalty is not a genuine estimate of damages (in the courts' eyes) but is unrelated to actual loss caused, the provision will be invalid. Once again, the notion of harshness or unfairness underlies the rule. In the *Interfoto Picture Library* case the Judges suggested that the offending term might also have been struck out as a penalty, but that ground had not been argued.

SOME EXAMPLES

36 In the last 15 years the courts have revived and expanded the notion of unconscionability. However, it is significant that although the English courts have reached very much the same results as those in New Zealand, they have for the most part used other legal doctrines, notably that of undue influence, to achieve them. The facts and results of some modern cases from England, Australia, Canada and New Zealand are worth summarising to show the sort of circumstances in which the courts will, or will not, intervene.

(1) An elderly farmer and his son had been customers of a bank for many years. The son

formed a company which banked at the same branch. The son asked the farmer to guarantee the company's overdraft for £11,000, using his farm as security. The farmer signed in the presence of his son and the assistant bank manager, who made it clear that the company would not be allowed to extend its overdraft without the guarantee. On a previous occasion he had been advised not to guarantee more than £5,000. However he signed, stating that he was behind his son one hundred percent. The farmer trusted the bank to look after his interests implicitly. The English Court of Appeal set aside the guarantee and security on the basis of undue influence on the part of the bank. (*Lloyd's Bank Ltd v Bundy* [1975] 1 QB 326.)

(2) A husband and wife bought a house on mortgage. The mortgage payments fell into arrears and the building society began proceedings for possession. At the request of the husband, the plaintiff bank agreed to make a short-term bridging loan, taking a legal charge on the house. The bank manager called at the house to obtain the wife's signature. Although concerned about the effect of the charge, she signed it. The house was subsequently repossessed. The House of Lords held that there was no undue influence as the relationship between the wife and the bank had not gone beyond the normal business relationship of banker and customer, and the transaction was not disadvantageous to the wife. (*National Westminster Bank Plc v Morgan* [1985] AC 686.)

(3) Two elderly Italian migrants who were unfamiliar with written English were asked by their son to execute a guarantee and mortgage over their land in favour of a bank. This was to secure the overdraft of a company which the son controlled. The bank and company had been selectively dishonouring the company's cheques to preserve the company's appearance of honesty. This was not disclosed to the parents. The son also misled the parents as to the terms of the mortgage. The bank was aware that they had been misinformed about the contents of the instrument they were executing. The High Court of Australia set the agreement aside on the grounds of unconscionability because the bank was fully aware of the parents'

disability and did not show that the contract was fair and reasonable. (*Commercial Bank of Australia v Amadio* (1982-83) 151 CLR 447.)

(4) A building company which was trading unsatisfactorily was granted an overdraft of $250,000 by a bank. The bank required guarantees from the company director's parents and parents-in-law, secured over most of their assets. Neither the parents nor parents-in-law were people of wide business experience or acumen. The parents also suffered from language difficulties. The bank manager failed to explain the terms of the guarantees. The company subsequently went into liquidation and the bank called up the guarantees. The Federal Court of Australia held that the guarantee from the *parents* was unconscionable. However, two judges thought that the guarantee from the *parents-in-law* was not unconscionable because there was no special disability (although the guarantee was set aside on other grounds). (*National Australia Bank Ltd v Nobile & Anor* (1988) ATPR 40,856.)

(5) An Indian who had limited education and was partially deaf, agreed to sell his fishing boat and licence for approximately one quarter of its value. The buyer who was a man of greater business experience and had full knowledge of the boat's value induced the sale by assuring the Indian that he could easily obtain another licence. The British Columbia Court of Appeal set aside the contract on the basis of unconscionability, mentioning in particular the substantive unfairness of the bargain and the appellant's weak bargaining position. (*Harry v Kreutziger* (1978) 95 DLR (3d) 231.)

(6) A man negotiated a loan from a bank to commence a business. The bank asked for security and the son induced his mother to give a guarantee which included a mortgage over her home. His mother was a widow who had had little schooling and was not fluent in English. The bank insisted on independent advice before the security was executed. The bank's solicitor (who also acted for the son) asked his partner to advise the mother. At no time was it explained to her that her house was at risk and that she was a principal debtor and not merely a guarantor.

When the business failed and the bank sought to enforce its security, the widow brought an action for a declaration that the promissory note and mortgage were void. On appeal she succeeded on the grounds that the bank knew that she did not understand the nature of the transaction, which from a business point of view was manifestly disadvantageous to her. Moreover, the bank knew or ought to have known that advice from the partner of its own solicitor was not independent. (*Bertolo v Bank of Montreal* (1987) 33 DLR (4th) 610.)

(7) An elderly woman agreed to sell land for an amount well below the market price ($17,000 as compared to $24,000). She was suffering from senile dementia. The purchaser did not know this, but he was aware of her advancing years and of some manifestations of her eccentricity. Furthermore, he did not realise that the land was being purchased at an undervalue price. Nonetheless the court rescinded the contract on the basis of unconscionability, with the main emphasis being on the substantive unfairness of the bargain. (*Archer v Cutler* [1980] 1 NZLR 386.)

(8) Four Maori had leased two blocks of land in Hawke's Bay to a farmer. A 10-year lease had been granted in 1960, and a fresh lease in 1970. Neither lease made any provision for renewal or rent review. By 1971, in accordance with unorthodox arrangements for advances against rent, the farmer was well ahead of the rent payments due. He asked for a further lease on the same terms to run from 1980 so as to have a further term to recoup his advances. His solicitor acted throughout for all parties. In 1978, by which time the value of the land had increased about fivefold, the Maori parties sought cancellation of the lease. The judge held that, although the defendant farmer had not acted unscrupulously, he had taken advantage of the plaintiffs' need for money to obtain an extremely beneficial bargain for himself. The parties were in unequal bargaining positions in respect of experience, knowledge of values and financial circumstances, and also in racial terms. Finally, the plaintiffs lacked independent legal advice. Consequently, the leases were cancelled. (*Riki v Codd* (1980) 1 NZCPR 242.)

(9) A man who was 83 and of unsound mind was the sole trustee of his father's estate. He farmed the trust property in partnership with two of his brothers. He entered into an agreement to sell it to his neighbour. The contract provided that the price was to be the market value as determined by an independent valuer, the neighbour was to have possession on 1 September 1977, and the price was payable on or before 1 September 1979. The value of the land substantially increased after 1 September 1977 (when it was valued). The Privy Council (overturning the New Zealand Court of Appeal and disagreeing with *Archer v Cutler*) held that the contract should be enforced since the neighbour had no knowledge of the vendor's state of mind and there were no imputations against his conduct. (*Hart v O'Connor* [1985] 1 NZLR 159.)

(10) The defendant, who was considered to be "muddleheaded", owned a piece of land with full frontage to the road. The plaintiff, a real estate agent, owned a piece of land behind the defendant's land with very limited access. He persuaded the defendant to enter into an agreement granting mutual rights of way over the two properties. The defendant was obviously confused and unhappy with the arrangement but signed reluctantly. The transaction had the effect of increasing substantially the value of the plaintiff's property and slightly reducing the value of the defendant's. The Court of Appeal stated that, to establish that a bargain is unconscionable, it is sufficient that the plaintiff ought reasonably to have known of the defendant's disability and remitted the case to the High Court for judgment. The High Court held that the defendant had acted unconscionably and that the contract should be set aside. (*Nichols v Jessup* [1986] 1 NZLR 226.)

PRINCIPLES UNDERLYING THE LAW

37 Many of the recent cases can usefully be explained under some general head such as taking undue advantage of inequality of bargaining power, or a more general (but, in this context, somewhat circular) doctrine of "unjust enrichment". In a few of them there are explicit suggestions of the broad notion of an underlying "fair dealing" principle. One of the judges in the *Interfoto*

Picture Library case, Bingham LJ said (at 445):

> The tendency of the English authorities has, I think, been to look at the nature of the transaction in question and the character of the parties to it; to consider what notice the party alleged to be bound was given of the particular condition said to bind him; and to resolve whether in all the circumstances it is fair to hold him bound by the condition in question. This may yield a result not very far from the civil law concept of good faith...

38 It is true to add that this sort of wide language has disturbed some commentators.

39 In *Waltons Stores (Interstate) Ltd v Maher* (1988) 62 ALJR 110, a decision of the High Court of Australia, gives a strong flavour of a concept of "good faith dealing" underlying the analogous doctrine of estoppel. The facts were as follows:

> Maher owned premises which it was agreed should be demolished and replaced by new premises that Waltons Stores would lease. Documents were drawn up giving effect to this.
>
> Amendments were called for. Waltons' solicitors wrote to Maher's solicitors: "We believe that approval will be forthcoming. We shall let you know if any amendments are not agreed to." Some days later, having heard nothing about the amendments, Maher's solicitors submitted executed documents "by way of exchange". Their covering letter was not acknowledged for nearly two months. The acknowledgement then indicated that Waltons were not proceeding with the transaction. Meanwhile, to meet a time for occupation Waltons had nominated, Maher had caused the old premises to be demolished and construction of new premises was well advanced.

40 All the judges held that Waltons' behaviour in the circumstances prevented them from denying that a valid contract existed. Deane J commented (at 129):

> Waltons deliberately failed to speak or to warn in circumstances where, as Priestley J A commented in the Court of Appeal, "simple standards of honesty and fair dealing required [it] to make known to [the Mahers] that the assumption they were acting on was mistaken". It is true that substantive merits ordinarily have little relevance to the application of legal principle by an appellate

> court. However, when doctrines of estoppel - with their underlying rationale of good conscience and fair dealing - are involved, it is unlikely that the law will penalise a failure to speak which would not stand condemned by ordinary standards of honesty and decency.

41 It may be asked, therefore, if the true basis of "unconscionability", along with various other doctrines of contract law, is the principle of fair dealing. Inequality of bargaining power simply sets up a situation where the need for fair dealing is more apparent. Or an even wider principle of unjust enrichment may be relevant: see the papers presented to a New Zealand Law Society seminar, "Unjust Enrichment - The New Cause of Action", February 1990, and a public address at Wellington on 27 April 1990 by Professor Stephen Waddams of the University of Toronto.

THE LIMITS OF JUDICIAL INTERVENTION

42 However, by no means all contracts where the parties are in an unequal bargaining position are at risk. The courts have consistently stated that outside very narrow areas (such as minors' contracts) the cloak of unfairness or unconscionability does not cover the merely foolish, naive or imprudent. Three quotations among many from England, Canada and New Zealand will suffice:

> "Unconscionable" must not be taken as a panacea for adjusting any contract between competent persons when it shows a rough edge to one side or the other... (Lord Radcliffe in *Bridge v Campbell Discount Co Ltd* [1962] AC 600, 626 England.)

> ... it is not the function of the courts to protect adults from improvident bargains. (*Griessenheimer v Ungerer* (1958) 14 DLR 2d 599, 604 Manitoba.)

> The equitable jurisdiction to set aside unconscionable bargains is not a paternal jurisdiction protecting or assisting those who repent of foolish undertakings. (Somers J in *Nichols v Jessup* [1986] 1 NZLR 226, 235.)

43 Simple inequality is not enough. Innumerable transactions take place where one side takes advantage of the needs of the other but which no one in their senses would challenge.

> The automobile dealer is under pressure from his supplier or his banker for greater volume. The shrewd buyer negotiates a price in the aura of that

> pressure. The annual clearance sale is often motivated by the pressure of anticipated style changes. The buyer at that sale accepts the price reduction knowing of that pressure on the retailer. (*Graham v Voth Brothers Cont (1974) Ltd* [1982] 6 WWR 365, 370.)

44 To begin with, only serious types of inequality are recognised as needing redress. It is sometimes said that there must be some sort of "special disability". In *CBA v Amadio* (1982-83) 151 CLR 447, 462 Mason J explained this as follows:

> I qualify the word "disadvantage" by the adjective "special" in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasise that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment in his own best interests...

45 In addition, the bargain itself must be tainted with unfairness attributable in some way to the stronger party. Somers J in the Court of Appeal in *Moffat v Moffat* [1984] 1 NZLR 600, 606 put it this way:

> ... it is at least a necessary element that an equity be raised against the party receiving or retaining the bargain or advantage - that is to say that the receipt or retention is unconscientious.

46 The cases have emphasised what are called the procedural aspects - the conduct of one party in taking advantage of or exploiting the weakness of the other. This fits with the origin of the notion of "unconscionability". However, in New Zealand at least, the exploiting party does not have to actually know of the other's disability. The conclusion that he or she "ought to have known" is enough. Again, Somers J has expressed the situation clearly:

> But, at least in its antipodean statement, a party may be regarded as unconscientious not only when he knew at the time the bargain was entered into that the other suffered from a material disability or disadvantage and of its effect on that other, but also when he ought to have known of that circumstance; when a reasonable man would have adverted to the possibility of its existence. (*Nichols v Jessup* [1986] 1 NZLR 226, 235.)

47 This objective test introduces a flavour of a standard of care that is foreign to traditional ideas

about contract law. Nor is it easy to talk of "taking advantage" if actual knowledge is lacking. However, there must be facts to put one party on inquiry, or the relationship of the parties must be such that knowledge can be presumed. Thus in the recent case, *Bayer v Preston* [1989] BCL 373:

> ... a man gave a mortgage over his land as part of a scheme whose instigator and principal intended beneficiary was one of his sons. The father was over 70, was very ill, and on the evidence was unlikely to have understood the transaction in any meaningful way. An attempt to set aside the mortgage failed because there was no evidence that the mortgagee was aware of these facts or was put on inquiry. Indeed the mortgagor's solicitor had given a certificate that the document was explained to the mortgagor, who fully appeared to understand it. So there was no unconscionable behaviour by the other party.

48 "Procedural" unfairness may not be sufficient either, at least outside such areas as undue influence and the breach of a fiduciary obligation. The result also must be unfair in the sense of a gross disparity of value.

49 Yet this too has a subjective element. *Elia v Commercial Mortgage Nominees Ltd* [1988] 2 NZBLC 99-136 was one such case:

> Elia was unable to write in English to any extent. His reading skills were limited. He had little experience in business matters. His de facto wife persuaded him to become involved in buying a rest home. A director of a mortgage nominee company and of a finance company recommended a solicitor to him, who was himself a director of the nominee company and solicitor to the finance company. An agreement was made for Elia and his wife to purchase the rest home business and lease the premises with an option to purchase. The deal was financed by a first mortgage over his house and an advance from the finance company secured by a second mortgage over the house and a debenture over the assets and undertaking of the company operating the rest home. Elia and his de facto wife personally guaranteed the company's borrowing.
>
> The relationship between the two deteriorated, the business went badly, there were defaults, and the nominee company took steps for a mortgagee's sale. Elia applied to the court for relief.

50 The court considered the transactions in question

were standard business arrangements, but they had to be seen in a different light in the circumstances of Elia's lack of understanding that the business was not a viable one.

51 In Canada, courts have set aside bargains where the exchange of values may have been objectively equal but one party more or less forced on the other a contract wholly inappropriate to that party's needs and circumstances. An example is *Gaertner v Fiesta Dance Studios Ltd* (1972) 32 DLR 3d 639, where a woman was tricked into taking expensive dancing lessons on the implication that she would be made into a star. She did indeed get the lessons she paid for, but the contract was nonetheless held unconscionable.

52 The element of substantive fairness, though it is often not mentioned explicitly in the cases, is simply common sense. It might be supposed that if someone has had in the result a fair bargain the circumstances in which it was made are unlikely to come before a court. However, people have been known to have second thoughts about transactions. Moreover, a term may seem less advantageous in the light of later events, as in *Jenkins v NZI Finance Ltd* (1989) 12 TCL 43/5, where a guarantor agreed under the expectation that the guarantee would not be called up because the company was expecting a favourable outcome in a pending arbitration. When the company lost the arbitration and the guarantee was called up the guarantor argued that the contract was unconscionable. The court rejected the argument, saying there was no substantive unfairness in the contract.

53 The truth is that if a contract could be unfair wherever one party is under a serious disadvantage known to the other party, no contract could safely be made with a disadvantaged person. This is not a result anyone would want.

LEGISLATION ABOUT UNFAIR CONTRACTS

54 The suspicion that the courts showed towards money-lending contracts was replicated in the Moneylenders Act, passed in Britain in 1900 following the report of a select committee that disclosed very serious abuses (see the 1977 report of the Contracts and Commercial Law Reform Committee on Credit Contracts). This Act was copied in New Zealand in 1901. The concept of reopening harsh and oppressive credit contracts is now at the heart of the Credit Contracts Act 1981.

55 The common law has been supplemented by other specific statutes in New Zealand and by both general and

specific legislation in many other countries. In New Zealand such legislation has tended to focus on particular terms of particular kinds of contracts, except for the Door to Door Sales Act 1967 and the Credit Contracts Act. The former deals with contracts for the supply of goods and services on credit made in defined circumstances, as the title indicates. The latter covers contracts of the class which is again expressed in the title.

56 Examples of other statutes include: the Hire Purchase Act 1971; the Layby Sales Act 1971; Part VII of the Motor Vehicle Dealers Act 1975; the Insurance Law Reform Acts 1977 and 1985; the Carriage of Goods Act 1979; the Contractual Remedies Act 1979; and the Residential Tenancies Act 1986. Such Acts may imply certain terms in the contracts they relate to, or declare specified provisions void, or enforceable only at the discretion of the court, or enforceable if fair and reasonable, and so on.

