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Legal Theory and Raison D'etre Behind the Use of Unfair Contract Terms

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LEGAL THEORY AND RAISON D'ETRE BEHIND THE USE OF UNFAIR CONTRACT TERMS

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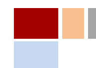
Abstract

This article discussed unfair contract terms, explores the relevant legal theories that underpin the use of unfair contract terms and examines the raison d'etre for using unfair terms in a contract. The qualitative and doctrinal legal research methods were used in this study. Data were obtained through documentation techniques, which included examining and analyzing several journals, books, and other related documents. Based on library research and content analysis of primary and secondary data sources, the findings indicated that the theory put forward by legal philosophers is to ensure that law and society can be balanced. The use of standard form contracts increases the implementation of unfair contract terms; nonetheless, this study found there is raison d'etre in using unfair terms, particularly in the event of safety, security, government regulatory, operational, and health concerns. Therefore, it is hoped that the study will contribute to a knowledge of contract law.

Keywords: *Contract; Legal Theory; Unfair Contract Terms; Standard Form Contract.*



A. Introduction

A contract is defined as an agreement between two parties to establish mutual legal obligations, with both parties agreeing on the terms in the same mind (*consensus id idem*). It is an enforceable promise and legally binding to the parties. There are at least two parties involves a promisor and a promisee (Beatson, Burrows, & Cartwright, 2016). Parties in a contract must perform their obligations as promised without prejudice to the law and themselves.

The contract can be fair or unfair depending on the intention of the contracting parties. Unfair contract terms are generally found in a standard form contract that contains terms that exclude or limits the liabilities, rights, and obligations of one party known as a weaker party i.e. buyer in a contract. According to Abu Bakar & Amin (2016), standard terms and standard form contracts are usually used to legalize transactions, and before payment and execution of the agreement, the buyer must consent to all the standard terms. In some circumstances, standard form contracts are unfair to the buyer. However, the use of unfair contract terms in a standard form contract is generally valid and binding the parties if they agree and ratify the terms. Sometimes, the buyer is agreeing with the terms and conditions of the contract in *bona fide* and free consent.

The legal issue of unfair contract terms is never-ending. Thus, ACCC (n.d.) and Alexandra (2013) outline the requirements to determine the unfair terms which are (i) the terms that would cause a significant imbalance in the contracting parties' rights and obligations; and (ii) it is not reasonable to protect the legitimate interests of the party who would benefit from using the term; and (iii) if it were to be used or relied on, it would cause detriment to a party (financial or otherwise); and/or (iv) transparency. In a situationwhere unfair contracts happen between sellers and buyers, Rod (2018) proposes penalties and notices of infringement should be enforced. The objective of this study is to discuss unfair contract terms, to explore the underpinned legal theory of the use of unfair terms in a standard form contract, and to examine the *raison d'etre* behind the use of unfair contract terms. Therefore, this study is hoped to be able to contribute to the new knowledge by adding existing literature on the unfair contract terms.

B. Method

This study employs a qualitative and doctrinal research methodology by examining several journals, books, and other related documents based on library research and content analysis of primary and secondary data sources. According to Cotterrell (1997); Chynoweth (2008); and Vibhute & Aynalem, (2009), doctrinal analysis is concerned with legal theory and its development based on an examination of concepts and existing legal principles contained in legislation and cases by conducts an analysis of the law, decision-making processes, and the principles that govern it.Webley (2010) contended qualitative research methodsmay be conducted by exploratory, explanatory, or descriptive research. Furthermore, the qualitative study focuses on the in-depth study to identify relevant facts, circumstances, phenomena, and factors concerning the topics in discussion(Muttaqin Mansur, Sulaiman, & Ali, 2020). Thus, a qualitative descriptive approach will be used to analyze the data obtained.

Documentation has been used to collect data for this study, which was carried out by examining the content of the document. This study requires a proper examination of both primary and secondary sources. Using primary sources is significant in presenting an argument that has legal relevance in line with understanding exactly what the law says about the topic discussed. Legislation, regulations, rules, case law, and laws are examples of primary sources while case law, textbooks, journal articles, seminar papers, newspapers, and official websites are examples of secondary sources.

