



Department  
for Business  
Innovation & Skills

**CONSUMER RIGHTS BILL:  
PROPOSALS ON UNFAIR  
CONTRACT TERMS**

**IMPACT ASSESSMENT: FINAL**

**JUNE 2013**

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<b>Title:</b> Consumer Bill of Rights: Proposals on Unfair Contract Terms  <b>IA No:</b> BIS 0397  <b>Lead department or agency:</b> Department for Business, Innovation and Skills  <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 8/03/2013		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Primary legislation		
<b>Contact for enquiries:</b> consumerbill@bis.gsi.gov.uk			

<b>Summary: Intervention and Options</b>	<b>RPC Opinion:</b> GREEN
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<b>Cost of Preferred (or more likely) Option</b>
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Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?	
£14.96m	£0.19m	£0.02m	Yes	IN

**What is the problem under consideration? Why is government intervention necessary?**

The law on unfair terms is particularly complex. It is contained in two separate pieces of legislation – the Unfair Contract Terms Act (1977; UCTA) and the Unfair Terms in Consumer Contracts Regulations (1999; UTCCRs) – that have inconsistent and overlapping provisions. The Regulations contain exemptions for the core bargain of the contract which have proved difficult to interpret. This causes uncertainty about how the law should be applied.

**What are the policy objectives and the intended effects?**

- To consolidate the existing two pieces of legislation on unfair terms in consumer contracts into one, and make it clear and straightforward to apply.
- In doing this, to maintain the existing levels of consumer protection.
- To provide greater clarity about which types of contract terms can be assessed for fairness and which cannot (the exemptions).
- To ensure that the resultant legislation complies with EU Directive 93/13/EEC on unfair terms in consumer contracts.

This will make it easier for businesses, consumers and enforcers to apply the law.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

1. Do nothing
2. (Preferred) Consolidate existing legislation and clarify definitions, particularly of exempt terms
3. Have no exemptions from an assessment of fairness

Option 2 is preferred because it will clarify consumer rights in a way which will benefit consumers, businesses and the market as a whole.

**Will the policy be reviewed?** It will be reviewed. **If applicable, set review date:** 01/2019

Does implementation go beyond minimum EU requirements?			YES		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			<b>Traded:</b>		<b>Non-traded:</b>

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.*

Signed by the responsible Minister: \_\_\_\_\_ **Jo Swinson** \_\_\_\_\_ Date: \_\_\_\_\_ **4 June 2013** \_\_\_\_\_

# Summary: Analysis & Evidence

# Policy Option 1

Description:

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.71	High: 30.62	Best Estimate: 14.96

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	7.8	0.0	7.8
High	16.4	0.0	16.4
Best Estimate	12.1	0.0	12.1

### Description and scale of key monetised costs by 'main affected groups'

**Business:** Familiarisation costs £1.32m, costs of updating terms and conditions £5.63m, Initial increase in legal advice costs £5.17m.

### Other key non-monetised costs by 'main affected groups'

None

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0.0	1.8	15.7
High	0.0	4.5	38.5
Best Estimate	0.0	3.2	27.1

### Description and scale of key monetised benefits by 'main affected groups'

**Business:** Cheaper complaint handling £0.32m, savings from reduction in issues escalating to court proceedings £1.07m.

**Consumers:** Reduced risk of consumer detriment £1.69m (increasing over 10 yr period)

### Other key non-monetised benefits by 'main affected groups'

**Business:** Reduced costs of ongoing revision for simpler terms and conditions.

**Consumer:** Increased redress

### Key assumptions/sensitivities/risks

Discount rate (%)

3.5

The key risk is that in clarifying and consolidating the law, the level of consumer protection and/or the burden on business will be inadvertently and negatively affected. By asking the Law Commission to consult widely with consumer groups, businesses, business groups and legal experts, we are confident that this risk has been mitigated.

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 1.4	Benefits: 1.4	Net: 0.0	Yes	IN

# Evidence Base (for summary sheets)

## Problem under consideration

1. This Impact Assessment relates to proposals to reform consumer law on unfair contract terms.
2. The proposals form part of a wider programme of work to reform consumer law (the 'Consumer Law Reform Programme'). This section outlines the overall motivation for simplification and clarification of consumer law, before explaining the specific proposals covered by this IA.

## Background context:

3. UK consumer law is unnecessarily complex. A benchmarking study by the University of East Anglia in 2008, found that the current system of consumer law offers a high degree of protection but is confusing, because it has grown piecemeal over the years<sup>1</sup>. Consumer law is fragmented and in places unclear, for example where the law has not kept up with technological change or lacks precision. There are also overlaps between EU and pre-existing UK legislation and the law is couched in legalistic language.
4. It is widely understood that consumers who understand their rights can play a strong part in driving growth because increasing consumer confidence will empower consumers to challenge incumbent firms, switch to competitors and take up new products. In turn, this should force businesses to compete on price and quality, stimulating innovation and growth – along with greater investment in the long term. For this driver to work, we need both competitive markets and a strong but simple framework of consumer law that can be effectively enforced.
5. For traders, poorly understood law wastes business time and creates costs arising from unnecessary and prolonged disputes with consumers, additional staff training and the need to seek legal advice. Unscrupulous traders can exploit the law's complexity and undermine competition from legitimate businesses. Consumers who lack confidence in their rights are less likely to try new market entrants and innovative products, which in turn weakens competitive pressure on incumbent firms<sup>2</sup>.
6. The proposals within this Impact Assessment form part of a proposed wider reform of Consumer Law. Reform will require primary legislation (the proposed Consumer Rights Bill) and amendment of the Consumer Protection from Unfair Trading Regulations. The package of reform intends to:
  - **Consolidate** the law to reduce fragmentation;
  - **Clarify** the law to reduce the scope for costly disputes;
  - **Update** the framework to ensure that consumer rights keep pace with technological advances;
  - **Deregulate** to introduce key business-friendly provisions; and
  - **Enhance** consumer rights where it is appropriate to do so
7. The proposals in this IA are intended to:

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<sup>1</sup> University of East Anglia 'Benchmarking the performance of the UK framework supporting consumer empowerment through comparison against relevant international comparator countries' for BERR 2008

<sup>2</sup> ICF GHK 'Consumer Rights and Economic Growth' for BIS Report (to be published 2013)

- **Clarify the law** to make clearer which types of contract terms can be assessed for fairness and which cannot (the exemptions); and
- **Consolidate** the existing two pieces of legislation on unfair terms in consumer contracts into one.

