Towards a Fairer Trading System for Micro and Small Businesses Post-Brexit? Comparative Aspects with Other Common Law Systems

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Abstract This chapter explores the position that the English legislator and courts would have on the issue of imposing unfair contract terms on Micro and Small Businesses (MSBs) in the post-Brexit era. The chapter looks into the extent that current applicable law and developments in English contract law offer protections for contractual trading with MSBs. In the presence of current legal gaps with regards to such protections that often lead to abuse by larger corporations there might be some solutions available in the current law to deal with the invalidation of unfair contract terms in Business to Business (B2B) transactions involving MSBs, however these still do not deal with the issue in its entirety and are also met with limitations. Given the uncertain developments on this matter after Brexit the chapter considers a brief comparative analysis with other common law jurisdictions on the issue as they might influence possible future reforms. The comparative analysis consists of examining the protections available on imposing unfair contract terms on small businesses in the Australian and the US legal systems. This chapter thereby analyses what possible solutions can be raised in dealing with this pressing issue after Brexit by considering these comparative results.

Keywords Unfair contract terms, Commercial Contracts, Micro and Small Businesses (MSBs), Comparative law, Brexit

1 Introduction

According to a statement made by the Department for Business Innovation and Skills (now part of the Department for Business, Energy and Industrial Strategy) in 2015, micro and small businesses made up to 99% of businesses in the UK and had a combined turnover of £655 billion.[1] It has been reported since that the number of these enterprises has risen in 2016 to constitute over 99% of the UK private sector businesses.[2] Micro and small businesses (MSBs) therefore form

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[1] Call for Evidence on Protection of Small Businesses When Purchasing Goods and Services by the Department for Business Innovation and Skills.

[2] According to the Federation of Small Businesses (FSB) small businesses accounted for 99.3% of all private sector businesses at the start of 2016 and 99.9% were small or medium-sized (SMEs). More information available at https://www.fsb.org.uk/media-centre/small-business-statistics

part of the UK's economic backbone as they are one of the key contributors to the current economy. A micro entity is defined in Section 384A of the Companies Act 2006 as consisting of not more than ten employees and having not more than £632,000 in turnover. Whereas a small business is defined in Section 382 of the same Act as consisting of not more than fifty employees and having a turnover of not more than £10.2 million. For the purpose of this chapter, MSBs will also encompass Medium enterprises that are defined in Section 466 of the same Act as not consisting of more than 250 employees and having a turnover not exceeding £36 million net or £43.2 million gross. The importance of MSBs has been gaining momentum as in the age of the digitisation of commerce the number of such businesses is on the rise.[3]

Despite their important contribution to the economy, MSBs remain as weaker parties in commercial agreements with larger companies due to their weaker bargaining position that has an impact over the negotiations and performance of their business contracts. MSBs have been undergoing a number of commercial pressures that include the imposition of unfair contract terms into their agreements with larger corporations. Thus, unfair commercial practices such as late payments are being imposed as part of the contract or during the performance of the contract. Other abusive terms and practices that are being imposed on MSBs consist of terms that make it hard for a business to cancel a long-term contract, terms that commit the business to paying price increases and terms that require full payment in advance for goods or services among others.[4]

The main reasons behind the vulnerability of MSBs with regards to their larger business counterparts are the lack of time, expertise, information, sufficient capital for access to legal advice, experience and economic independence.[5] Moreover, the majority if not all unfair contract terms are imposed in standard form contracts with the MSBs which means that the MSB is not given a chance to negotiate the terms of the business agreement.[6] However, even if given a chance to negotiate contract terms MSBs would not have much room for negotiation due to the greater market power that the larger corporation has in comparison. This means that the position that MSBs have on the market then is similar to that of a consumer as a party who is worthy of more contractual protection.[7] The imposition of unfair contract terms on MSBs normally have

[3] See The Chartered Trading Standards Institute E-Commerce Crib Sheet for Local Authority Regulators of January 2017 https://www.tradingstandards.uk/media/documents/news--policy/lead-officer/e-commerce-crib-sheet-for-regulators-v-10.pdf

[4] See Schleper M, Blome C, Wuttke D (2017), p 98 for case examples of the use of these contract terms.

[5] See Hesselink M (2008), p 32.

[6] See Van Loock S (2014), p 89.

[7] Dias Simões F (2014), p 19.

detrimental effects as this can lead to capital constraints and even the closure of the business itself due to the emergence of cash flow problems.[8]

1.1 The Legal Issues with Unfair Contract Terms in B2B Contracts Involving MSBs

The legal dilemma currently faced by MSBs in the UK is that there is a legal gap for protections against the imposition of unfair contract terms upon them. The only available legal instrument that applies to such terms in Business to Business (B2B) contracts is the Unfair Contracts Terms Act (UCTA) 1977. However, the UCTA is limited in its scope of application as it only applies to exclusion and limitation of liability clauses that are deemed as unfair. There were suggestions for implementing unfair contract terms protections for micro businesses by a Law Commission report of 2005[9], but no further action was taken on the matter.

The concern for the protection of micro and smaller businesses as weaker parties in business transactions with larger corporations was voiced by the European Parliament and the European Commission in 2006.[10] Although no further action was taken by the European institutions on the issue, recital 13 of the Directive 2011/83/EU of the European Parliament and of the Council on consumer rights states that Member States are competent to apply the Directive to scopes beyond consumer rights. The Directive suggests that Member States have the liberty of choosing to apply the rules of the Directive to legal persons or natural persons such as start-ups or SMEs.[11] However, the UK did not adopt this suggestion and there remains a legal gap with regards to the protection of MSBs against unfair contract terms. It will be seen nevertheless in section 2.2.3 of this chapter that other European measures have been adopted to tackle certain aspects of this issue.

Given this legal gap, the Federation of Small Businesses (FSB) has called for improved protections for MSBs when buying goods and services.[12] The FSB has called for the Government and regulators of energy, financial services and telecoms to focus on small business vulnerabilities and suggested that Trading Standards[13] should also be given the power to take action against suppliers

[8] According to a study carried out by the FSB half (52%) of small firms have been affected by unfair contract terms with suppliers, costing them nearly £4 billion in the last three years. Results available at http://www.fsb.org.uk/media-centre/press-releases/unfair-contract-terms-costing-small-firms-billions

[9] See The law commission and the Scottish law commission (law com no 292) (scot law com no 199) (2005).

[10] See European Parliament resolution on European contract law and the revision of the acquis, pp 109-112.

[11] Official Journal of the European Union L 304, 22 November 2011, 65.

[12] See Fletcher A, Karatzas A and Kreutzmann-Gallasch A (2014).

[13] Trading Standards offices are governmental authorities that have the duty to ensure consumer protection and support legitimate business activity.

imposing unfair terms.[14] A call for evidence for purchasing goods and services by MSBs was made by the Government in 2015, but no further action was taken upon the issue so far with regards to unfair contract terms.[15]

Therefore, it remains clear that one of the issues in need of legal regulation concerns unfair contract terms imposed in B2B contracts where MSBs are involved. The rising importance of MSBs in the UK economy demonstrates the need for current legislation to keep up with the regulation of trade involving these smaller entities. The introduction of such reforms has been met with concern from the Government as it stated that MSBs do not only act within their quality as customers, but mainly as business suppliers which shows the difficulties in shaping legal protections for these smaller businesses.[16] Whilst it is true that MSBs are not necessarily weaker parties in all business contexts, these entities still require further protection on the contractual front.[17]

1.2 Aims and Objectives of the Chapter

Given the trend of 'Europeanisation' that has introduced the application of notions of fairness in contracts as a result of the influence of EU law especially in the context of consumer contracts and the protection of weaker parties to the contract more generally, the question that ensues is what position the UK Government will have on the imposition of unfair contract terms on MSBs post-Brexit. This question is important as legal developments on this issue could have an important impact on the viability of small businesses and consequently on the economy as a whole. The arguments advanced in this chapter argue that an improved regulation of trade involving MSBs would encourage an increase in their creation which would lead to boosting trade and economic development.[18]

This chapter thereby aims to explore the position that the English legislator and courts would have on the issue of effectively imposing unfair contract terms on MSBs in the post-Brexit era. The discussion aims to analyse whether there are solutions to this issue as a result of the current legal developments in English contract law with regards to the protection of weaker parties to the contract. In this light, the chapter seeks to observe what position other common law systems

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[14] FSB press release on unfair contract terms costing small firms billions, available at https://www.fsb.org.uk/media-centre/press-releases/unfair-contract-terms-costing-small-firms-billions

[15] See Call for Evidence on Protection of Small Businesses When Purchasing Goods and Services by the Department for Business Innovation and Skills.