Accordingly, qualitative and doctrinal legal research is an appropriate methodology to use in this study to explore the underpinned legal theory of the use of unfair terms in a standard form contract and to examine the *raison d'etre* behind the use of unfair contract terms.

C. Result and Discussion

The study discusses unfair contract terms, explores the legal theory underpinning the use of unfair contract terms, and examines the *raison*

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d'etre behind the use of unfair terms in a contract. The result of this study is based on the discussion of the documentary analysis presented in this study.The discussion in this study resulted in the finding that some terms that tend to be unfair terms are acceptable in some situations and become legal, particularly where the purpose of the used terms is significant and for the benefit of the party to the contract, particularly in the event of the operational, safety, government regulation, health or security issues.

1. Unfair Contract Terms

Unfair contract terms are terms in a contract that exclude or limit one party's liabilities, rights, and obligations. Unfair contract terms, which are commonly found in standard form contracts, are legally binding if the parties in a contract have agreed and accept the terms.Normally, unfair contract terms used in the form of exclusion clauses and the written form of receipts, invoices, and other sales documents, and almost the normal form of the contract to be drawn up by the seller, it must be predicted that unfair contract terms exist (Amin, 2013). It is normally prepared by one person called the dominant party i.e. seller to make a promise and offer benefit to them without allowing room for negotiation to the weaker party i.e. buyer.

According to Yasmin (2016), a standard form clause in a standard form contract that provides a limitation or elimination of liability for the legal implications is known as an exclusion clause. In the 19th century, the widely used exclusion clause was a part of a *laissez-faire* philosophy. It was derived from the theory of freedom of contract which unfair trade practices and have undermined consumer rights in many commercial transactions (Abdullah & Shaik Ahmad Yusoff, 2018). The clause in the standard form of a contract that excludes the liability of a contracting party for breaches of the specified or implied terms of the contract is operated harshly and to the detriment of consumers (Mahmood, 1993).

According to Mahmood (1993) and K. Ilobinso (2018), the most common type of contract uses standard form contracts and include the exclusion clause are disclaimer notices used in prescription packets, terms printed on flight bookings, terms, and conditions used in newly purchased electronics or consumer

goods, public transport tickets, receipts, and other forms of standard consumer contracts which lead to being unfair for the buyer as a weaker party in a contract.

In a case of a limitation of liability clause, it is often used as a disclaimer in a contract that limits the liability for loss or harm and further determines the scope of damages which can be sought under such cases. Generally, limitation occurs in the context of a limitation on damages, such as a limitation clause on liability or a liability limit, and unfair provision in a limited liability on the compensation of damages (Mallet & Flayyih, 2020).The terms of the contract may usually be explicit or unambiguous but often consist of unfair contract terms. In this situation, the weaker party agrees because he has no choice but to agree with the contract (Zulhafiz & Rahman, 2020). This is based on the 'take-it or leave-it contract that is commonly used nowadays.

The extensive use of unfair contract terms in commercial contracts today requires an examination of the legal theories that underpin the use of such terms, as well as identifying the reason for its application.

2. Legal Theories Underpinning the Use of Unfair Contract Terms

The implementation of a standard form contract has evolved with theories of equal bargaining power and freedom of contract in the contract (Mallor, 1986). Nevertheless, it deviated from the theoretical approach, and from time-to-time, the buyer becomes a weaker party when facing with standard form contract. This study explores five (5) legal theories underpinning the use of the unfair contract.

a. The Theory of Freedom of Contract

Contract freedom implies the right to make any contract, to rely on its compliance, and does not to have the contract's simple terms scrutinized for fairness. Contract freedom is formed based on the voluntary process of allocating risk where parties are free to rely on their decisions where they have the power to determine worthiness and to take responsibility for future-oriented decisions. Brand (2009) contended that it would be contrary to the market environment and the need for commercial and contractual certainty to make contracts subject to equal considerations. Before the era of contractual freedom, parties to a contract often had much less power over the formation of

their contractual obligations, as the concept of a binding promise was the opposite as to what it eventually was under contractual freedom. The philosophy of contractual freedom transforms each individual as absolutely autonomous, independent, and free from any obligation to any other person.