### Problems with the law covering unfair contract terms

8. In 2005, the Law Commission and Scottish Law Commission<sup>3</sup> concluded following an earlier consultation that the law on unfair terms is particularly complex. It is contained in two separate pieces of legislation – the Unfair Contract Terms Act (1977; UCTA) and the Unfair Terms in Consumer Contracts Regulations (1999; UTCCR) – that have inconsistent and overlapping provisions. The UCTA relates to a broad range of contracts including contracts between two business, contracts between businesses and consumers and even, to a limited extent to consumer to consumer contracts. It focuses on exclusions – terms or notices which aim to restrict liability for: causing death or personal injury; other loss or damage caused by a breach of a duty of care; breaches of certain terms implied by law; and breach of contract generally. Some types of contracts are exempted, for example those relating to insurance contracts, interests in land or, other than in Scotland, intellectual property rights.
9. The UTCCRs are narrower than the UCTA in that they only apply to non-negotiated (standard term) consumer contracts but they apply to all such contracts, there are no exemptions and they apply UK-wide. Contract terms must be “fair” and written in “plain and intelligible language”. The definition of fairness differs from that in the UCTA and while overall, both pieces of legislation usually achieve a similar effect, they do it in different ways. The Law Commission said that this caused uncertainty about how the law should be applied
10. In 2012, BIS asked the Law Commission to look at this issue again in the light of some high profile legal cases and they undertook a consultation in 2012<sup>4</sup>, to provide up-to-date evidence about the problems and to get views on potential remedies. The focus of the consultation was on two particularly difficult areas:
  - contract clauses that are exempted from an assessment of fairness by the courts because they concern the essential bargain of the contract – the subject matter and the price; and
  - the “grey list”, a schedule of types of clauses that courts may assess regardless of whether they concern the subject matter or the price.
11. A test case on exempt clauses was brought by the OFT against a group of UK banks represented by Abbey National. The issue was whether unauthorised bank charges could be considered for fairness (the OFT’s position) or whether they were exempt and could not be considered (the banks’ position). The High Court found in favour of the OFT but this was overturned by the Supreme Court in 2009. Although the charges might not appear to be part of the essential bargain concluded between a consumer and bank when a bank account is opened, the Supreme Court found that they were exempt from being assessed for fairness because they concerned the “price” under the contract between consumer and bank.
12. Most respondents to the Law Commission’s 2012 consultation - businesses, consumers and organisations providing legal or consumer advice – agreed that despite, or even because of, the Supreme Court judgement, considerable uncertainty remains about the way the exemptions are interpreted. For example:

The British Banking Association said:

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<sup>3</sup> [http://lawcommission.justice.gov.uk/consultations/unfair\\_consumer\\_contracts.htm](http://lawcommission.justice.gov.uk/consultations/unfair_consumer_contracts.htm)

<sup>4</sup> *Ibid*

The BBA agrees with the aims of the Law Commission review of Unfair Terms in Consumer Contracts Regulations to ensure that both parties to the contract have clarity and certainty on unfair terms in consumer contracts. Our agreement with these aims rests on the assumption that any reforms would complement rather than conflict with the Supreme Court's judgment in *OFT v Abbey National plc* (the "test case").

BSkyB said:

Sky appreciates that there has been some uncertainty engendered by the decision in the *Abbey National* case and subsequent case law.

The OFT said:

We agree with the Law Commission (at paragraph 8.12 of the consultation document) that, in the wake of the Supreme Court's decision, businesses may be lulled into a false sense of security, relying on charges (for example unexpected or contingent) as a source of revenue that are in fact fully assessable for fairness.

MoneySavingExpert.com said:

We agree that the current law on which terms should be exempt from the assessment of fairness under the Unfair Terms Directive is unduly uncertain. As it stands, consumers are not being treated fairly and this must be improved.

Which? said:

We agree that the scope of the exemptions are currently unclear and in need of reform.

13. These problems have the following direct outcomes:

- the risk of detriment to consumers accepting unclear contract terms which turn out to be unfair. According to the Consumer Detriment Survey 2012<sup>5</sup>, unfair contracts and Terms and Conditions accounted for 4-10% of all consumer problems;
- the financial and other costs to consumers of obtaining redress;
- costs to businesses of handling complaints about contract terms, including legal costs; and
- costs to businesses of developing and maintaining terms and conditions (T&Cs) that are aligned with the current complex legislation.

14. These direct outcomes lead to wider market detriment as unfair contracts and detrimental business practices are not challenged, consumers merely accepting the situation or being left unsuccessful in their attempts to secure satisfactory redress.

- Consumers are less likely to engage in the market, as consumer confidence and empowerment are undermined where consumers are not sure what they are entitled to expect from businesses.
- Consumers are more likely to suffer detriment they are unable to resolve, as they are unlikely to know what they are entitled to demand from the business when they encounter problems with contracts.
- Productivity, innovation and market growth are inhibited, as consumers do not sufficiently drive competition.

15. In the light of responses to their 2012 consultation the Law Commission made a number of recommendations to Government to address these problems. We have taken their recommendations into account in developing and assessing the impact of the options described in this document as part of the package of reforms in the Consumer Bill of Rights.

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<sup>5</sup> <http://www.consumerfocus.org.uk/publications/consumer-detriment-2012>

The Government will be formally responding to the Law Commission alongside its responses to the BIS consultations on other parts of the Bill.



