Director General of Fair Trading v. First National Bank [2001] UKHL 52 (25th October, 2001)

HOUSE OF LORDS

Lord Bingham of Cornhill Lord Steyn Lord Hope of Craighead Lord Millett Lord Rodger of Earlsferry

OPINIONS OF THE LORDS OF APPEAL FOR JUDGMENT

IN THE CAUSE

THE DIRECTOR GENERAL OF FAIR TRADING

(ORIGINAL RESPONDENT AND CROSS-APPELLANT)

v

FIRST NATIONAL BANK PLC

(ORIGINAL APPELLANTS AND CROSS-RESPONDENTS)

ON 25 OCTOBER 2001

[2001] UKHL 52

LORD BINGHAM OF CORNHILL

My Lords,

1. First National Bank plc ("the bank") is licensed to carry on consumer credit business. It is a major lender in the market and has lent large sums to borrowers under credit agreements regulated under the Consumer Credit Act 1974. Such agreements are made on its printed form which contains a number of standard terms. The Director General of Fair Trading ("the Director"), in exercising powers conferred on him by regulation 8 of the Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994/3159) ("the regulations"), sought an injunction to restrain use of or reliance on one such standard term on the ground that it was unfair. The bank resisted the Director's application on two grounds. The first, rejected by Evans-Lombe J at first instance ([2000] 1 WLR 98) and the Court of Appeal (Peter Gibson, Waller and Buxton L JJ) ([2000] QB 672), was that the fairness provisions of the regulations did not apply to the term in question. The second, accepted by the judge but partially rejected by the Court of Appeal, was that the term in question was not unfair. In this appeal to the House the bank again relies on both these arguments. The Director seeks to uphold the decision of the Court of Appeal but contends that the term was more fundamentally unfair than the Court of Appeal held it to be. Thus there are two broad questions before the House:

(1) Do the fairness provisions of the regulations apply to the term in question?

(2) If so, is the term unfair and, if it is, on what ground?

2. By its standard form of regulated credit agreement the bank agrees to make a sum of money available to the borrower for a specified period in consideration of the borrower's agreement to repay that sum by specified instalments on specified dates with interest at a specified rate. Condition 4 of the bank's standard form provided that:

> "The rate of interest will be charged on a day to day basis on the outstanding balance and will be debited to the Customer's account monthly in arrears . . ."

and provided that the rate of interest might be varied. Condition 8 of the agreement was in these terms:

> "Time is of the essence for making all repayments to FNB as they fall due. If any repayment instalment is unpaid for more than 7 days after it became due, FNB may serve a notice on the Customer requiring payment before a specified date not less than 7 days later. If the repayment instalment is not paid in full by that date, FNB will be entitled to demand payment of the balance on the Customer's account and interest then outstanding together with all reasonable legal and other costs charges and expenses claimed or incurred by FNB in trying to obtain the repayment of the unpaid instalment of such balance and interest. *Interest on the amount which becomes payable shall be charged in accordance with Condition 4, at the rate stated in paragraph D overleaf (subject to variation) until payment after as well as before any judgement (such obligation to be independent of and not to merge with the judgement)."*

Emphasis has been added to the last sentence of this condition, since it is to that sentence alone that the Director's objection relates. I shall refer to this sentence as "the term".

3. The bank's stipulation that interest shall be charged until payment after as well as before any judgment, such obligation to be independent of and not to merge with the judgment, is readily explicable. At any rate since *In re Sneyd; Ex p Fewings* (1883) 25 Ch D 338, not challenged but accepted without demur by the House of Lords in *Economic Life Assurance Society v Usborne* [1902] AC 147, the understanding of lawyers in England has been as accurately summarised by the Court of Appeal at p 682 of the judgment under appeal:

> "It is trite law in England that once a judgment is obtained under a loan agreement for a principal sum and judgment is entered, the contract merges in the judgment and the principal becomes owed under the judgment and not under the contract. If under the contract interest on any principal sum is due, absent special provisions the contract is considered ancillary to the covenant to pay the principal, with the result that if judgment is obtained for the principal, the covenant to pay interest merges in the judgment. Parties to a contract may agree that a covenant to pay interest will not merge in any judgment for the principal sum due, and in that event interest may be charged under the contract on the principal sum due even after judgment for that sum."

4. To ensure that they were able to recover not only the full sum of principal outstanding but also any interest accruing on that sum after judgment as well as before, it became the practice for lenders to include in their credit agreements a term to the effect of the term here in issue. If such a provision had not been included, a lender seeking to enforce a loan agreement against a borrower in the High Court would suffer prejudice only to the extent that the statutory rate of interest on judgment debts at the material time is lower than the contractual interest rate, because the High Court has, since 1838, had power to award statutory interest on a judgment debt until payment.

5. But a lender seeking to enforce a regulated credit agreement is in a different position. He is obliged by section 141 of the 1974 Act to sue in the county court. Until the Lord Chancellor, exercising his power under section 74 of the County Courts Act 1984, made the County Courts (Interest on Judgment Debts) Order 1991 (SI 1991/1184), the county court lacked power to award statutory interest on any judgment debt and, when such a general power was conferred by the order, judgments given in proceedings to recover money due under agreements regulated by the 1974 Act were expressly excluded from its scope. It was further provided in the order:

> "3 Where under the terms of the relevant judgment payment of a judgment debt -
> (a) is not required to be made until a specified date, or
> (b) is to be made by instalments,
> interest shall not accrue under this Order -
> (i) until that date, or
> (ii) on the amount of any instalment, until it falls due,
> as the case may be."

6. Thus a lender under a regulated credit agreement who obtains judgment against a defaulting borrower in the county court will be entitled to recover the principal outstanding at the date of judgment and interest accrued up to that date but will not be entitled to an order for statutory interest after that date, and even if the court had power to award statutory post-judgment interest it could not do so, in any case where an instalment order had been made, unless there had been a default in the due payment of any instalment. The lender may recover post-judgment interest only if he has the benefit of an independent covenant by the borrower entitling him to recover such interest. There is nothing to preclude inclusion of such a covenant in a regulated credit agreement, unless it falls foul of the fairness requirement in the regulations.

7. Section 71 of the County Courts Act 1984 conferred a general power on the county court, where any judgment was given or order made for payment of a money sum, to order that the money might be paid "by such instalments payable at such times as the court may fix". The 1974 Act also conferred on the county court three powers relevant for present purposes. First, the court was empowered to make a time order. Sections 129 and 130 of the Act, so far as relevant, provided:

> "129. (1) If it appears to the court just to do so -
> . . .
> (c) in an action brought by a creditor or owner to enforce a regulated agreement or any security, or recover possession of any goods or land to which a regulated agreement relates,
> the court may make an order under this section (a 'time order').
> (2) A time order shall provide for one or both of the following, as the court considers just -
> (a) the payment by the debtor or hirer or any surety of any sum owed under a regulated agreement or a security by such instalments, payable at such times, as the court, having regard to the means of the debtor or hirer and any surety, considers reasonable;
> . . .
> "130. (1) Where in accordance with rules of court an offer to pay any sum by instalments is made by the debtor or hirer and accepted by the creditor or owner, the court may in accordance with rules of court make a time order under section 129(2) (a) giving effect to the offer without hearing evidence of means. . . ."