[16] Ibid.

[17] See Dias Simões F (2014).

[18] A poll by the Forum of Private Business (FPB) has said the growth of UK SMEs is being undermined by spiralling costs of doing business, suffocating red tape and bullying tactics from big companies, available at http://www.howardworth.co.uk/red-tape-and-bullying-from-big-firms-continue-to-affect-smes-4453/

such as Australia and the US have adopted on this particular matter given that they are also potential future trading partners with the UK that could eventually influence the development of English rules on contracts. This chapter consequently seeks to analyse what the future of unfair contract terms with MSBs in English law could be and what legal reform in the post-Brexit era could bring to the issue.

In order to answer these questions, the chapter will first examine in Section 2 the legal developments, the current applicable law and potential solutions to the use of unfair contract terms in B2B contracts with MSBs in English contract law. In Section 3, the chapter will carry out a comparative observation of the approach of the issue in the Australian and US legal systems. Finally, Section 4 will effect an analysis of the comparative results of this chapter's discussion in order to show a potential outcome that English law could have on the issue of unfair contract terms after Brexit.

2 The English Legal Framework on Unfair Contract Terms in B2B Contracts: Recent Developments, Current Law and Potential Solutions

2.1 The Legal Developments on Unfair Contract Terms in B2B Contracts in English Law

The most recent legislative initiatives that have been introduced for a more extensive policing of unfair contract terms in B2B contracts with MSBs include the Groceries Supply Code of Practice (GSCOP). Nonetheless, more transparency on payment methods used by larger companies has been imposed by the Small Business, Enterprise and Employment Act 2015. Also, the EU adopted Directive 2011/7/EU on combating late payment in commercial transactions in February 2011 that succeeded the 2000 late Payment Directive.[19] This legal instrument was transposed into English law through the Late Payment of Commercial Debts Regulations 2013. Although these last texts do not directly govern unfair contract terms, they do have as their objective to tackle the late payments problem which is normally an abusive term used in contracts with MSBs as mentioned at the beginning of this chapter.[20]

2.1.1 The Groceries Supply Code of Practice (GSCOP)

The Groceries Supply Code of Practice (GSCOP) came into force in February 2010 to replace the Supermarkets Code of Practice. The GSCOP was created as a result of a recommendation by the UK Competition Commission due to the

[19] Directive 2000/35/EC OF THE European Parliament and of the Council of 29 June 2000 on combatting late payment in commercial transactions.
[20] See Section 1 of this chapter.

inefficiency of its predecessor. It is a commercial code of practice and does not have a legislative value, however, it is true that the role of the Grocery Adjudicator increases its enforcement value.

The Supermarkets Code of Practice was first suggested by the Competition Commission as the outcome of an inquiry conducted by the Commission.[21] The inquiry found that supermarkets were acting contrary to public interest by reducing the choice and quality of goods. The inquiry was started as a request by the Office of Fair Trading (OFT) after a number of complaints for abusive behaviour by supermarkets was filed by suppliers. The OFT thereafter introduced the Supermarkets Code of Practice to deal with the abusive behaviour of supermarkets with regards to the suppliers in 2002.

The Supermarkets Code of Practice applied to supermarkets that benefited from at least 8% of grocery purchases which in fact consisted of the UK supermarket chains of Asda, Safeway, Sainsbury and Tesco. The Code of Practice applied to contracts that these major supermarkets concluded with suppliers. In trying to control unfair contract terms and practices the Supermarkets Code of Practice imposed a number of principles that needed to be respected by the supermarkets in question. The Code stated that there would not be undue delay in payments, that there would be no retrospective reduction in price without reasonable notice, and that a supermarket should not directly or indirectly require a supplier to reduce the agreed price of or increase the agreed discount without reasonable notice among other provisions. If a claim of breach of any of the provisions of the Code ensued, the parties necessitated to first attempt to resolve the matter themselves. If this was to fail then the parties had to go through mediation, and if that failed again then the case could have been advanced to the OFT's Director General either by the supplier itself or by their trade body.

However, as part of an independent audit in 2005, it was shown that supermarkets did not change their abusive practices therefore demonstrating the inefficiency of the Supermarkets Code of Practice. It appeared that the Code was being breached without any reports or claims being raised regarding the breach.[22] In its 2004 review of the efficiency of the Code, the OFT reported that the inequality of bargaining power between the MSB supplier and the supermarket meant that the supplier felt pressured not to make any claims unless there was hard evidence against the supermarket, which was very difficult to achieve given the context. Therefore, the Supermarkets Code of Practice had failed to control the imposition of unfair contract terms on the

[21] Shears P (2013), p 60.
[22] Ibid, p 62.

MSB grocery suppliers mainly due to the fear of the economic consequences of making a complaint.[23]

In 2008, the Competition Commission recommended to replace the above text with the GSCOP and to also establish a special adjudicating body to tackle complaints arising from the application of the GSCOP. The GSCOP applies to 10 UK retailers who have a turnover in the groceries market that goes over one billion GBP. These retailers are Tesco, Asda, Sainsbury's, Morrisons, Waitrose, M&S, Aldi, Lidl, Iceland and the Co-op.[24] The Code applies to these retailers and their direct suppliers.[25]

The GSCOP introduced a somewhat revolutionary provision that governs the Code as a whole. This provision is the principle of fair dealing that is imposed under Section 2 of the Code and stipulates that:

> a Retailer must at all times deal with its Suppliers fairly and lawfully. Fair and lawful dealing will be understood as requiring the Retailer to conduct its trading relationships with Suppliers in good faith, without distinction between formal or informal arrangements, without duress and in recognition of the Suppliers' need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues.

It can be argued that this provision imposes the obligation on the retailer not to impose terms that are contrary to ideals of good faith or fairness, which means that the retailer would not be able to impose terms that are deemed unfair.

This is considered to be a big step in protecting MSBs as there is generally a rejection to apply a general duty of good faith and fair dealing in English contract law,[26] especially in the context of B2B contracts. This general provision on the duty to act in accordance with standards of fairness specifically states that the retailers are not allowed to use undue commercial pressure on the suppliers who are normally MSBs to make them accept terms that are detrimental to them. This includes terms that affect the costing of goods and payment times.

To this effect, the following sections of the GSCOP provide a clear obligation for the retailer not to vary supply agreements retrospectively, to pay suppliers within a reasonable time, not to oblige suppliers to contribute to marketing costs, not to make them pay for shrinkage, not to put additional payments on the

[23] Ibid, pp 62-63.
[24] The Groceries (Supply Chain Practices) Market Investigation Order, 2009, Schedule 2 available at http://webarchive.nationalarchives.gov.uk/20111108202701/http://competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf
[25] Ibid, p 63.
[26] See Section 2.2.2 of this chapter.

suppliers for better positioning of goods unless this is related to promotions, to provide compensation for forecasting errors, to take due care when ordering for promotions and there are limited circumstances for payments as a condition of being a supplier among other provisions.[27] The retailers that come under the application of the GSCOP are not allowed to enter into or perform a supply agreement unless the Code's standards are incorporated and that such agreements would not include any stipulations contrary to the Code's standards.[28]

The GSCOP is considered to be more successful than its predecessor due to the amelioration of the dispute resolution procedure that the parties, and more particularly the suppliers, can be benefit from. The GSCOP is accompanied by the Groceries Code Adjudicator Act 2013 which established the powers of the Code Adjudicator to be able to police the dispute arising from the application of the Code.[29] According to the Groceries Code Adjudicator Act 2013 the adjudicator has the power to arbitrate the dispute,[30] the Adjudicator can open investigations for suspected breaches of the GSCOP by a large retailer if there has been a complaint by a supplier,[31] and in cases where he finds that there has been breach by the retailer of the Code he has the power to make recommendations, publish information in the aim of naming and shaming the retailer in question and to impose fines.[32] In addition, in order to deal with the intimidation issue that suppliers felt under the Supermarkets Code of Practice, the Grocery Adjudicator can use evidence forwarded by third parties including whistleblowers and trade associations to carry out investigations against retailers who have been accused of using unfair trading practices with their suppliers.[33] Also, the Adjudicator has the duty of confidentiality with regards to the identity of the complainant supplier in order to encourage suppliers to feel confident enough to file claims against breaches by the retailers.[34]

In sum, it can be argued that the GSCOP has further developed the controls over unfair contract terms in contracts with MSB suppliers in comparison to the

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[27] For a more extensive understanding of the provisions of the GSCOP see the GSCOP available at https://www.gov.uk/government/publications/groceries-supply-code-of-practice/groceries-supply-code-of-practice#no-delay-in-payments

[28] Shears P (2013), p 63.