57 The most general New Zealand provision is s 9 of the Fair Trading Act 1986, though it is directed at conduct rather than at contracts as such. It provides simply: no person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

58 In July 1990 the Minister of Consumer Affairs announced that a Consumer Transactions Bill was being drafted. It would:

- define consumer transactions as involving the supply of a good or service ordinarily supplied for consumer use by a person acting in the course of business;

- contain an obligation for the good or service to meet the standard that a reasonable person would regard as satisfactory taking account of price, quality of goods (state and condition), fitness for the purpose for which such goods are commonly supplied, appearance and finish, freedom from minor defects, and safety and durability;

- cover services other than professional services;

- contain a requirement that spare parts and repair facilities be reasonably available or their absence be clear at the time of purchase;

- limit contracting out of statutory

obligations;

- provide a remedy of cancellation or termination and refund for fundamental breach and cure for other breach.

59 The New Zealand legislation is discussed in greater detail in Appendix A.

60 Overseas legislation has gone further. The Uniform Commercial Code, adopted in nearly all 50 of the United States, makes unconscionable sales contracts or unconscionable terms in sales contracts unenforceable.

61 Section 2-302 is not confined to consumer contracts although its main impact has been there. Moreover, although it expressly relates only to sales contracts, its substance has been applied to other contracts. California did not enact s 2-302 but has an unconscionability statute applying to all contracts.

62 Under the Uniform Commercial Code, there is a general bar on contracting out of the obligations, themselves imposed by the Code, of good faith, diligence, reasonableness and care: s 1-102(3). This is underpinned by the general provisions of s 1-203:

> Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

63 Under the German Civil Code, article 242 states that an "obligor" must observe requirements of good faith performance, ordinary usage being taken into consideration. This provision has been used to regulate a range of unfair contractual practices. There is also specific legislation dealing with standard form contracts, which blacklists and greylists a number of terms in consumer contracts particularly. The Netherlands has recently adopted broadly similar legislation. Sweden also has legislation dealing with standard form consumer contracts which empowers a "consumer ombudsman" to apply for clauses to be struck down: Contract Terms Act 1971.

64 Both the United States and West Germany, highly sophisticated commercial societies with economies founded on freedom of contract, thus have general doctrines of fairness to which contracts are subject. They are not alone in this. Article 1134(3) of the French Civil Code requires all contracts to be performed in good faith. The courts have extended this obligation to the formation as well as the performance of contracts. The Cour de Cassation has, for instance, excised an exoneration of liability clause from a manufacturer's contract of sale.

65 There is, moreover, a substantial and increasing body of law in many European countries that deals with unfair contracts. These are not always limited to what would be seen as "consumer contracts". The end consumer is not seen as the only one needing and deserving some protection. An informative discussion is Beale, "Unfair Contracts in Britain and Europe" (1989) 42 Current Legal Problems 197.

66 In Denmark, for instance, s 36 of the Contracts Act (as extended in 1975) enables the court to set aside a contract or other legal act wholly or partly if it would be unreasonable or contrary to honest conduct to enforce it. Regard has to be paid to the circumstances prevailing at the making of the contract, to its terms, and to subsequent circumstances. The section applies to business as well as consumer contracts. See Madsen, "The Impact of Consumer Law on the Law of Contracts" (1984) 28 Scandinavian Studies in Law 85.

67 In the United Kingdom an Unfair Contract Terms Act was passed in 1977. Its title belies its limited scope - it is in fact concerned almost wholly with "exclusion clauses" in contracts - clauses that limit or deny the liability of one party for failure to perform or wrongful performance. Such clauses have been common in standard contracts in many countries. There have been suggestions that legislation on these lines should be considered for New Zealand. More recently, the use of compulsory arbitration clauses in most consumer contracts has been excluded in the United Kingdom by the Consumer Arbitration Agreements Act 1988. The Unfair Contract Terms Act also draws some distinctions between consumer and other contracts.

68 In 1984 the Commission of the European Communities published a discussion document on unfair terms of contract: Bull EC (1984) Supp 1/84. This was directed principally at the harmonisation of national consumer laws. Recently the European Commission approved a proposal for a directive on unfair terms in consumer contracts. The contents appear to have been influenced by legislation or legislative proposals in a number of European countries - in particular Germany, Belgium, Luxembourg and the Netherlands. A copy of the proposed directive is found in Appendix F of this paper.

69 New South Wales has a Contracts Review Act 1980. Essentially it gives the court power to grant relief where it finds a contract or a provision of a contract unjust. The Act lays down a large number of matters (one general and at least 11 specific) to which the court is to have regard. The Crown, public bodies and corporations are not eligible for relief under the Act; nor is anyone who

entered into the contract in the course of trade, business or profession (with the exception of farming).

70 The language of this Act has been followed at some points in s 52A of the Trade Practices Act 1974 of the Commonwealth of Australia. The Australian Act also contains (s 52) provisions about misleading or deceptive conduct in trade, of which s 9 of the New Zealand Fair Trading Act is a copy - but there is no New Zealand equivalent to s 52A. The Australian provision is largely limited to trade between consumers and corporations. Similar legislation without the second limit exist in most of the Australian States. Some of the Canadian provinces have fair trading statutes with unconscionability provisions, for example the British Columbia Trade Practices Act 1979. In its *Report on Amendments to the Law of Contract* (1987), the Ontario Law Reform Commission has proposed general legislation on unconscionability broadly along the path taken by the United Kingdom 1977 Act and the New South Wales Contracts Review Act.

71 Further details of the United States, Australian, English and German legislation are in Appendices B to E.

THE SIZE OF THE PROBLEM

72 To try to gain an initial impression of the extent to which, and the contractual areas in which, unfair or oppressive conduct occurs, the Law Commission consulted the Ministry of Consumer Affairs and the Consumer Council. It also wrote to community law centres, citizen's advice bureaux and similar organisations. The replies suggested that credit contracts continue to be a major source of perceived unconscionable or harsh practices. So too does hire purchase. It is noteworthy that both fields are already closely regulated by statute - the Credit Contracts Act and the Hire Purchase Act. Other sources of complaints included building contracts and quotes, hire, insurance and real estate agents. The number of complaints reported was substantial. One community law centre alone mentioned 50 allegations of "unconscionable contracts" in the first half of 1989.

73 One feature was the large proportion of cases that were thought to fall in the "high-handed but legal" category. A second aspect was that many of the complaints related to the harsh or oppressive exercise of rights. Any solution that limits itself to the actual terms of contracts seems unlikely to be accepted as adequate.

74 However, on the one hand replies were by no means complete, and on the other the cases were of complaints

only. It does not follow that all or most of them were justified. So it would be unwise to draw too much by way of inference from the information received so far.

75 The Ombudsman's November 1989 report on the standard Telecom contract is of interest in this context. The following examples taken from the report are for the purpose of illustration only. The fact that Telecom has amended a number of these clauses since the Ombudsman's investigation does not affect their exemplary value.

76 Some of the clauses:

- gave an open-ended power to modify the contract unilaterally upon giving a month's notice (and even the month's notice could be abbreviated under the clause);

- imposed a duty on the consumer to give access to certain premises although they might not be the consumer's premises, the consumer therefore having no legal power to give access;

- imposed a liability on the consumer to pay for all services that Telecom's records purported to show were requested - in other words, one party's records were to be conclusive of the other's liability to pay;

- made the consumer liable to pay for charges after he or she had given notice of termination until the service was actually disconnected;

- required the consumer to pay all legal costs on a solicitor/client basis in the event of any breach of the contract - it was claimed that such a provision was common in mortgages and other contracts (in *Kensington Swan Solicitors Nominee Co v Dempsey* (1989) 12 TCL 20/7 the Master disallowed such a clause in a mortgage);

- excluded all liability for loss or damage caused by Telecom or its employees or agents, with certain limited defined exceptions (such a term would be at peril under the British Unfair Contract Terms legislation);

- imposed a duty on the consumer to indemnify Telecom from all loss damage liability or expense arising from anyone's use or attempted use of the consumer's network

service (again, the United Kingdom Act is apposite);

- provided that any notice was effective against a consumer three days after its posting, whether or not it was delivered by them; there was no corresponding provision in respect of notices *to* Telecom.

DISADVANTAGES OF PRESENT LAW

77 The Law Commission does not see the existing law, as built up by the courts and supplemented by statutes, as being essentially deficient. However, the Commission sees a number of reasons that might justify the intervention of Parliament.

(1) The absence of any clearly understood general doctrine or principle has encouraged the multiplication of specific statutory provisions (see paras 54-56 above for examples). These have not by any means covered all kinds of contract where claims of abuses have rightly or wrongly been made - commercial leases, guarantees, franchise agreements, supply of services, vehicle hire agreements, and others. The Ombudsman's 1989 report on Telecom contracts indicates that even standard form contracts of public authorities may contain questionable terms. Inevitably, therefore, there will be consumer-driven pressure for further piecemeal legislation. Yet it is by no means certain that a host of ad hoc prohibitions of this kind is the only or the best way of dealing with what may be a few cases of abuse.

(2) On the other hand there may be a case for the regulation of some specific types of term, in whatever contracts they occur. One of the few New Zealand instances is s 4 of the Contractual Remedies Act. Some overseas legislation in the United Kingdom, Scandinavia and other parts of Europe, for instance, is much more far-reaching.

(3) The development of the general law by the courts has been measured and cautious. Nevertheless, it has left a degree of uncertainty. One has the impression of a judicial oscillation between approaches to contractual unfairness - advances and retreats that have done little to provide

clarity in the law. Moreover, different judges have sometimes reached the same result by different pathways. The sort of cases that in New Zealand have been decided on "unconscionability" grounds have been dealt with in England as cases of "undue influence". In New Zealand cases, also, a variety of routes have been taken. So in *Shotter v Westpac Banking Corp* [1988] 2 NZLR 316, the court felt obliged to resort to a somewhat tortuous exploration of various possible paths to reach a plainly sensible result. Legislation could encourage the courts to take a direct route to the proper answer.

(4) Legislation might be useful to put beyond doubt whether or not objective knowledge (that a contracting party *ought* to have known of the other's disadvantage) can be enough under New Zealand law to make a contract unconscionable.

The Law Commission's attention has been drawn to a possible implication of this. If it is sufficient that a defendant in an action to review a contract ought to have known the facts that made the other party vulnerable, what of the situation where he or she has learned of those facts after the contract is made? Should it be possible to shelter behind the principle that the time of making the contract is decisive? Or is it to be regarded as inequitable (in the legal as well as in the moral sense) to continue to take the benefits of a grossly unbalanced transaction after its nature becomes known? Logic would seem to suggest the second view. However, if this be so, what time limits if any should there be for what might loosely be called restitution? Ought a change of position defence be available?

The Commission would welcome comments on this possible extension of the law, which does not seem to have been raised in previous cases or extensively discussed in legal writing.

(5) Legislation could promote access to and use of the law on a subject of considerable public importance and interest. Very few standard form contracts have been litigated before the court, although some of those to which publicity has been given are on the face of it harsh. Is this because the

process of obtaining remedies by litigation is defective, or because people do not know what their rights are?

(6) Whether a contract is unfair is judged by the circumstances at the time it is made. This is surely right, if every contract is not to become provisional. However, it is unclear how far the courts are able to deal with a harsh or oppressive exercise of a contractual power or discretion; eg, a power to repossess goods, a power to enter property, a power to end the contract or call up the full amount owing for any default. Such a power may have a legitimate scope, and could not be said to be inherently unfair. But it may equally be capable of serious abuse. In some circumstances the courts have intervened, as with forfeiture clauses in leases, and clauses imposing a fixed penalty for breach. So the concept itself is not novel. There is already legislation on credit contracts enabling the courts to intervene.

(7) Perhaps of greater practical importance, there may be need for more flexibility of remedy. The common law, in this situation, has tended to adopt a black-or-white approach. A contract is either void or it is not, a party must either restore everything or nothing, a term is either struck down or it is fully valid. Sometimes indeed the courts have adjusted rights, as in *Hart v O'Connor* where the Court of Appeal awarded compensation after setting aside the contract. (The Privy Council overturned its judgment on substantive grounds.) A greater ability to make adjustments between the parties may be in everyone's interest. This might be assisted by legislation.

In fact statutory reforms have been taking New Zealand along this path for some time. The law about payments made under a mistake (Judicature Act 1908 ss 94A, 94B), minors' contracts, illegal contracts, including contracts in restraint of trade (Illegal Contracts Act 1970), the Contractual Mistakes Act 1977 and parts of the Contractual Remedies Act illustrate this.

(8) An underlying problem exists of practical access to justice. This of course is far from being limited to unfair contracts. It

may not be enough that the courts can do justice in cases that come before them. For various reasons (and the availability of legal aid is only one) many who are vulnerable cannot or do not pursue their rights in the courts. Empirical evidence suggests that members of groups most likely to be the victims of exploitation or unconscionable behaviour are least likely to "take it to court". It suggests also that the system of Disputes Tribunals (valuable though it is) is not the full answer. So some machinery for public action may be unavoidable if there is to be a truly effective remedy for unfair contractual practices: see an address by D F Dugdale given at the national conference of the New Zealand Credit and Finance Institute Incorporated on 13 October 1989. He pointed out that substantive remedies do exist (for instance, under the Hire Purchase Act 1971 and the Credit Contracts Act 1981) for many contractual practices that have been strongly criticised as harsh. However, the remedies have been little used and the question is, why?

One possibility is for a consumer ombudsman (as under the Swedish Act). An ombudsman might have powers not merely to investigate unfair contractual practices (on complaint, and perhaps on his or her own initiative) but also to hear the parties and make recommendations. Probably by analogy with the Ombudsmen under the Ombudsmen Act 1977, a consumer ombudsman should not be able to make binding orders. There is already a precedent in the Motor Vehicles Disputes Tribunals which were established under statute, although they can make decisions and not just recommendations. Recently the insurance industry has set up a procedure for hearing complaints by policy-holders.

II

POSSIBLE LEGISLATIVE CHANGES

78 Any legislation that tries to deal generally with abuses of inequality of bargaining must almost inevitably be expressed in terms of standards that have some subjective element. The alternative seems to be to specify particular terms that may be considered unfair, and particular circumstances in which the courts may intervene on this ground. The West German legislation has gone some way towards specifying what terms in standard form contracts are objectionable and the United Kingdom Unfair Contract Terms Act comprehensively regulates exemption clauses: so that approach should not be discounted.

79 However, that sort of legislation too is often expressed in terms of a standard. The British Act says that certain exclusion clauses are invalid unless they are fair and reasonable. Some of these provisions apply to business as well as to consumer contracts.

80 What is "unreasonable", "unfair" or "oppressive" is not capable of precise definition in advance. The introduction of such standards, whether by judges through case law or by legislation, has therefore been criticised as diluting the policies of certainty and predictability in contract. The answer to an assertion that a contract or a term is unfair or unconscionable must depend in part on the response of a particular judge in a particular court. In this respect, standards are akin to judicial discretions, which are disliked for the same reasons.

81 This concern is legitimate and it needs to be respected. However, its force ought not to be exaggerated. Outside contracts, the law frequently uses standards as a basis for decision. Thus every lawyer is familiar with the "reasonable man" test in deciding if there has been a breach of a "duty of care" amounting to negligence. Judging necessarily involves uncertainty. On issues of fact, the weight that a judge will give to particular evidence is not easy to predict. It may be useful to express the relevant standards in such a way that the policies underlying them are clear and understood.

82 The truth is that there is already some degree of uncertainty in the law of contract, both as developed by the courts and as modified by statute. So the question is not whether more legislation about unfair contracts and unfair terms would introduce uncertainty into the law. Rather the question is whether or not it would increase uncertainty, and if it would, whether this is acceptable.

83 Much overseas legislation has created standards against which contracts are measured. An obvious example is the unconscionability and fair dealing principles of the Uniform Commercial Code in the United States. The Unfair Contract Terms Act in the United Kingdom has already been mentioned. Dutch, German and Scandinavian legislation contains comparable provisions. Closer to home are the provisions of the Trade Practices Act in Australia.

84 What is desirable is that uncertainty should be reduced to the lowest practicable level by defining limits (what things are not to be regarded as unfair), setting down criteria (what things are to be taken or not taken into account) and leaving scope for people to take risks where they wish to.

85 The adoption of s 52A of the Trade Practices Act may seem an easy answer and the Commission does not exclude that option. It could also have advantages from the point of view of Closer Economic Relations with Australia to harmonise the law in this area. However, adoption of s 52A, without more, would leave a number of aspects uncovered and the section seems to have some unsatisfactory features; eg, the broad unrelated criteria against which conduct is measured, and the leaving open of the way for other unspecified criteria to be used. It has a larger subjective element than s 52 (s 9 of our Fair Trading Act), which is concerned with misleading or deceptive conduct. Nor is it at all certain that such a provision would catch the sort of undesirable terms to which much New Zealand legislation is already directed.

86 In any event, therefore, there may be need to do something about specific kinds of contractual terms. The sort of stringent test used by the courts in unconscionability cases may not be enough. Quite apart from the unconscionability doctrine, the common law has sometimes itself either refused to enforce a provision altogether (eg, "penalty" and "forfeiture" clauses) or applied a test of reasonableness (eg, to restraints on trade). If a general unconscionability test were the sole criterion, parties to contracts would have less protection than under the common law, and under recent legislation such as ss 11-15 of the Hire Purchase Act, s 4 of the Contractual Remedies Act and Part I of the Credit Contracts Act. That would seem unlikely to find general favour. So either rules of this kind would have to be kept in their existing form or developed into more general statements as in Britain and West Germany. The second course may be the better one. However, there will perhaps always be a place for dealing with specific terms applicable to particular types of transaction, as in the Layby Sales Act.