## Economic Rationale for Intervention

16. The key motivation for simplifying and reforming consumer law is to make markets work more effectively and to drive economic growth.
17. Well-functioning competitive markets encourage growth by creating incentives for firms to become more efficient and innovative.<sup>6</sup> Markets can only be fully competitive if consumers are active and confident, meaning that they are willing to challenge firms to provide a better deal, switch between suppliers, and take up new products.<sup>7</sup> Consumer law reform can play a central role in empowering consumers and hence supporting more effective competition.
18. First, by consolidating, simplifying and clarifying consumer law, the reforms aim to raise consumers' awareness and understanding of their existing rights. The proposed consumer law reforms will reduce and streamline the number of pieces of consumer legislation. They will also clarify consumer rights where these are currently unclear – for example, adopting a single definition of fairness and providing clarity on when terms can or cannot be assessed for fairness.
19. Greater awareness of consumer rights make markets work more effectively because consumers will have greater confidence to switch to alternative suppliers or take up new products. Where consumers are unclear what will happen if things go wrong with a new product or service, they will take account of this risk either by engaging in costly search to find out more about the product, or by requiring a 'risk premium' on the new product. Clarifying consumer rights can thus reduce transaction costs of switching suppliers or taking up a new product. It can also help to overcome behavioural inertia, where customers prefer to stick with what they know rather than the slightly less certain (but potentially better) alternative.
20. This is particularly important in allowing new entrants to compete and win customers from established firms. For example, in online markets the strength of established brands comes in part from a perceived lack of consumer confidence in the protections afforded by consumer law for consumers purchasing from smaller suppliers.
21. Second, and related to these simplification benefits, consumer law reform can also ensure that substantive consumer protections are focused on addressing key market failures – particularly information asymmetries between consumers and firms.
22. There is strong academic support for the position that some minimum degree of consumer protection is required in order for markets to function effectively.<sup>8</sup> For example, in the absence of consumer law, consumers would typically not know how a firm would respond if something went wrong with a product or service. Having to find out this information in each case, and potentially negotiate an insurance agreement with each firm, would be extremely costly. Having a minimum level of consumer protection in place is an efficient way of reducing search and transaction costs.
23. The overall impact on growth of consumer law simplification could be significant. For example, in Australia the Productivity Commission estimated that simplifying national consumer law could increase productivity by 0.13 per cent, and in turn lead to higher GDP. In the longer term, these productivity gains were estimated at A\$6 billion over forty years.

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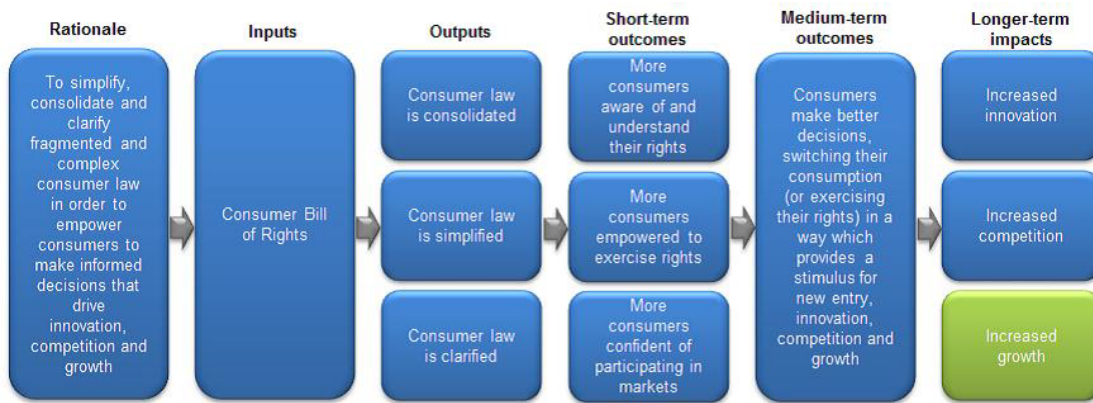
<sup>6</sup> For references to literature on the links between competition and growth, see OFT (2011), 'Competition and growth'

<sup>7</sup> Mark Armstrong (2008), 'Interactions between competition and consumer policy'

<sup>8</sup> Armstrong (2008)

24. Figure 1 summarises the way simplified consumer rights can have an impact on economic growth.

**Figure 1: Logic model linking simplified consumer rights and economic growth<sup>9</sup>**



<sup>9</sup> Model taken from ICF GHK 'Consumer Rights and Economic Growth' for the Department for Business, Innovation and Skills (to be published 2013) pg20

## Policy Objectives

25. This impact assessment concerns proposals relating to the law on unfair contract terms. These proposals sit within a wider package of reforms to consumer law as explained above.
26. The proposals have the following objectives:
- To consolidate the existing two pieces of legislation on unfair terms in consumer contracts into one, and make it clear and straightforward to apply.
  - In doing this, to maintain the existing levels of consumer protection.
  - To provide greater clarity about which types of contract terms can be assessed for fairness and which cannot.
  - To ensure that the resultant legislation complies with EU Directive 93/13/EEC on unfair terms in consumer contracts.
27. As with the other reforms, achieving these objectives should:
- Benefit the market as a whole by increasing consumer confidence, empowering consumers and driving stronger competition between firms.
  - Make it easier for consumers to secure redress when their rights in relation to service provision are breached.
  - Reduce business costs, by allowing traders to resolve disputes more quickly and easily, and reduce expense in staff training over consumer rights.
28. Increasing consumer confidence will empower consumers to challenge incumbent firms, switch to competitors and take up new products. In turn, this should force businesses to compete on price and quality, stimulating innovation and growth – along with greater investment in the long term.
29. Actions such as issuing guidance and providing education on the current law would be insufficient to achieve these policy objectives.
- For example, whilst it did have some success, the OFT's 2009 'Know Your Consumer Rights Campaign' was only able to address a limited amount of the confusion experienced. The Consumer Detriment 2012 Survey by Consumer Focus shows that consumers continue to suffer unacceptable levels of detriment, and consultation responses strongly suggest that a high level of confusion continues to exist.
  - Whilst it is vital that consumers are educated about their rights, the success of such education may be dependent on the clarity of its content. In a report for BIS on how consumer contract law could be simplified, streamlined and rationalised, Professor Howells and Professor Twigg-Flesner noted that where the law is clear and accessible this makes it easier to provide effective consumer education<sup>10</sup>. If consumers cannot understand the education they are given because the content is too complex they are likely to become more, rather than less, confused.
  - Behavioural economics further suggests that consumers are unlikely to be able to understand complex law; consequently, the way information is presented to them, and the ease with which it can be understood, is likely to be crucial in consumers' awareness<sup>11</sup>.
30. Therefore, a consolidation, clarification and, where appropriate, enhancement of the law is needed. This should be delivered along with consumer and business education campaigns, in order to ensure that all involved in the provision of services are aware of the rights and obligations that affect them.