According to May Fong (2009), freedom of contract allows the parties the right to choose whether to enter into a contract or not, and it requires for the parties to be obliged to the contracts they voluntarily entered into. However, the freedom of contract causes several issues, such as inequalities of bargaining power, the use of standard form contracts, and implementation of implied terms as well as consumer protections since in reality, it does not enable the effective practice (Klappstein, 2014).

The contract depends on the free will of the contracting parties, not only for its formation but also for the interpretation and validity of the terms of the contract. 'However, freedom of contract exists in a broad domestic environment in which individual rights are limited to those resulting from particular legal contracts and apply only to the other party or parties to such a contract (Rosenfeld, 1985). The role of the law in establishing contract freedom is to ensure that legal and commercial institutions are set up in such a way as to support a free and open market (Irakli, 2017).

Adam Smith who introduced the doctrine of economic *laissez-faire* gave rise to contract law where the parties enter into a contract by freedom without any interference by the government thus, economic by freedom would generate a higher degree of economic welfare than would accumulate if it were to be guided or controlled by government, inefficient, incompetent and profligate, as it was in practice (Bishop, 1995).

This study observed that the freedom of contract approach is to maximize the freedom to agree and to enforce what has been agreed upon by the contracting parties. The standard form contract is commonly used in the commercial industry offers terms as stated in a contract based on a 'take-it or leave-it basis. Sometimes, in standard form contract, unfair terms are present on the limited liability of the offeror, exclusion clause, and security reason for unforeseen and expected circumstances. However, if the buyer by free consent agrees to enter into and abide by the contract even several terms are found

unfair to them, the contract becomes valid. Unless if the buyer does not know of the existence of the unfair terms in the contract they agreed to.

b. Doctrine of Consideration

One of the developed theories in the common law is the doctrine of consideration. It originated in the early stages of English contract law and was part of the English legal system. Consideration is a required element of any legal contract on which the parties negotiate, and it is also important for the parties in a contract to uphold and execute their duties. The consideration serves an important rule which it helps to differentiate between promises and mere intention (Gordon, 1990). Levin & Mcdowell (1983) contended there must be consensus and consideration to make a contract valid and bind the parties.

As far as promises are concerned, it was not enforceable unless the parties in a contract met the reciprocity requirement. A major effect of the requirement for mutuality is the existence of a possible paradigm between the moral and legal obligations to uphold promises. Within the requirement of consideration, the principle of reciprocity finds its principal embodiment. Consideration was used to denote the *quid pro quo* requirement and was defined as the exchange element necessary for a contract to be enforceable as a bargain (Rosenfeld, 1985).

To make an agreement enforceable, it must be delivered formally and is supported by consideration, but it cannot be justified in principle, at least with regards to the consideration element (Lorenzen, 1919). Consideration is one of the aspects required for a contract to be supported. The content of the contract is represented; that is, what is exchanged between the parties. It must also be proved that legal consideration has been expressed as part of the agreement (Giancaspro, 2019).

Contract law requires a balance of two opposing intentions where the contract must not restrict the legitimate exercise of the freedom of an individual to enter into agreements as he chooses; but it must be vigilant to ensure that an apparent agreement is the product of a genuine exercise of that freedom ('Inequality of Bargaining Power as an Occasion for the Non-

Enforcement of Bargains in Which the Consideration Is Inadequate', 1927). Choi & Triantis (2012) examined the issue of excessive distributions of bargaining power because one side has the right to enforce trade terms. However, it is observed during a negotiation process, contract imbalance may occur and as a result, the negotiation can also be unfair (Trakic, 2016).

Therefore, in the situation where unfair contract terms are used in a standard form contract, if the buyer agrees to the terms specified in the contract and gives his consideration, the contract becomes enforceable, and he is obliged to adhere to the terms of the contract. However, the contract would not be concluded or enforceable if the buyer does not give his consideration to the terms stated in a contract. The significance of this doctrine is that it indicates that all parties benefit from the contract.

c. The Theory of Good Faith

The doctrine of the utmost good faith, also known as "uberrimae fidei" by its Latin name, is a legal doctrine of contracts that requires contracting parties to act honestly andnot mislead or withhold information essential to the contract. The issue of good faith is raised when such an agreement is imperfectly expressed and prepared for an uncertain future (Burton, 1980).