87 In this area of the law, reform must be cautious lest the baby goes out with the bath water. Freedom of contract and predictability ought not to be limited without good reasons. Accepting that, the Law Commission asks whether legislation of a general kind on the subject of unfair contracts is desirable. Its aim might be modest - to clarify the limits of freedom of contract in cases where inequality of bargaining power is abused. A number of recent legal writers have suggested that some sort of codification might, in itself, help to promote commercial certainty. Thus Robert Baxt, commenting in the Australian Law Journal on the *Nobile* decision (para 36(4)) thought that the time had come to rationalise the law so as to make the rules clearer to the community at large and to legal advisers: (1989) 63 Australian LJ 429. Writing on s 52A of the Australian Trade Practices Act, John Goldring ((1988) 11 Sydney LR at 533) suggested that:

> The effect of the legislation should be to place on notice all those who enter into contracts of the type affected by the particular legislation that they should not risk having the contract set aside by the courts by engaging in such conduct as appears to fall within the range of circumstances to which the court is directed ... to consider. Therefore, the degree of certainty in the law is reduced.

88 The remainder of this paper outlines a possible scheme of legislation, although the Commission is not wedded to it in detail or in its approach.

INTRODUCTION TO SCHEME

89 The scheme set out below, and reproduced in full on pp 51-56 sketches a possible approach to the regulation of contractual practices that are unconscionable or unfair. The drafting is indicative only, and is not in the form of a Bill ready for introduction into Parliament. The aim is simply to complement the discussion paper by suggesting one sort of legislative approach New Zealand might take to the problems of unfair contracts.

90 The scheme has six principal features:

- The New Zealand common law of unconscionability in relation to contracts is restated and clarified, with only minor extensions: cls 2-4. For a contract to be unfair under these clauses three elements are generally required

  - a serious imbalance of power between the parties,

- one party taking undue advantage of that imbalance,

- a substantial disparity of result.

- Generally, the law applied to contracts is the same as that which deals with oppressive terms in credit contracts contained in the Credit Contracts Act. In turn, this law was built on recognised common law doctrines: cls 5 and 6. These concentrate on gross unfairness of result, although inequality of the parties' bargaining position will often be relevant.

- Certain types of term sometimes found in standard contracts are mentioned as possibly justifying proscription altogether, or in "consumer" transactions, or subject to a "fair and reasonable" test: cls 7 and 8. There are statutory precedents in New Zealand for each of these approaches. Clause 9 complements this by subjecting terms incorporated in contracts by reference to other documents to a "fair and reasonable" test.

- The courts may review the exercise of contractual powers in an oppressive manner: cl 10. This again extends to contracts generally the law applicable to credit contracts.

- The powers of the courts are enlarged and made more flexible to grant relief where a contract or contractual terms are unfair, or contractual powers are used oppressively. The Commerce Commission is given standing to take proceedings in respect of a single contract or a group of contracts.

- Within its scope of application, the scheme is meant to replace the common law governing the reopening of "unfair" contracts under the various heads of "unconscionability", "undue influence", "duress" etc. It is not intended merely to add a new statutory remedy to those now available.

OUTLINE OF SCHEME AND COMMENTARY

1 Purposes

The purposes of this scheme are to:

(a) clarify and extend the circumstances in which the courts may review contracts, and terms of contracts, as being unconscionable, oppressive, or unfair;

(b) provide remedies for the abuse of a superior bargaining position by one party in making a contract, without impairing general freedom and certainty of contract;

(c) make certain contractual terms invalid, and to make certain other contractual terms invalid unless they are reasonable in the circumstances;

(d) require minimum standards of fair dealing by the parties in the performance of contracts;

(e) clarify and extend the relief that the courts can give upon reviewing unfair contracts and contractual terms, and the unfair exercise of contractual powers.

Comment

91 The essence of the scheme is to achieve a better and clearer balance between the legitimate desire for contractual freedom and certainty, and the equally legitimate need to avoid injustices flowing from the misuse of a superior bargaining position. The scheme recognises that neither of these concepts can be treated as absolutes.

92 Within that overall aim, the scheme is designed to do a number of things:

(1) clarify the circumstances in which the court may review contracts and terms of contracts on grounds of unfairness. The scheme draws on the common law doctrine of unconscionability as developed in *Hart v O'Connor* and *Nichols v Jessup*, and related doctrines such as undue influence and duress. In relation to contractual terms it takes account of the variety of existing New Zealand legislation, eg, the Hire Purchase and Layby Sales Acts, the Insurance Law Reform Acts, the Contractual Remedies Act s 4 and the Credit Contracts Act. It also takes account of general and particular overseas statutes, notably s 52A of the Australian Trade Practices Act, the British Unfair Contract Terms Act and the German Standard Contract Terms Act.

(2) To extend the focus beyond the actual making of the contract, to recognise that some contractual terms may not be unfair in themselves but can be applied in an unfair or harsh manner. A provision of this kind already exists in the Credit Contracts Act.

(3) To provide better and more practical remedies for unfair contractual practices. To this end it gives the Commerce Commission power in certain cases to take proceedings to have unfair terms struck down.

2 General test of unfairness

A contract, or a term of a contract, may be unfair if a party to that contract is seriously disadvantaged in relation to another party to the contract because he or she:

(a) is unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; or

(b) is in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; or

(c) is legally or in fact dependent upon, or subject to the influence of, the other party or persons connected with the other party in deciding whether to enter into the contract; or

(d) reasonably relies on the skill, care or advice of the other party or a person connected with the other party in entering into the contract; or

(e) has been induced to enter into the contract by oppressive means, including threats, harassment or improper pressure; or

(f) is for any other reason in the opinion of the court at a serious disadvantage;

and that other party knows or ought to know of the facts constituting that disadvantage, or of facts from which that disadvantage can reasonably be inferred.

Comment

93 This clause, and cls 3 and 4, set out the basic criteria for establishing whether contracts or contractual terms are unfair in the circumstances. They are based on the concept of unjustly exploiting the other party's inferior position. This is consistent with the case law under s 2-302 of the United States Uniform Commercial Code. The clauses also encompass the case where the circumstances of a transaction make a real choice impossible.

94 The criteria for procedural unfairness correspond roughly to those in s 52A of the Australian Trade Practices Act - in particular the general reference there to inequality of bargaining power (and more specific references to lack of comprehension, and undue influence, pressure or unfair tactics brought to bear). The more detailed drafting of the clause is an attempt to pin down the elements of unconscionability to avoid unnecessary uncertainty.

95 Clause 2 specifies an extra element, not identified in s 52A of the Australian Act. In New Zealand, as exemplified by *Nichols v Jessup*, there is an objective test of knowledge based on what the stronger party knew or ought to have known. Constructive knowledge of a party's weakness may be sufficient.

96 The clause states the general requirement of a serious bargaining weakness, and this is elaborated in paras (a)-(f). These largely follow the common law but may extend it in a few cases.

97 Thus para (b) includes cases of pure economic need in the categories of bargaining weakness. For instance, suppliers of essential commodities (or at least things which are essential in the circumstances of those who seek to have them) may find their standard terms the subject of scrutiny.

98 "Ignorance of business affairs" (para (a)) has been an element of a number of recent decisions under the common law, particularly in guarantee cases. Lenders are well advised to inform prospective guarantors as to the nature and extent of their obligations, unless the guarantor is adequately advised by a third party or has sufficient business acumen (cf *Jenkins v NZI Finance*). Disadvantage caused by emotional distress is also recognised in the cases. Thus in *K v K* [1976] 2 NZLR 31 the court found that a wife's emotional condition and distress deprived her of proper judgment.

99 Paragraphs (c) and (d) overlap the common law of

undue influence, breach of fiduciary duty, negligence and estoppel. Under (d) it is sufficient for the weaker party to rely on the skill and care of the other and for the other to know of that, or at least to have constructive knowledge. Dependence or reliance on a third party are also relevant under (c) and (d) if there is a "connection" between him or her and the other party to the contract. Obvious cases are an agent or solicitor of the other party, but because it would be almost impossible to pin down all variations the provision is left general. Whether the contracting party is in a position to know of the dependence may be a question of fact. But as appears to be so under the present law, the fact that a guarantee was procured by a close friend or relative of the guarantor (who also stands to benefit from the guarantee) would not itself be a ground for reopening the contract to the lender. Here again the presence of independent advice will be relevant in determining whether there really was independence or reliance.

100 Paragraph (e) relates primarily to duress, and corresponds to s 10(1)(c) of the Credit Contracts Act 1981. It is not limited to cases of physical duress. Sufficiently overpowering mental or emotional pressure would also be covered - for instance harassing sales tactics (cf the Door to Door Sales Act 1967). Economic pressure may also be relevant - as with the common law instance of a contract modification agreed to under threat of non-performance.

101 Paragraph (f) is a residual provision. It is designed to give the courts a continued flexibility in the myriad variety of circumstances that can arise and avoids setting up closed categories.

3 Professional advice

In considering whether a contract, or a term of a contract, is unfair the court shall have regard, among other things, to whether the disadvantaged party received appropriate legal or other professional advice.

Comment

102 This makes it clear that the existence of independent advice (normally but not necessarily always legal advice) can be a relevant factor in deciding whether a contract is unfair. This follows the common law (see also s 4 of the Contractual Remedies Act 1979). In some cases the fact that a party has had legal advice may be decisive. In others, of course, knowledge of his or her legal rights may not suffice.

4 Result must be unfair

(1) Notwithstanding clause 2, a contract is not unfair unless in the context of the contract as a whole:

(a) it results in a substantially unequal exchange of values; or

(b) the benefits received by a disadvantaged party are manifestly inappropriate to his or her circumstances; or

(c) the disadvantaged party was in a fiduciary relationship with the other party.

(2) A grossly unequal exchange of values may create a presumption that the contract is unfair.

Comment

103 Paragraphs (a) and (b) require that the contract be substantively as well as procedurally unfair, reflecting the general approach of the common law - see, for instance, *Bayer v Preston*, *Jenkins v NZI Finance*. They accord with the approach of the United States courts to s 2-302 of the Uniform Commercial Code as exemplified by *Williams v Walker Thomas Furniture Co*. (Also cf the Minors' Contracts Act, and the Contractual Mistakes Act with respect to mistake.)

104 Substantive unfairness is broadly defined to include not only cases where the values exchanged under the contract (deliberately not framed in terms of the technical term "consideration") are objectively disproportionate, but also the more difficult case of a contract which may appear objectively to provide a reasonable exchange but which, given all the circumstances of one party as known to the other, does not. For instance the dancing lessons in *Gaertner v Fiesta Dance Studios Ltd* would be covered (as would the mortgage in *Elia v Commercial Mortgage Nominees*). The term "manifestly", however, makes clear that questions of unfairness are to be approached robustly. Thus, as for procedural unconscionability, there should be at least constructive knowledge attributable to the other party.

105 The reference to "substantially unequal exchange of values" in subcl 1(a) would allow a court to take direct account of excessive price (a major category of cases under the Uniform Commercial Code provision). Here the

"circumstances of the contract as a whole" will be very important since these allow account to be taken, among other things, of the market price (see cl 6). Evidence of market conditions is particularly relevant in determining whether a price is in fact excessive. The price difference would no doubt have to be substantial, even gross, to come within the subclause.

106 By way of exception, para (c) is intended to reflect the present law whereby in a fiduciary relationship it is not necessary to show that there was a disparity of result. There seems a case for preserving this special equitable exception. There is some uncertainty whether the position is the same in undue influence cases, but it seems not to be. In any event, there seems no good reason for maintaining such an exception - if there has been a fair exchange of values, the presence of a strong influence should not matter.

107 Subclause 2 is in line with statements in a number of the cases in New Zealand and elsewhere, that, if the terms of a contract on their face are hopelessly unbalanced, a presumption of unconscionability may arise. It can, of course, be rebutted.

5 Harsh and oppressive terms

(1) A term of a contract is also unfair if, in the context of the contract as a whole, it is oppressive.

(2) A term of a contract is oppressive if it:

(a) imposes a burdensome obligation or liability which is not reasonably necessary to protect the interests of the other party; *and*

(b) is contrary to commonly accepted standards of fair dealing.

(3) A transaction that consists of two or more contracts is to be treated as a single contract if it is in substance and effect a single transaction.

Comment

108 This is a supplementary provision, which makes "oppressive" terms unenforceable without reference to the specific situations described in cls 2-4.

109 Essentially the clause is an extension to other

contracts of the rule that now applies to credit contracts, which in turn was built upon well-established common law. It corresponds to much overseas legislation that requires "good faith" and basic standards of fair dealing in the formation and performance of contracts. Moreover, like overseas legislation, its scope is not limited to consumer contracts. Having regard to the general nature of the clause, the threshold of what is "oppressive" should be high - more than merely unreasonable or burdensome. On the other hand it is *not* meant to simply replicate across the board the common law relating to moneylending transactions: cf the dictum of Vautier J in *Italia Holdings (Properties) Ltd v Lonsdale Holdings (Auckland) Ltd* [1984] 2 NZLR 1, 16 - "It would be difficult to argue in my view that an applicant under the Credit Contracts Act could succeed in having a credit contract set aside by setting up facts that would have been insufficient to enable a person in an unequal bargaining situation to have a contract entered into by him set aside on equitable grounds." Rather is it intended that clause 5 should stand on its own feet and be a starting point for judicial application and development.

110 The definition of "oppressive" in s 9 of the Credit Contracts Act is somewhat circular and has not been used. Instead clause 5 identifies these elements:

(1) The term unnecessarily imposes a burdensome obligation or liability. "Unnecessarily" is used in the sense that it goes beyond anything reasonably needed to protect the other party's interests. Section 52A(2) of the Australian Trade Practices Act lists as one of the criteria for unconscionable conduct the requirement of the consumer to comply with conditions that were not reasonably necessary for the protection of the supplier's legitimate interests. This phrase comes from the New South Wales Contracts Review Act. There is no stated need in that Act for the condition to be harsh or unduly onerous, and the provision is rather looser than the clause here proposed.

(2) It is contrary to commonly accepted standards of fair dealing. No specific reference is made in the clause to reasonable standards of commercial practice, as there is in s 9 of the Credit Contracts Act, because many contracts are not commercial ones. However, cl 6(2) deals with this point. The phrase "honesty and fair dealing" is used in this sort of context in *Walton Stores v Maher*.

(3) "Oppressiveness" is to be judged in the context of the contract as a whole. (See cl 6 for an elaboration of that concept.) To prevent circumvention, a transaction that is in substance and effect a single transaction is to be treated as a single contract, although it may consist of two or more contracts (cf s 2(3) Hire Purchase Act and the much more detailed provisions of s 4 of the Credit Contracts Act).

6 Context of the contract

(1) In considering the context of the contract as a whole, the Court may, among other things, take into account the identity of the parties and their relative bargaining position, the circumstances in which it was made, the existence and course of any negotiations between the parties, and any usual provisions in contracts of the same kind.

(2) In relation to commercial contracts the court shall take into account reasonable standards of commercial practice.

Comment

111 This enables a court to look broadly at the background to the contract in deciding whether a particular term is oppressive. In keeping with the reference in cl 5 to "commonly accepted standards", the clause makes usual provisions in similar contracts relevant, although of course not conclusive. The Credit Contracts Act s 13 approaches the matter less directly by allowing evidence of terms on which credit was available from other persons. The unconscionability section of the United States Uniform Commercial Code allows evidence to be given as to the "commercial setting purpose and effect" of the contract.

7 Circumstances judged at time of contract

The question whether a contract, or a term of a contract, is unfair shall be decided in the light of the circumstances at the time the contract was made.

Comment

112 This is in line with the common law. A contract is unfair or not unfair in the light of the circumstances

when it was made. Subsequent events are to be ignored, even if they make it difficult or extremely onerous for one (or both) parties to carry out their promises (cf *Jenkins v NZI Finance*). They would seem to be better dealt with (if at all) by an extension of the doctrine of frustration of contract. The question whether one party exercises powers under the contract unfairly is a different one. It is dealt with in cl 10.

8 Unfair terms

Without limiting or affecting clauses 2-5:

(a) A term of a contract is of no effect if ....

(b) A term of a contract is of no effect if ... unless the term is fair and reasonable.

(c) A term of a consumer contract is of no effect if ....

(d) A term of a consumer contract is of no effect if ... unless the term is fair and reasonable.

(e) For the purposes of subclauses (2) and (4), the question whether a term is fair and reasonable shall be decided in the context of the contract as a whole, including the:

(i) identity of the parties and their relative bargaining positions;

(ii) circumstances in which the contract was made;

(iii) course of any negotiations between the parties;

(iv) degree to which it was reasonable for any party to cover his or her liability by insurance.

Comment

113 This draft makes no attempt to assign particular kinds of term to the different categories:

- void altogether;
- void in consumer contracts only;
- void altogether unless found to be reasonable in the circumstances;

- void in consumer contracts only unless found to be reasonable in the circumstances.

