

# Guidance on unfair terms in contracts for communications services

## Introduction

1. Standard form terms in contracts for the supply of goods and services in the UK, between sellers or suppliers and consumers, must comply with the Unfair Terms in Consumer Contracts Regulations 1999 (“the Regulations”). The OFT, together with a number of other bodies including Ofcom, share the task of enforcement. As a qualifying body, Ofcom has certain duties to consider complaints about terms in contracts used by communications providers (“CPs”)<sup>1</sup>.
2. The OFT has published general unfair contract terms guidance, based on its experience of enforcing the Regulations, which addresses a wide range of terms in consumer contracts.<sup>2</sup> While in many cases this is helpful in considering terms in consumer contracts within communications markets, it does not directly address some of the common terms in contracts for communications services.
3. Ofcom believes that sector-specific guidance (this “Guidance”) on a limited range of such issues will benefit CPs and consumers. This Guidance focuses principally on contract terms which provide for the payment by the consumer of additional charges, default charges, minimum contract periods and notice periods, and contract terms which may lead to additional charges being incurred.
4. Ofcom expects CPs to review their terms in light of the Guidance and to amend or remove any that are unfair. Unfair terms are not legally enforceable against consumers (see Regulation 8(1)), so it is in CPs’ interests, as well as consumers,’ to ensure that terms are fair.

## Aims of this Guidance

5. Whether a term is unfair is a matter ultimately for the courts to decide. But, there is only limited case law to assist CPs and consumers in this area, and no guidance which directly addresses terms in contracts for communications services. So, Ofcom considers that it is in the interests of all parties for us to set out our views as to the likely application of the Regulations to certain such terms.
6. The aim of this Guidance, therefore, is to set out how Ofcom considers the Regulations are likely to apply to certain standard terms in contracts for the supply of communications services and on terms that in our view may be unfair (or potentially unfair). It is intended to help CPs meet the requirements of the Regulations, as well as to assist Ofcom and any other bodies which have powers to enforce the Regulations. It complements OFT guidance on the Regulations.

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<sup>1</sup> As we define them below, for the purposes of this Guidance.

<sup>2</sup> See, for example, [http://www.ofcom.gov.uk/shared\\_ofcom/reports/unfair\\_contract\\_terms/oft311.pdf](http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/oft311.pdf)

7. Whether or not Ofcom takes enforcement action, and any enforcement action that we may take, will depend on the facts of any individual case. This Guidance sets out the approach we expect to take in performing our obligations and exercising our powers under the Regulations.
8. We will take an active role in enforcing the Regulations. We will monitor complaint levels and examine CPs' standard terms to see whether they are consistent with our view of the law as set out in this Guidance. Where they are not, we will consider the best way to enforce the law, including taking the necessary formal enforcement action using our powers under the Regulations and/or the Enterprise Act 2002.
9. Whilst it sets out the approach we are likely to take, this Guidance is not binding on Ofcom, nor is it an exhaustive statement about unfair terms in contracts for communications services. We may depart from it where there are good reasons for doing so. If, in any given situation, we decide to depart from what we say in this Guidance, we will normally set out our reasons for doing so.
10. We note that in addition to the Regulations, CPs are also subject to General Conditions (under the Communications Act 2003), including GC 9 about contract terms, GC 10 on transparency and publication of information and GC 12 on itemised bills.

### **Scope of this Guidance**

11. While the Regulations apply to all sellers and suppliers of goods and services to consumers, this Guidance relates in particular to all suppliers of services in sectors that Ofcom regulates. We use the term 'services' to include fixed and mobile telephony, broadband, and pay-TV services; and we use the term "CPs" to refer to suppliers of such services.<sup>3</sup>
12. This Guidance relates to standard terms and conditions for the provision of services where there is an ongoing monthly liability and does not therefore cover, for example, pre-pay mobile telephony or pay on demand TV. Contracts for such services are also subject to the Regulations but the charges addressed in this Guidance do not usually apply to those services.
13. The Guidance covers the following terms and the charges provided for by them:
  - 13.1 Non-direct debit ("non-DD") charges (i.e. charges imposed by CPs on customers who do not pay their bills by direct debit or a similar method)
  - 13.2 Default charges (i.e. late payment charges, charges for payment failure and charges for reconnection)
  - 13.3 Initial Minimum Contract Periods ("MCPs") and Early Termination Charges ("ETCs")
  - 13.4 Subsequent Minimum Contract Period ("subsequent MCPs")

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<sup>3</sup> And we include in the term any organisation providing services in the sectors we regulate.

- 13.5 Minimum notice periods (“MiNPs”)
  - 13.6 Itemised and paper billing charges
  - 13.7 Cease charges
14. Although this Guidance does not cover all types of terms in CPs’ contracts, they are, of course, also subject to the Regulations (and the OFT’s general guidance will apply to them). If it becomes appropriate, we may in the future decide to issue further sector-specific guidance in relation to other terms (for example, where this may be helpful in supplementing or clarifying existing guidance). We will also apply the principles set out in this Guidance insofar as they are relevant to any other types of terms. The fact this Guidance does not cover other terms does not mean Ofcom may not have concerns about their fairness nor preclude Ofcom action in relation to them.
15. In addition to providing this Guidance on the Regulations, Ofcom has identified areas of best practice. We recognise that some practices which we consider important for consumer protection do not fall within the requirements of the Regulations. In these cases we have identified the actions we would like to see CPs take. These aspects may not fall within our enforcement activity under the Regulations but if we identify consumer harm arising from a failure to adhere to these standards we may consider using other powers and legislation to address that harm.