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<sup>10</sup> Department for Business, Innovation and Skills, *Consolidation and Simplification of UK Consumer law* 2010. Para 4.42 (Edited by Professor Howells and Professor Twigg-Flesner)

<sup>11</sup> See discussion at <http://web.iese.edu/jestrada/PDF/Research/Others/L&BE.pdf> (Accessed on 7/2/13 at 16:50)

## Options considered

### **Do nothing**

#### *Why rejected*

31. This would fail to address the consumer detriment and the costs to business listed at paragraphs 13 and 14.

### **Option 1 – consolidate existing legislation and clarify definitions, particular of exempt terms**

#### *Description*

32. This option would implement most of the Law Commission's recommendations. In summary (a fuller explanation is at Annex A), these are:

- Clarify the law by bringing consumer aspects of the Unfair Contract Terms Act (UCTA) and all of the Unfair Terms in Consumer Contracts Regulations (UTCCRs) into a single regime in the Consumer Bill of Rights.
- Change the exemption of terms relating to the 'essential bargain' of main subject matter and price of the contract, so that such terms are exempt from being assessed for fairness only if they are prominent and in clear and comprehensible language.
- Add to the existing UTCCR schedule of terms that may be assessed as unfair (the "grey list") terms that:
  - i) allow the trader to claim disproportionately high early termination charges from the consumer;
  - ii) give the trader discretion to decide the price of the contract after the contract has been entered into;
  - iii) give the trader discretion to decide the subject matter of the contract after the contract has been entered into.
- The new consolidated legislation should cover both negotiated and non-negotiated terms between businesses and consumers, as UCTA does. Currently the UTCCRs only address non-negotiated terms.

#### *Why preferred*

33. This option is preferred because it will clarify consumer rights in a way which will benefit consumers, businesses and the market as a whole.

34. This package of reforms has been broadly welcomed by consultation respondents as striking a good balance between minimising the burdens on business and maximising the benefits to businesses and consumers from clarifying and consolidating consumer law. It does not provide significant additional consumer rights but should make it easier for consumers to understand and exercise their rights and to be confident in seeking redress. Even after high profile court cases there is uncertainty as to precisely how the exemptions work and these reforms makes clear that terms describing the core bargain of the contract are exempt, providing they are prominent. This should create more "empowered" consumers who know their rights, recognise when these have been breached and if so, complain and seek redress

when necessary”.<sup>12</sup> It should reduce the number of cases where consumers over-estimate their rights and demand remedies beyond their legal entitlement, which businesses say cost them significant time and money.

35. According to the European Commission “as well as being able to maximise their own welfare, empowered consumers are a significant driver of growth, as they intensify competition and innovation.” When consumers know they are backed up by legal rights and remedies they can make their purchasing decisions based on factors such as quality and price, rather than, for example, being over-reliant on firms with a track record in fair dealing. This opportunity for lesser-known firms drives competition. The Commission also asserts that “empowered consumers who complain and assert their rights are the most effective consultants in helping businesses to innovate and improve.”<sup>13</sup>
36. In accordance with the objectives of the reforms in paragraph 24, this option would retain the existing levels of protection from UCTA alongside those in the UTCCRs. In that sense it goes further than simply copying out the Directive and so represents gold-plating. As these protections already exist in domestic legislation, this will not directly impact on business.
37. The additions to the grey list are slightly different. The grey list is in a practical sense guidance to the courts in assessing fairness of contract terms and we are not proposing to change this. The Law Commission in its consultation expressed the view that the ability of a trader to change the price (price escalation clauses or default charges) or the subject matter of a contract were already covered by the grey list but that they could be usefully made more explicit. Respondents to the consultation agreed with this. Again this will not result in a direct impact on business. (See section on OIOO).
38. Although the current list covers terms which give the trader the right to retain sums already paid by the consumer, it does not cover sums which are still due. The Law Commission recommended that a new paragraph should be added to cover terms which impose disproportionately high charges if a consumer cancels a contract. This reflected several cases (including at least one court case<sup>14</sup>) where consumers had been forced to pay high fees if they wished to get out of long term contracts for gym membership. While the OFT has recently secured voluntary agreement from several gym management firms that they will not apply such terms, to add price escalation terms explicitly to the grey list seems a proportionate way to prevent this sort of problem occurring in other sectors.

## **Option 2 – Have no exemptions from an assessment of fairness**

### *Description*

39. Some committees favoured going further than the preferred option and removing all exemptions so that even terms concerned with the main subject matter and the price would be assessable for fairness. This was justified on the basis that that the legislation should properly reflect the way consumers typically behave and should not assume that they are reasonably circumspect or likely to take rational decisions. Accordingly, even main subject matter and price terms should be assessable.

### *Why rejected*

40. This option was rejected because it would be a significant shift from the current position where the core bargain of the contract – the relationship between the goods or services and

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<sup>12</sup> EU Consumer Strategy Commission Staff Working Paper, ‘Consumer Empowerment in the EU - [http://ec.europa.eu/consumers/consumer\\_empowerment/docs/swd\\_consumer\\_empowerment\\_eu\\_en.pdf](http://ec.europa.eu/consumers/consumer_empowerment/docs/swd_consumer_empowerment_eu_en.pdf)

<sup>13</sup> *ibid*

<sup>14</sup> Office of Fair Trading vs Ashbourne Management Services, 2011

the price – is determined by the contract between business and the consumer and is subject to competition in the market, rather than review by the courts. To remove the exemptions would mean that even the core bargain of the contract could be assessable for fairness and a business would have to manage the risks involved which would be an undue burden.