114 Such a clause is potentially a most important provision, because unlike cls 2-5 it would go a good deal further than the existing law, and takes a rather different and less "subjective" approach than those clauses do. It is specifically aimed at problems that arise in some "standard contracts" or "contracts of adhesion", where there may not be genuine bargaining or anything like equal bargaining capacity, or (in some cases) appreciation by one party of the implications of a particular term. On the other hand, such terms might fall short of the stringent standard in cl 5.

115 The issue of "procedural" unfairness is irrelevant under this clause - as it is under most if not all of the existing New Zealand and overseas specific statutes. In this respect it is not novel. Moreover, although the common law has no such general rule or doctrine, there are instances (as in the law governing the incorporation of terms by reference in unsigned writings) where it looks to the reasonableness rather than the conscionability of a particular transaction. Again, the courts have tended to construe a contract as far as practicable to avoid the effect of what it considers to be, eg, an "unreasonable" exemption clause.

116 The approach follows the general pattern of the United Kingdom 1977 legislation and (at a greater distance) the German Standard Contract Terms Act.

117 In contrast to the provisions of the earlier clauses, it is not a matter of allowing the courts to reopen contracts containing such terms. In accord with the approach of nearly all the specific New Zealand legislation and overseas statutes, the contract terms to be covered by the clause are prohibited, either generally or conditionally.

118 More work needs to be done to identify those kinds of terms that might be regarded as "unfair", either unconditionally in all cases or in "consumer transactions" (however these might be defined) only, or subject to a test of being fair or reasonable in the circumstances. There are precedents in New Zealand as well as overseas for each of these approaches. Among terms that possibly justify intervention are the following. The list is based on existing New Zealand, United Kingdom and German legislation:

- those taking manifestly excessive security for the performance of obligations;

- "penalty clauses", those which impose arbitrary or excessive consequences for breach;

- "exclusion clauses" which unreasonably exclude or restrict liability for one party's misrepresentations, negligence, or breach of contract;

- at least in consumer sale and hire contracts, clauses which exclude or limit the terms of title and freedom from encumbrance implied by law;

- in goods and services contracts, clauses negating a duty of reasonable care/skill;

- clauses which make goods at buyer's/owner's risk while in possession of seller/repairer;

- compulsory arbitration clauses, at least in consumer contracts;

- clauses which fix unreasonably brief limitation periods for claims;

- clauses which unreasonably deny or penalise the early repayment of a debt;

- clauses in leases which automatically raise the rent or provide that rent reviews can raise the rent but never lower it ("ratchet clauses");

- clauses which give a party a right to terminate the contract without good reason and without payment of compensation.

9 Terms not known to party

(1) A term of a contract is not enforceable against any party to the contract who at the time of entering into the contract did not know of it, and did not have an opportunity reasonable in all the circumstances of ascertaining its provisions before entering into the contract, whether or not that party signed the contract, unless the term is fair and reasonable.

(2) A person who in the course of business from time to time makes contracts of a particular kind, or with a particular person or class of

persons, is presumed to know any usual terms of such contracts.

Comment

119 This clause deals with the particular case of terms "incorporated by reference" in a contract. The actual contract document, which may for instance be simply a ticket, may purport to incorporate terms and conditions contained in some other writing, eg, a company's bylaws. This may not be accessible to the other party. He or she may have no practical possibility of finding out what it contains.

120 The common law already requires a reasonable opportunity to read terms incorporated by reference into unsigned writings. Failing this, the terms are not part of the contract. (See *Interfoto Picture Libraries v Stiletto Visual Programmes.*)

121 It appears that a signature is enough to make such terms binding, but the reality of that distinction may be queried in the light of the purpose of the common law rule. However, even an opportunity to read the terms is often unlikely to affect the ability of the parties to choose (although it could well have in the *Interfoto* case). When someone is buying goods or services from a large trader, knowledge of the terms may leave him or her no better off, and any worthwhile protection requires something more. (See the *Suisse Atlantique* case.)

122 The subject of writings incorporated by reference into contracts (which may or may not be signed) was discussed by the Contracts and Commercial Law Reform Committee in its 1967 report, *Misrepresentation and Breach of Contract*. Such "ticket" cases are the paradigm of contracts of adhesion, and the committee's comments are germane to the issue of unfair terms. They read in part:

> We have given particular consideration to the situation where one party to a contract propounds the contents of unsigned writings as terms on which he is prepared to contract. This situation has given rise to a number of decisions, often referred to as the "ticket cases". The present law is that such writings form part of the contract if reasonable steps have been taken to bring the unsigned writings to the notice of the parties charged before or at the time of, but not after, contracting.
>
> This is one instance where terms imposed by one party are binding on the other whether or not he has had a real opportunity to acquaint himself with

them. It was suggested by the subcommittee that the contents of unsigned writings in these circumstances should be terms of the contract if the party to be charged with them had notice of the existence of such writings and had an opportunity, reasonable in all the circumstances in which the contract was made, to read the terms contained therein before contracting. The requirement that there should be a reasonable opportunity to read the writings would be an addition to the present law.

The objection can be made however that this approach is impracticable, illusory and fails to go to the heart of the problem, which is not so much the incorporation of unsigned writings as the fairness or otherwise of their provisions.

We consider that in this particular type of situation the test of reasonableness might properly and usefully be imported to determine the validity or otherwise of the incorporated terms. We are confirmed in this approach by the fact that in many cases unsigned writings incorporated by reference are bylaws of the body providing the goods or, more usually, the service. Under the common law a bylaw is void for unreasonableness and a similar test of general application will therefore fit in neatly.

123 The Law Reform Committee recommended (at 103):

... that it should be enacted that unsigned writings incorporated in a contract by reference shall be enforceable against a party who has not signed the part of the contract which contains the reference only to the extent that the Court considers fair and reasonable having regard to all the circumstances of the case.

124 No action has been taken on this proposal. Clause 9 substantially follows it, but does not distinguish between signed and unsigned writings. Signature may no more involve a true acceptance or understanding of incorporated terms than an unsigned document, and the need for signature is often presented as a "mere formality". On the other hand there seems no reason why the rule should apply where there is a course of business dealings between the parties. Subclause (2) accordingly creates a presumption that business people who make a series of contracts know their "usual terms". (This would probably not have helped the appellants in the *Interfoto* case.)

10 Unfair exercise of contractual powers

(1) Where the exercise of a power, or discretion, or the refusal to waive any right, conferred by a contract is oppressive or contrary to commonly accepted standards of fair dealing, the Court may review that exercise or refusal and give relief although the term conferring the power or right is not itself unfair.

(2) Nothing in subclause (1) prevents the parties to a contract from expressly allocating any risk under it, or has any affect on the law relating to frustration of contract.

Comment

125 This is an important provision. The previous clauses are concerned with fairness at the time of entering into the contract. Clause 10 extends that approach to circumstances beyond the time of contracting. It provides that every party to a contract is under an obligation to observe standards of fair dealing in the performance of a contract. Drawing on the United States and German good faith performance doctrines, the clause recognises that duties of fairness do not stop at the point of contracting.

126 There is a direct New Zealand precedent for cl 10 in the Credit Contracts Act which extends the regulation of oppressive credit contracts to "the oppressive exercise of a right or power conferred by the contract". The clause really extends that provision to contracts generally. Cases under the Credit Contracts Act 1981 might be useful in applying cl 10, for instance *Hart v Haydon and Grove* (1983) 6 TCL 9/5, where the court restrained a mortgagee from exercising his power of sale when the mortgagor was able to show he could remedy the default.

127 There are specific limits on cl 10 which relate back to the contract itself. The concept of fair dealing is only concerned with performance of the contract as given - not with rewriting it as at the time of performance. That would be in breach of cl 7. Thus subcl 10(2) states that it is not intended to prevent the parties to a contract from expressly allocating any risk (although if the express allocation is unfair there would be a case for reviewing the term under cls 4 or 5); nor does it affect the law of frustration.

11 Who may seek relief

An application for relief may be made by:

(a) a party to the contract claiming to have been disadvantaged;

(b) any person claiming through or under that party;

(c) the Commerce Commission in respect of any contract, or a number of similar contracts or a class of contracts, whether or not there is any common party to such contracts.

Comment

128 For the reasons discussed at para 89(8) of this discussion paper, para (c) adds something in the nature of a public law remedy to the normal provision for court proceedings by a party. The ordinary courts (including Disputes Tribunals) will have sole jurisdiction to decide claims and grant relief. But the Commerce Commission, which seems to be the only suitable existing agency, is given express standing to apply.

129 The Commerce Commission may bring proceedings either on an individual contract or on a class of contracts. Such contracts need not be proffered in business by one person; for instance, they might be contracts drawn up by a trade association and proffered by its members. As the clause stands, the Commerce Commission will not simply be acting as a complainant's representative but in the public interest. (Possibly for individual contracts it could be authorised to act on behalf of an aggrieved party.) When the Commerce Commission does bring proceedings, the court may enjoin an unfair term generally (see cl 13).

130 Some countries go further. In Sweden, for example, quite apart from the consumer ombudsman (see para 63) an independent agency has jurisdiction to settle consumer disputes (including allegations of unfair contractual terms). However, the decisions of the Board, although usually accepted, are not legally binding (see Nils Mangard "A Scandinavian System of Settling Consumer Disputes out of Court" (1983) *The Art of Arbitration*). It may well be, although the scheme does not provide for it, that a broadly similar institution should be set up in New Zealand.

12 Powers of court

(1) A court on reviewing under this scheme any contract, or any term of a contract, or the exercise of a power or discretion or the refusal to waive any right under a contract,

may grant such relief as it thinks just.

(2) Without limiting the power of the court to grant relief, it may do one or more of the following things:

(a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;

(b) cancel the contract;

(c) declare that a term of the contract is of no effect;

(d) vary the contract;

(e) award restitution or compensation to any party to the contract;

(f) annul the exercise of a power, discretion or right under the contract, or direct that it be exercised in a particular way;

(g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;

(h) order that an account be taken, and reopen any account already taken, in respect of any transaction between the parties to the contract.

Comment

131 This list is drawn partly from the Contractual Mistakes Act and partly from the Credit Contracts Act. However, the various relief provisions of these and other Acts are very disparate for no discernible reason. The oppressive exercise of rights and powers particularly needs attention; the Credit Contracts Act is surprisingly inadequate here.

13 Injunction against unfair terms in standard contracts

If the Commerce Commission brings proceedings under clause 11 and it appears to the Court that a form of contract proffered by a person in the course of business and relating to a particular type of transaction, or transactions with persons generally

or a particular class of persons, contains an unfair term, or a term that is invalid under clause 7, the Court may, as well as granting any other relief, order the omission of that term, or any term having in substance the same effect, from all contracts subsequently proffered by that person.

Comment

132 Clause 13 draws on the Fair Trading Act in that it extends the relief available to the obtaining of an injunction to stop the offending conduct. However, it limits those able to seek such an order to the Commerce Commission, consistent with the recognition of its role as public watchdog in this area.

14 Relief may be subject to conditions

Any order may be made on such conditions as the Court thinks just.

15 Other legal doctrines preserved

(1) Nothing in this scheme limits or affects the law relating to breach of fiduciary duty, duress, estoppel, or undue influence in cases to which the scheme does not extend.

(2) Nothing in this scheme limits or affects the law of mistake (including the provisions of the Contractual Mistakes Act 1977) or the provisions of the Fair Trading Act 1986.

Comment

133 It is important to appreciate the proposed relation between this scheme and the common law. In the broad realm of unfairness there are several doctrines of the common law which have a large overlap with this scheme. Indeed, as the discussion paper points out, courts in different countries have used distinct doctrines for much the same purpose and have achieved much the same results. The scheme is intended to operate as a code as far as it extends. It is *not* meant simply to clarify, extend and replace the common law doctrine of "unconscionable contracts", and leave analogous doctrines unaffected, eg, duress, undue influence, estoppel, breach of fiduciary duty. That would merely superimpose an additional cause of action. It *is* meant to subsume all these doctrines as far as they make contracts invalid or unenforceable or enable them to be reopened. This is because, according to this paper's argument, a common principle underlies all of

them, which the scheme aims to embody. However, some of these and other doctrines have an application and relevance beyond the making and performance of contracts. Moreover some of them (eg, estoppel) may operate so as to *create* a binding contractual obligation. The scheme preserves them in those spheres.

134 The law governing the effect of *mistake* on the formation of contracts (partly common law, and partly to be found in the Contractual Mistakes Act) is in a rather different position. It deals essentially with the question of whether a contract or a contractual term has come into existence. The consequences of mistake are now set out in the Contractual Mistakes Act, and it is not a purpose of the scheme to review that.

135 The relation between the scheme and other existing statute law also calls for comment. Insofar as contractual practices are concerned, the scheme is meant to avoid the need for a provision corresponding to s 52A of the Australian Trade Practices Act. Instead, it assumes that s 9ff of the Fair Trading Act, which deal with misleading or deceptive conduct, will remain. Where both apply there would be a choice of remedies.

136 An object of the scheme is to permit the repeal of various other statutory provisions. They include Part 1 of the Credit Contracts Act, s 4 of the Contractual Remedies Act, s 8 of the Insurance Law Reform Act 1977 and s 15 of the Insurance Law Reforms Act 1985. However the scheme will not altogether cover the field of certain legislation; eg, the Sharemilking Agreements Act 1937, the Layby Sales Act and the Residential Tenancies Act.

16 Scheme to override inconsistent provisions

This scheme applies notwithstanding any provision in any contract.

Comment

137 It would frustrate the central object of the scheme if it could be overridden by the insertion of a term to that effect in a contract. The obligation of fair dealing as described in the scheme is to be an absolute. Most analogous specific statutes have the same provision.

SCHEME IN FULL

1 Purposes

The purposes of this scheme are to:

(a) clarify and extend the circumstances in which the courts may review contracts, and terms of contracts, as being unconscionable, oppressive, or unfair;

(b) provide remedies for the abuse of a superior bargaining position by one party in making a contract, without impairing general freedom and certainty of contract;

(c) make certain contractual terms invalid, and to make certain other contractual terms invalid unless they are reasonable in the circumstances;

(d) require minimum standards of fair dealing by the parties in the performance of contracts;

(e) clarify and extend the relief that the courts can give upon reviewing unfair contracts and contractual terms, and the unfair exercise of contractual powers.

2 General test of unfairness

A contract, or a term of a contract, may be unfair if a party to that contract is seriously disadvantaged in relation to another party to the contract because he or she:

(a) is unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; or

(b) is in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; or

(c) is legally or in fact dependent upon, or subject to the influence of, the other party or persons connected with the other party in deciding whether to enter into the contract; or

(d) reasonably relies on the skill, care or advice of the other party or a person connected with the other party in entering into the contract; or

(e) has been induced to enter into the contract by oppressive means, including threats, harassment or improper pressure; or

(f) is for any other reason in the opinion of the court at a serious disadvantage;

and that other party knows or ought to know of the facts constituting that disadvantage, or of facts from which that disadvantage can reasonably be inferred.

3 Professional advice

In considering whether a contract, or a term of a contract, is unfair the court shall have regard, among other things, to whether the disadvantaged party received appropriate legal or other professional advice.

4 Result must be unfair

(1) Notwithstanding clause 2, a contract is not unfair unless in the context of the contract as a whole:

(a) it results in a substantially unequal exchange of values; or

(b) the benefits received by a disadvantaged party are manifestly inappropriate to his or her circumstances; or

(c) the disadvantaged party was in a fiduciary relationship with the other party.

(2) A grossly unequal exchange of values may create a presumption that the contract is unfair.

5 Harsh and oppressive terms

(1) A term of a contract is also unfair if, in the context of the contract as a whole, it is oppressive.

(2) A term of a contract is oppressive if it:

(a) imposes a burdensome obligation or liability which is not reasonably necessary to protect the interests of the other party; *and*

(b) is contrary to commonly accepted standards of fair dealing.

(3) A transaction that consists of two or more contracts is to be treated as a single contract if it is in substance and effect a single transaction.

6 Context of the contract

(1) In considering the context of the contract as a whole, the Court may, among other things, take into account the identity of the parties and their relative bargaining position, the circumstances in which it was made, the existence and course of any negotiations between the parties, and any usual provisions in contracts of the same kind.

(2) In relation to commercial contracts the court shall take into account reasonable standards of commercial practice.

7 Circumstances judged at time of contract

The question whether a contract, or a term of a contract, is unfair shall be decided in the light of the circumstances at the time the contract was made.

8 Unfair terms

Without limiting or affecting clauses 2-5:

(a) A term of a contract is of no effect if ... [not completed - see para 113ff].

(b) A term of a contract is of no effect if ... unless the term is fair and reasonable.

(c) A term of a consumer contract is of no effect if ....

(d) A term of a consumer contract is of no effect if ... unless the term is fair and reasonable.

(e) For the purposes of subclauses (2) and (4), the question whether a term is fair and reasonable shall be decided in the context of the contract as a whole, including the:

(i) identity of the parties and their relative bargaining positions;

(ii) circumstances in which the contract was made;

(iii) course of any negotiations between the parties;

(iv) degree to which it was reasonable for any party to cover his or her liability by insurance.

9 Terms not known to party

(1) A term of a contract is not enforceable against any party to the contract who at the time of entering into the contract did not know of it, and did not have an opportunity reasonable in all the circumstances of ascertaining its provisions before entering into the contract, whether or not that party signed the contract, unless the term is fair and reasonable.

(2) A person who in the course of business from time to time makes contracts of a particular kind, or with a particular person or class of persons, is presumed to know any usual terms of such contracts.