Secondly, section 136 provided:

> "136. The court may in an order made by it under this Act include such provision as it considers just for amending any agreement or security in consequence of a term of the order."

Thirdly, by sections 137, 138 and 139 of the Act the county court was given power to reopen credit agreements "so as to do justice between the parties" if it found a credit bargain to be "extortionate". A credit bargain was defined as extortionate if it

> "(a) requires the debtor or a relative of his to make payments (whether unconditionally, or on certain contingencies) which are grossly exorbitant, or
> (b) otherwise grossly contravenes ordinary principles of fair dealing."

In determining whether a credit bargain was extortionate regard was to be had to such evidence as might be adduced concerning interest rates prevailing at the time the bargain was made, a number of factors relating to the debtor and the circumstances of the transaction and "any other relevant considerations".

8. The provisions of the regulations directly at issue in these proceedings must be considered in more detail below. It should however be noted that the regulations were made to give effect in the United Kingdom to Council Directive 93/13/EEC (OJ 1993, L95, p 29) on unfair terms in consumer contracts ("the directive"). (They were superseded by further regulations in 1999, but these are to very much the same effect, do not govern this case and need not be further considered). It is common ground that the regulations should be construed so as to give effect to the directive, to which resort may properly be made for purposes of construction. Regulation 5, giving effect to article 6 of the directive, provides:

> "(1) An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer.
> (2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term."

Thus the Director's challenge, although addressed only to the bank's use of and reliance on the term, if upheld, may well invalidate any similar term in any other regulated agreement made by any other lender with any borrower. The questions at issue are accordingly of general public importance.

(1) The applicability of the regulations

9. Regulation 3(2) of the regulations provides:

> "In so far as it is in plain, intelligible language, no assessment shall be made of the fairness of any term which -
> (a) defines the main subject matter of the contract, or
> (b) concerns the adequacy of the price or remuneration, as against the goods or services sold or supplied."

This gives effect, almost word for word, to article 4(2) of the directive, although some light may be shed on its meaning by the 19th recital to the directive:

> "Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject matter of the contract and

> the price/quality ratio may nevertheless be taken into account in assessing the fairness of other terms; whereas it follows, *inter alia*, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;".

10. In reliance on regulation 3(2)(b) Lord Goodhart QC, on behalf of the bank, submitted that no assessment might be made of the fairness of the term because it concerns the adequacy of the bank's remuneration as against the services supplied, namely the loan of money. A bank's remuneration under a credit agreement is the receipt of interest. The term, by entitling the bank to post-judgment interest, concerns the quantum and thus the adequacy of that remuneration. This was the more obviously true if, as Lord Goodhart submitted, the merger rule as commonly understood is unsound. Where judgment is given for outstanding principal payable under a loan agreement and interest accrued up to the date of judgment, those claims (he accepted) are merged in the judgment. That is a conventional application of the principle of res judicata. But no claim for future interest has been the subject of adjudication by the court and such a claim cannot be barred as res judicata. The borrower's covenant to pay interest on any part of the principal loan outstanding thus survives such a judgment, and *In re Sneyd*, above, was wrong to lay down any contrary principle. Lord Goodhart adopted the observation of Templeman LJ in *Ealing London Borough Council v El Isaac* [1980] 1 WLR 932 at 937:

> "I do not for myself understand how a debt payable with interest until actual repayment can be merged in a judgment without interest or with a different rate of interest payable thereafter."

11. To this submission Mr Crowe, representing the Director, gave two short answers. First, condition 8, of which the term forms part, is a default provision. Its purpose, and its only purpose, is to prescribe the consequences of a default by the borrower. It does not lay down the rate of interest which the bank is entitled to receive and the borrower bound to pay. It is an ancillary term, well outside the bounds of regulation 3(2)(b). Secondly, there is no merger "rule" but only a rule of construction. It is a question of construction of any given agreement whether the borrower's covenant to pay interest is or is not to be understood as intended to continue after judgment. But whatever the correct approach to merger, it is an irrelevance. Even if a bank's borrower's covenant to pay interest is ordinarily to be taken, as in Scotland (see *Bank of Scotland v Davis* 1982 SLT 20), to continue until the full sum of principal is repaid, after as before judgment, the term remains part of a default provision and not one falling within the provisions of regulation 3(2)(b).

12. In agreement with the judge and the Court of Appeal, I do not accept the bank's submission on this issue. The regulations, as Professor Sir Guenter Treitel QC has aptly observed (*The Law of Contract*, 10th ed, 1999, p 248) "are not intended to operate as a mechanism of quality or price control" and regulation 3(2) is of "crucial importance in recognising the parties' freedom of contract with respect to the essential features of their bargain" (*ibid*, at p 249). But there is an important "distinction between the term or terms which express the substance of the bargain and 'incidental' (if important) terms which surround them" (*Chitty on Contracts*, 28th ed, 1999, "Unfair Terms in Consumer Contracts", p 747, para 15-025). The object of the regulations and the directive is to protect consumers against the inclusion of unfair and prejudicial terms in standard-form contracts into which they enter, and that object would plainly be frustrated if regulation 3(2)(b) were so broadly interpreted as to cover any terms other than those falling squarely within it. In my opinion the term, as part of a provision prescribing the consequences of default, plainly does not fall within it. It does not concern the adequacy of the interest earned by the bank as its remuneration but is designed to ensure that the bank's entitlement to interest does not come to an end on the entry of

judgment. I do not think the bank's argument on merger advances its case. It appears that some judges in the past have been readier than I would be to infer that a borrower's covenant to pay interest was not intended to extend beyond the entry of judgment. But even if a borrower's obligation were ordinarily understood to extend beyond judgment even in the absence of an independent covenant, it would not alter my view of the term as an ancillary provision and not one concerned with the adequacy of the bank's remuneration as against the services supplied. It is therefore necessary to address the second question.

(2) *Unfairness*

13. Regulation 4 of the regulations is entitled "Unfair terms" and provides:

> "(1) In these Regulations, subject to paragraphs (2) and (3) below, 'unfair term' means any term which contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.
> (2) An assessment of the unfair nature of a term shall be made taking into account the nature of the goods or services for which the contract was concluded and referring, as at the time of the conclusion of the contract, to all circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.
> (3) In determining whether a term satisfies the requirement of good faith, regard shall be had in particular to the matters specified in Schedule 2 to these Regulations.
> (4) Schedule 3 to these Regulations contains an indicative and non-exhaustive list of the terms which may be regarded as unfair."

Schedule 2 to the regulations provides:

> "In making an assessment of good faith, regard shall be had in particular to:
> (a) the strength of the bargaining positions of the parties;
> (b) whether the consumer had an inducement to agree to the term;
> (c) whether the goods or services were sold or supplied to the special order of the consumer, and
> (d) the extent to which the seller or supplier has dealt fairly and equitably with the consumer."