In the case of *Kirke La Shelle Co. v. Paul Armstrong Co.* 263 N.Y. 79 (N.Y. 1933), the implied agreement of good faith and fair dealing were introduced where the court referred to the fiduciary relationship which had its origin in the contract and imposed upon the parties the duty of utmost good faith. Court of Appeal stating that:

> *"in every contract, there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing",*

The duties of good faith should be included in all future contracts and equally and fairly updated (Dimatteo & Sacasas, 1995). The doctrine of good faith thus seems to be a warrant for the use of judicial wisdom and is possibly unpredictable and inconsistent. Hence, this theory of good faith can be used to protect a weaker party in a contract against a dominant party

(Burton, 1980). However, agreements in which performance in good faith is fundamental cannot be enforceable due to indefiniteness or lack of mutuality.

d. Law of Obligation

A person who made a contract has a duty and an obligation to fulfill and execute the contract when he has promised to do so by agreeing with the terms stated in a contract (Kronman, 1981). An obligation is not meant to be used in conjunction with a contract; rather, it refers to a voluntary act that a reasonable person would regard as binding on him or her. The obligation becomes voluntary to the extent that the obligor wishes to enter into a contract voluntarily and willingly (Levin & Mcdowell, 1983).

Klappstein (2014) contended, despite one of the parties' wishes to the contrary, the obligation to contract is the responsibility to perform a contract with a party who requires the subject matter of the contract. Furthermore, the obligation to contract is administered by public law, while the implication of the contract is governed by private law. Al-Tawil (2012) indicated that the promisor is bound by legal and moral obligations in a contract. For a contractual obligation to be legally binding, both voluntariness and fairness must be fulfilled where a voluntary contract is one in which the party's consent to the terms of the contract without being forced to do so (Levin & Mcdowell, 1983).

e. The Reliance Theory

According to the doctrine of reliance, a contract determines the performance of the contracting party, however, the party does not ensure performance and does not have an obligation to do so (Jaffey, 1998). This guarantees that the contracting parties shall carry out their obligations as specified in the contract. In general, the contract reflects the contracting party's performance, but in fact, it does not guarantee the contracting parties' ability to perform the contract. Thus, the parties in a contract have to rely on the terms as they agree and perform the obligation as stated in a contract with a *bona fide*.

Gordon (1990) contended that the reliance theory can provide expectation damages if it is needed by the court and this theory is concerned with the

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promisee's reliance on the contract enforceable between the parties. The simple agreement can rise to the level of an enforceable duty if the real test of reliance is used. Facts of actual reliance on the simple agreement would then support the case of a plaintiff which is commonly the weaker party in a contract.

In several simple agreement cases, courts have used the reliance principle to describe a liability determination, and if a plaintiff may show real reliance on the simple agreement and that the reliance was reasonable, then the contract can be a cause of action (Dimatteo & Sacasas, 1995). Furthermore, if the plaintiff can prove any misrepresentation in the cost paid by him or his willingness to make a deal with the market price is sufficient to disregard the theory (Contreras, 2015). If one party has taken appropriate steps to bring the contractual terms to the notice of the other party and entering into the contract, the first party's reliance on the other party's intention to be bound by those terms would be considered reasonable (Jaffey, 1998).

3. Raison D'etre Behind the Use of Unfair Terms in a Contract

Bayles (1983) indicated it is essential to determine the numerous function that a contract law theory can implement i.e. by prediction, explanation, and justification. Therefore, this study found that the use of unfair terms in standard form contracts for security and safety reasons, is for the benefits of all parties, and the urgent situation to state the unfair terms is based on the parties' knowledge and interpretation.