[29] Ibid.

[30] Section 2 of the Act.

[31] Section 4 of the Act.

[32] Section 6 of the Act.

[33] See Schedule 2 of the Act.

[34] Section 18 of the Act; this has given some successful results as for example Tesco was named and shamed for its breach of the GSCOP for delays in payment as can be seen at https://www.gov.uk/government/news/tesco-breached-code

Supermarkets Code of Practice. This is mainly through the fairness principle that is imposed throughout the GSCOP, but most importantly through the innovative dispute resolution procedure of the Groceries Adjudicator that allows for more MSB suppliers to be encouraged to file claims against retailers and the powers that the Adjudicator has in order to enforce the application of the GSCOP by the retailers. This new dispute resolution procedure has also allowed for a stronger enforcement of the Code and its application by the larger retailers in question.

Nevertheless, the GSCOP has limitations with regards to the advancement of the law on unfair contract terms in B2B contracts involving MSBs in English law as it only applies to grocery retailers and these retailers with a turnover in the groceries market of over one billion GBP.[35] Thus, for the retailers that do not cover the groceries sector, for grocery retailers who do not meet this threshold, or for larger businesses that are not retailers they would still be legally able to impose unfair contract terms on MSBs. Also, questions of the efficiency of the GSCOP ensue with regards to its efficacy as only a small number of claims have been raised for its breach by suppliers.[36]

2.1.2 The Small Business, Enterprise and Employment Act 2015: More Transparency on Payment Methods by Large Companies

In order to further tackle unfair practices suffered by MSBs as a result of their imposition by large businesses the Small Business, Enterprise and Employment Act 2015 was created. One of the areas covered by this Act includes the issue of late payments by these larger corporations. The Small Business, Enterprise and Employment Act 2015 was enacted in order to render the UK a more attractive place to start a business, particularly a small business, by aiming to reduce a number of market barriers that these small businesses face when trying to compete and grow on the market. The Act touches on a number of issues such as business payment practices and other issues dealing with transparency regarding corporate activities.

Concerning the business payment practices issue, Section 3 of the Act imposes on large companies the obligation to publish their payment practices and performance. This provision aims to put pressure on large businesses to make

[35] The GSCOP has been praised to be one of the most successful texts within the EU Member States for policing unfair contract terms in B2B contract as can be seen from the final report of 26 February 2014 prepared for the European Commission, DG internal market DG MARKT/2012/049/E on the study on the legal framework covering business-to-business unfair trading practices in the retail supply chain.

[36] See the retailers' GSCOP reports for 2014-2015 available at http://www.britishbrandsgroup.org.uk/upload/file/GSCOP%20retailer%20compliance%20report%202015-16.pdf

timely payments and avoid to impose late payment terms in their contracts, especially when dealing with MSBs. This obligation also has the objective to make large companies avoid any payment deductions that are seen as unfair. Although this provision adds more pressure on large businesses to be more transparent with their payment practices and performance, this does not add any sanctions for such unfair practices through which unfair contract terms are imposed on MSBs.

2.1.3 The Late Payment of Commercial Debts Regulations 2013

The Late Payment of Commercial Debts Regulations 2013 is the transposition of the EU Directive 2011/7/EU on combating late payment in commercial transactions. The Directive was developed with the idea of protecting SMEs from the abusive payment practices that larger companies impose on them as Article 1 of the Directive clearly explains. Article 7 of the Directive provides that contract terms or practices relating to late payment are considered to be unfair. Article 7 states that "Member States shall provide that a contractual term or a practice relating to the date or period for payment, the rate of interest for late payment or the compensation for recovery costs is either unenforceable or gives rise to a claim for damages if it is grossly unfair to the creditor."

The Directive also made a distinction between payments due by public authorities and those by private entities. It provides that public entities need to ensure payment is made within 30 days or in exceptional circumstances within 60 days.[37] Whereas private entities need to pay their invoices within 60 days unless otherwise agreed and provided that this would not be grossly unfair within the meaning of Article 7.[38]

In this light, the English transposition of the above Directive also imposes the same rules for payment terms with SMEs.[39] Section 2 subsection 5 of the Act adopted the fairness test and partly disposes that a contract term or practice on late payment is grossly unfair if the circumstances of the case show anything that is a gross deviation from good commercial practice and contrary to good faith and fair dealing. Therefore, it can be argued that the 2013 Regulations have managed to demonstrate that abusive contract terms and practices that impose late payment in the contract or its performance are considered to be unfair and would consequently not be applicable in English law. What is interesting in this amendment of the Late Payment of Commercial Debts (Interest) Act 1998 is that good faith and fair dealing are taken into account

[37] Article 4 of the Directive.
[38] Article 3 of the Directive.
[39] See Section of the late payment of commercial debts regulations 2013.

when determining whether a term or practice relating to late payment is legally valid or not. Moreover, although a company is allowed to pay within a delay that exceeds 60 days of the invoice if there is an agreement on this basis, this agreement is still subject to the fairness test of the Regulations.[40] The Regulations state that such terms would be invalid whether they are part of standard terms contracts or individually negotiated agreements.[41]

As it has been observed, English law has introduced a number of very much needed legal developments to further control unfair contract terms in B2B contracts especially those that affect MSBs. The GSCOP introduced more rigour in the application of its principles and code of conduct with MSBs in order to avoid the imposition of certain unfair contract terms on MSBs, the Small Business, Enterprise and Employment Act 2015 allows for more transparency with regards to the payment methods and practices that larger companies have with MSBs and the Late Payment of Commercial Debts Regulations 2013 impose a strict regime on rendering inapplicable unfair contract terms that touch on late payment.

2.2 The Statutory and Common Law Mechanisms Applicable to Unfair Contract Terms in B2B Contracts in England

2.2.1 The Unfair Contract Terms Act 1977

The Unfair Contract Terms Act 1977 (UCTA) was enacted by Parliament to deal with unfair contract terms, and more specifically to regulate unfair exemption and restriction of liability clauses for B2C and B2B contracts. It is the only legislative text that currently controls unfair contract terms for B2B contracts in English law. A term imposing an exclusion or limitation of liability is subject to the UCTA as well as the scrutiny of the incorporation and construction tests. The UCTA exercises direct control over the substance of the terms that it governs as opposed to applying a particular method in regulating unfair terms, as the incorporation test does.

The Act established some prohibitions in sections 2(1), 3, 6 and 7 under which the terms caught by them would be void. For example, section 6 prohibits the exclusion or restriction of liability with regard to implied terms relating to the transfer of a good title to the goods, compliance of the goods with their description, delivering goods of satisfactory quality and goods which are fit for the specific purpose communicated to the seller, and in cases of sale by sample,

[40] See Section 2(3C) of the Regulations.
[41] See Section 3(4) of the Regulations.

that the delivered goods correspond to the sample in consumer contracts.[42] Nevertheless, the same provision allows for the exclusion or limitation of liability in commercial contracts as long as it satisfies the requirement of reasonableness found in the Act. Moreover, other provisions of the UCTA are also subject to a test of reasonableness in respect of which they refer to, thereby making this test key to the functioning of the Act.[43]

Section 11(1) of the UCTA disposes that:

> in relation to a contract term, the requirement of reasonableness…is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

This test has a broad scope of interpretation as it refers to what the courts would assess as being fair and reasonable in relation to the terms concerned. Moreover, the test specifies that the term should also have been fair in being incorporated into the contract, which also implies that there should be some compliance with standards of fair dealing.