## Monetised and non-monetised costs and benefits

### **Business Population**

41. The majority of businesses that sell goods and services<sup>15</sup> to consumers via consumer contracts will be within scope of the policy described in this impact assessment.
42. The total number of businesses selling either goods or services to consumers has previously been defined as all retail, accommodation, automotive and personal service enterprises<sup>16</sup>. Using this definition and the 2012 Business Population Estimates for the UK, this was estimated to be 742,000 businesses<sup>17</sup>.
43. Data from the IFF survey has enabled us to estimate the proportion of firms within this population specifically selling goods and services via consumer contracts; 54% of businesses (400,645) have pre-drafted standard terms and conditions and so are in scope of this policy. The remaining businesses are likely either to provide goods and services that don't require a contract, such as perishable goods, or they would be negotiable contracts where the price of the product will be determined as part of the negotiation such as buying a car and so will be outside the scope of the changes. Therefore we estimate that the scope of the changes will impact on around 400,645 businesses, 99% of which will be small and micro employers with fewer than 49 employees<sup>18</sup>. Table 1 sets out a summary of the estimated costs and benefits of the preferred option. These costs and benefits are described in more detail in the following paragraphs.

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<sup>15</sup> The UCT population figure includes digital content firms. This estimate includes all consumer facing businesses of which digital content firms would be a subgroupselling either goods or services.

<sup>16</sup> Department for Business, Enterprise and Regulatory Reform: Impact Assessment: The Consumer Protection from Unfair Trading Regulations (2008)

<sup>17</sup> <https://www.gov.uk/government/organisations/department-for-business-innovation-skills/series/business-population-estimates>

<sup>18</sup> Micro business accounts for 93% (692,315 businesses), small business 6% (43,550 business)

**Table 1: Summary of costs and benefits of preferred option**

Type of Cost/Benefit	Impact	High (£ million)	Low (£ million)	Best Estimate (£ million)
Transition costs to business	Familiarisation costs to business	1.91	0.74	1.32
	Cost of revising Terms and Conditions (T&Cs)	7.50	3.75	5.63
	One-off transitional legal costs	7.00	3.34	5.17
<b>Total Costs (PV)</b>				12.1
Ongoing Benefits to business	Savings from simpler complaint handling	0.53	0.11	0.32
	Savings from reduced number of issues escalating to legal proceedings	1.43	0.71	1.07
Ongoing benefits to consumers	Reduced risk of consumer detriment	2.41	0.96	1.69
<b>Total Benefit (PV)</b>				27.1
<b>Equivalent Annual Net Cost to Business</b>				0.02

## **Costs**

### **Transition Costs**

#### **Costs to business**

44. The transition costs incurred by business as a result of the proposed reforms include:

- Familiarisation costs
- Costs of revising terms and conditions (T&Cs)
- One-off transitional legal advice costs

#### *Familiarisation costs*

45. We anticipate that all businesses will incur familiarisation costs from the proposed change to unfair contract terms but these costs will be relatively small because the changes are intended to simplify existing law, making it easier to understand and apply. Moreover, as these proposals will be introduced in parallel with other reforms within the Consumer Bill of

Rights, we believe that the cost incurred may be lower than if these changes were introduced in isolation (synergy in familiarisation)<sup>19</sup>.

46. As the proposed reforms are predominantly intended to provide clarity in relation to the existing legal position, we do not think it will take more than 5-10 minutes for a staff member to become familiar with the changes. This is based on the assumption that the training for all consumer rights reform will be delivered in one session, of which 5-10 mins would be spent on the changes to unfair contract terms. This is underpinned by the plan to include an awareness campaign as part of the reforms and the reality that most businesses are informed of changes by their trade associations and businesses groups, and are likely to read purpose-drafted literature about the changes.
47. Most (93%) goods and services firms are micro businesses with 9 or fewer staff members. For these, we assume that consumer complaints are typically handled by a senior staff member (often the owner or proprietor). Therefore we have based our familiarisation cost on the wages costs for Customer Service Managers and Supervisors, at £15.55 per hour<sup>20</sup>. Assuming the time taken for familiarisation is 5-10 mins as noted above, the average cost per business would be £1.30 to £2.60. Extrapolated across the business population<sup>21</sup> who have existing Terms & Conditions (400,645 businesses), the overall cost is in the range £0.52m to £1.04m, with a best estimate of £0.78m.
48. For larger firms with 10 or more employees, we have assumed that staff at management level would be familiarised with the reforms (included above at the same wage cost noted above for customer service managers and supervisors). We estimate that in addition, there would also be familiarisation costs in training 5-10 frontline staff members on the reforms at an hourly cost of £9.78<sup>22</sup>. This will result in an overall cost for larger firms in the range £0.22m to £0.87m, with a central estimate of £0.55m.
49. In total, we estimate in-scope businesses will incur familiarisation costs of £0.74m to £1.91m, with a mid point best estimate of £1.32m.

### *Cost of ensuring Terms and Conditions (T&Cs) are compliant<sup>23</sup>*

50. According to the IFF responses, 54% of businesses have pre-drafted T&Cs which will have to be revised to comply with the proposed changes. Therefore these firms will incur costs to ensure the T&C are compliant with the proposed changes. We have assessed this impact in two ways; costs of reviewing T&Cs and the costs of changing T&Cs. This provides a range of estimates which reflects the expected variation in costs; businesses with T&Cs that are already compliant, only needing to be checked and the remaining businesses needing to make changes to become compliant, thus incurring higher costs.
51. We assessed the costs by firm size to take account of the differing costs associated with size (micro and small/medium/large). From the IFF costs sheet responses, we estimated the average annual cost of changing T&Cs at £83 for micro businesses and £331 for larger firms<sup>24</sup>. From the IFF survey we have evidence of how often T&Cs are changed<sup>25</sup> – at least

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<sup>19</sup> Cited within British Retail Consortium in discussions with Department for Business, Innovation and Skills Policy Officials

<sup>20</sup> This is based on ASHE 2012 hourly wage of £13.58 for Customer Service Managers and Supervisors, with non-wage labour costs at 14.5%, giving an hourly cost of £15.55

<sup>21</sup> Business population for businesses selling goods and services to consumers via consumer contracts is 400,645

<sup>22</sup> Based on ASHE 2012 hourly wage for frontline customer service occupations at £8.54, uprated to include 14.5% non-wage labour cost is £9.78 per hour.