10 Unfair exercise of contractual powers

(1) Where the exercise of a power, or discretion, or the refusal to waive any right, conferred by a contract is oppressive or contrary to commonly accepted standards of fair dealing, the Court may review that exercise or refusal and give relief although the term conferring the power or right is not itself unfair.

(2) Nothing in subclause (1) prevents the parties to a contract from expressly allocating any risk under it, or has any affect on the law relating to frustration of contract.

11 Who may seek relief

An application for relief may be made by:

(a) a party to the contract claiming to have been disadvantaged;

(b) any person claiming through or under that party;

(c) the Commerce Commission in respect of any contract, or a number of similar contracts or a class of contracts, whether or not there is any common party to such contracts.

12 Powers of court

(1) A court on reviewing under this scheme any contract, or any term of a contract, or the exercise of a power or discretion or the refusal to waive any right under a contract, may grant such relief as it thinks just.

(2) Without limiting the power of the court to grant relief, it may do one or more of the following things:

(a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;

(b) cancel the contract;

(c) declare that a term of the contract is of no effect;

(d) vary the contract;

(e) award restitution or compensation to any party to the contract;

(f) annul the exercise of a power, discretion or right under the contract, or direct that it be exercised in a particular way;

(g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;

(h) order that an account be taken, and reopen any account already taken, in

respect of any transaction between the parties to the contract.

13 Injunction against unfair terms in standard contracts

If the Commerce Commission brings proceedings under clause 11 and it appears to the Court that a form of contract proffered by a person in the course of business and relating to a particular type of transaction, or transactions with persons generally or a particular class of persons, contains an unfair term, or a term that is invalid under clause 7, the Court may, as well as granting any other relief, order the omission of that term, or any term having in substance the same effect, from all contracts subsequently proffered by that person.

14 Relief may be subject to conditions

Any order may be made on such conditions as the Court thinks just.

15 Other legal doctrines preserved

(1) Nothing in this scheme limits or affects the law relating to breach of fiduciary duty, duress, estoppel, or undue influence in cases to which the scheme does not extend.

(2) Nothing in this scheme limits or affects the law of mistake (including the provisions of the Contractual Mistakes Act 1977) or the provisions of the Fair Trading Act 1986.

16 Scheme to override inconsistent provisions

This scheme applies notwithstanding any provision in any contract.

QUESTIONS

The Law Commission would be particularly helped by having views on the following questions:

1 Is there any need for legislation relating to unfair or unconscionable contracts?

2 If so, should legislation be general, particular, or both?

3 Would s 52A of the Australian Trade Practices Act be a satisfactory model for general legislation? (See paras 12, 85 and Appendix C)

4 In addition, or instead, is legislation along the broad lines of the United Kingdom Unfair Contract Terms Act 1977 desirable? (Para 78 and Appendix D)

5 Should any such legislation be limited to exemption of liability clauses or should it have a wider scope? (Para 78)

6 Should any legislation - or aspects of it - be limited to "consumer transactions"? (Paras 65-70 and Appendices B-E. See also cl 8 Scheme)

7 If so, how should a "consumer transaction" be defined?

8 Or should legislation also apply to business contracts and "one-off" transactions (such as the individual sale of a piece of land), and with what restrictions?

9 Should legislation cover

- unfair contracts as a whole (para 87 and cl 2-7)
- unfair terms (para 86 and cl 8)
- unfair (harsh or oppressive) use of powers given by a contract (para 77(6) and cl 10)?

10 Where should the dividing line be drawn between the merely bad or imprudent bargain (which the law should not interfere with) and unfair or unconscionable transactions that the law should not enforce? (Paras 42, 87 and cl 1)

11 To overturn a contract as unfair or unconscionable, should it be enough that one party ought to have

known that the other party was disadvantaged and benefits from that disadvantage ("constructive knowledge"), or should actual knowledge be required? The present New Zealand law is that constructive knowledge is sufficient. (Para 77(4) and cl 2)

12 If constructive knowledge by a party of certain facts may give a contract an unconscionable character, should any obligation be imposed on a party who later becomes aware of the facts to adjust the bargain or offer restitution? (Cl 7)

13 Should parties to *unsigned* contracts be bound by terms which they did not know of, and which they had no reasonable opportunity to ascertain? (The present law is that they are not bound.)

14 Should the law be the same for *signed* contracts?

15 Should terms be binding in these circumstances if they are fair and reasonable but not otherwise? (Cl 9)

16 Should there be a legal obligation of fair dealing in the performance of a contract? (Para 83, Appendix B and cl 10)

17 Are further procedures, such as the establishment of a "consumer ombudsman", desirable to give better protection to people who lack confidence in and familiarity with ordinary legal procedures to remedy grievances? (Paras 63, 77(8) and cl 11)

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APPENDICES

APPENDIX A

New Zealand Legislation

Faced with a serious threat to the general interest, the New Zealand Parliament has historically been willing to depart from received doctrines of contract, and to interfere even with existing contracts. One well-known example is the Mortgagors and Lessees Rehabilitation Act 1936 and its less comprehensive predecessors beginning with the Mortgagors Relief Act 1931. These pieces of legislation were an extraordinary response to what was seen as an emergency situation, where collapsing produce prices and fixed interest rates and rents had created a balance of indebtedness that threatened to drive many farmers off their land and the land itself possibly out of production.

The 1936 Act stated its general purpose in relation to farmer applicants as being:

> ... to retain them in the use and occupation of their farms as efficient producers, and to make such adjustments of their liabilities as will ensure that the liabilities secured on any property do not exceed the value of that property, that the rent of any leasehold property does not exceed the rental value of that property, and that the total amount and terms of payment of all their liabilities (whether secured or unsecured) are such that, after allowing for all normal current expenditure and providing for the maintenance of themselves and their families in a reasonable standard of comfort, the applicants may reasonably be expected to meet their liabilities as they become due, either out of their own moneys or by borrowing on reasonable terms.

The Act created adjustment commissions and a Court of Review to deal with applications for relief by mortgagors, guarantors and lessees. The Court could reduce the principal and interest payable under mortgages and the rent payable under leases, and reduce or remit arrears, including unsecured debts. Although designed chiefly to assist farmers, it made analogous provisions for home owners and others. During its operation nearly 24,000 orders were made.

There was no suggestion that the vast majority of these mortgages, guarantees and leases were unfair at their execution. Rather, later and unforeseen events had created something analogous to frustration of contract -

the economic context and the expectations in the light of which they were made had drastically altered. The legislation is mentioned therefore not as a precedent for reopening "unconscionable bargains" but as a rejection by the Parliament of the day of any absolute principle of sanctity or certainty of contract.

CLASSIFICATION OF LEGISLATION

Statutory provisions relating directly or indirectly to contractual fairness are not uncommon in New Zealand. They offer almost a kaleidoscope of approaches, and the reasons why one path, or one formula, is followed in a particular statute are not always apparent.

For instance, standard contracts (Sharemilking Agreements Act 1937) or terms (Layby Sales Act 1971) may be prescribed, and terms less favourable to the protected party prohibited or invalidated. Alternatively, statutory rights may be given that cannot be yielded by agreement; eg, the Residential Tenancies Act 1986 which supplemented by a series of sections the Property Law Act 1952. Formalities may be required as a condition of the validity of a contract or a term of a contract, or the exercise of contractual powers. An analogous type of provision imposes a "cooling off" period during which a party may withdraw from an agreement; eg, the Door to Door Sales Act 1967. The enforceability of a term may be at the discretion of the court applying specified criteria (Contractual Remedies Act 1979, s 4). Under s 11(1) of the Residential Tenancies Act, any agreement inconsistent with the Act or excluding its operation is of no effect unless the Tenancy Tribunal permits it "having regard to all the relevant circumstances". This seems an extremity of vagueness. Finally, certain behaviour (not necessarily in the direct context of contracts) may be made unlawful (Fair Trading Act 1986), or provision made for the reopening of contracts tainted in a particular way: Credit Contracts Act 1981. A single statute, like the Hire Purchase Act 1971, may contain several of these approaches.

Another division of the statute law is based on remedies. For the most part the enforcement of rights is left to the parties through the courts in the ordinary way. Some of these Acts provide explicitly for the reopening of contracts. The relief that may be given and adjustments made by the court in such cases are generally wider than is traditionally seen as existing under the common law. (Note, however, that recent judicial development of equitable remedies sometimes makes it hard to say exactly how much further these statutory remedies do go.)

A few Acts, however, have more of a public law flavour, notably the Fair Trading Act. This creates criminal liability for certain breaches, and provides for civil injunctions (s 41). These may be sought by the Commerce Commission "or any other person". In proceedings brought under s 41, the court may make a variety of "other orders", including compensation (s 43), so that injunction appears to be the primary remedy intended.

LEGISLATIVE APPROACHES

The following types of approach, not necessarily exhaustive, may be mentioned:

- Prohibiting unfair behaviour
- Conferring statutory rights or prescribing standard contracts
- Importing non-excludable terms
- Prohibiting specific terms
- Subjecting terms to a "fairness" test
- Imposing formalities as pre-requisite to validity or enforcement
- Providing for "cooling-off" periods.

Broad prohibitions

This approach is to be found in ss 9ff of the Fair Trading Act and in Part I of the Credit Contracts Act. It comes close to overseas legislation which prohibits unconscionability or unfair dealing, such as s 2-302 of the Uniform Commercial Code, Article 248 of the German Civil Code, and parts of the Australian Trade Practices Act.

Section 9 of the Fair Trading Act provides simply:

> No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

Sections 10-12 embody similar provisions which are related specifically to misleading conduct in relation to goods, services and employment. Later sections prohibit a large number of specified false or misleading representations and practices considered inherently unfair or susceptible of abuse; eg, trading stamp schemes, bait advertising,

referral and pyramid selling, and harassment or coercion. The provisions about false or misleading representations appear to overlap the common law and the Contractual Remedies Act; the remedies are, however, wider and include criminal prosecution.

This scheme was taken from and closely follows parts of the Australian Trade Practices Act. In the year that the Fair Trading Act was passed, the Australian Act was extended to prohibit unconscionable conduct in certain circumstances: see Appendix C. This has not been followed here.

Part I of the Credit Contracts Act is of comparable generality in its language. It applies to credit contracts, which are defined in an extensive but very complex way. The central provision is s 10(1):

> (1) Where, in any proceedings (whether or not instituted pursuant to this Act), the Court considers that -
>
> (a) a credit contract, or any term thereof, is oppressive; or
>
> (b) a party under a credit contract has exercised, or intends to exercise, a right or power conferred by the contract in an oppressive manner; or
>
> (c) a party under a credit contract has induced another party to enter into the contract by oppressive means -
>
> the Court may reopen the contract.

It is a question whether, as the courts have used Part I, it goes much beyond the current common law as to unconscionability, except in relation to the oppressive exercise of powers (see *Italia Holdings Ltd* v *Lonsdale Holdings (Auckland) Ltd* [1984] 2 NZLR 1). In fact, oppression has been held to exist in only a small minority of the cases.

One can only speculate why so few credit transactions have been reopened. There may be a natural tendency among counsel to throw in the Credit Contracts Act as a last resort in weak cases. However, there is reason to wonder whether the really bad cases are not litigated. If these are remedied it may be through other forms of intervention and pressure. Undoubtedly some cases as described in a recent report by the Wellington Community Law Centre and the Consumers Institute, *Loan Companies and Credit - A Consumer Crisis*, go beyond the unfair and border on

outright fraud. Moreover, with or without the Credit Contracts Act, it is hard to imagine some of the contractual provisions quoted being upheld by any court.

Industrial law offers a more specialised example of a wide power to override a contractual provision in the application by the courts of the provisions for "unjustifiable dismissal" in s 210 of the Labour Relations Act 1987, formerly s 117(1) of the Industrial Relations Act 1973.

Statutory rights and standard contracts

These are not always easy to disentangle. Parts of the Hire Purchase Act in effect lay down a code. Likewise the Layby Sales Act provides a scheme which governs the passing of risk, the right of the buyer to cancel, the rights of the parties on cancellation, and the status of layby goods on the seller's insolvency. So, also, does the Property Law Act (as supplemented by the Residential Tenancies Act 1986) and Part VII of the Motor Vehicle Dealers Act 1975 in relation to sales by dealers of secondhand motor vehicles. The Carriage of Goods Act 1979 illustrates a limited standard scheme, defining four types of contracts with certain incidents (the parties being free to choose between them) and allowing parties to override certain of the general provisions by agreement.

Non-excludable terms

The Hire Purchase Act implies a number of terms in hire purchase contracts (ss 11-15) that, with one exception, the parties cannot exclude. Rather similar in nature are some provisions of the Layby Sales Act.

Prohibited or invalid terms

The Insurance Law Reform Acts 1977 and 1985 contain examples of this. Thus s 8 of the 1977 Act declares compulsory arbitration clauses not to be binding on an insured person, and s 15 of the 1985 Act prohibits "subject to average" clauses in contracts of insurance in respect of residential property.

Section 4(2) of the Contractual Remedies Act can also be seen as an instance of this. This provision invalidates any contractual provision that purports to preclude a court from inquiring into or determining whether anyone had any actual or ostensible authority to give a promise or undertaking on behalf of a party - the "attributed agency" situation.

Terms subject to "fairness" test

A modern example is the Contractual Remedies Act, s 4(1), which deals with the sort of contractual statement whereby one party acknowledges that no statement or representation was made to him or her, or that he or she did not rely on it. Such a provision is conclusive between the parties only if the court considers that to be fair and reasonable:

> ... having regard to all the circumstances of the case, including the subject-matter and value of the transaction, the respective bargaining strengths of the parties, and the question whether any party was represented or advised by a solicitor at ... any relevant time.

A very similar provision had been added in 1975 to the Door to Door Sales Act (see s 11A).

The status of contracts by unmarried minors over 18 years of age is defined in the Minors' Contracts Act 1969. These contracts are valid, but if the court is satisfied that the consideration was so inadequate as to be unconscionable, so that any obligation imposed on the minor is harsh or oppressive, it may cancel the contract or declare it unenforceable, and order compensation or restitution as it thinks just. The court is specifically empowered to receive evidence of commercial practice in contracts of the same kind.

Conversely, most contracts by a minor under 18 years of age are unenforceable against him or her. However, the court can inquire whether the contract was fair and reasonable at the time it was made. If it was, the court may (among a number of other things) enforce the contract. The court is to have regard to:

- the circumstances surrounding the making of the contract;
- the subject-matter and nature of the contract;
- in the case of a contract relating to property, the nature and the value of the property;
- the age and the means (if any) of the minor;
- all other relevant circumstances.

Wide discretions of this sort are traditional and more readily accepted in relation to minors, whom the law is concerned to protect in most if not all societies. Cases

under the Act have however been very few, and the practicality of these provisions has not really been tested.

There are other instances in the rather special realm of family law. Custody and maintenance agreements have always been subject to overriding by the courts. The general public interest and the paramount aim of promoting the welfare of children set these apart. Section 18 of the Guardianship Act 1968 now provides:

> An agreement between the father and mother of a child with respect to the custody or upbringing of or access to the child shall be valid, whether or not either of the parties is a minor, but shall not be enforced if the Court is of opinion that it is not for the welfare of the child to give effect to it.

Closer to the typical contract situation are agreements between husband and wife for the holding and division of matrimonial property. Section 21 of the Matrimonial Property Act 1976 authorises husband and wife to contract out of the Act but imposes procedural requirements for the validity of these contracts and also makes their enforcement discretionary.

Under subss (4) and (5), such agreements must be in writing signed by both parties, witnessed by a solicitor or (outside New Zealand) by a notary public. Each party must have independent legal advice before signing. Even so, a s 21 agreement is invalid if the court considers "it would be unjust to give effect to it" (subs (8)(b)). The court is to have regard to:

- the provisions of the agreement;
- the time that has elapsed since the agreement was entered into;
- whether the agreement was unfair or unreasonable in the light of all the circumstances at the time it was entered into;
- whether the agreement has become unfair or unreasonable in the light of any changes in circumstances since it was entered into (whether or not those changes were foreseen by the parties);
- any other matters that the court considers relevant.

An early example of a term whose validity is subject to a

"reasonableness" test was s 4 of the Carriers Act 1948, with antecedents going back to English legislation of 1830. The legislation went about it in a somewhat oblique way. Subsection (1) made a carrier of goods liable for negligence notwithstanding any "notice, condition, declaration or contract." Subsection (2) added the gloss that this should "not be construed to prevent a carrier from such limitations of negligence as were adjudged by the court to be just and reasonable, provided that such a contract or condition was in writing signed by the other party or by the person delivering the goods for carriage". The 1948 Act was replaced in 1979 by a much more elaborate and sophisticated code governing the carriage of goods (Carriage of Goods Act).

Section 8(7) and (8) of that Act contain a rather similar provision:

> (7) No contract of carriage purporting to be a contract for carriage "on declared terms" shall have effect as such (but instead shall have effect as a contract for carriage "at limited carrier's risk") unless the contract is -
>
> (a) freely negotiated between the parties; and
>
> (b) in writing; and
>
> (c) signed by the parties or their agents.
>
> (8) Where, in any proceeding, the question of whether any contract of carriage was or was not freely negotiated is in issue, the Court in determining that question shall have regard to the following matters:
>
> (a) the respective bargaining strengths of the parties;
>
> (b) the course of dealing between the parties in respect of the particular transaction in question, and any other transactions between them;
>
> (c) the value of the transaction;
>
> (d) any extraordinary features of the goods to be carried or the route over which they are to be carried;
>
> (e) any other matters that the Court considers may properly be taken into account;

> and either party may adduce evidence relating to any such matter.