Notwithstanding the wide meaning of what could be perceived as being fair and reasonable, the UCTA and the courts have developed guidelines to help in indicating what would constitute a reasonable term in the sense of section 11. Schedule 2 of the UCTA provides that guidelines which should be taken into account are the bargaining positions of the parties, whether there were alternative means by which the customer's requirements could have been met, whether the customer received an inducement, whether the customer had an alternative choice of contracting with another business offering better terms, whether there was transparency of the term, whether compliance with an exclusion or restriction of liability at the time of the conclusion of the contract was practicable and whether the goods were manufactured, processed, or adapted to the special order of the customer.

The courts have also identified further indications used for assessing whether a contract term under the UCTA is reasonable. Thus, it has been concluded that it would be taken into account by the courts whether the task in respect of which liability is being exempted or limited is a particularly difficult one.[44] Moreover, the 'practical consequences' of the decision regarding the reasonableness of the term are considered broadly by the courts.[45] This means that the courts take into

[42] These are the implied terms under Sections 12-15 of the UK Sale of Goods Act 1979.
[43] See McKendrick E (2011), p 205.
[44] *Smith v Eric S Bush* [1989] 2 All ER 514 at 531.
[45] Ibid.

account the financial impacts upon the parties by deciding whether or not the term is reasonable, such as looking into whether there was any insurance available to cover the liability.[46] The courts also generally qualify terms as being unreasonable if they cover a wide scope of liabilities.[47] Finally, the term is usually concluded to be unreasonable if it excludes or restricts liability for fundamental breach.[48] These guidelines contribute to curtailing the wide scope of the reasonableness test. However, they are not exhaustive and still give discretion to the courts in assessing what is reasonable. Also, the guidelines in Schedule 2 of the Act are only applicable to the meaning of reasonableness in sections 6(3), 7(3) and (4), 20 and 21. Nevertheless, they still help in pinning down the meaning of reasonableness within the context of the UCTA, which could be seen as an English common law characteristic in dealing with general tests and standards of fairness and reasonableness.[49]

Other provisions of the UCTA which help in considering the reasonableness of an exemption or restriction of liability clause are sections 11(4), 13 and 17. Section 11(4) deals with limitation of liability clauses and specifies that regard should be given to the resources available to the person imposing the clause for meeting the potential liability, and whether it was possible for this party to cover himself by insurance in deciding the validity of the term. Section 13 applies to duty defining clauses and extends the scope of section 2 of the Act concerning the exemption or limitation of liability for negligence.[50] Section 17 provides more detail regarding which terms would be considered to be unreasonable. For example, in section 17(1)(b), it is stated that:

> any term of a contract which is a consumer contract or a standard form contract shall have no effect for the purpose of enabling a party to the contract in respect of a contractual obligation, to render no performance, or to render a performance substantially different from that which the consumer or customer reasonably expected from the contract, if it was not fair and reasonable to incorporate the term in the contract.

In consequence, it can be observed from the above analysis that the general test of reasonableness under the UCTA covers a wider number of exclusions and/or restrictions of liability clauses. Considering the limitations of the incorporation and construction tests, a general test of reasonableness would be applicable to a larger variety of unfair clauses. Therefore, it can be stated that this general test under the UCTA responds to the need for more flexibility, as the context and

[46] Willett C (2007), paragraph 2.127.
[47] *Balmoral Group Ltd v Borealis (UK) Ltd* [2006] 2 Lloyds Rep. 629.
[48] Willett C (2007), paragraph 2.127.
[49] See McKendrick E (2011), p 198.
[50] Ibid.

facts of exemption or limitation of liability clauses differ from one another. Nonetheless, the application of this general test is only confined to terms imposing an exclusion and/or limitation of liability subject to the UCTA. Thus, the UCTA alone does not provide further legal protections to MSBs against unfair contract terms that do not exclude or limit liability.[51]

2.2.2 The Incorporation and Construction Tests

There is no general principle of good faith that acts as an overriding duty in English contract law, which means that there is no obligation on the parties to the contract to take each other's interest into account when entering into or performing a contract. Albeit this is not necessarily true for consumer contracts anymore, it still applies as an underlying ethic to B2B contracts including those where MSBs are involved. This specific ethic is the adversarial position of the parties that English contract law is based upon whereby commercial parties to a contract are encouraged to have a 'cut-throat' approach to negotiating and performing contractual agreements. This means that parties do not have to take into account the legitimate interests or expectations of the other party.[52] Thus, the imposition of a duty of good faith on the parties would be incompatible with this position, where the parties would have to consider each other's contractual interests or expectations.

Historically there was no legal protection against the inclusion of unfair contract terms in English Law. However, the law started to develop a number of mechanisms to invalidate certain abusive contractual terms, specifically if they excluded or limited liability of one of the parties in an unfair manner. Two main mechanisms were developed by the courts to deal with these unfair clauses for both B2C and B2B contracts; the incorporation and the construction mechanisms.

Under the incorporation test the concerned terms would not be given any legal effect for they would have not been duly incorporated into the contract. However, the incorporation test only applies to unsigned documents.[53] In cases of signed documents or contracts, the purchaser is bound by his signature and the terms would not be assessed against the incorporation mechanism.[54] The notion 'unfair terms' for the purposes of the incorporation test is confined to the understanding of terms that impose unfair obligations or exclude or limit liability for important breaches that are not transparent to the buyer. Thus,

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[51] See Van Loock S (2014), pp 104-105 and pp 128-131.
[52] Brownsword R (1999), p 15.
[53] See Wang FF (2015), p 14.
[54] There are a number of limited exceptions to this rule, such as *non est factum* [this is not my deed]; See *l'Estrange v Graucob Ltd* [1934] 2 KB 394.

according to the test, for a term to be valid it must have been validly incorporated into the contract. This means that the term or terms had to be reasonably brought to the attention of the buyer at or prior to the time of the conclusion of the contract.[55] Namely, the party imposing the terms must have done what was reasonably sufficient to draw the terms to the attention of the other party.[56] What is considered to be reasonable notice depends upon the facts and circumstances of each individual case.[57]

Notwithstanding, terms that are regarded as particularly onerous or unusual must be fairly and reasonably brought to the attention of the buyer as individual terms.[58] This was held in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd.*[59] On the facts of the case, the plaintiffs concluded a contract with the defendants for lending transparencies which were delivered with a note containing the conditions. Condition 2 stipulated that all the transparencies had to be delivered within 14 days of delivery, otherwise there would be a charge of a GBP 5holding fee plus value added tax for each transparency retained by the defendants each day thereafter. The defendants had not read the conditions, as the plaintiffs had not drawn them to their attention. It was concluded by the court that where a penalty clause was out of step with market norms and was not brought to the special attention of the other party, it would not be incorporated into the contract.[60]

As it can be observed, the incorporation test has limitations regarding the scope of its application to unfair contract terms. Such limitations relate, for example, to the coverage of the test, as it does not apply to documents that have been already signed, and where unfair terms would apply to the contract in such situations. Also, this mechanism does not require that contracts are transparent in their entirety, meaning that they should be available, clearly formulated, in clear sized print, in plain intelligible language, and so on.[61] Furthermore, the incorporation test does not cover all types of unfair terms, as unfairness in the sense of the test is limited to what is not drawn to the reasonable attention of the buyer. In other words, if there is sufficient transparency of the term, the term would qualify as having been incorporated into the contract, and thereby as

[55] McKendrick E (2011), p 158.
[56] See *Parker v South Eastern Railway* (1877) 2 CPD 416; Ibid, p 159.
[57] McKendrick E (2011), p 159.
[58] Willett C (2007), paragraph 2.111.
[59] [1989] QB 433.
[60] Also see *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163; and *AEG (UK) Ltd v Logic Resources Ltd* [1996] CLC 265.
[61] Willett C (2007), paragraph 2.111.

being fair in this context. Thus, in the face of these limitations, the law further developed other tests to deal with unfair contract terms.