Each of (a), (b) and (c) also appear in Schedule 2 to the Unfair Contract Terms Act 1977 among the guidelines for application of the reasonableness test laid down by that statute, suggesting that some similarity of approach in applying the two tests may be appropriate. In a case such as the present, where the fairness of a term is challenged in the absence of any individual consumer, little attention need be paid to (b) and (c). It may however be assumed that any borrower is in a much weaker bargaining position than a large bank contracting on its own standard form. (d) applies a general test of fair and equitable dealing between supplier and consumer. Schedule 3 contains a list of indicative and illustrative terms which may because of their object or effect be regarded as unfair. Examples are terms which have the object or effect of "(e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;", "(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;", or "(k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided". It is not suggested that the term falls within any specific entry in the list. It is common ground that fairness must be judged as at the date the contract is made, although account may properly be taken of the likely effect of any term which is then agreed and said to be unfair.

14. The 15th and 16th recitals to the directive are relevant. They provide:

> "Whereas it is necessary to fix in a general way the criteria for assessing the unfair character of contract terms;
> Whereas the assessment, according to the general criteria chosen, of the unfair character of terms, in particular in sale or supply activities of a public nature providing collective services which take account of solidarity among users, must be supplemented by a means of making an overall evaluation of the different interests involved; whereas this constitutes the requirement of good faith; whereas, in making an assessment of good faith, particular regard shall be had to the strength of the bargaining positions of the parties, whether the consumer had an inducement to agree to the term and whether the goods or services were sold or supplied to the special order of the consumer; whereas the requirement of good faith may be satisfied by the seller or supplier where he deals fairly and equitably with the other party whose legitimate interests he has to take into account;".

Article 3(1) of the directive is the counterpart of regulation 4(1), and is in terms which are for present purposes indistinguishable. The directive has no annex to the effect of Schedule 2 to the regulations, but has an annex in terms identical to those of Schedule 3.

15. The trial judge first asked himself whether the term was inherently unfair and concluded that it was not because a borrower, to whom the effect of the term had been fully explained, would not have regarded it as unfair that he would be obliged, in the event of his default, to pay interest on the full sum owed to the lender until complete repayment, even if the court permitted him to pay by instalments extending over a substantial period ([2000] 1 WLR 98 at 108C-H). The judge then considered whether the term was unfair because a defaulting borrower would not expect to bear an interest charge over and above any instalments ordered by the court, and whether the term deprived the consumer of a benefit or advantage which he might reasonably expect to receive. The judge resolved these issues in favour of the bank (pp 108-111), observing (at p 111H) that

> "if the provisions of sections 129 and 136 of the Act of 1974 are correctly used by the courts the inclusion of the provisions of clause 8 need not operate to impose on a borrower post judgment interest where it would not be appropriate and just to do so."

16. The Court of Appeal differed from the judge on the question of unfairness. In the judgment of the court it was said ([2000] QB 672 at 688):

> "In our judgment the relevant term is unfair within the meaning of the Regulations of 1994 to the extent that it enables the bank to obtain judgment against a debtor under a regulated agreement and an instalment order under section 71 of the Act of 1984 without the court considering whether to make a time order, or, if it does and makes a time order, whether also to make an order under section 136 to reduce the contractual interest rate. The bank, with its strong bargaining position as against the relatively weak position of the consumer, has not adequately considered the consumer's interests in this respect. In our view the relevant term in that respect does create unfair surprise and so does not satisfy the test of good faith; it does cause a significant imbalance in the rights and obligations of the parties by allowing the bank to obtain interest after judgment in circumstances when it would not obtain interest under the Act of 1984 and the Order of 1991, and no specific benefit to compensate the borrower is provided; and it operates to the detriment of that consumer who has to pay the interest."

The Court of Appeal did not grant an injunction but instead accepted undertakings offered by the bank (subject to appeal) which would bring to the borrower's attention the powers of the court under sections 129 and 136 of the 1974 Act and ensure that a claim to post judgment contractual interest would not be enforced by the bank after the court had made an instalment order unless the court's attention had previously been drawn to its powers under sections 129 and 136 and it had considered whether to exercise those powers.

17. The test laid down by regulation 4(1), deriving as it does from article 3(1) of the directive, has understandably attracted much discussion in academic and professional circles and helpful submissions were made to the House on it. It is plain from the recitals to the directive that one of its objectives was partially to harmonise the law in this important field among all member states of the European Union. The member states have no common concept of fairness or good faith, and the directive does not purport to state the law of any single member state. It lays down a test to be applied, whatever their pre-existing law, by all member states. If the meaning of the test were doubtful, or vulnerable to the possibility of differing interpretations in differing member states, it might be desirable or necessary to seek a ruling from the European Court of Justice on its interpretation. But the language used in expressing the test, so far as applicable in this case, is in my opinion clear and not reasonably capable of differing interpretations. A term falling within the scope of the regulations is unfair if it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirement of good faith. The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour. This may be by the granting to the supplier of a beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty. The illustrative terms set out in Schedule 3 to the regulations provide very good examples of terms which may be regarded as unfair; whether a given term is or is not to be so regarded depends on whether it causes a significant imbalance in the parties' rights and obligations under the contract. This involves looking at the contract as a whole. But the imbalance must be to the detriment of the consumer; a significant imbalance to the detriment of the supplier, assumed to be the stronger party, is not a mischief which the regulations seek to address. The requirement of good faith in this context is one of fair and open dealing. Openness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in Schedule 2 of the regulations. Good faith in this context is not an artificial or technical concept; nor, since Lord Mansfield was its champion, is it a concept wholly unfamiliar to British lawyers. It looks to good standards of commercial morality and practice. Regulation 4(1) lays down a composite test, covering both the making and the substance of the contract, and must be applied bearing clearly in mind the objective which the regulations are designed to promote.

18. In support of his contention that the term is unfair the Director adduced evidence of complaints made to him by a number of borrowers. Some of these disclose a very highly unsatisfactory state of affairs. In one case a husband and wife borrowed £3,000 plus £443.70 for insurance to finance improvements to their home. The principal was repayable over a five-year term by instalments of £84.89 plus £8.98 insurance. The borrowers fell into arrear and judgment was given for £3,953.11. The court ordered this sum to be paid by monthly instalments of £4.18, at which rate (it was calculated) the judgment debt would take 78 years to clear. Meanwhile, under the contract, interest would continue to accrue even if the instalments were fully and punctually paid. The bank's deponent described these borrowers as "a good example of customers who demonstrated

an ability easily to pay the instalments for home improvements when the credit was granted but thereafter appeared to have undertaken many other financial commitments which seriously prejudiced their ability to pay" the bank. A financial statement prepared on these borrowers some months before the county court judgment is consistent with that assertion.

19. For the Director, reliance was placed on the provisions in the 1991 order which denied the court power to order payment of statutory interest on money judgments given under regulated agreements and precluded entitlement to interest in any case where payment by instalments had been ordered and the instalments had been fully and punctually paid. It was argued that the term was unfair because it denied the borrower the protection which those provisions afforded. It was argued, in the alternative, that the term was unfair for the more limited reason upheld by the Court of Appeal.