For example, Conditions 5.8 Contract of Carriage of Air Asia (Malaysia) airlines states:

> *"We do not guarantee to provide any particular seat in the aircraft. This may be necessary for operational, safety, government regulatory, health or security reasons..."*

In an earlier discussion, there are four (4) requirements to be met to determine terms and conditions are unfair contract terms. As an example in the terms and conditions of Air Asia above, the terms and conditions used by the airline carriage contract are not considered to be unfair contract terms because the second requirement is not met i.e. the terms of a contract are

not reasonable in protecting the legitimate interests of the party that will benefit from using the terms. The purpose of the terms in conditions 5.8 is to protect the airline company as well as the passenger in the event of operational, safety, government regulation, health, or security issues.

By exploring the five legal theories of the use of unfair contract terms, the first theory of contract freedom is based on a voluntary process of contractual terms in which parties are able to rely on their own decisions and take responsibility for future-oriented decisions. If a negotiation process achieves a decision in a contract even when the contract terms are found unfair, the contract is valid because the parties to the contract act in a *bona fide* and agree to abide by the terms without being pressured to enter into a contract.

The second theory discussed in this study is the doctrine of consideration. One of the elements that make a contract valid is a consideration. The concept of 'something in return' refers to the obligation of the parties to execute the terms of a contract that they have agreed to,according to the element of offer and acceptance. As an example of the condition 5.8 of Contract of Carriage of Air Asia, when the buyer agrees to the terms and conditions with the purchase of airline ticket, the consideration arise when a buyer wants to use the service of the airlines and for 'something in return, he makes a payment for the service. Thus, unfair contract terms are not an obstacle to performing an obligation as long as the parties are in the knowledge and understand the terms and conditions used. It is observed, contract imbalance may arise during the negotiating process, and for an agreement to be enforceable, it must be delivered formally and supported by consideration.

The theory of good faith is the third theory explored in this study. Contracting parties must act honestly and do not mislead or withhold information essential to the contract. The question of good faith occurs where such an agreement is inadequately expressed and not prepared for an unforeseen situation. Contracts must be performed with good faith and become fair to the contracting parties; particularly where unfair terms are included in a contract. Thus, the contract drafter must be able to justify the reason for the use of unfair contract terms as well as ensure the parties acknowledge the transparency by the use of the terms.

The next theory discussed in this study is the theory of obligation. An obligation is described as a voluntary act that a reasonable person would consider as binding on him because he has assented to do so by agreeing to the terms specified in a contract, and a person who has made a contract should uphold and execute the contract. The theory of obligation indicates that the parties are bound by their promises. Even if unfair contract terms were used, the parties are obligated to fulfill the contract as they promise as well as there are reasonable and significant reasons of the use of unfair term in a contract. The rule of obligations is very important, and it deals with good faith and the fair performance of the contract.

The reliance theory is the fifth theory exploredin this study. The parties to a contract must rely on the terms as they agree and fulfill the obligations stated in the contract to ensure that they carry out their obligations as specified in the contract. According to the reliance theory, the contracting parties must carry out their obligations as specified in the contract. The use of unfair contract terms demonstrates that the parties relied on the terms stated during the promise. If the use of unfair contract terms is transparent, it brings to the knowledge and understanding of the parties in a contract. However, if the use of unfair contract terms is proven to be insignificant and unreasonable, the contract's remedies will be considered, particularly if the weaker party has not had free consent to conclude a contract.

D. Conclusion

Based on the discussion above, unfair contract terms are commonly used in a standard form contract and there are four requirements to fulfill in determining whether the terms used are unfair contract terms or *vice versa*. If one of the requirements is not met, the terms are not considered unfair contract terms. To use unfair terms in a contract, one of the important elements which are transparency is required to state clearly the terms and conditions in the notice or tickets, thus, the contracting parties will understand and have the ability to interpret the terms. The importance to determine unfair contract terms is to balance the right and obligations of the contracting parties. Thus, by exploring the theory underpinning the use of unfair contract

terms, this study observed the theory put forward by legal philosophers is to ensure that law and society can be balanced. By using standard form contracts today, the weaker parties in a contract could question whether the legal theory developed a long time ago has been implemented following the contract of commercial transactions. Therefore, by exploring the legal theories of unfair contract terms based on different jurisprudence, this study concluded that the use of some terms that are deemed to be unfair has its justification and its reason behind it. Thus, the statute, the lawmaker, and the court all have a huge role in this issue past, present, and future.

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