The second test that was developed to be applied to a term in assessing its fairness is the construction of the term test. The construction test also implements requirements of a more general objective of fairness and of establishing fair terms in contracts. In doing so, it has a strict approach towards the construction of exemption clauses. In cases of ambiguity, exclusion or limitation of liability clauses are usually construed *contra proferentem* by the courts. This means that they would be interpreted against the party seeking to rely on them. Namely, the exemption clause has to cover the damage or relevant liability that is being invoked in question.[62] For example, in *Wallis, Son and Wells v Pratt and Haynes*[63], the exemption clause stipulated that the sellers gave "no warranty express or implied" with regard to the description of the goods.[64] It was held by the court that the clause did not cover the breach as the clause only covered breaches of warranties, but not breaches of conditions as was the case in the circumstances of the dispute, since the description of the goods is a condition.

Therefore, the courts assess whether intent from the wording of the clause is:

clear, unambiguous and incapable of misleading.[65]

Nevertheless, the strict construction of exclusion of liability terms has been criticised in *Photo Production Ltd v Securicor Transport Ltd*[66]. In this case, Lord Diplock stated that such an approach should not be applied to exemption clauses which are clear and unambiguous in terms of covering the breach in question. Thus, it is not an absolute that exemption clauses would necessarily be strictly construed in such a manner as to not give legal effect to the exclusion of liability concerned.

Also, there are limitations to this test in terms of rendering inapplicable terms that are deemed to be unfair. An illustration of this is where the term in question covers fundamental breach or an exemption of an important liability in a clear and unequivocal manner.[67] According to the construction method, such a term could still be qualified as applicable, and thereafter as fair due to the lack of ambiguity in reading it. However, the law on controlling unfair contract terms

[62] Ibid, paragraph 2.112; McKendrick E (2011), p 189.
[63][1911] AC 394.
[64] McKendrick E (2011), p 190.
[65] *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352 at 377.
[66] [1980] AC 827.
[67] Willett C (2007), paragraph 2.112.

for both B2C and B2B contracts further developed and the standards set by statutes circumvent the limitations posed by the incorporation and construction of terms tests.

2.2.3 Other Common Law Solutions

In the absence of a more extensive legal framework to protect MSBs from unfair contract terms that do not fall under the scope of the UCTA and the other common law mechanisms for controlling such terms under English law, economic duress is a mechanism that already exists in the current law and that can be applied to controlling such terms. Economic duress is one of the tools used by the English courts in order to set aside a contract in cases of extreme imbalance or unfairness affecting the contract.

Economic duress is a type of duress which ensues when one party to the contract uses their superior economic power in an illegitimate manner in order to pressure the other party to accept certain terms that are to their financial detriment.[68] Economic duress was first recognised by Kerr J in *Occidental Worldwide Investment Corporation v Skibs A/S Avanti (The Siboen and the Sibotre)*.[69] Case law has been in constant development on the question of assessing the elements that compose economic duress.[70] More recently, it was established in *R v A-G for England and Wales*[71] that the wrong of duress consists of two elements; pressure amounting to compulsion of the will of the victim and the illegitimacy of the pressure.

Therefore, according to this statement, duress controls and regulates problems of fairness with regard to lack of free consent and illegitimate pressure to contract. In addition, the pressure must have been sufficient to have induced the party to enter into the contract, and there must have been a lack of an alternative choice or course of action for the victim.[72] Henceforth, it is important to establish a causal link between pressure used by the defendant and the consent given by the claimant to conclude or renegotiate the contract in order to establish duress.[73]

The illegitimacy of the pressure concerned in cases of economic duress is assessed according to the nature of the pressure and the nature of the demand which the pressure applied is to support.[74] In line with this assessment, on one

[68] Mckendrick E (2015), p 294.
[69] [1976] 1 Lloyd's Rep 293.
[70] See McKendrick E (2010), p 636.
[71] [2003] UKPC 22.
[72] See Treitel (2011), p 445, paragraph 10-009.
[73] McKendrick E (2010), p 636.
[74] This was stated by Lord Hoffmann *in R v A-G for England and Wales* [2003] UKPC 22 at 16.

hand, if the threat from the pressure is unlawful, this would give rise to duress.[75] On the other hand, in circumstances where the threat is lawful but is used to support an unlawful demand, it may amount to duress.[76]Notwithstanding, cases of threatened breach of contract are particularly problematic, as it is not always clear whether such threats are lawful or not, thereby leading to duress. In this context, the issue arises of how the courts should decide in which situations the party is entitled to make such threats, as these could be part of the normal cut and thrust of commercial practice. It was held in *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)*[77] that pressure exerted under the form of a threatened breach of contract would amount to economic duress.

Moreover, it has been suggested by some scholars that there has to be an element of bad faith in order to determine whether the pressure is unlawful.[78] Thereafter, a threat to breach a contract encompassing bad faith is likely to affect the consent of the other party and to constitute economic duress.[79] This would mean that economic duress can be used as a tool to prevent the larger corporations from pressuring the MSB into accepting contract terms that are deemed as unfair or that would be very detrimental to them. However, there needs to be a threat to breach the contract by the larger corporation or an illegitimate form of pressure for the MSB to accept the problematic terms for economic duress to apply. This can limit the possibility of invaliding the unfair terms in question on the basis of duress if the pressure is not considered to be illegitimate, or that the demand to impose the terms upon the claimant is seen to be lawful by the courts. Namely, there is no established understanding of what illegitimate pressure means in a commercial context. This adds more uncertainty regarding whether economic duress can be considered as an adequate tool to control unfair contract terms imposed on MSBs.

Despite the advancements in the law to deal with the issue of unfair contract terms imposed on MSBs, there are still gaps as these legal developments do not cover all MSBs or unfair contract terms. For example, the Late Payment of Commercial Debts Regulations 2013 has a robust system for dealing with terms relating to late payments but are only limited in their application to these terms. In light of this legal lacuna in English law, the question arises as to whether there is a solution that currently lies in the mechanisms and developments of

[75] McKendrick E (2011), p 298.
[76] Ibid.
[77] [1979] QB 705.
[78] See Burrows (2010) in McKendrick E (2011), p 299.
[79] See McKendrick E (2011), p 299.

English contract law to deal with this issue. In answering this question, the next sub-section will discuss the whether there are any such solutions, even if partial, to further protect MSBs from these terms.

2.3 Potential Solutions to the Unfair Contract Terms in B2B Contracts with MSBs Issue in the Current Law in England?

The question that this discussion is raising is whether it would be possible to use contract interpretation for invalidating unfair contract terms or at least for limiting their effect by protecting the parties' expectations to the contract and taking into consideration their respective bargaining positions with each other. It has been observed in Section 2.2.2 of this chapter that English law has already developed the contract construction test by using the *contra proferentem* approach for the courts to determine whether an exclusion or limitation of liability clause is unfair or not. However, the limitation of this test is that it only applies to exclusion and limitation of liability contract terms. So the question would be whether it would be possible to extend this test beyond these specific terms to other terms that do not exclude or limit liability but that are deemed as unfair by applying the more general tool of contract construction to these.

Contract interpretation is used as a tool in English law in cases of conflict over the performance of the contract as a whole or a specific clause in the contract.[80] In such cases, the clause would normally be ambiguous or unclear thus requiring an objective interpretation given by the courts made from the stand point of a reasonable person. Consequently, it can be argued that in cases of ambiguity or lack of clarity surrounding certain clauses that are deemed as unfair by one of the parties there is the possibility for that party to approach the courts in order to interpret the clause in question.