20. In judging the fairness of the term it is necessary to consider the position of typical parties when the contract is made. The borrower wants to borrow a sum of money, often quite a modest sum, often for purposes of improving his home. He discloses an income sufficient to finance repayment by instalments over the contract term. If he cannot do that, the bank will be unwilling to lend. The essential bargain is that the bank will make funds available to the borrower which the borrower will repay, over a period, with interest. Neither party could suppose that the bank would willingly forgo any part of its principal or interest. If the bank thought that outcome at all likely, it would not lend. If there were any room for doubt about the borrower's obligation to repay the principal in full with interest, that obligation is very clearly and unambiguously expressed in the conditions of contract. There is nothing unbalanced or detrimental to the consumer in that obligation; the absence of such a term would unbalance the contract to the detriment of the lender.

21. It seems clear, as the judge pointed out ([2000] 1 WLR 98 at 111) that a secured lender who does not obtain a money judgment but instead proceeds for possession and sale under the mortgage may obtain interest at the contract rate provided for in the mortgage down to the date when he is actually repaid, and in my opinion there is nothing unbalanced or detrimental to the consumer in that result either.

22. Should it then be said that the provisions of the 1991 order render the term unfair, providing as it does for a continuing obligation to pay interest after judgment notwithstanding the payment of instalments by the borrower in accordance with a court order? It is, I think, pertinent that the 1974 Act, which laid down a number of stipulations with which regulated agreements must comply, did not prohibit terms providing for post-judgment interest even though it required claims to enforce regulated agreements to be brought in the county court which could not at the time award statutory interest in any circumstances. The 1974 Act was passed to protect consumers and such a prohibition would no doubt have been enacted had it been recognised as a necessary or desirable form of protection. The Crowther Committee, on whose report (Cmnd. 4596, March 1971) the Act was based, did not recommend such a prohibition; indeed, it contemplated the recovery of contractual interest: see paragraphs 5.4.3, 6.6.33, 6.6.44(iv) and 6.7.16). It is also pertinent that judgments based on regulated agreements appear to have been excluded from the scope of the county court's power to award statutory interest in response to observations of Lord Donaldson of Lymington MR in *Forward Trust Ltd* v *Whymark* [1990] 2 QB 670 at 681: but that was a case based on a flat rate agreement, in which the judgment in default would include a sum for future interest not yet accrued, in contrast with a simple rate agreement of the present kind (see [2000] 1 WLR 98 at 110-111; [2000] QB 672 at 679); the logic underpinning exclusion of statutory interest in the one case would not apply, at any rate with the same force, in the other. It is understandable that when a court is exercising a statutory power to order payment by instalments it should not also be empowered to order payment of statutory interest if the instalments are duly paid, but the term is directed to the

recovery of contractual and not statutory interest. I do not think that the term can be stigmatised as unfair on the ground that it violates or undermines a statutory regime enacted for the protection of consumers.

23. It is of course foreseeable that a borrower, no matter how honourable and realistic his intentions when entering into a credit agreement, may fall on hard times and find himself unable to honour his obligations. The bank's standard conditions recognise that possibility by providing for the contingency of default. The 1974 Act even more fully recognises that possibility, by providing for time orders to be made and providing that when a time order is made the terms of the underlying agreement may also be amended. These provisions are clearly framed for the relief not of the borrower who, having the means to meet his contractual obligations, chooses not to do so, but for the relief of those who cannot pay or cannot pay without more time. Properly applied, these provisions enable the undeserving borrower to be distinguished from the deserving and for the contractual obligations of the deserving to be re-drawn in terms which reasonably reflect such ability, if any, as he may then have to repay within a reasonable period. Where problems arise in practice, it appears to be because borrowers do not know of the effect of sections 129 and 136; neither the procedure for giving notice of default to the borrower nor the prescribed county court forms draw attention to them; and judgments will routinely be entered in the county court without the court considering whether to exercise its power under the sections.

24. I have no hesitation in accepting the proposition, inherent in the Director's submissions, that this situation is unacceptable. I have much greater difficulty in deciding whether the difficulties derive, as the Court of Appeal concluded, from the unfairness of the term or from the absence of procedural safeguards for the consumer at the stage of default. When the contract is made, default is a foreseeable contingency, not an expected outcome. It is not customary, even in consumer contracts, for notice to be given to the consumer of statutory reliefs open to him if he defaults. The 1974 Act does not require that notice of the effect of sections 129 and 136 be given. The evidence contains examples of clauses used by over 30 other lenders providing for the payment of interest after judgment, and none alerts the borrower to these potential grounds of relief. Regulation 4 is directed to the unfairness of a contract term, not the use which a supplier may make of a term which is in itself fair. It is readily understandable that a borrower may be disagreeably surprised if he finds that his contractual interest obligation continues to mount despite his duly paying the instalments ordered by the court, but it appears that the bank seeks to prevent that surprise by sending what is described in the evidence as a standard form of letter:

> "You need only pay the amount ordered by the Court under the terms of the judgment but you should be aware that under the terms of the agreement interest continues to accrue on your account.
> It is therefore in your interest to increase the instalment paid as soon as possible otherwise a much greater balance than the judgment debt may quickly build up."

On balance, I do not consider that the term can properly be said to cause a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirement of good faith.

25. I do not think that the issues raised in this appeal raise any question on which the House requires a ruling from the European Court of Justice to enable it to give judgment and I would not accordingly order a reference to be made.

26. For the reasons I have given, and those given by each of my noble and learned friends, I would allow the bank's appeal with costs in the House and the Court of Appeal and restore the order of the judge.

27. In conclusion, I would add a footnote on sections 129 and 136 of the 1974 Act. In the course of argument the House was referred to the decision of the Court of Appeal in *Southern and District Finance plc v Barnes and Barnes* and two related appeals reported at [1995] CCLR 62. The effect and interaction of sections 129 and 136 were there considered.

28. Of section 129 the court said (at p 68):

> "When a time order is made, it should normally be made for a stipulated period on account of temporary financial difficulty. If, despite the giving of time, the debtor is unlikely to be able to resume repayment of the total indebtedness by at least the amount of the contractual instalments, no time order should be made. In such circumstances it will be more equitable to allow the regulated agreement to be enforced."

I would in general agree that time orders extending over very long periods of time are usually better avoided. But I note that the court dismissed an appeal against a judge who had rescheduled payments over a period of 15 years ("Though the judge's methods were robust and his reasoning economical, his instincts were sound and his order just": p 71), and the broad language of section 129 should be so construed as to permit the county court to make such order as seems to it just in all the circumstances.

29. Of section 136 the court said (at p 68):

> "The court may include in a time order any amendment of the agreement, which it considers just to both parties, and which is a consequence of a term of the order . . ."

In the case already referred to the judge had ordered that no additional interest should be payable beyond that which had already accrued, and the Court of Appeal upheld his decision. It was right to do so: provided the amendment is a consequence of a term of the time order, the court should be ready to include in a time order any provision amending the agreement which it considers just to both parties.