<sup>23</sup> Policy changes in the Consumer Rights Directive and the Unfair Contract Terms will require changes to terms and conditions. It will only be necessary for businesses to change their terms and conditions once but estimating the cost of making the specific changes for Consumer Rights Directive and Unfair Contract Terms has proven impossible so we have split the costs 50/50 between the Consumer Rights Directive and Unfair Contract Terms.

<sup>24</sup> There are 373,850 micro businesses and 26,795 small / medium and large businesses in scope of this impact.

<sup>25</sup> IFF Survey Table 26/3



every 12 months, between every year and every 2 years and less often/ad hoc reviews. We have attempted to incorporate the regularity of change into our analysis<sup>26</sup>:

- 26% of businesses change their T&Cs at least yearly<sup>27</sup>. We do not envisage any additional costs for them from this measure because the lead-in time for implementation allows them to take account of the change in their regular update;
- 30% businesses change T&Cs every 1 to 2 years. It may be that the changes will require these firms to bring forward a review and so some additional costs will be incurred. We have taken account of this impact by discounting their average annual review costs i.e. they should not incur the full cost of change but a proportion because it is done in advance of their preferred time for updating<sup>28</sup>;
- 30% businesses only change T&Cs less often or on an ad hoc basis and as with the previous category, they should not incur the full cost of a change but a proportion based on bringing forward the update from their preferred date<sup>29</sup>;
- 14% of firms do not change their T&Cs<sup>30</sup>. This category includes firms that never review or don't know when they will review. We believe that this group will incur the full annual cost of a change.

52. By combining the costs accruing across the categories of business, we have estimated the cost of changing T&Cs at £3.75m. We take this as our lower bound estimate of the costs involved in ensuring T&Cs are compliant.

53. The lower bound estimate of ensuring T&Cs are compliant includes the cost to business of developing new consumer contracts, invoices, advertising and notifying customers. Businesses that are already compliant with the regulations and don't have to make any changes will not incur these costs but will review their terms and conditions to ensure compliance. We believe the majority of these costs will be covered by firms seeking external legal advice, and becoming familiar with the changes. However evidence from the IFF survey indicates a significant difference between the cost to business of changing their T&Cs and the combined cost of reviewing and updating. To account for this we have cautiously assumed that the upper bound estimate for becoming compliant is twice the size of the lower bound or £7.5 million, with a best estimate of £5.63 million.

### *One-off transitional legal costs*

54. We believe that the legal nature of these reforms will initially lead some businesses to seek additional external legal advice; this will be a one-off transition cost to help business apply the reforms such as ensuring their terms and conditions comply with the policy changes. From the IFF survey we know that 54% of businesses have pre-drafted standard terms and conditions and that a proportion of these firms are likely to employ external legal advice (approximately 22%) to ensure they are compliant. We have estimated a potential increase of 10-20% as a result of understanding and applying these reforms. Using the legal advice costs provided by firms in the IFF survey, we have calculated the average annual legal costs

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<sup>26</sup> This involves discounting the costs to take into account the realistic impact of making businesses revise T&C before their preferred date.

General discounting formula =  $1/((r)^t)$

<sup>27</sup> 26% = 104,168 businesses. To calculate the average time that the review is being brought forward, we have assumed that businesses are uniformly distributed across the time period before their next review.

<sup>28</sup> 30% = 120,193 businesses - discount rate of  $1/((0.035)^{0.5})$  with the uniform distribution half of these businesses will have their review in the year up to implementation. Therefore incur no costs. The remaining firms will be between a year and a small amount of time before their next review and so the average time period before the next review is 6 months. This means that for micro business the discounted value of the update will be £81.68 and for small to large businesses £325.72 so 1.73% (percentage difference between £83 and £81.68) of the cost of the update has been brought forward.

<sup>29</sup> 30% = 120,193 businesses - discount rate of  $1/((0.035)^{4.5})$  using a similar method to above, 10% of businesses will have their review in the period up to implementation and so incur no cost. The remain firms will be up to 9 years away from their review and so the average firm will be 4 and a half years from review. The discounted cost to business is £71.18 for micro business and £283.85 for small to large businesses, therefore 17% of the cost of the update has been brought forward.

<sup>30</sup> 14% = population of 56,090 businesses

for micro businesses and larger firms<sup>31</sup> at £309 and £853 respectively resulting in costs across the in-scope population of £3.18m to £6.36m and a best estimate of £4.77m.

55. In addition, we believe that some firms that do not currently seek legal advice will now need to on a one-off basis as a result of the proposed reforms. We have estimated that this will involve a further 5-10% of the business population. We envisage that there will be a 10-20% increase in costs as firms seeks to ensure they are compliant with the reforms similar to those already using external legal advice. Using the average annual legal costs as outlined above, we have calculated the costs to the additional businesses seeking external legal advice at £0.16m to £0.64m, with a best estimate of £0.40m. While this is a significant cost upfront, it should lead to savings for firms in the longer term as they experience fewer complaints escalating to court cases (discussed under benefits to business section).
56. In total, the initial increase in legal advice costs due to the changes is estimated at £3.34m to £7.0m with a best estimate of £5.17m.