There has been more flexibility introduced into this mechanism in recent years as the courts started accepting to take into account other aspects surrounding the contract such as the context of the conclusion and performance of the agreement by the parties.[81] The traditional approach consisted of the traditional four corners rule where the courts would only be able to abide by the four corners of the contract to interpret it without having the possibility to have recourse to other information in order to interpret the clause or contract in question.[82] The move towards a more contextual approach in contract interpretation was seen in

[80] See Beale H (ed) (2009), Chapter 13, Section 3.
[81] See Hooley R (2013), pp 65-90.
[82] See *Lovell and Christmas Ltd v Wall* (1911) 104 LT 85.

the case of *Investors Compensation Scheme v West Bromwich Building Society*[83]where Lord Hoffmann held that:

> interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.[84]

Lord Hoffmann placed an emphasis on the importance of the background information to the contract when interpreting it. This case is considered to have played a key role in the shift of the doctrinal development from a traditional towards a contextual approach in contract interpretation.[85]

This development continued through other major cases such as *Rainy Sky S.A. v Kookmin Bank*[86]where the court held that it is important to take context into account when interpreting a contract, especially in cases of commercial contracts. In this case special significance was placed on interpreting the contract according to its commercial context and business common sense.[87] It was stated by the Supreme Court in *Rainy Sky* that it is important to give the contract an interpretation that is in line with its business common sense in order to better reflect the parties' expectations from the agreement. Furthermore, the developments in contract interpretation saw their peak in the High Court case of *Yam Seng Pte Ltd v International Trade Corporation Ltd.*[88] In this case, Justice Leggatt stated that good faith was an implied duty which governs the performance of the contract by the parties.[89] The judge discussed that the context of the contract would consist of taking into account the honesty and expectations of the parties when executing the contract.[90] Further, Justice Leggatt stated that a key aspect of good faith is the observance of generally accepted standards of commercial dealing.[91] Therefore, according to Justice Leggatt's reasoning the parties to a commercial contract would need to take into account each other's expectations in order to have a satisfactory performance of the contract.

These developments that have affected the mechanism of contract interpretation in English law can be used in situations where one of the parties, perhaps the

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[83] [1997] C.L.C. 1243.
[84] Ibid.
[85] Brownsword R (2015), p 533 and McKendrick E (2016), p 377.
[86] [2011] UKSC 50.
[87] Ibid at paragraph 40.
[88] [2013] EWHC 111 (QB).
[89] See ibid at paragraph 153.
[90] Ibid at paragraphs 141 and 142.
[91] Ibid at paragraph 138.

MSB, is suffering from an imposition of an unfair contract term by its larger counterpart. The context of the parties' bargaining positions can be taken into account by the courts when assessing how to interpret the disputed term in question. Also, with regards to interpreting the context of commercial agreements in accordance with business common sense, unfair commercial practices which are found in contract terms can be interpreted in such a way as to not affect the MSB party to its detriment. It has been observed in Section 2.1 of this chapter that certain practices and contract terms that impose a change in the payment terms or late payment are considered to be unfair even in a commercial context. Since these have already been recognised as unfair commercial practices and terms by the legal instruments discussed in Section 2.1, then the courts already have legal sources indicating what contract terms are considered to be as contrary to business common sense which requires a stricter interpretation of these terms. Moreover, when interpreting the disputed contractual term according to this developed logic of contract interpretation in English law, the courts need to ensure that the expectations of both parties are reflected. This means that contract terms that have been imposed on the MSB party in a way that does not reflect their expectations should be interpreted in a way that it should, which might lead to minimising the effects of the unfair contract term in question.

For example, this logic can be applied in a situation where a contract term is ambiguous with regards to payment to the MSB which can potentially lead to payment changes or late payment. If the above logic of contract interpretation is applied, then this contract term can be interpreted in favour of the MSB by taking into account all of the above factors and thereby reducing the effect of the unfair contract term in that specific circumstance.

Although contract interpretation could be a potential solution for tackling unfair contract terms in B2B contracts with MSBs, this method does carry a number of limitations that affects its effectiveness to generally control such terms. First, this method would only apply to cases where the contractual clause is unclear or ambiguous to necessitate its interpretation by a third party adjudicator. Second, contract interpretation might lessen the effect of the clause in question or interpret it in a way that might not be too detrimental to the parties, however, the courts might not have the power to invalidate it.

Third, the English courts are normally reticent to interfere with the freedom of contract that parties dispose of especially in the context of commercial contracts.[92] In the need to promote certainty in commercial dealings, the courts

[92] See Van Loock S (2014), p 130 and Lawson R (2005).

are normally quite discouraged to interpret the contract in a way that would lead to rectification rather than interpretation. The recent Supreme Court case of *Arnold v Britton*[93]held that the contract needs to be construed in a manner that gives importance to the language used by the parties.[94] This means that the Supreme Court might set back the trend of applying a more traditional approach in contract interpretation rather than allocate a meaning to the contract term that takes other factors into account.[95] Protecting the parties' reasonable expectations through contract interpretation has also been criticised for being elusive and vague which endangers the certainty of the agreement.[96]

Further, the case of *Yam Seng Pte Ltd v International Trade Corporation Ltd* was not very well received as there has been a lot of criticism against it mainly for the reason that there is no general duty of good faith that applies in English law, especially in a commercial context.[97] This criticism has however been confirmed in the recent Court of Appeal case of *MSC Mediterranean Shipping Company SA v Cottonex Anstalt*[98]where it was stated that there is a preference for the law to develop along established lines rather than apply a general organising principle.[99] The court added that establishing and applying a general principle of good faith would undermine the certainty that parties have to the contract.[100] Fourth, there is no protection against inequality of bargaining power in English law as there is no legal principle of unconscionability in its law of contracts. There have been a number of objections against the inclusion of such a doctrine in English law that is mainly based on the importance of certainty of contract and the adversarial position of the parties to a commercial agreement.[101]

As it has been observed so far in the English legal system, there are gaps in the law in dealing with the issue of protecting MSBs against unfair contract terms. The question that ensues is to what extent Brexit will have an impact over developments on this matter as the influence of EU law will cease. In this context, it would be important to understand how other common law jurisdictions deal with this issue and whether there are any legal developments in those systems to control unfair contract terms with MSBs. It can be argued

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[93] [2015] UKSC 36.
[94] Ibid at paragraph 19.
[95] Also see *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72 and *Wood v Capita Insurance Services Ltd* [2017] UKSC 24 on this point.
[96] See Barnes R (2011), p 197.
[97] See for example Carter JW and Courtney W (2016), pp 608-619.
[98] [2016] EWCA Civ 789.
[99] Ibid at paragraph 45.
[100] Ibid.
[101] Mckendrick E (2015), pp 306-307.

that it would be important to observe the position that other common law systems have on the issue outside a European influence, as 51% of cases on contracts in England refer to other legal systems, and more particularly, they refer to common law systems.[102] Thus, the next section will discuss this issue in the Australian and US legal systems.

3 A Comparative Observation of Unfair Contract Terms in B2B Contracts with MSBs in Other Common Law Systems: The Australian and US Examples

3.1 Legal Developments on the Issue of Unfair Contract Terms with MSBs in Australian Law

Australian law has very recently introduced a legislative text for protecting small businesses against unfair contract terms in B2B contracts with larger corporations. The Treasury Legislation Amendment (Small Businesses and Unfair Contract Terms) Act 2015 came into force on 12 November 2016. This Act is an extension to the current protections against unfair contract terms in consumer contracts. The Australian Productivity Commission first recommended the inclusion of legislative protections against unfair contract terms for both consumer contracts and contracts with small businesses in a report in 2008.[103] This report was mainly inspired by the laws on unfair contracts with consumers in the State of Victoria, but also as a result of the implementation of similar laws in the UK through the Unfair Terms in Consumer Contracts Regulations 1999.[104] However, even though the draft legislation on unfair contract terms was to apply to both consumers and small businesses, the final draft only imposed such protections for consumer contracts.[105] Due to the recognition of need to protect small businesses in a contractual context though, the Australian Competition and Consumer Commission (ACCC) suggested to extend the protections for unfair contract terms to small businesses.[106]

The main reasons for this extension consisted in the fact that small businesses were recognised to have a weaker bargaining position in comparison to their larger counterparts which created a power imbalance from a contractual

[102] Burrows A (2014).
[103] Phillips K (2016), p 343.
[104] Australian Treasury (2009) The Australian consumer law: consultation on draft provisions on unfair contract terms. Canberra: commonwealth of Australia.
[105] See Van Esch P (2015), p 93.
[106] Phillips K (2016), p 343.

perspective.[107] This is due to the use of standard form contracts in most cases with small businesses which means that they do not have a chance to negotiate the contract in actuality and that their consent to the contract is not secured or protected by the law.[108] Also, the Australian Treasury consultation paper on the proposed new legislation for small businesses cited US research that stated that only around 4% of survey participants who were small businesses reported reading standard form contracts.[109] This was stated to be due to having less access to information and advice as well as having less experience which puts small businesses in a vulnerable position when entering into agreements with larger businesses.[110] The new Treasury Legislation Amendment (Small Businesses and Unfair Contract Terms) Act 2015 thereby reformed the Australian Consumer Law as the new rights of the small businesses have been added and both work in tandem.