Provisions such as those in the Carriage of Goods Act and Contractual Remedies Act correspond to what are sometimes called "greylisted" clauses in statutes overseas like the Unfair Contract Terms Act 1977 (United Kingdom) and the Standard Contract Terms Act 1976 (West Germany).

Terms subject to formalities requirement

Examples are ss 12(1)(d) and 13 of the Hire Purchase Act - exclusion of merchantable quality condition for secondhand goods - and s 16 of the Insurance Law Reform Act 1985 - "average" clauses in non-residential insurance contracts.

The former allow the implied terms of merchantable quality and fitness for purpose to be excluded in hire purchase agreements if the goods are secondhand and the agreement contains a conspicuous statement separately signed by the purchaser in the following terms:

> I understand that the goods to which this agreement relates are secondhand goods and that [the vendor] does not promise that they are fit for use or for any particular purpose.

The essence of s 16 of the Insurance Law Reform Act 1985 is that *pro rata* conditions of average are of no effect (except in marine insurance contracts) unless before the contract is made (or in certain circumstances thereafter) the insurer clearly informs the insured in writing of the nature and effect of the condition. The section contains a form of statement that is sufficient to comply with the requirement.

A number of other Acts, such as the Door to Door Sales Act (s 6(1)) require formalities such as writing and signature by the party who is considered vulnerable.

Cooling-off requirement

The two principal instances are the Door to Door Sales Act and the Credit Contracts Act.

The Door to Door Sales Act was designed to prevent consumers from being pressured into buying goods and services on credit by the importunities of salespeople visiting their homes. The Act is extremely detailed, but its thrust is indicated by its long title:

> An act to regulate agreements for the sale of goods

> and the provision of services on credit, hire purchase agreements and agreements for the hire of goods entered into at places other than appropriate trade premises.

Section 7 creates a right of cancellation within seven days of the making of the agreement.

The policy of the Credit Contracts Act in this respect is slightly different. The purpose of ss 22 and 23 is to give persons seeking credit a practical opportunity, before being irrevocably committed, of finding what the terms of their contract are and of reflecting on those terms. The sections accordingly supplement the disclosure requirements for what the Act called "controlled credit contracts". Again, the provisions are elaborate, but their heart is s 22(1):

> A debtor under a controlled credit contract (other than a contract to which subsection (2) of this section applies), or modification contract, may cancel the controlled credit contract or modification contract, as the case may be, by:
>
> (a) giving written notice of cancellation; and
>
> (b) returning any credit and other property received by a debtor pursuant to the contract
>
> to a creditor or dealer under the contract, not later than the end of the third working day after the day initial disclosure or modification disclosure (as the case may be) of the contract is made (or at any time if disclosure has not been made).

POST-CONTRACTUAL CONDUCT

Most New Zealand legislation touching on contractual fairness limits itself to the status of contracts and terms at the time they are entered into. There is no general statutory concept of good faith or fair dealing in the performance of contracts. A few provisions, however, do concern themselves with the exercise of rights under a contract. The most recent is also the widest: ss 9-14 of the Fair Trading Act, already referred to. These apply to conduct that is misleading or deceptive as distinct from harsh, oppressive or unfair, although of course the two could overlap. In contrast the Credit Contracts Act allows the reopening of contracts where a party has exercised, or intends to exercise, a right or power conferred by the contract in a harsh or oppressive manner. (This is less than felicitous - the contract

itself may not be oppressive, and strictly what seems to be called for is more a review of the behaviour or intended behaviour of the party.)

There are several more specialised provisions. Thus s 117 of the Property Law Act restricts rights of re-entry or forfeiture for breaches of a lease other than the non-payment of rent. A right of re-entry or forfeiture for breach of any covenant is unenforceable unless: (a) the lessor serves notice of breach which requires the lessee to remedy it if possible and in any case to pay compensation; (b) the lessee fails to remedy and to make reasonable compensation to the lessor's satisfaction.

In any case, under s 117, the lessee may apply to court for relief:

> ... and the Court, having regard to the proceedings and conduct of the parties under the foregoing provisions of this section, and to all the circumstances of the case, may grant or refuse relief, as it thinks fit; and in case of relief may grant the same on such terms (if any) as to costs, expenses, damages, compensation, penalty, or otherwise, including the granting of an injunction to restrain any like breach in the future, as the Court in the circumstances of each case thinks fit.

The grievance provisions of the Labour Relations Act 1987 (s 210) confer remedies for (among other things) unjustifiable dismissal. In the nature of things this relates to conduct after a contract is made. (Interestingly, the courts have, apart from statute, tended to create a natural justice restriction on the exercise of powers of dismissal; eg, *Marlborough Harbour Board v Goulden* [1985] 2 NZLR 378, which, in effect, treats the predecessor of s 210 as a source of public policy.) Section 26 of the Hire Purchase Act regulates the exercise of contractual powers to repossess goods - although the section has been criticised as insufficient.

CONCLUSION

One may ask, surveying the number and variety of statutory interventions in contracts and the terms of contracts, why in these and not in other cases? It seems improbable that it is in these, and only in these, areas that people may be exploited by unfair contract practices. Equally, the rationale for the almost bewildering variations in detailed approach is elusive, so there is something to be said for a broader, more comprehensive and more consistent approach.

APPENDIX B

United States Legislation

The basic law in the United States that governs the effects of unfairness in the making and performance on contracts is set out in s 2-302 and s 1-203 of the Uniform Commercial Code (UCC). They read:

> s 1-203 Obligation of Good Faith
>
> Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.
>
> s 2-302 Unconscionable Contract or Clause
>
> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
>
> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

The UCC has been adopted in almost all of the States since the official text was first promulgated in 1952. The exceptions are Louisiana, which has enacted s 1-203 but not s 2-302, and California, whose legislation also omits s 2-302. However, there is a general unconscionability provision in the California Civil Code, s 1670-5 applicable to all contracts.

Although s 2-302 is in the part of the UCC dealing with contracts of sale, most courts have applied it to other contracts also. The Second Restatement of the Law of Contract includes a provision in the same terms as s 2-302(1) as part of the general law of contract. The Restatement s 208 suggests that the provision has become part of the common law either by analogy or for reasons of social policy.

There has thus been experience of the operation of the two provisions over a long period of time, and they appear to be generally accepted as legal ground rules for contracts generally. However, s 2-302 in particular has met with criticism that it is undesirably general, that the courts have still not developed a consistent approach, and that it can enable bargains that ought to be protected to be set aside. Conversely, claims have been made that it is inadequate to protect the disadvantaged, especially with regard to remedies. However, as far as the Law Commission is aware, no serious move has been made towards eliminating s 2-302 in any of the States where it has been adopted.

It is noteworthy that bad faith and unconscionability are distinct though related concepts. The fact that a party acts in good faith does not mean that a resulting agreement is necessarily conscionable. The concept of good faith, however, runs though the code and informs the unconscionability provision.

UNCONSCIONABILITY

The UCC is said to go beyond the previous doctrine of unconscionability at common law and equity. In particular, the previous doctrine applied primarily to individual contracts rather than to standard form provisions (S Deutch *Unfair Contracts* 1976).

The decisions of the courts have established some classifications and principles. For example:

- A distinction can be drawn between *procedural* and *substantive* unconscionability. Procedural unconscionability exists when the consumer has no meaningful choice because something is wrong in the bargaining process. Substantive unconscionability exists when the terms of the contract itself are unreasonable or harsh. Normally both kinds of unconscionability must be present before a contract or a term is set aside but, rarely, substantive unconscionability may be enough on its own (see example 2).

- Different kinds of procedural unconscionability are recognised. *Unfair surprise* exists where parties find a term unfairly and unexpectedly included in the contract. This might be because they lack education, business skills, or knowledge of the contracting language. It might also be because the contract is badly structured, the

term is hidden in an unexpected place, it is in fine print, or it is written in unintelligible language (see examples 1, 3 and 6 below). *Oppression* is another source of procedural flaw. Parties are oppressed where their choice is limited by pressure put upon them, or where their bargaining strength is very weak. This happens, for instance, where the term is an industry-wide term and the party cannot go anywhere else to choose another term (see example 5).

- Substantive unconscionability has many examples. Relief has been granted, for instance, where the price has been unreasonably high, and against liability exclusion clauses and high liquidated damages clauses.

- There is a distinction between the way the courts react to consumer cases and commercial cases. Nothing in the provision limits its effect to consumer cases, and the principles above apply to commercial cases. But the courts have been less eager about intervening in commercial cases.

Examples

(1) W purchased household items from a store. There was a standard form hire purchase contract, with a title retention clause. An obscurely drafted term purported to retain title in all the goods supplied to the purchase until each was fully paid off. W had nearly paid off her first lot of purchases when the supplier allowed her more credit to buy a stereo. The supplier knew she was in a difficult financial situation at the time. She fell into default and the supplier sought to repossess all the goods she had bought. An Appeal Court held that the term in the contract retaining title in all the goods may well have been unconscionable and sent the issue back to a lower court for determination. (*Williams v Walker-Thomas* 350 F 2d 445, 2 UCC 955 (1965).)

(2) M entered into a contract to renovate part of his house. The contract included a credit provision that did not comply with statutory disclosure requirements. But the court also held that the credit charges and commission were excessive and the contract was unconscionable. (*American Home Improvements Inc v MacIver* 105 NH 435, 201 A 2d 886, 2 UCC 235 (1964).)

(3) M bought a car from a used car sales yard. It was defective. The standard form contract disclaimed any warranty of merchantability or fitness for the purpose. The term was in large black type. M's knowledge of English was limited; the term was not communicated to him. There was no equality of bargaining power. The term was held to be unconscionable. (*Jefferson Credit Corp v Marcano* 60 Misc 2d 138, 302 NYS 2d 390, 6 UCC 602 (1969).)

(4) W contracted for a listing in the Yellow Pages. The listing was omitted. A term of the contract limited damages. The term was clear, it was part of a contract that balanced the rights of the parties. W was an experienced business person. Although the term was industry standard and offered on a take it or leave it basis, the contract was not unconscionable. (*Wille v Southwestern Bell Telephone Co* 219 Kan 755, 549 P 2d 903, 19 UCC 447 (1976).)

(5) RME leased equipment from Industrialease. The standard form contract included a disclaimer of warranty. The contract was signed in an atmosphere of pervasive haste and pressure, in substitution for an original contract which the supplier said was unusable. RME had no knowledge about the technical nature of the equipment, and relied on the supplier. The warranty disclaimer was held to be unconscionable. (*Industrialease Automated & Scientific Equipment Corp. v RME Enterprises Inc* 58 AD 2d 482, 396 NYS 2d 427, 22 UCC 4 (1977).)

(6) A contract for the lease of a service station included an exclusion of consequential damages clause benefitting the lessor. The lessee had had a truncated education and could not read (except for items in the sports section of the newspaper). The terms of the contract may not have been explained to him. In any case the court found that he was not aware of the exclusion clause. The court held that the clause was therefore unconscionable. (*Johnson v Mobil Oil* 415 F Supp 264,20 UCC 637 (1976).)

GOOD FAITH

The UCC defines "good faith" simply as "honesty in fact" (s 1-201). For merchants, good faith for the purposes of article 2 is defined as "honesty in fact and observance of reasonable standards of commercial fair dealing" (s 2-103).

The Restatement (s 205) states that:

> Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

The Restatement is wider in that the duty to deal fairly is imposed generally and goes beyond the UCC concept of honesty.

The general duty is one of good faith and fair dealing. This is said to have no "single positive unified meaning" Summers "The General Duty of Good Faith ..." (1982) 67 Cornell LR 810, 820. Rather it excludes conduct characterised by bad faith. Its meaning varies with the context. The Restatement emphasises faithfulness to the agreed common purpose and upholding community standards of decency, fairness and reasonableness.

Examples

(1) N, owner of a shopping centre, leased part of it to D, giving D the exclusive right to conduct a supermarket, the rent to be a percentage of D's gross receipts. During the term of the lease, N acquired adjoining land, expanded the shopping centre, and leased part of the adjoining land to X for a competing supermarket. The court held there was a mutual covenant to perform the contract in good faith and it had been breached by N. (*Daitch Crystal Dairies, Inc v Neiloss,* 8 AD 2d 965, 190 NYS 2d 737 (1959) aff'd 8 NY 2d 723, 167 NE 2d 643 (1960).)

(2) J suffered a loss of property covered by an insurance policy issued by S, and submitted to S notice and proof of loss. The notice and proof failed to comply with requirements of the policy as to form and detail. S did not point out the defects, but remained silent and evasive, telling J to perfect his claim. The court held that the defects did not bar recovery under the policy. (*Johnson v Scottish Union Insurance Co* 160 Tenn 152, 22 SW 2d 362 (1962).)

APPENDIX C

Australian Legislation

TRADE PRACTICES ACT 1974 s 52A

In 1986, the Trade Practices Act 1974 (Cth) was enlarged to prohibit unconscionable conduct by corporations "in trade or commerce" in relation to certain goods and services. The enactment followed the report of the Trade Practices Review Committee (the Swanson Committee) which had recommended an amendment of this sort in 1976. The Act, with some exceptions, is limited to corporations for constitutional reasons, the Federal Parliament having no general power to proscribe such conduct by individuals. However, most of the States have passed similar legislation applying to persons other than corporations.

Section 52A reads:

> **52A(1) General prohibition**
>
> A corporation shall not, in trade or commerce, in connection with the supply or possible supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.
>
> **52A(2) Factors to which Court may have regard**
>
> Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation has contravened sub-section (1) in connection with the supply or possible supply of goods or services to a person (in this sub-section referred to as the "consumer") the Court may have regard to:
>
> (a) the relative strengths of the bargaining positions of the corporation and the consumer;
>
> (b) whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation;
>
> (c) whether the consumer was able to understand any documents relating to the supply or possible supply of the goods or services;
>
> (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used

against, the consumer or a person acting on behalf of the consumer by the corporation or a person acting on behalf of the corporation in relation to the supply or possible supply of the goods or services; and

(e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation.

52A(3) Mere institution of legal proceedings not unconscionable

A corporation shall not be taken for the purposes of this section to engage in unconscionable conduct in connection with the supply or possible supply of goods or services to a person by reason only that the corporation institutes legal proceedings in relation to that supply or possible supply or refers a dispute or claim in relation to that supply or possible supply to arbitration.

52A(4) Relevant circumstances

For the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person:

(a) the Court shall not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and

(b) the Court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.

52A(5) Meaning of "goods or services"

A reference in this section to goods or services is a reference to goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption.

52A(6) Exclusion of certain matters from meaning of "supply or possible supply of goods"

A reference in this section to the supply or possible supply of goods does not include a reference to the supply or possible supply of goods for the purpose of re-supply or for the purpose of using them up or transforming them in trade or commerce.

As of July 1990 almost no cases had been decided under s 52A. Questions of interpretation, therefore, are speculative. The Australian courts have approached s 52, the section on misleading and deceptive conduct (comparable to s 9 of the Fair Trading Act 1986 in New Zealand) conservatively. (Compare the approach of the High Court of Australia in *Parkdale Custom Built Furniture Pty v Paxu Pty Ltd* (1981-82) 149 CLR 191, with that of the New Zealand Court of Appeal in *Taylors Textile Services Auckland Ltd v Taylor Bros Ltd* [1988] 2 NZLR 1, and in *Trust Bank Auckland Ltd v Auckland Savings Bank Ltd* [1989] 3 NZLR 385.) If a conservative approach prevails under s 52A, it may not go much further than the common law in its effect.

Subsections (5) and (6) apply the section to a supply of "goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption", and not intended for the purpose of resupply etc. If the goods or services are of this character then the section covers everyone, not simply "consumers" in the normally understood sense. One commentator has remarked that a very large company like BHP could be a "consumer" for the purposes of s 52A. "Services" is very widely defined in s 4, and goods and services together would seem to cover most contracts. Contracts of employment are specifically excluded.

The drafting of the section is less than ideal. Subsection (2) refers to "persons (in this subsection referred to as consumers)". Section 4B defines "consumer" and might conceivably, therefore, affect the scope of s 52A. It probably does not, but there could be doubt.

"Unconscionable" is not defined in the Act. Certain criteria are set out in subs (2) but these are neither mandatory nor exclusive. No doubt the courts will be influenced by them in deciding cases. In the light of the definitional uncertainty, it remains to be seen whether the courts will regard the section as going beyond the common law.

The criteria are a mixture of procedural (eg, "unfair tactics" para (d)) and substantive (eg, the price comparison in para (e)). However, the section is concerned with unconscionable "conduct" and most of the criteria relate to procedural matters. This may colour the application of the section so that "procedural unconscionability" must be present to grant relief.

Paragraph (e) provides that "the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services" elsewhere is relevant. This could mean that conduct

cannot be unconscionable if everyone else does it. If everyone does it, arguably it is reasonable. Such an interpretation would inhibit the section's application to standard form contracts used by all or most of the suppliers in a particular market. This would deprive the provision of some force. Situations could arise where a consumer had no real choice about accepting the term, yet the contract would not be unconscionable. Conversely, it may be argued that, where the general practice is harsh, para (e) would point to unconscionability, because the consumer has no way of escaping an unfair term. Again the position at present is quite uncertain.