## **Benefits**

### **Ongoing benefits**

#### **Benefits to business**

##### *Simpler complaint handling*

57. A key objective of the proposed reform is to provide clarity for consumers and businesses on their rights and obligations on contract terms. According to the Consumer Detriment Survey 2012, unfair contracts and contract T&Cs accounted for 4-10%<sup>32</sup> of all consumer problems<sup>33</sup>. We envisage that the proposed changes will result in quicker and easier handling of complaints for business, where less time and staff resource will be required to resolve issues including a reduced number escalating to court cases. Savings under this impact include moving complaints handling to more junior staff because procedures can be simplified. We have estimated the potential savings to business using ranges for both the number of complaints (4-10%) and the time savings (5-10 mins) accruing to firms. For this we calculated a saving of £0.11m to £0.53m with a best estimate of £0.32m.

##### *Savings from reduced number of issues escalating to legal proceedings*

58. The clarification through the proposed reforms is expected to reduce the number of consumer complaints which escalate into court cases. This is based on clarifying the language of the legislation and raising the understanding of both consumers and businesses on rights and obligations.
59. The IFF survey indicated that only a small percentage of businesses (5%) with pre-drafted T&Cs incurred costs for legal proceedings in the previous year and so we assume that only a small proportion of the business population will experience savings; - complaints are less likely to end up in court because the T&Cs will be clearly set out.
60. Using IFF survey evidence, we calculated the impact of less cases escalating to legal proceedings by splitting business into two groups – micro and small/medium/large – as the

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<sup>31</sup> There are approximately 692,315 micro businesses and 49,620 larger businesses (this group includes small, medium and large businesses).

<sup>32</sup> Question 2, Show Card B- Multi choice.

<sup>33</sup> The three relevant categories are Contracts, terms and Conditions (4%), Unfair terms (4%) and Contract terms were not clear or did not provide enough information (2%). The survey allowed more than one response per consumer therefore there may be some double answers resulting in a 4-10% proportion across all three categories.

estimated costs varied significantly based on business size. These savings were calculated on the business population that have pre-drafted T&C and currently incur external legal advice, with 18,693 micro businesses firms and 1,340 larger firms in scope<sup>34</sup>. The average annual legal costs are £655 for micro firms and £1,507 for small, medium and large firms. We have conservatively estimated a saving of 5-10% as a result of the clarifications as stakeholders have indicated that they expect the clarifications to lead to reduced court cases but did not provide figures on expected savings. From the above, we estimate that the annual savings to business will be between £0.71m and £1.43m, with a best estimate of £1.07m. This is also likely to be a conservative estimate as it is based on the cost of legal fees and not on the full cost of going to court to contest the case (e.g. time spent not on the shop floor).

*Reduced costs of revising simpler terms and conditions*

61. We believe that there will be savings to business from amending T&Cs in line with the clarified law (one-off costs analysed above) meaning there is a reduced need for ongoing review and update to remove confusion. It has not been possible for us to quantify or monetise the reduced costs to business of revising T&C at this point. However, this will be considered for inclusion in the Post Implementation Review (see Annex B).

Benefits to Consumers

*Reduced risk of consumer detriment*

62. According to the Consumer Detriment Survey 2012, unfair contracts and T&Cs accounted for 4-10% of all consumer problems. We believe that the proposed reforms on contracts will result in benefits to consumers through reduced risk of consumer detriment. This is where businesses have existing contracts which may cause consumer detriment and will now be amended in line with the legislative changes. We have previously included a figure for reduced risk of consumer detriment for the changes in the Goods, Service and Digital Content impact assessments. Using the proportion of problems attributed to unfair contracts in the Consumer Detriment Survey, we estimate that the risk of consumer detriment could be reduced by £1.69m to £1.84m<sup>35</sup> over the life of the policy reforms, as outlined in Table 2 below.

**Table 2: The ongoing net benefit to consumers from reduced risk of detriment: UCT (£ millions)**

	Year									
	0	1	2	3	4	5	6	7	8	9
<b>Best</b>	1.69	1.70	1.72	1.74	1.75	1.77	1.79	1.81	1.83	1.84
<b>Low</b>	0.96	0.97	0.98	0.99	1.00	1.01	1.02	1.03	1.04	1.05
<b>High</b>	2.41	2.43	2.46	2.48	2.51	2.53	2.56	2.58	2.61	2.63

*Increased redress payments*

63. Some benefits may accrue to consumers because of increased redress payments under the proposed reforms where cases escalate to court. However, we have not quantified or monetised these impacts as we believe that businesses on finding their contract terms in breach of the law will act to bring them in line with compliance and this impact will therefore be negligible.

<sup>34</sup> These figures are based on total populations of which 54% have pre-drafted T&C (equalling 373,850 micro businesses and 26,795 larger businesses), with a subsequent 5% seeking external legal advice in the previous year.

<sup>35</sup> Consumer detriment avoided increases annually by 1% taking account of expected year-on-year increases in household expenditure

## One-in, One-out

64. This measure is in scope of OIOO as it has direct impacts on business. The Government expects the proposed changes to result in an IN of £0.02m. This has been calculated on the basis of best estimate calculations on impacts which are direct and in scope for businesses as follows:

### Costs:

- One-off familiarisation costs for business of £1.32m
- Transitional, one-off legal advice costs of £5.17m
- Cost of updating terms and conditions of £5.48m

### Benefits:

- Time savings from simpler complaint handling of £0.32m per year;
- Savings from reduced number of cases escalating to a court case of £1.07m per year;

65. This measure involves goldplating the Unfair Terms Directive (UTD), although only to reflect the consumer protections that currently exist in domestic legislation. Therefore we do not believe that the goldplating in this measure is in scope of OIOO as it results from retaining pre-existing UK standards.

66. Over the life of this measure there are direct annual costs of £1.4m and direct annual benefits of £1.4m accruing to business, netting to an IN of £0.02m (Equivalent Annual Net Cost to Business).

## Risks and assumptions

67. The key risk is that in clarifying and consolidating the law, the level of consumer protection and/or the burden on business will be inadvertently and negatively affected. By asking the Law Commission to consult widely with consumer groups, businesses, business groups and legal experts, we are confident that this risk has been mitigated.