LORD STEYN

My Lords,

30. This is the first occasion on which the House has had the opportunity to examine an important branch of consumer law. It is therefore appropriate to consider the framework in which the questions before the House must be considered.

31. As between the directive and the domestic implementing regulations, the former is the dominant text. Fortunately, the 1994 Regulations, and even more so the 1999 Regulations, appear to have implemented the directive in domestic law in a manner which ought not to cause serious difficulty. The purpose of the directive is twofold, viz the promotion of fair standard contract forms to improve the functioning of the European market place and the protection of consumers throughout the European Community. The directive is aimed at contracts of adhesion, viz "take it or leave it" contracts. It treats consumers as presumptively weaker parties and therefore fit for protection from abuses by stronger contracting parties. This is an objective which must throughout

guide the interpretation of the directive as well as the implementing regulations. If contracting parties were able to avoid the application of the directive and regulations by exclusionary stipulations the regulatory scheme would be ineffective. The conclusion that the directive and regulations are mandatory is inescapable.

32. The directive is not an altogether harmonious text. It reflects the pragmatic compromises which were necessary to arrive at practical solutions between member states with divergent legal systems. But, despite some inelegance and untidiness in the text, the general principle that the construction must be adopted which promotes the effectiveness and practical value of the system ought to overcome difficulties. And the concepts of the directive must be given autonomous meanings so that there will be uniform application of the directive so far as is possible.

33. The directive made provision for a dual system of *ex casu* challenges and pre-emptive or collective challenges by appropriate bodies: see article 7. This system was domestically enacted in the 1994 Regulations, with the Director General of Fair Trading as the administering official to investigate and take action on complaints: see regulation 8. The 1999 Regulations extended the system of enforcement by including other bodies as qualified to undertake pre-emptive challenges. The system of pre-emptive challenges is a more effective way of preventing the continuing use of unfair terms and changing contracting practice than *ex casu* actions: see Susan Bright, "Winning the battle against unfair contract terms", (2000) 20 Legal Studies 331, 333-338. It is, however, to be noted that in a pre-emptive challenge there is not a direct *lis* between the consumer and the other contracting party. The directive and the Regulations do not always distinguish between the two situations. This point is illustrated by the emphasis in article 4.1 of the directive and regulation 4(2) on the relevance of particular circumstances affecting a contractual relationship. The directive and the regulations must be made to work sensibly and effectively and this can only be done by taking into account the effects of contemplated or typical relationships between the contracting parties. Inevitably, the primary focus of such a pre-emptive challenge is on issues of substantive unfairness.

34. Under the Regulations, a term in a standard form contract that is unfair is not binding on the consumer. But certain provisions, sometimes called core terms, have been excepted from the regulatory regime. Regulation 3(2) so provides:

> "In so far as it is in plain, intelligible language, no assessment shall be made of the fairness of any term which - (a) defines the main subject matter of the contract, or (b) concerns the adequacy of the price or remuneration, as against the goods or services sold or supplied."

Clause 8 of the contract, the only provision in dispute, is a default provision. It prescribes remedies which only become available to the lender upon the default of the consumer. For this reason the escape route of regulation 3(2) is not available to the bank. So far as the description of terms covered by regulation 3(2) as core terms is helpful at all, I would say that clause 8 of the contract is a subsidiary term. In any event, article 3(2) must be given a restrictive interpretation. Unless that is done article 3(2)(a) will enable the main purpose of the scheme to be frustrated by endless formalistic arguments as to whether a provision is a definitional or an exclusionary provision. Similarly, article 3(2)(b) dealing with "the adequacy of the price of remuneration" must be given a restrictive interpretation. After all, in a broad sense all terms of the contract are in some way related to the price or remuneration. That is not what is intended. Even price escalation clauses have been treated by the Director as subject to the fairness provision: see Susan Bright, loc. cit., at pp 345 and 349. It would be a gaping hole in the system if such clauses were not subject to the fairness requirement. For these further reasons I would reject the argument of the bank that regulation 3(2), and in particular 3(2)(b), take clause 8 outside the scope of the regulations.

35. Given these conclusions the attack on the merger principle mounted by the bank was misplaced. In any event, I am not willing to uphold criticism by the bank of the well tried and tested principle of merger. I would therefore reject the bank's submissions under this heading.

36. It is now necessary to refer to the provisions which prescribe how it should be determined whether a term is unfair. Implementing article 3(1) of the directive regulation 4(1) provides:

> "'unfair term' means any term which contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer."

There are three independent requirements. But the element of detriment to the consumer may not add much. But it serves to make clear that the directive is aimed at significant imbalance against the consumer, rather than the seller or supplier. The twin requirements of good faith and significant imbalance will in practice be determinative. Schedule 2 to the Regulations, which explains the concept of good faith, provides that regard must be had, amongst other things, to the extent to which the seller or supplier has dealt fairly and equitably with the consumer. It is an objective criterion. Good faith imports, as Lord Bingham has observed in his opinion, the notion of open and fair dealing: see also *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433. And helpfully the commentary to the 2000 edition of Principles of European Contract Law, prepared by the Commission of European Contract Law, explains that the purpose of the provision of good faith and fair dealing is "to enforce community standards of fairness and reasonableness in commercial transactions": at 113; *A fortiori* that is true of consumer transactions. Schedule 3 to the Regulations (which corresponds to the Annex to the directive) is best regarded as a check list of terms which must be regarded as potentially vulnerable. The examples given in Schedule 3 convincingly demonstrate that the argument of the bank that good faith is predominantly concerned with procedural defects in negotiating procedures cannot be sustained. Any purely procedural or even predominantly procedural interpretation of the requirement of good faith must be rejected.

37. That brings me to the element of significant imbalance. It has been pointed out by Hugh Collins that the test "of a significant imbalance of the obligations obviously directs attention to the substantive unfairness of the contract": "Good Faith in European Contract Law," (1994), 14 Oxford Journal of Legal Studies 229, 249. It is however, also right to say that there is a large area of overlap between the concepts of good faith and significant imbalance.

38. It is now necessary to turn to the application of these requirements to the facts of the present case. The point is a relatively narrow one. I agree that the starting point is that a lender ought to be able to recover interest at the contractual rate until the date of payment, and this applies both before and after judgment. On the other hand, counsel for the Director advanced a contrary argument. Adopting the test of asking what the position of a consumer is in the contract under consideration with or without clause 8, he said that the consumer is in a significantly worse position than he would have been if there had been no such provision. Certainly, the consumer is worse off. The difficulty facing counsel, however, is that this disadvantage to the consumer appears to be the consequence not of clause 8 but of the County Courts (Interest on Judgment Debts) Order 1991. Under this Order no statutory interest is payable on a county court judgment given in proceedings to recover money due under a regulated agreement: see regulation 2. Counsel said that for policy reasons it was decided that in such a case no interest may be recovered after judgment. He said that it is not open to the House to criticise directly or indirectly this legal context. In these circumstances he submitted that it is not legitimate for a court to conclude that fairness requires that a lender must be able to insist on a stipulation designed to avoid the statutory regime under the 1991 Order. Initially I was inclined to uphold this policy argument. On reflection, however, I have been

persuaded that this argument cannot prevail in circumstances where the legislature has neither expressly nor by necessary implication barred a stipulation that interest may continue to accrue after judgment until payment in full.