The Trade Practices Commission is empowered to act for disadvantaged consumers, in negotiations and in court actions.

In any action, private or commission, the court has wide discretion to give relief. The court may:

- grant injunctions, s 80
- make awards of money as damages or as restitution, ss 82(2)(c) and (d)
- order that services be provided, s 87(2)(f)
- order that repairs be made, s 87(2)(e)
- void any contractual provision, or vary it, effective from any time, ss 87(2)(a) and (b)
- refuse to enforce a provision, s 87(2)(ba)
- order the variation or termination of an interest in land, s 87(2)(g).

CONTRACTS REVIEW ACT 1980 (NSW)

In 1980, New South Wales enacted the Contracts Review Act 1980, an Act which allows the court to give relief to parties to unjust contracts.

This Act is narrower than the Trade Practices Act in that it applies only to contracts and provisions of contracts. Even so, it has been held to go beyond the common law. The Act requires a court to investigate whether a contract is "unjust". A contract may be "unjust" under the Act without being "unconscionable" under the common law. Holland J has commented:

> The Act seems to me clearly to call for a fresh and direct approach to the individual case, without

> preconceived notions of conditions on which a court may set aside or vary a contract derived exclusively from established doctrine.... (*Sharman v Kunert* (1985) 1 NSWLR 225.)

In *Melverton v Commonwealth Development Bank* (1989) ASC 55-921, the court found a contract unjust under the Act although not unconscionable under the equitable doctrine.

> A son sought a mortgage over his parents' home as security for further finance for his business. The parents were elderly and the house was their only significant asset. The son assured his parents that the business was doing well and that the loan would be for six months only. The parents were unaware of any financial difficulty the son was facing. At the time of signing the mortgage, the parents were not given an explanation of the terms of the documents, nor was independent legal advice suggested. The NSW Supreme Court found that the mortgage was not unconscionable at general law, but it was "unjust" in terms of the *Contracts Review Act*. The bank had no knowledge of any special disability that the parents were labouring under, so there was no basis for a finding of unconscionability at general law. The mortgage was, however, harsh with regard to the parents' position. The bank knew of the son's financial problems, so it was aware of the possible harshness of the contract. (*Australian Trade Practices Reporter* 15,363 (CCH).)

In New Zealand, such a contract might be unconscionable under the common law, because constructive knowledge by the stronger party of the other party's disadvantage can be sufficient.

The Act limits its scope to consumer transactions, and also transactions in the course of a farming enterprise. However, it approaches this concept quite differently from s 52A of the Trade Practices Act. The definition does not relate to the subject matter of the contract ("goods and services") but rather to the circumstances in which it is made. The definition is exclusionary. Contracts entered into "in the course of or for the purpose of a trade, business or profession" are not covered.

"Unjust" is defined in the interpretation section of the Act in somewhat general terms as including "unconscionable, harsh or oppressive". Criteria are laid out in s 9(2). They are not exclusive but do appear to be mandatory. The court is not limited in the scope of its consideration to the inclusive definition of "unjust" in s 4 or the factors listed in s 9(2).

In order to find injustice the court will normally require elements of both substantive and procedural injustice. According to McHugh JA in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, 621 some substantive unfairness will normally be required, and may suffice, to give rise to injustice under the Act:

> In an appropriate case gross disparity between the price of the goods or services and their value may render the contract unjust in the circumstances even though none of the provisions of s 9(2) can be invoked by the applicant. Indeed, notions of unfairness or unreasonableness will, I think, generally be present when a contract or its provisions are declared unjust. This will particularly be the case when procedural injustice is relied on. If a contract or one of its relevant provisions is neither unfair nor unreasonable so far as the applicant is concerned, it is difficult to see how the existence of inequality of bargaining power or lack of independent advice, for example, can render the contract or provision unjust.

Remedies are similar to those under the Trade Practices Act. Under s 7 the court can make orders refusing to enforce, voiding, or varying the contract. It may make the voiding or variation effective from any time it chooses. It may order the execution of an instrument voiding or varying a land instrument. Under s 8 and the First Schedule it has wide ancilliary powers to make any orders "just in the circumstances". A non-exclusive list is given including:

- orders for repair and supply of goods
- orders for supply of services
- orders for sale of property and dispersal of the funds
- orders compensating non-parties to the contract.

APPENDIX D

United Kingdom Legislation

UNFAIR CONTRACT TERMS ACT 1977

The Unfair Contract Terms Act 1977, which has no counterpart in New Zealand, applies both to consumer and "commercial" contracts, but its rules vary between the two in some cases. The Act applies to Scotland as well as England, Wales and Northern Ireland but there are some slight differences in the provisions for Scotland.

Despite its title, the Act is limited to the regulation of "exclusion clauses" - those directly or indirectly denying or restricting the liability of one party to the contract for fault or breach. Most of its provisions apply only to "business liability", defined in s 1(3) (cf s 25(1) for Scotland) as:

> liability for breach of obligations or duties arising:
>
> (a) from things done or to be done by a person in the course of a business (whether his own business or another's); or
>
> (b) from the occupation of premises used for business purposes of the occupier.

So, even though there are questions of application at the threshold, it seems clear that the legislation does not catch the one-off contract - or even series of contracts - between private individuals. There are areas of doubt about the sale of capital assets by companies, and leases and property transactions. The Fair Trading Act 1986 in New Zealand and its Australian counterpart, the Trade Practices Act 1974, use the simple phrase "in trade". This may come to much the same thing.

Central to many of the Act's provisions is the "fair and reasonable" concept, which has several antecedents in British statutes going back to the Carriers Act 1830 and the Railway and Canal Traffic Act 1854. However, there is no consistent dichotomy between consumer contracts and others. Some terms are absolutely invalid, some are valid for all contracts insofar as they are reasonable. Certain other terms are valid in consumer contracts if they are reasonable, but unaffected in commercial contracts. Yet others are wholly invalid in consumer contracts but valid in commercial contracts if they meet the reasonableness test. The various provisions of the Act must presumably be seen simply as a series of value judgments by the

United Kingdom Parliament on particular sorts of contractual terms.

Note that on the face of the Act the reasonableness test is one of presumptive invalidity - certain terms are valid *if* they are (found to be) fair and reasonable, or invalid *unless* they are so. Section 11(5) (cf s 24(4) Scot) makes this explicit in words of unusual simplicity: "It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does".

It is therefore surprising that two major decisions under the Act (by the House of Lords in *Photo Production Ltd v Securicor Ltd* [1980] AC 827 and *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803) suggest a somewhat milder approach. Indeed, in the former case Lord Wilberforce seemed to imply that there was a presumption in favour of validity in commercial contracts:

> This Act applies to consumer contracts and those based on standard terms and enables exception clauses to be applied with regard to what is just and reasonable. It is significant that Parliament refrained from legislating over the whole field of contract. After this Act, in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said, and this seems to have been Parliament's intention, for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.

The *George Mitchell* approach appears neutral, against starting from any presumption. (See Adams and Brownsword "The Unfair Contract Terms Act: A Decade of Discretion" (1988) 104 LQR 95.)

The Act has been said to have introduced discretion into commercial contracts so that "parties to commercial contracts cannot be certain when their exemption clauses will be effective and when they will not" (Adams and Brownsword, ibid). However, the courts have not regarded decisions under the Act as made in the exercise of a discretion. If the Act has truly created a discretion, then every tort decision founded on the concept of "reasonable care" is a discretionary one.

The Act's long title states its scope and purpose:

> An Act to impose further limits on the extent to which ... civil liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms or otherwise ....

It is carefully and elaborately drafted, and it will suffice to note its salient provisions.

(1) Liability for death or personal injury arising from negligence cannot be excluded or restricted by a contractual term or notice (s 2(1), cf s 16(1)(a) Scot).

(2) Liability for negligence in respect of other loss or damage can be excluded or restricted only if it is reasonable to do so (s 2(2), cf s 16(1)(b) Scot).

(3) In a consumer contract (defined, in broad terms, as a contract entered into between parties, one who is dealing in the course of business, and the other who is not) or where one party deals on the other's written standard terms of business, the party propounding the contract cannot:

(a) when in breach of contract exclude or restrict liability in respect of the breach, or

(b) decline to perform any contractual obligation or perform in a way different from what was reasonably expected of him or her,

unless the term is reasonable (s 3, s 17 Scot).

(4) A consumer cannot be made liable to indemnify any other person for liability that he or she incurs for negligence or breach of contract, unless the term providing for it is reasonable (s 4, s 18 Scot).

(5) Liability cannot be excluded or restricted for loss or damage arising from defective goods in consumer use as a result of the negligence of a person concerned in their manufacture or distribution, if the goods are of a kind ordinarily supplied for private use or consumption (s 5, s 19 Scot).

(6) The implied undertakings as to title to goods under the Sale of Goods and Hire Purchase Acts cannot be excluded or restricted (s 6(1), s 20(1) Scot).

(7) Liability for breach of implied terms as to conformity with description or sample, and

quality and fitness for purpose, cannot be excluded or restricted against a consumer. They can be excluded or restricted against others only if the term is reasonable (s 6(2), ss 20(2) and 21 Scot). In *George Mitchell* such a clause in a purely business contract was struck down.

(8) Evasion by means of secondary contracts is prevented (s 10, s 23 Scot).

(9) A "reasonable term" is one that it is fair and reasonable to include having regard to the circumstances that were, or ought reasonably to be, known to or in the contemplation of the parties when the contract was made (s 11(1), s 24(1) Scot). The Second Schedule provides a number of (non-exhaustive) guidelines. The guidelines are expressed to apply only to contracts for the supply of goods, but they would seem to be relevant generally. They are worth setting out in full:

(a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;

(b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;

(c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);

(d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;

(e) whether the goods were manufactured,

processed or adapted to the special order of the customer.

(10) Excluding or restricting liability includes making the liability or its enforcement subject to restrictive or onerous conditions, or excluding or restricting any right or remedy in respect of the liability, or subjecting any one to prejudice because he or she pursues a right or remedy (s 13, s 25(3) Scot).

(11) The Act does not apply to certain contracts. They include:

- international supply contracts
- insurance contracts
- contracts for the creation, transfer or termination of intellectual property rights
- contracts dealing with an interest in land
- contracts for the creation or transfer of securities.

A number of cases indicate that exclusion clauses in commercial contexts will usually be upheld in the light of the parties' equal bargaining position. In *R & B Customs Brokers Co Ltd v United Dominions Trust Ltd* [1988] 1 WLR 321 the court took the view that if the reasonableness test had applied, the clause excluding liability would have satisfied it. The plaintiff company would then have been dealing in the course of business and the owner was "not devoid of business experience". In *The Zinnia* [1984] 2 Lloyd's Rep 211 an exclusion clause was in small print, convoluted and prolix, but given the commercial setting and the relative equality of bargaining strength the clause was upheld. On the other hand in *Phillips Products Ltd v Hyland* [1987] 2 All ER 620, although involving a "commercial" contract, the Court of Appeal thought that the trial judge was justified in saying the plaintiff was faced with a take it or leave it situation.

Not surprisingly, the bargaining strength of the parties can be important in "consumer" contracts. In *Smith v Eric S Bush Ltd* [1989] 2 All ER 514 Lord Templeman observed that a house purchaser, faced with the building society's clause excluding the liability of itself and of the valuer, was "not in a position to insist on anything". Lord Griffiths similarly observed that if the court was

dealing with a one-off situation between parties of equal bargaining power the requirement of reasonableness would be more easily discharged than in a case such as the present where the disclaimer was imposed upon the purchaser who had no effective power to protest.

Another test is whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to custom and any previous course of dealing). In *Phillips Products* a factor influencing the trial judge to hold that the disclaimer did not apply was that the plaintiff had not had a chance to look at the details of the agreement. In *Stevenson v Nationwide Building Society* (1984) 272 EG 663 a disclaimer was upheld. The plaintiff was an estate agent who bought a property on loan from the defendants. The plaintiff was familiar with the building society's disclaimer and, in the circumstances, it was perfectly reasonable for the society to charge less for a valuation with the disclaimer.

The insurance position was taken into account in *George Mitchell*'s case. Lord Bridge observed that seedsmen could insure against the risk of crop failure caused by supplying the wrong seeds without materially increasing the price of seeds. Much weight was placed on this factor by Lord Griffiths in *Smith v Eric S Bush*. His Lordship considered the practical consequences of a decision on the question of reasonableness, recognising that this had to involve the sums of money potentially at stake and the ability of the parties to bear the loss involved, which, in its turn, raised the question of insurance. The case involved the value of a modest house, against which it could be expected that the surveyor would be insured.

CONCLUSION

The limited scope of the United Kingdom Act and the complexity of its drafting suggest that it may not be a model for New Zealand to follow closely. However, that very complexity indicates the importance of care and clarity in framing any legislation that deals with unfair (or unreasonable) contract terms.

The Act places the concept of "reasonableness" at the heart of many contractual disputes - disputes over business contracts as well as "consumer" ones. In this it follows the United Kingdom Misrepresentation Act 1967 which introduced the doctrine of negligence into contract law. Comparable legislation in some continental European countries, and the European Community efforts at harmonisation (see Appendix F), suggest that this doctrine may well continue and strengthen in ordinary trading situations.

APPENDIX E

West German Legislation

The general provisions of the Civil Code in Germany were supplemented in 1976 by legislation specifically regulating standard form contract terms. The general provisions are not limited to "consumer" transactions in the usual sense. While the principal concern of the Standard Contracts Act 1976 is with specific types of term in consumer contracts, the Act follows the case-law under the Civil Code in applying to all standard term contracts a proscription of terms that are contrary to "good faith" and that place the other party at a disadvantage (s 9).

The Act's principal thrust is to list specific terms that, if used in standard consumer contracts, are declared either void under all circumstances (s 11) or dependent on judicial evaluation of a factor such as the reasonableness of a time limit, the reasonableness of compensation or reimbursement, or the adequate definition of an obligation to be performed by the other party (s 10). Note that some provisions of the British Unfair Contract Terms Act 1977 likewise require the court to decide if a particular term is fair and reasonable.

The Standard Contracts Act 1976 defines a "standard term" as a contractual provision drawn up for a large number of contracts which one contracting party presents to the other for assent. Conditions individually negotiated between the parties are declared not to be standard terms. "Consumer contract" is defined indirectly by excluding the application of ss 10 and 11 (except indirectly as a means of interpreting s 9) to standard terms used in contracts with merchants acting in the course of business or with public institutions or corporations (s 24).

The kinds of term declared void unconditionally are instructive. They include clauses:

- providing for short-term price increases
- prohibiting set-off
- prescribing a "penalty" for default
- limiting liability for gross negligence
- excluding warranties
- altering the burden of proof.

One advantage of this specificity is to give business people clear notice of what terms may not be inserted and what terms are at risk. Consumers and others can know what their rights are. Businesses can up to a point draft their standard contracts so as to avoid proscribed terms. However, predictability is by no means complete. The status of greylisted or conditionally valid terms seems much the same as for instance under the NSW Contracts Review Act 1980. The general back-up provision of s 9 should be noted as it shows one way in which inevitable gaps in the list of absolutely and conditionally void terms could be cured. It could discourage enterprising attempts at evading their letter, a problem when legislation is too specific (cf Hire Purchase Act 1971, s 2(3)). So neither the trader nor the consumer seeking complete certainty will find it in the West German law. Moreover, the broad provisions of the Civil Code concerning good faith are unimpaired.

A notable feature of the Standard Contract Terms Act 1976 is that an individual is not permitted to bring an action under it, but consumer groups and trade associations may. Individuals may of course bring actions under the general law.

The powers of the courts are limited to orders for discontinuance or retraction. There are no provisions for adjusting a particular contract or awarding compensation. These restrictions are consistent with the inability of individuals to claim under the Act and clearly give it the flavour of public law rather than a private law remedy.

EXCERPTS FROM GERMAN STANDARD CONTRACT TERMS ACT (1976 BGBl.I 3317)
Source: (1978) 26 Amer J Comp L 568. Reprinted with the kind permission of the editor.

1 **Definitions**

(1) Standard contract terms are all those contractual provisions drawn up for a large number of contracts which one contracting party (the proponent) presents to the other contracting party for his assent. It makes no difference whether the stipulations are contained in a separate instrument or included in the contract itself, what their scope may be, what type of writing is used, or what the form of the contract may be.

(2) Standard contract terms are not involved when and insofar as the contractual conditions are individually negotiated between the parties.

8 Limitations on control over contents

Articles 9 through 11 govern only those stipulations in standard contract terms by which it is agreed to deviate from legal rules or their supplementary regulations.

9 General clauses

(1) Stipulations in standard contract terms are invalid if the contracting partner prejudices unreasonably the command of good faith.

(2) In case of doubt, an unreasonable prejudice is presumed if a stipulation

1 cannot be reconciled with the fundamental idea underlying the legal rule from which it deviates, or

2 so limits essential rights or duties inherent in the nature of the contract that attainment of the purpose of the contract is jeopardized.