## Alternative Approaches for Small/Micro Businesses

68. We do not propose to exempt small or micro businesses from the new consumer protection regime as this would be detrimental to consumers and businesses, and would hinder rather than improve market conditions.

69. At the beginning of 2012 small and micro-businesses accounted for 99% of businesses in scope of this policy (i.e. selling goods and services via contacts)<sup>36</sup>. All such businesses are subject to the existing consumer law. To exempt such a large proportion of businesses from the new consumer protection regime would create an even more complex legal regime with consumer rights varying according to the size of the trader. This would deprive the changes

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<sup>36</sup> <http://www.bis.gov.uk/assets/biscore/statistics/docs/b/12-92-bpe-2012-stats-release.pdf>

of most, if not all, of their desired clarity and would disadvantage the small and micro-businesses it purported to protect.

70. Responses to the BIS consultations on other parts of the Consumer Bill of Rights (goods, service and digital content)<sup>37</sup> showed strong and widespread support for applying the consumer protection regime to all businesses, regardless of size. There was no support for a small or micro-business exemption. The reasons respondents gave for supporting the application of a uniform regime across businesses of all sizes were numerous. In particular it was noted that any exemption:

- would be counter-productive, and detrimental to small and micro businesses, as consumers would be discouraged from buying from them. Consumers would be encouraged to stick to large businesses and would be less likely to try out new suppliers, hindering innovation and growth and creating obstacles to market entry<sup>38</sup>;
- would not encourage business growth, and would cause problems to businesses looking to expand beyond the small business threshold<sup>39</sup>;
- would allow rogue traders to continue to operate, benefiting from the opacity of the current law and might encourage unscrupulous traders to manipulate the way they trade in order to fall into the exemption<sup>40</sup>; and
- would cause confusion among businesses, consumers and enforcers, undermining the aim of achieving a clear and consistent consumer protection regime<sup>41</sup>.

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<sup>37</sup> <http://discuss.bis.gov.uk/consumer-bill-of-rights/>

<sup>38</sup> Response to Department for Business, Innovation and Skills Consultation on Clarifying Consumer Law 2012 - BVRLA, Consumer Focus, Retail Motor Industry Federation, Electrical Safety Council, British Retail Consortium, Ofcom, Citizens Advice, various local Trading Standards Services

<sup>39</sup> Ibid - Trading Standards Institute, Retail Motor Industry Federation

<sup>40</sup> Ibid - Retail Motor Industry Federation, Electrical Safety Council, Which?, Citizens Advice);

<sup>41</sup> Ibid - Co-operative Food, Law Society of Scotland, Consumer Focus, British Retail Consortium, Finance and Leasing Association, Citizens Advice Scotland, Ofcom, Direct Line Group, Bar Council, Citizens Advice, various local Trading Standards Services

## **Annex A – Full list of proposed changes to unfair contracts legislation**

The following changes are in response to the Law Commission's recommendations (due to be published at the end of March)

- Clarify the law by bringing consumer aspects of the Unfair Contract Terms Act (UCTA) and all of the Unfair Terms in Consumer Contracts Regulations (UTCCRs) into a single regime in the Consumer Rights Bill.
- Change the exemption of terms relating to the 'essential bargain' of main subject matter and price of the contract, so that such terms are exempt from being assessed for fairness only if they are prominent and in clear and comprehensible language.
- Clarify how the terms on the grey list are assessable for fairness.
- Add to the grey list terms that:
  - i) allow the trader to claim disproportionately high early termination charges from the consumer;
  - ii) give the trader discretion to decide the price of the contract after the contract has been entered into;
  - iii) give the trader discretion to decide the subject matter of the contract after the contract has been entered into.
- The new consolidated legislation should use the fairness test in the Unfair Terms Directive, rather than that in the UCTA.
- The new consolidated legislation should apply throughout the UK rather than having separate provisions for England, Wales and Northern Ireland on the one hand, and for Scotland on the other (as in the UCTA).
- The new consolidated legislation should retain the UCTA provisions concerning terms that purport to exclude liability for causing death or personal injury to include those that result from negligence or a breach of duty. Such terms should always be regarded as unfair.
- The new consolidated legislation should cover both negotiated and non-negotiated terms between businesses and consumers, as UCTA does. Currently the UTCCRs only address non-negotiated terms.
- The new consolidated legislation should retain the UCTA provision placing the burden of proof on the business to show that a term is fair. In addition, the legislation should codify the case law to make clear that the court is entitled to consider the fairness of a term, even if the consumer has not raised the issue.

## Annex B: Post Implementation Review (PIR) Plan

<p><b>Basis of the review:</b></p> <p>This Impact Assessment includes a commitment to review the proposed changes 3-5 years after implementation.</p>
<p><b>Review objective:</b></p> <p>To assess:</p> <ul style="list-style-type: none"><li>• whether the policy changes are meeting policy objectives</li><li>• reduce the number of disputes regarding contracts' terms and conditions</li><li>• whether policy objectives are in practice feeding through to increased consumer empowerment.</li></ul>
<p><b>Review approach and rationale:</b></p> <p>The review would evaluate the effectiveness of the changes within this Impact Assessment. The review will incorporate stakeholders' views that will include consumer groups, business groups, and the Citizens Advice services.</p>
<p><b>Baseline:</b></p> <p>Total detriment suffered by consumers has been estimated at £3.08 billion per year. This results from a wide variety of consumer problems with unfair contracts and terms accounting for 4-10%.</p>
<p><b>Success criteria:</b></p> <p>Increased consumer empowerment, reduction in consumer detriment, reduced disputes including court cases.</p>
<p><b>Monitoring information arrangements:</b></p> <p>Feedback from businesses and consumers groups will be achieved through regular engagement. The transition costs will be recorded during the implementation stage and Government will monitor the ongoing impacts via annual reports and management information.</p> <p>More general information about the impacts on business from the proposed changes will be collected from business groups and through surveys.</p>
<p><b>Reasons for not planning a review:</b></p> <p>N/A</p>

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