39. For these reasons as well as the reasons given by Lord Bingham I agree that clause 8 is not unfair and I would also make the order which Lord Bingham proposes.

LORD HOPE OF CRAIGHEAD

My Lords,

40. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Bingham of Cornhill. I agree with it, and for reasons which he has given I too would allow the appeal. I also agree with my noble and learned friend Lord Millett that the real source of the problem revealed by this case remains to be tackled. It is with that point particularly in mind that I wish to add these observations.

41. The term to which the Director has taken objection is to be found in the last sentence of condition 8 of the bank's standard form. It seeks to do three things. Firstly, it provides that interest on the amount which becomes payable under that condition is to be payable in accordance with condition 4. Second, it provides that interest is to be payable on that amount until payment after as well as before any judgment. Third, it makes it clear that the obligation to pay interest is to be independent of and not to merge with the judgment. The amount on which the interest is to be charged is described in the preceding sentence. It consists of (a) the balance on the customer's account, (b) interest outstanding at the specified date and (c) other costs, charges and expenses incurred in trying to obtain the repayment of the unpaid instalment of such balance and interest. Mr Crowe for the Director made it clear that no objection was taken to the provision in the first part of the sentence that interest was to be payable on that amount. He accepted that this part of the sentence cannot be regarded as unfair. The contractual term which he says is unfair is to be found in the other parts of the sentence, which provide that interest on the amount referred to in the first part of it is to be payable after as well as before any judgment and that the obligation to do so is to be independent of and not to merge with the judgment.

42. Regulation 3(2)(b) of the Unfair Terms in Consumer Contracts Regulations 1994 provides that no assessment is to be made of the fairness of any term which concerns the adequacy of the price or remuneration as against the goods or services supplied. This is the provision on which Lord Goodhart QC relied when he said that the fairness provisions did not apply in this case. But it seems to me to be plain that the last sentence of condition 8 is not concerned with the adequacy of the remuneration which the bank is to receive for making its money available to the borrower.

43. As the nineteenth recital to the Council Directive 93/13/EEC indicates, regulation 3(2) applies only to terms which describe the main subject matter of the contract or are directly related to the adequacy of the price charged for the goods or services. The last sentence of condition 8 is concerned with neither of these two things. The obligation to pay interest on the outstanding balance is set out in condition 4. It is there that the provisions are to be found that concern the adequacy of the price charged for the loan. Condition 8 is a default provision. The last sentence of it is designed to enable interest to be recovered on the whole of the amount due on default. That amount includes legal and other costs, charges and expenses, so it is not confined to the outstanding balance due by the borrower. I do not think that it can be said to be directly related to the price charged for the loan or to its adequacy. It is concerned instead with the consequences of the borrower's breach of contract. It sets out what is to happen if he fails to make the repayments to the

bank as they fall due. I agree that regulation 3(2)(b) does not apply to it, and that its fairness as defined in regulation 4(1) of the 1994 Regulations must be assessed.

44. The primary reason which the Director has given for maintaining that the term is unfair is the uncertainty, confusion and hardship which has been shown to result from the bank's practice of claiming contractual interest from its borrowers after judgment has been given for the principal. Particular unfairness is said to arise where an order is made to pay the debt by instalments, whether under section 71 of the County Courts Act 1984 or a time order under section 129 of the 1974 Act, and where no consideration has been given to making an order under section 136 of the 1974 Act to amend the agreement so as to prevent the accrual of contractual interest on instalments which are paid when they fall due. The fact that it is commonplace for no consideration to be given to the use of section 136 when payment by instalments is being ordered is not in dispute. So it is not surprising that borrowers, on finding that they are liable for further amounts in addition to the instalments provided for in judgments obtained against them by the bank, have complained to the Director.

45. I am not persuaded that, despite these consequences, the term is unfair. The meaning to be given to the word "unfair" in this context is laid down in regulation 4(1) of the 1994 Regulations. Guidance as to how the words used in that paragraph are to be understood is to be found in the sixteenth recital to the directive. The recital explains what "constitutes the requirement of good faith". It states that an assessment of the unfair character of unfair terms must be supplemented by an overall evaluation of the different interests involved. Regulation 4(2) indicates the wide range of circumstances to be taken into account in the assessment. It provides that the assessment is to be done as at the time of the conclusion of the contract. But an appreciation of how the term will affect each party when the contract is put into effect must clearly form part of the exercise. It has been pointed out that there are considerable differences between the legal systems of the member states as to how extensive and how powerful the penetration has been of the principle of good faith and fair dealing: *Lando and Beale, Principles of European Contract Law, Parts I and II* (Combined and Revised, 2000), p 116. But in the present context there is no need to explore this topic in any depth. The directive provides all the guidance that it needed as to its application.

46. Following this approach it does not seem to me that there is a significant imbalance to the detriment of the borrower in the stipulation that the interest which is payable in terms of the first part of the last sentence is to be charged after as well as before any judgment and that this obligation is not to merge in the judgment. The primary obligation in condition 4 is to pay interest on the outstanding balance due to the bank. The plain fact is that, in the event of a default by the borrower, the bank will not have recovered all of its money until the entire balance on the borrower's account has been paid. The main purpose of the last sentence is to ensure that the borrower does not enjoy the benefit of the outstanding balance after judgment without fulfilling the corresponding obligation which he has undertaken to pay interest on it as provided for in the contract. While the working out of that purpose may give rise to uncertainty in practice, the term itself does not seem to me to be unfair.

47. There is however an underlying problem, and it is not difficult to identify. It is not possible for a lender who seeks to enforce a regulated agreement in England and Wales to obtain from the court an order for interest to be paid on the judgment debt. Section 141 of the 1974 Act provides that the county court is to have jurisdiction to hear and determine such actions and that they shall not be brought in any other court. The County Courts (Interest on Judgment Debts) Order 1991 (SI 1991/1184) enables the county court to award statutory interest, but it excludes regulated agreements from that power. It also provides that where payment of a judgment debt is to be made by instalments interest is not to accrue under that Order on the amount of any instalment until it

falls due. Where there is an independent covenant to pay interest which does not merge in the judgment, contractual interest will continue nevertheless to accrue and remain payable. It is not unreasonable to think that the problem would be greatly reduced, and perhaps removed entirely, if it were possible for the lender to obtain an order from the county court which included post-judgment contractual interest when judgment was being given for the principal. If that were possible, separate proceedings to recover post-judgment contractual interest would be unnecessary. It would also enable the court to take account of the borrower's liability for post-judgment contractual interest when it is considering whether to make an order for the amount due to be paid by instalments.