The new 2015 Act applies to standard form contracts that are entered into with a small business. A small business is referred to as one consisting of less than 20 employees according to Section 12BF of the Act. Although there is no specific definition in the legislation of what standard form contracts are, they are known to be 'take it or leave it' contracts whereby the party accepting it would only adhere to accept it without having the possibility to negotiate any of the terms involved.[111] The Australian Consumer Law adds some explanations of what standard form contracts are such as whether one of the parties has all the bargaining power or whether the contract was negotiated by both parties in Section 27 without adding a specific definition of what these are. The contract concluded with the small business needs to also cover a certain threshold with regards to the amount of money it covers. Section 12BF of the Treasury Legislation Amendment (Small Businesses and Unfair Contract Terms) Act 2015 provides that contracts with small businesses that have an upfront contract price of AUD 300,000 or less, or AUD 1,000,000 or less where the term of the contract is for more than 12 months are covered under the new Act.

A contract term is considered as unfair in the sense of the new Act and the Australian Consumer Law if it causes a significant imbalance in the parties' rights and obligations in the contract, if it is not reasonably necessary to protect

[107] See Consumer Affairs Australia, and New Zealand (CAANZ), Treasury, Implementation of the Australian consumer law, Report on Progress IV.
[108] Phillips K (2016), p 345. Also see Simons J and Geer T (August 2014), p 433 and Casson J (March 2016), p 76.
[109] Australian Treasury (2014) Extending unfair contract term protections to small businesses: consultation paper. Canberra: commonwealth of Australia, p 9.
[110] See Phillips K (2016), p 345.
[111] See Casson J (March 2016), p 76.

the legitimate interests of the party who would be advantaged by the term and if it would cause detriment to a party if it were to be applied or relied on.[112] In determining whether a term is unfair the courts could also take into account the extent to which the term is transparent and the sense of the contract as a whole.[113] A non-exhaustive list is also provided by the Australian Consumer Law, which also extends in its application to contracts concluded with small businesses now, gives examples of what terms are considered to be unfair. For example, according to these legal texts, a term that avoids or limits performance of the contract by the party imposing the terms is unfair, or a term that varies the terms of the contract is also considered to be unfair, a term that varies the price payable under the contract without the right of the other party to terminate the contract is unfair too. It must be noted that the new Act covers unfair contract terms with small businesses when they acquire and supply goods and/or services.[114] This means that the new Act offers protections to small businesses when they enter into commercial agreements with other businesses. If a contract term is found to be unfair by the court then the remedy against this would to render it as void. Section 23 of the Australian Consumer Law and Section 12BF(2) of the new Act provide that the unfair term may be severed from the contract to the extent that the contract can be performed without it.[115]

The Australian legal system has been the first system globally to introduce such a specific protection for small businesses against unfair contract terms. The Treasury Legislation Amendment (Small Businesses and Unfair Contract Terms) Act 2015 blended with the Australian Consumer Law provide a fairness test for the courts to apply which is seen as a welcome step to the protection of vulnerable businesses. Now small businesses that fit within the definition of this legislation can benefit from such protections and perhaps reduce the issues that they were facing before the enactment of this text. However, the Act does come with its limitations for the protection of small businesses more generally. The protections afforded by the new legislation does not extend to MSBs that have more than 20 employees but are still vulnerable entities on the market. The legislation does not apply to individually negotiated contracts or terms which can be a gap that can be used by the larger companies to impose unfair contract terms on MSBs. The limitation of the application of the new protections with regards to the amount covered in the contract also acts as an obstacle towards a more general protection of all contracts that MSBs conclude with larger companies.

[112] See Section 24 of the Australian Consumer Law.
[113] Ibid.
[114] See Section 31 of ibid.
[115] See Casson J (March 2016), p 77.

Definite progress has been made in Australian law with regards to the protection of MSBs against unfair contract terms nevertheless there are still numerous gaps as discussed in this section. In the absence of a legal framework to protect MSBs coming under these gaps, they have the possibility of pursue a case for unconscionable conduct.[116] However, this still remains as an uncertain solution to the issue of unfair contract terms imposed on more vulnerable commercial parties. This is the method that US law has developed in order to tackle such terms as will be discussed in the next subsection of this chapter.

3.2 Tackling Unfair Contract Terms in B2B Contracts with MSBs in US Law Through The Doctrine of Unconscionability

There is no explicit law on unfair contract terms in US law, however, unconscionability is a fundamental doctrine that is applied to protect parties to an agreement against unconscionable or unfair contract terms. The doctrine of unconscionability finds its roots in equity, however it only started being more widely used from the 1960s in the US.[117] The popularity of the doctrine led to its codification within the UCC and the US Restatement Second of Contracts. Prior to this codification, the courts had developed different legal devices to protect contracts from being affected by abusive behaviour, especially during the bargaining process.[118] The courts were using public policy and principles drawn from equity and tort to save the weaker party to the contract from unfair contractual bargains.[119] Namely, legal tools such as fraud, misrepresentation, duress and undue influence were developed by the courts in order to control these abuses but were still not sufficient to protect all abuses.[120] A contract was only policed by the courts if it was affected by these recognised abuses or if it was contrary to public policy. The courts were more reticent to apply notions of fairness to police the contract and widen their scope due to their application of the fundamental principles of certainty and freedom of contract.

However, with the increased use of standardised contracts in practice there was a rise in issues relating to the inequality of bargaining power between the parties to the contract.[121] The consent of the weaker party to the contract was affected due to many obstacles such as not having sufficient power to negotiate the terms of the contract or not having sufficient time to revise and read the contract in its

[116] See See Van Esch P (2015), p 93.
[117] See Mallor J (1986-1987), p 1065.
[118] Ibid, p 1068.
[119] Swanson C (2001), p 361.
[120] Mallor J (1986-1987), p 1068.
[121] Ibid, p 1069.

entirety.[122] These issues resulted in an initial legal response from the courts as they started controlling the imposition of unconscionable terms in these standardised contracts either through interpreting contracts against the party imposing the terms or rendering the contract as void due to lack of mutual consent and/or consideration.[123] In recognition of this legal gap, given the inadequacies in applying the classical doctrines and critical of the way that the courts handled unfair contract terms arising from the inequality of bargaining power between the parties to the contract, the drafters of the UCC included the doctrine of unconscionability in the code.[124] The main objective of the doctrine of unconscionability as incorporated into the UCC is to rectify abuses in standard form contracts and other contracts for the sale of goods too, and it applies to both consumer and commercial contracts.

This doctrine is incorporated within § 2-302 of the UCC and provides that:

> (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.

According to this provision, contracts or terms that are considered to be unconscionable by the courts are not applicable. Namely, the courts have the power to modify or withhold the enforcement of contracts that contain unfair contract terms.[125] Therefore, the UCC tackles unfair contract terms through their interpretation by the courts then rendering them as void. The courts tend to adopt a stricter approach when applying this provision to commercial contracts due to difficulties in assessing whether there is an unequal bargaining power between the parties.[126] However, there is a number of successful cases where a merchant invoked the presence of unconscionability in a contract.[127]

Despite the developments on protecting contracting parties against unfair contract terms in US law, there are a number of limitations that touch on the doctrine of unconscionability as it is currently codified within the UCC. One of the major weaknesses that affect the application of this doctrine relate to the lack of a definition of what unconscionability is.[128] Cases that preceded the codification of the UCC confirmed the equitable historical roots of the doctrine,

[122] See ibid.
[123] Ibid, pp 1069-1070.
[124] Nottage L (1996), p 258 and Mallor J (1986-1987), p 1070.
[125] Mallor J (1986-1987), p 1070.
[126] DiMatteo L and Rich B (2005-2006), p 1082 and see Nottage L (1996), p 258.
[127] Mallor J (1986-1987), p 1066.
[128] Ibid, p 1070 and see Murray J (2014), p 264.

but these do not help in providing a modern meaning to the doctrine.[129] There is currently no direction given to the courts for how to apply this provision.[130] This why the manner in which this doctrine needs to be implemented by the courts has been the subject of major scholarly discussion.[131] This lack of guidance has resulted in difficulties with how to implement the doctrine in practice which eventually led to the adoption of different approaches in its application by the courts.