10 Clauses prohibited subject to evaluation

In all standard contract terms the following in particular are invalid:

1 (Time-limits for acceptance and performance)
a stipulation by which the proponent prescribes unreasonably long or inadequately defined time-limits for the acceptance or refusal of an offer or the performance of an act;

2 (Extension of time-limit)
a stipulation by which the proponent prescribes an unreasonably long or inadequately defined extension of time for his performance contrary to s 326 paragraph 1 of the civil code;

3 (Right to withdraw)
the grant of a right for the benefit of the proponent to withdraw without justification or adequate legal basis specified in the contract; this does not apply to long-term contractual relations;

4 (Provisions for modification)
the stipulation of a right for the benefit of the proponent to alter or deviate from the prescribed performance, unless the stipulation of the alteration or the deviation can be anticipated by the contracting partner, taking into consideration the interests of the proponent;

5 (Simulated declarations)
a stipulation according to which a performance or omission of a specified act by the contracting partner of the proponent is deemed the equivalent of the making of or the failure to make a declaration, unless

(a) a reasonable time-limit for the making of an express declaration is granted to the contracting partner, and

(b) the proponent undertakes in particular to bring to the attention of the contracting partner at the commencement of the time-limit the significance ascribed to his conduct;

6 (Fiction of receipt of notice)
a stipulation which provides that a declaration by the proponent with special significance is deemed to have been received by the other party to the contract;

7 (Settlement of contracts)
a stipulation by which the proponent, in the event that a contracting party withdraws or gives notice of withdrawal, claims

(a) an unreasonably high compensation for the enjoyment or use of a thing or right or for the completed performance, or

(b) an unreasonably high reimbursement for expenses;

8 (Choice of law)
the stipulation that foreign law or the law of the German Democratic Republic shall govern contracts where no such recognizable interest exists.

11 Clauses prohibited per se

In standard contract terms, the following are invalid:

1 (Short-term price increases)
a stipulation which prescribes an increase in the price of goods or services within four months from the date when the contract is made or is to be performed; this does not apply to goods or services which are to be delivered or performed over a period of time or to performances whose price is regulated by s 99 paragraph 1 or 2 number 2 of the act against unfair competition;

2 (Right to refuse performance)
a stipulation by which

(a) the right to refuse performance, which belongs to the contracting partner or the proponent according to s 320 of the civil code, is eliminated or restricted, or

(b) a right of retention belonging to the contracting partner or the proponent and arising from the same contractual relationship is excluded or restricted, particularly if made dependent upon the acknowledgment of the existence of defects by the proponent;

3 (Prohibition of set-off)
a stipulation by which the contracting partner of the proponent is deprived of his right to set off an undisputed or legally valid claim;

4 (Notice, grant of time-limit)
a stipulation by which the proponent is released from a statutory obligation to give notice to the other party to the contract, or to grant an additional time-limit for performance;

5 (Deduction of lump-sum as indemnity)
the agreement to a lump-sum claim for the proponent as indemnity or compensation for depreciation, if

(a) the lump sum exceeds the amount which in ordinary circumstances would be paid as compensation in the normal course of events or as the usual amount for depreciation, or

(b) it eliminates proof by the other party to the contract that damage or depreciation did not occur or were substantially less than the lump sum provided for;

6 (Penalties)
a stipulation by which payment of a penalty to the proponent is prescribed in the event of nonacceptance or late acceptance of his performance, or in the event that the other party withdraws from the contract;

7 (Limitation of liability for gross negligence)
an exclusion of or limitation on

liability for damages arising from a grossly negligent breach of contract by the proponent or a deliberate or grossly negligent breach of contract by a statutory agent or employee of the proponent; this applies also to damages for the violation of duties during the course of contract negotiations;

8 (Default, impossibility)
a stipulation by which, in the event of default by the proponent or impossibility of performance for which he is responsible

(a) the right of the other party to rescind the contract is either excluded or limited or

(b) the right to claim compensation is excluded or limited contrary to number (7);

9 (Partial default, partial impossibility)
a stipulation which excludes the right of the other contracting party, in the event of partial nonperformance by the proponent or partial impossibility of performance for which he is responsible, to claim compensation for the failure to perform the whole obligation or to cancel the whole contract, if partial performance of the contract is of no benefit to him;

10 (Warranty)
a stipulation by which, in contracts providing for deliveries of newly produced goods and services,

(a) (Exclusion and notice to third parties)
claims of warranty against the proponent, including contingent claims for repair and substitution relating to the whole or to a separate part, are excluded, are limited to the recovery of claims against third parties, or are made contingent upon the bringing of a prior legal action against third parties;

(b) (Limitation on repair)
claims of warranty against the proponent relating to the whole or to a separate part are limited to a right to repair or substitution if there is no express reservation of the right of the other contracting party to a reduction in compensation upon the failure of the

repair or substitution or, if the subject of the warranty is not a construction contract, to demand rescission of the contract at his election;

(c) (Expenses of repair)
the duty of the proponent warrantor to bear the expenses which are necessary to fulfil the purpose of the contract, particularly the costs of transport, tolls, and work and materials, is excluded or limited;

(d) (Withholding correction of a defect)
the proponent conditions the correction of a defect or the substitution of a defect-free item on prior payment of the whole price or of a sum disproportionately high in light of the nature of the defect;

(e) (Time-limit for notice of defect)
the proponent sets a time-limit for notice of hidden defects which is shorter than the period of limitation for statutory warranties;

(f) (Limitation of period of warranty)
the statutory period of warranty is shortened;

(11) (Liability for warranty of quality)
a stipulation by which in a contract of sale, for work, or for work and materials, claims for indemnity against the proponent under s 463, 480 paragraph 2 and 635 of the civil code for breach of warranty of quality are excluded or diminished;

(12) (Duration of term of continuing obligation)
in a contractual relation which has as its object regular deliveries of merchandise or the regular performance of services or work by the proponent,

(a) a term of more than two years during which the contract is binding on the other party,

(b) a tacit extension of the term of the contract for more than a year is binding on the other party,

(c) the other party is required to give notice of cancellation more

than three months before the date of the express or tacit extension of the contract;

(13) (Change of contracting partner)
a stipulation in a contract of sale, for service, or for work, in which a third party may take the place of the proponent with respect to the rights and duties under the contract, unless

(a) the third party is mentioned by name, or

(b) a right is granted to the other party to withdraw from the contract;

(14) (Liability of the agent entering into a contract)
a stipulation by which the proponent imposes upon an agent who concludes a contract for the other party

(a) without a proper express and separate statement, a personal responsibility or duty to indemnify, or

(b) in the case of an unauthorised agent, a responsibility greater than that provided for in s 179 of the civil code;

(15) (Burden of proof)
a stipulation by which the proponent alters the burden of proof to the prejudice of the other contracting party, particularly one by which he

(a) imposes upon the latter the burden of proof of circumstances which fall within the scope of responsibility of the proponent,

(b) requires the other party to allege certain facts.

Subsection (b) does not apply to a separately signed acknowledgment;

(16) (Form of notice and explanation)
a stipulation by which a notice or explanation delivered to the proponent or to a third party is required to be in a form more exacting than the written form or dependent upon notice requirements.

APPENDIX F

European Commission Proposal

The problem of unfair contracts has been recognised at the national level by a number of Member States of the European Community. Since 1974 nine of the twelve have adopted laws designed to establish a better balance between consumers and suppliers. Only Belgium, Greece and Italy do not as yet have any law specifically relating to unfair contracts and Belgium, at least, has a legislative proposal. Nevertheless, there are significant differences between the Member States which have legislated - both in terms of scope and substance (and in general approach) of the laws.

A series of Council Resolutions have supported the idea of protection of consumers against unfair terms of contract by Community law and there is a legal basis for acting in article 100A of the EEC Treaty (Approximation of laws). In 1984 the Commission published a consultation paper with a view to the preparation of a proposal for an EC Council Directive (see Bull EC 1984 Suppl 1/84). In 1985 and 1986 two committees of the European Parliament accepted the need for consumer protection and for Community-wide rules on the subject. In 1987 "Further Draft Articles for Discussion on Unfair Terms of Contract" were circulated to Member States for comment. These form the basis of the present proposal, approved by the European Commission in July 1990.

Article 1 of the proposed Directive defines its scope as including every contract between a consumer and a party acting in the course of trade, business or profession, whether the contract is a take it or leave it contract, or is in standard terms or is negotiated individually. Thus the proposed Directive is broader than the German Standard Contract Terms Act 1976, which is limited to the first two categories. It is also narrower than the German Act which is not limited to consumers (at least in its general provisions). In general, however, the European Commission's proposal appears to draw particularly on the German Act and similar Luxembourg and Netherlands legislation (and Belgium draft legislation).

Other provisions of the proposed Directive can be summarised as follows:

- art 2 defines "unfair terms" and "consumer";
- art 3 prohibits the use of unfair terms, making them void if used in contravention of

the prohibition. (A list of types of unfair terms is annexed to the proposal);

- art 4 provides for the control of unfair terms by the Member States and extends beyond judicial means to administrative forms of control (the method employed under the French Consumer Protection and Information Act of 1987) and self regulation;

- by art 5, the Commission undertakes to report to the Council on experience of the Directive in operation;

- art 6 sets the implementation date for the Directive as 31 December 1992 (coinciding with the completion of the Internal Market);

- art 7 formally addresses the proposed directive to Member States.

It still remains to be seen whether the proposed Directive will be adopted by the Council of the European Communities, but it is likely it will be brought to the relevant working party of the Council in September 1990.
In July 1990 the Commission of the European Communities made the following proposal for a Council Directive on Unfair Terms in Consumer Contracts:

THE PROPOSED DIRECTIVE

THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100A thereof,

Having regard to the proposal from the Commission,

In cooperation with the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas it is necessary to adopt measures to establish progressively the internal market before 31 December 1992; whereas the internal market compromises an area which has no internal frontiers and in which goods, persons, services and capital move freely;

Whereas national laws of Member States relating to the terms of contract applicable between the seller of goods or services, on the one hand, and the purchaser of them, on the other hand, show many disparities, with the result that the national markets for the sale of goods and services to consumers differ from each

other and that distortions of competition may arise amongst the sellers, notably when they sell in Member States other than their own;

Whereas, in particular, national laws of Member States relating to unfair terms in contracts concluded with consumers show marked divergences, and the same is true of their national laws relating to the obligation of the seller of goods to answer for the quality of them, for their fitness for the purpose for which they are sold, and for their conformity to the contract, and of the supplier of services to answer for the performance of them;

Whereas consumers do not know the laws which, in other Member States than their own, govern contracts for the sale of goods or services; and whereas this difficulty may deter them from direct transactions of purchase of goods or services in another Member State;

Whereas in order to facilitate the establishment of a single market and to safeguard the citizen in his role as consumer when buying goods and services by contracts which are governed by the laws of other Member States than his own, it is essential to remove unfair terms from those contracts;

Whereas sellers of goods and services will thereby be helped in their task of selling goods and services, both at home and throughout the single market; and whereas competition between sellers will thus be stimulated, so contributing to increased choice for Community citizens as purchasers;

Whereas the Community's programmes for a consumer protection and information policy underlined the importance of safeguarding consumers in the matter of unfair terms of contract; and whereas this protection ought to be provided by laws and regulations which are either harmonised at Community level or adopted directly at that level;

Whereas in accordance with the principle laid down under the heading "Protection of the economic interests of the consumers", as stated in those programmes: "Purchasers of goods and services should be protected against the abuse of power by the seller, in particular against one-sided standard contracts and the unfair exclusion of essential rights in contracts";

Whereas more effective protection of the consumer can be achieved by adopting uniform rules of law in the matter of unfair terms; and whereas those rules should apply to all consumer contracts, whether concluded in writing or by word of mouth, and (if in writing) whether by means of one document or several;

Whereas more effective protection of the consumer can be achieved by adopting rules of law which, in the matter of unfair terms, are to apply to all of them;

Whereas Member States should ensure that unfair terms are not used in contracts concluded with consumers in the course of the trade, business or profession of the person who carries it on, and that if, nevertheless, such terms are so used they will be treated as void, but the remaining terms will remain valid and the contract shall continue to bind the parties upon these terms if it is capable of continuing in existence without the void provisions;

Whereas it is desirable to identify certain types of terms which must not be used in contracts concluded with consumers;

Whereas persons or organisations, if regarded under national law as having a legitimate interest in the matter, must have facilities for initiating proceedings concerning terms in contracts concluded with consumers, and in particular unfair terms, either before a court or before an administrative authority which is competent to decide upon complaints or to initiate appropriate legal proceedings;

Whereas the courts of administrative authorities must have powers enabling them to order or obtain the withdrawal from use of offending terms,

HAS ADOPTED THIS DIRECTIVE:

Article 1

The purpose of this Directive is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in consumer contracts.

Article 2

For the purposes of this Directive:

(1) A contractual term is unfair if, of itself or in combination with another term or terms of the same contract, or of another contract upon which, to the knowledge of the person or persons who conclude the first-mentioned contract with the consumer, it is dependent:

- it causes to the detriment of the consumer a significant imbalance in the parties' rights and obligations arising under the contract; or

- it causes the performance of the contract to be unduly detrimental to the consumer; or

- it causes the performance of the contract to be significantly different from what the consumer could legitimately expect; or

- it is incompatible with the requirements of good faith.

(2) The Annex contains a list of types of unfair terms.

(3) "The consumer" means a natural person who, in transactions covered by this Directive, is acting for purposes which can be regarded as outside his trade, business or profession.

(4) "Trade" and "business" shall be taken to include the activities of suppliers, whether publicly owned or privately owned, and those expressions also cover the sale, hiring out or other provision of appliances by those suppliers.

(5) The fairness or unfairness of a contractual term is to be determined by reference to the time at which the contract is concluded, to the surrounding circumstances at that time and to all the other terms of the contract.

Article 3

Member States shall:

- prohibit the use of unfair terms in any contract concluded with a consumer by any person acting in the course of his trade, business or profession; this prohibition shall be without prejudice to the seller's right to obtain compensation from his own supplier;

- provide that if, notwithstanding this prohibition, unfair terms are used in such a contract they shall be void, and that the remaining terms of the contract shall continue valid and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the void provisions.

Article 4

(1) Member States shall ensure that in the interests of consumers, competitors and the public generally, adequate and effective means exist for the control of unfair terms in contracts concluded with consumers and of the terms of contracts for the sale of goods or services to them.

(2) Such means shall include provisions of law whereby persons or organisations, if regarded under national law as having a legitimate interest in protecting consumers, may take action before the courts or before an administrative authority competent to make a decision for determination of the question whether the terms used in such a contract are inconsistent with the provisions of this Directive.

Article 5

Not later than 31 December 1997 the Commission shall present a report to the Council concerning the operation of this Directive.

Article 6

(1) Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive not later than 31 December 1992 and shall forthwith inform the Commission thereof. Those provisions shall apply to all contracts concluded with consumers after 31 December 1992.

(2) The provisions adopted pursuant to the first subparagraph shall make express reference to this Directive.

(3) Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 7

This Directive is addressed to the Member States.

ANNEX

The following types of terms are unfair if they have the object or effect of:

(a) excluding or limiting the liability of a contracting party in the event of death or personal injury to the consumer resulting from an act or omission of that contracting party;

(b) providing that a seller or supplier of goods or services may alter the terms of contract unilaterally, or terminate unilaterally a contract of indeterminate duration by giving an unreasonably short period of notice. This prohibition shall not prevent a supplier of financial services:

(i) from altering the rate of interest on a loan or credit granted by him or the amount of other charges therefor, or

(ii) from terminating unilaterally a contract of indeterminate duration,

provided the contract confers the power to do so and also requires suitable notice of the alteration or termination to be given to the other contracting party or parties. Moreover, this paragraph (b) shall not affect:

(i) the application of price indexation clauses where these are lawful;

(ii) stock exchange transactions;

(iii) contracts for the purchase of foreign currency;

(c)

(1) denying the consumer the right, as purchaser under a contract for the sale of goods:

- to receive goods which are in conformity with the contract and are fit for the purpose for which they were sold;

- to complain that the goods contain hidden defects;

- to require the seller (in the event that the goods supplied are not in conformity with the contract or are not fit for the purpose for which they were sold):

  (i) to reimburse the whole of the purchase price, or

  (ii) to replace the goods, or

  (iii) to repair the goods at the seller's expense, or

  (iv) to reduce the price if the consumer retains the goods;

- to require the seller (whichever of the foregoing options the consumer chooses) to compensate the consumer for damage sustained by him which arises out of that contract;

- (in cases where the seller transmits to the consumer the guarantee of the manufacturer of the goods) to benefit from the manufacturer's guarantee for a period equal, at the least, to the normal life of the goods or twelve months, whichever is the shorter; and to enforce payment, either by the seller or by the manufacturer, of the costs incurred by the consumer in obtaining implementation of that guarantee;

(2) denying the consumer the right, as purchaser under a contract for the supply of services:

- to be supplied with those services at the agreed time and efficiently from his point of view;

- to have the supplier's warranty that the supplier has the requisite skill and expertise to supply the services in the manner specified in the foregoing indent.

(d) providing for the price of goods to be determined at the time of delivery or allowing a seller or supplier of goods to increase their price, notwithstanding that in these various cases the consumer buyer has no corresponding right to cancel the contract if the final price is too high in relation to the price he expected when concluding the contract; but the application of price indexation clauses where lawful shall not hereby be affected;

(e) excluding or limiting the liability of the seller or supplier or of another party in the event of total or partial non-performance by him;

(f) imposing on the consumer a burden of proof which, according to the applicable law, should lie on another party to the contract;

(g) in relation to a contract for the purchase of a timeshare interest in a building, fixing the date of conclusion of the contract in such a way as to deny to the consumer the possibility of withdrawing from the contract within seven clear days after making it.