48. This is an English appeal, so the practice of the Scottish courts as regards the making of orders for the payment of contractual interest is not directly relevant. But the 1974 Act extends to the whole of the United Kingdom, and the bank uses the same standard form when it is entering into transactions with Scottish borrowers. In Scotland, actions to enforce regulated agreements must be brought in the sheriff court: section 141(3) of the 1974 Act. It appears never to have been doubted that post-judgment interest may be awarded on a money claim in the sheriff court, although a sheriff does not have power to order the payment of interest on the sum awarded in any decree unless it has been asked for expressly in the sum sued for: Dobie, *Sheriff Court Practice* (1952), p 104; Macphail, *Sheriff Court Practice* (2nd ed, 1998), para 9.93. The rate at which interest may be recovered on a judgment in that court is regulated by section 9 of the Sheriff Courts (Scotland) Extracts Act 1892 (55 & 56 Vict (c17)) as amended from time to time by various Acts of Sederunt. It provides that where interest is included in a decree or extract it shall be deemed to be at the prescribed rate (currently 8 per cent) "unless otherwise stated."

49. The question whether it was competent for post-judgment interest to be ordered at the contractual rate was the subject of competing decisions in the sheriff court. But doubts on this point were removed by the decision of the Inner House in *Bank of Scotland v Davis* 1982 SLT 20. It was held in that case that there was no good reason why the court should refuse to grant a decree for payment of interest in terms of the parties' contract. The Lord Justice-Clerk (Wheatley) referred with approval to observations by Sheriff Sir Allan G Walker QC in *Bank of Scotland v Forsyth* 1969 SLT (Sh Ct) 15. I think that it is worth quoting the following passage from the sheriff's note in that case:

> "When an obligation to pay is created for the first time by a decree of court, as in an action of damages for negligence, it is clearly desirable that interest from the date of the decree until payment should be at the customary rate which at present is 5 per cent. No doubt this customary rate is susceptible of change, but until it is deliberately changed by the courts, it will be allowed automatically on all such decrees. I can see no reason, however, why this customary rate should be applied when the parties themselves have, by their own contract, fixed the rate of interest which is to be paid….It seems clearly inequitable that the bank should be denied the right to obtain the agreed interest on the money lent because, from the date of the decree onwards, the court absolves the defender from paying interest in excess of 5 per cent. The view has been expressed that when pursuers obtain the advantages and sanctions of the law by constituting their debt by action, they must be content with interest at the rate of 5 per cent. I cannot myself understand, however, why it should be regarded as just that a contracting party must be denied the aid of the court in enforcing a contract, unless he is prepared, as the price of obtaining that aid, to surrender his right to receive the rate of interest which the other party contracted to pay."

50. As the sheriff's use of the phrase "constituting their debt by action" indicates, a similar rule is followed in Scotland to that which applies in England under the merger rule. When the court pronounces decree for a principal sum due under a contract, the obligation to pay that sum is then

owed under the court's decree and not under the contract. This principle has been recognised by the Prescription and Limitation (Scotland) Act 1973, which provides that the five year prescription which applies to any obligation to pay a sum of money does not apply to an obligation to obtemper a decree of court: Schedule 1, para 2 (a). The sheriff's discussion of the application of the principle appears also to assume - consistent with the merger rule - that, if the court is unable to award post-judgment interest on the principal sum at the rate provided for in the contract, the right to recover interest thereafter at the contractual rate would be lost.

51. The question whether the court will enforce a term that interest at the contractual rate may be charged on the principal sum due after as well as before any judgment does not seem to have been tested in Scotland. But it has been rendered academic by the decision in *Bank of Scotland v Davis* that post-judgment interest at the contractual rate may be awarded in the sheriff court. In contrast to the position which applies in England under the County Courts (Interest on Judgment Debts) Order 1991, section 1(7) of the Debtors (Scotland) Act 1987 provides that interest may be recovered on a time to pay order pronounced in the sheriff court if the creditor has given notice to the debtor of his intention to claim interest: see also the Act of Sederunt (Summary Applications, Statutory Applications and Appeals etc Rules) 1999 (SI 1999/929) which prescribes the form of notice which is to be used. There is no provision which excludes regulated agreements from this power.

52. As Lord Millett has observed, the Scottish practice of awarding post- judgment interest at the contractual rate in the sheriff court avoids the uncertainty, confusion and hardship which would otherwise arise if the borrower were to be exposed to further proceedings to satisfy the bank's claim for interest at the contractual rate. Like him, I do not think that it would be right to express a view in this case as to whether the Scottish practice could be followed under existing law and practice in England in the county court. But I suggest that consideration should now be given to the question whether the present constraints on the awarding of interest in the county court should be relaxed to enable this to be done. Any such relaxation could be combined with the making of rules, similar to those in the 1999 Act of Sederunt, designed to ensure that a borrower against whom proceedings were brought is made fully aware at the outset of the powers which the county court has under the relevant statutes to prevent hardship.

LORD MILLETT

My Lords,

53. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Bingham of Cornhill. I agree with it, and for the reasons he gives I too would allow the appeal. Because of the importance of the case, and because the real source of the problem remains to be tackled, I propose to add a few brief observations of my own.

54. A contractual term in a consumer contract is unfair if "contrary to the requirement of good faith [it] causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer". There can be no one single test of this. It is obviously useful to assess the impact of an impugned term on the parties' rights and obligations by comparing the effect of the contract with the term and the effect it would have without it. But the inquiry cannot stop there. It may also be necessary to consider the effect of the inclusion of the term on the substance or core of the transaction; whether if it were drawn to his attention the consumer would be likely to be surprised by it; whether the term is a standard term, not merely in similar non-negotiable consumer contracts, but in commercial contracts freely negotiated between parties acting on level terms and at arms' length; and whether, in such cases, the party adversely affected by the inclusion of the term or

his lawyer might reasonably be expected to object to its inclusion and press for its deletion. The list is not necessarily exhaustive; other approaches may sometimes be more appropriate.

55. The substance of the transaction in the present case is self-evident. It is a loan repayable by instalments with interest on the balance from time to time outstanding until the whole of the principal is repaid. The borrower would have no difficulty in understanding this. Nor would he think it unfair. If his attention were drawn to the impugned term, ie that interest should continue to be paid on the outstanding balance after as well as before judgment, he might well be surprised at the need to spell this out, but he would surely not be at all surprised by the fact. It is what he would expect. The term does not affect the substance of the transaction, which is that the borrower should continue to pay interest on the principal from time to time outstanding, nor does it impose any further or unexpected liability upon him not inherent in the basic transaction. It is included only to protect the lender from the (to modern eyes artificial) meaning placed on a covenant to pay interest by the Court of Appeal in *In re Sneyd, Ex p Fewings* (1883) 25 Ch D 338, where a covenant to pay interest on the balance of the principal sum from time to time remaining unpaid was construed as meaning remaining due under the covenant, so that it fell when the covenant was subsumed in the judgment.