The courts started applying the doctrine by basing their reasoning on the procedural and substantive elements of unconscionability.[132] The case authority that established this is *Williams v Walker-Thomas Furniture Co*[133]and was later reinstated in a 2002 case which held that the courts must look for two factors when considering whether there is unconscionability; first, there must be unfairness in the formation of the contract and second, there must be a case of excessively disproportionate terms.[134] The first factor being the procedural element, and the second being the substantive element.[135] Nevertheless, one of the questions that the courts were faced with consisted of how they should apply the doctrine in cases where one factor is more overtly present and evident but the other is not.[136] This was questioned for example by the Arizona Supreme court where it held that a balancing approach between both factors needs to be applied in order to establish whether there is unconscionability present in a contract.[137] This court also stated that some courts held that establishing either of these factors would be sufficient to hold a term as unconscionable.[138] Other courts have also emphasised the importance of the substantive ground in establishing whether there is unconscionability such as in the case of *Brower v Gateway 2000, Inc.*[139] However, there is still no clear position in theory and in practice on how to establish whether there is unconscionability.

Certain scholars have debated whether emphasis should be placed on the procedural aspect rather than on both factors to establish the presence of the abusive contract or clauses.[140] Certain scholars such as Professor Hillman also

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[129] Swanson C (2001), p 361.
[130] See Nottage L (1996), p 258 and DiMatteo L and Rich B (2005-2006), p 1068.
[131] DiMatteo L and Rich B (2005-2006), p 1068.
[132] Ibid, p 1072.
[133] 350 F.2d 445 (D.C. Cir. 1965).
[134] *Sitogum Holdings, Inc,* 800 A.2d at 921.
[135] See Murray J (2014), pp 265-266.
[136] DiMatteo L and Rich B (2005-2006), p 1073.
[137] *Maxwell v Fid. Fin. Sers., Inc,* 907 P2.d 51, 58 (Ariz. 1995).
[138] DiMatteo L and Rich B (2005-2006), p 1074.
[139] 676 N.Y.S.2d 569 (N.Y. App. Div. 1998).
[140] See Hillman R (1981) and Leff A (1967).

raised the question of whether unconscionability should apply to B2B contracts since merchants normally have the same bargaining power and can protect themselves against the imposition of abusive terms in the contract.[141] However, Hillman did admit that there are exceptions to these cases where merchants share the same characteristics as those of consumers and the doctrine would have to then apply to these.[142]

Based on this observation, there is currently no clarity on the manner in which the application of the doctrine of unconscionability should be effected which also means that there is no clarity regarding the extent to which the doctrine can be applied to protect MSBs against unfair or unconscionable terms. This vagueness has meant that the doctrine is rarely invoked by the courts due to being seen as grossly interfering with the freedom of contract.[143] There was an attempt for the revision of the unconscionability provision in the UCC that had started in the 1980s and 1990s but it did not culminate in much change.[144]

What can be said though is that the courts did show their willingness to protect some of these in certain cases as already mentioned earlier in this section. Also, the discussions behind the attempted revision of Article 2 of the UCC on unconscionability showed an opposition towards the enforcement of a more protective application of the doctrine in favour of consumers alone.[145] Actually, the importance of the protection of business parties against such terms was emphasised.[146] In the meanwhile, courts are in the process of expanding this doctrine and including when it comes to its application to contracts with MSBs.[147] However, it still remains that not many cases are normally decided on the basis of unconscionability as courts cautiously apply it[148] due to the ambiguities surrounding it and due to not wanting to impede over established fundamental principles of contract law, especially in a commercial context, which puts MSBs at a certain risk of suffering from unfair contract terms.

After having carried out an analytical study of the issue of unfair contract terms imposed on MSBs in English law, Australian law and US law, the next section of this chapter will consider the comparative conclusions relevant to this analysis and to what extent MSBs will be granted protections against this problem in a post-Brexit era.

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[141] See Mallor J (1986-1987).
[142] Ibid.
[143] DiMatteo L and Rich B (2005-2006), p 1072.
[144] Swanson C (2001), p 372.
[145] Ibid, p 399.
[146] Ibid.
[147] See Posner E (1995), p 306.
[148] Swanson C (2001), p 361.

4 Comparative Conclusions on the Issue of Unfair Contract Terms with MSBs: What Next after Brexit?

As it has been mentioned throughout this chapter, the issue of having a legal gap with regards to protecting MSBs against unfair contract terms in English law is a pressing matter. The research conducted in this chapter has sought to analyse what the situation with regards to this matter is in other major common law jurisdictions, notably the Australian and US jurisdictions, in order to gain an understanding of whether there are any common trends that English law might share with them. This is particularly significant so as to get an understanding of potential directions that English legislation and courts could take on the issue after the UK leaves the European Union and EU law diminishes in its influence. As the issue of unfair contract terms imposed on MSBs in England is a pressing matter, it is important to further develop the law on this and not have this compromised after Brexit. This crucial need for protection stems from the concern that MSBs to have a sustainable economic growth.

From the analysis conducted in this chapter, it is clear that all three legal systems tend to protect MSBs against certain types of unfair contract terms. There is a trend to protect certain interests of smaller businesses at a contractual level albeit there are limitations to that. The common approach that the three legal systems use in dealing with unfair contract terms consists of having court control. The Australian and US legal systems have shown that they embraced legal developments on unfair contract terms to eventually protect smaller businesses through a favourable court attitude towards these protections. The English system has developed controls on unfair contract terms through the courts such as the common law mechanisms for dealing with these and other piecemeal solutions such as duress. Moreover, it has been raised in this chapter that contract interpretation by the courts can be used as a method for further controlling unfair contract terms affecting MSBs in English law. The second degree of similarity also lies between the English approach and Australian approach as both systems have adopted piecemeal solutions that specifically deal with controlling certain unfair contract terms affecting MSBs.

If a hard Brexit occurs in the sense that EU law would cease to have any influence and effect over English law, then all of the protections that have been advanced through EU law will diminish. This includes rules on late payment that have been seen as a development of the protection of MSBs against unfair contract terms through the EU Directive 2011/7/EU on combating late payment in commercial transactions as discussed in section 2.2.3 of this chapter. This

would also mean that the European *aquis* or the Europeanisation of English contract law which has introduced more extensive norms of fairness will cease to have any effect.[149] The Europeanisation of English law can be particularly seen in the development of consumer law and the standards of fairness that apply to consumers to protect them against unfair contract terms.[150] This influence had also started to extend beyond the consumer context as was seen in the case of Yam Seng v ITC mentioned above in section 2.3.

Therefore, the results of this comparative analysis show that although contract interpretation by the courts can be used as a tool for further extending the protection of unfair contract terms for contracts with MSBs, English courts have demonstrated that they are more reticent in assessing these issues especially when it comes to B2B contracts as opposed to the Australian and US courts. Also, this reticence will only increase after Brexit as courts will probably go back to adhering to a more adversarial approach when applying principles of contract law and will be less keen on introducing more flexibility through notions of fairness to protect the weaker commercial party to an agreement. The most probable option for dealing with this issue in English law would be through specific rules or regulation. The Australian developments on unfair contract terms applying to small businesses seem like a good example that might eventually influence English law to adopt a similar text. Nevertheless, if the courts are reticent to support such protections, especially in the absence of European protections, this might create further difficulties to adopt such a legal instrument. Thereby, in the absence of a robust legal framework to protect MSBs against unfair contract terms, it might very well be the case that the UK courts and legislation would not adopt any protections for MSBs against such terms after Brexit.

What is yet to come will depend on the economic policies that the UK will be adopting post-Brexit, however, it is clear that there is great uncertainty looming over the fate of contractual protections afforded to MSBs in English law. What is certain though is that immediate legal reform is needed in order to deal with these legal discrepancies which only have a negative effect over the overall economy.

[149] See Twigg-Flesner C (ed) (2013).
[150] See Macmillan C (2016), pp 420-430 and for more extensive reading see Giliker P (2015), pp 237-265.

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