56. The term is not only a standard term in non-negotiable loans to consumers, but in commercial loans freely negotiated between parties on equal terms and acting with professional advice. I venture to think that no lawyer advising a commercial borrower would dream of objecting to the inclusion of such a term, which merely reinforces and carries into effect what the parties themselves would regard as the essence of the transaction.

57. I am satisfied, therefore, that the term is not unfair. It does not cause an imbalance in the parties' rights and obligations; and the lender did not act in bad faith by taking advantage of the borrower's weakness of bargaining power or lack of professional advice to insist upon a term which would otherwise have been omitted.

58. This is not to say that the many complaints which the Director General has received from borrowers are without substance. These are borrowers who have failed to keep up the instalments and suffered a judgment in consequence. Asked to suggest terms on which they can satisfy the judgment, they offer to pay it off by instalments. They are advised to offer as much as they can afford. They do so; their offer is accepted; and they duly pay all the instalments required of them. Despite having done so, they find that they have not discharged their contractual obligations but are still liable in respect of interest which has accrued since judgment and which was not covered by the instalment agreement. Where the agreed instalments are insufficient to keep interest down, the amount still outstanding when all the instalments have been paid is greater than the amount for which judgment was given.

59. Despite the fact that lenders draw attention to these consequences when inviting borrowers to agree terms of repayment, they must still come as a nasty shock to many of them. I think that they have a legitimate grievance. A man who breaks his contract, suffers a judgment, makes an offer which is accepted to satisfy the judgment by instalments, and duly pays all the instalments required of him, would expect to be discharged from all further liability. The reason that this is not the case is that the amount for which judgment is given is not co-extensive with the amount for which the borrower is contractually liable. The practice in England and Wales is for the court to give judgment for the amount of principal and interest outstanding at the date of judgment, without reference to the borrower's continuing liability to pay interest on the outstanding balance of the principal sum after judgment. This has the unfortunate (though not I think the inevitable)

consequence that the parties subsequently agree terms of repayment of the judgment debt rather than of the borrower's greater contractual liability.

60. This does not happen in Scotland, where I understand the courts give judgment for the arrears of principal and interest at the date of judgment together with interest at the contractual rate on the arrears of principal until payment. If the judgment were in that form, then the borrower's compliance with a repayment schedule designed to satisfy the judgment debt would automatically discharge his contractual obligations. This would avoid the unfairness that occurs where a borrower who could not afford the instalments necessary to discharge his contractual obligations is induced to offer the smaller or fewer instalments sufficient to satisfy the judgment, and (because he can afford them) refrains from applying for relief while leaving himself exposed to further proceedings.

61. But this unfairness does not arise from any inherent unfairness of the term. It is due to the limited nature of the judgment and the fact that it does not cover the whole of the borrower's indebtedness to the lender. I am not myself convinced that an English court could not make an order in the same form as the Scottish courts do; and there is old authority that it could do so: *Arnott v Redfern* (1826), 3 Bing 353. Counsel were unable to identify any persuasive reason why it cannot. But we have heard no argument on the question, and it would be wrong to express any concluded view on so important a matter without full argument. In the meantime I would hope either (i) that lenders would invite borrowers to agree instalment terms to discharge the contractual indebtedness and not merely the judgment debt or (ii) that administrative arrangements could be made so that instalment agreements which left an outstanding contractual liability were automatically referred to the district judge for consideration.

LORD RODGER OF EARLSFERRY

My Lords,

62. I have had the opportunity of reading the speech of my noble and learned friend Lord Bingham in draft and, for the reasons which he gives, I too would allow the appeal. I add two short observations.

63. On behalf of the appellants Lord Goodhart submitted that the last sentence in condition 8 fell within regulation 3(2)(b) of the Unfair Terms in Consumer Contracts Regulations 1994 which provides:

> "In so far as it is in plain, intelligible language, no assessment shall be made of the fairness of any term which -
>
> …
>
> (b) concerns the adequacy of the price or remuneration, as against the goods or services sold or supplied."

This is a transposition of part of article 4(2) of Directive 93/13/EEC:

> "Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language."

It is common ground, of course, that the domestic regulation requires to be read in conformity with the meaning of the directive.

64. At first sight the language of both the regulation and the directive is somewhat strange since it might seem to suggest that the court is not to consider the fairness of a term which concerns "the adequacy", in its usual sense of "the sufficiency", of the price or remuneration as against the goods or services sold or supplied. But it is obvious from the context that this cannot be what is intended. In his opinion Evans-Lombe J accepted a submission to the effect that "adequacy" must be read "as meaning the equivalent of 'the extent of … the remuneration' ": *Director General of Fair Trading v First National Bank PLC* [2000] 1 WLR 98, at p. 107 B - C. That interpretation seems to me to risk watering down what the directive may have intended. While the point was not explored before us and I therefore express no concluded view on it, I note that the French text of the directive uses the word "adéquation" and the German text the word "Angemessenheit". Both may suggest that what is in issue is the "appropriateness" of the price or remuneration as compared with the services or goods - in other words whether there is an equivalence between the services or goods and the consideration for them. This would seem to be consistent with the reference to "the price/quality ratio" in the nineteenth recital. It may therefore be that "adequacy" in both the directive and the regulations should be interpreted in that spirit. Which is indeed how I understand your Lordships to have approached the matter.

65. The appeal reveals that, under the system that prevails in England and Wales, a borrower may punctually pay all the instalments required of him under a time order and still find, to his dismay, that he owes money to the bank because post-judgment interest has been accruing and has not been factored into the instalments. I share the general view that this is a highly unsatisfactory state of affairs. Basing himself on this unsatisfactory position, in one part of his argument the Director General suggested that the final sentence of condition 8, which ensures that post-judgment interest is recoverable, is unfair because the bank do not draw attention to the borrower's rights under section 129 of the Consumer Credit Act 1974 to apply for a time order and, more particularly perhaps, under section 136 to ask the court making a time order to amend the loan agreement. The suggestion was that, if the borrower were made aware of the powers and drew attention to it, the county court judge might use section 136 to adjust the rate of post-judgment interest so as to ensure that the borrower who duly paid the required instalments thereby discharged the whole of his liability to the bank.

66. I agree with your Lordships that condition 8 cannot be regarded as unfair simply because the bank do not draw the borrower's attention to the remedies that may be available under the 1974 Act. The Act itself does not require that the borrower should be alerted to the effect of sections 129 and 136. But if the Director General thinks that the borrower's attention should be drawn to this matter at the time when the agreement is made, then he has powers under the Act to deal with the situation. The form and content of documents embodying regulated agreements, such as the agreement in this case, are prescribed by regulations made by the Secretary of State under section 60(1) of the 1974 Act. In terms of paragraph (c) of that subsection the Secretary of State may make such provisions as appear to him appropriate with a view to ensuring that the debtor is made aware of the protection and remedies available to him under the Act. It would therefore be open to the Secretary of State to amend the relevant regulations so as to require the prescribed form of agreement to include a reference to the borrower's remedies under sections 129 and 136. This is a matter as to the working of the regulations on which the Director General could advise the Secretary of State, in the exercise of his general duty under section 1(2)(b) of the Act.