## The Regulations and enforcement

16. Standard form terms<sup>4</sup> in contracts between sellers and suppliers of goods and services and consumers must comply with the Regulations (which implement EU Directive 93/13/EEC on unfair terms in consumer contracts). The Directive was initially implemented in the Unfair Terms in Consumer Contracts Regulations 1994, which came into force on 1 July 1995, and which were subsequently replaced by the Regulations (coming into force on 1 October 1999).
17. The OFT has issued extensive guidance on the Regulations, both general and sector-specific. The two documents below provide general guidance:
- 17.1 the briefing note *Unfair Standard Terms*;<sup>5</sup> and
  - 17.2 the comprehensive *Unfair Contract Terms Guidance*.<sup>6</sup>
18. These documents give a fuller explanation of certain points made below about the Regulations and consumer contract terms in general. Reference will also be made to the OFT’s guidance on *Calculating fair default charges in credit card contracts*.<sup>7</sup>
19. Unfair terms are not binding on consumers and it is open to consumers themselves to challenge in court terms they consider unfair. In addition, under the Regulations the OFT, or a qualifying body such as Ofcom, has a duty to consider any complaint it receives about unfair standard terms. The

<sup>4</sup> Terms that are not subject to individual negotiation – sometimes called “the small print”.

<sup>5</sup> OFT143, [http://www.of.gov.uk/shared\\_of/business\\_leaflets/unfair\\_contract\\_terms/oft143.pdf](http://www.of.gov.uk/shared_of/business_leaflets/unfair_contract_terms/oft143.pdf)

<sup>6</sup> OFT311, [http://www.of.gov.uk/shared\\_of/reports/unfair\\_contract\\_terms/oft311.pdf](http://www.of.gov.uk/shared_of/reports/unfair_contract_terms/oft311.pdf)

<sup>7</sup> OFT 842, [http://www.of.gov.uk/shared\\_of/reports/financial\\_products/oft842.pdf](http://www.of.gov.uk/shared_of/reports/financial_products/oft842.pdf)

OFT and other qualifying bodies have the power to take action on behalf of consumers in general to stop the continued use of unfair terms, if necessary by seeking an injunction in England, Wales and Northern Ireland or an interdict in Scotland. It is ultimately for the courts to decide if a term is unfair under the Regulations.

20. In addition, Part 8 of the Enterprise Act 2002 gives the OFT and other bodies including Ofcom another enforcement mechanism against sellers and suppliers who breach consumer protection legislation.
21. In particular, the Enterprise Act enables the OFT and other enforcers to seek court orders against businesses that breach UK laws giving effect to EC Directives listed in Schedule 13 of that Act, where the collective interests of consumers are harmed. These UK laws include EU Directive 93/13/EEC on unfair terms in consumer contracts. Again, it is ultimately for the courts to decide if a term breaches the law and whether an order should be made.<sup>8</sup>
22. Where we consider that a CP is using unfair terms, we may accept undertakings from it that it will stop. We may also take action using whichever powers referred to above that we consider most appropriate. For example, if our concerns are not satisfactorily addressed by a CP's undertakings (or otherwise), Ofcom could apply to the courts and seek an injunction under the Regulations, or an enforcement order under the Enterprise Act. If the infringement needs to be tackled urgently, the court may make an interim injunction or enforcement order. In very urgent cases, where we think an enforcement order should be sought immediately, we can start court proceedings without entering into consultation as ordinarily required.
23. There are a number of key elements to the Regulations, to which we refer specifically in this Guidance:

23.1 **Exempt and non-exempt matters:** In some circumstances, some terms are exempt from the Regulations' test of fairness in relation to certain matters: they need not be fair (see Regulation 6(2) below). We refer to these matters as "exempt matters" (and to other matters as "non-exempt matters") and this exemption as "the exemption."

The exempt matters are:

23.1.1 the definition of the main subject matter of the contract (Regulation 6(2)(a)); and

23.1.2 the adequacy of the price as against the goods or services provided in exchange, (Regulation 6(2)(b)).

The exemption only applies where the relevant term is transparent enough: e.g. in plain, intelligible language that the consumer is able to read and understand (see below). What it means is that, as long as the relevant term is sufficiently transparent, Ofcom and the courts may not consider:

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<sup>8</sup> More information about the Enterprise Act 2002 is at: [http://www.opsi.gov.uk/acts/acts2002/ukpga\\_20020040\\_en\\_1](http://www.opsi.gov.uk/acts/acts2002/ukpga_20020040_en_1)

23.1.3 whether what the CP will provide (i.e. the main subject matter of the contract: the goods and services) is fair; nor

23.1.4 whether the price consumers must pay in exchange for goods and services is appropriate (not too high) for those goods and services.

These are the matters which reflect the two sides of a consumer contract: what the seller or supplier will provide and what the consumer will pay for it. The law does not require either of these things to be “fair.”

23.2 **Test of fairness:** Except in relation to a narrow range of exempt matters like those referred to above, terms must be fair. They must pass the test of fairness set out in Regulation 5(1).

23.3 **Transparency:** All terms, whether they relate to exempt or non-exempt matters, are required to be expressed in plain, intelligible language (Regulations 6(2) and 7(1)). Terms must also be set out with due prominence which reflects their importance to the parties.<sup>9</sup> We refer to these as requirements of “transparency.”

Amongst other things, these transparency requirements mean that the wording of terms must be comprehensible to consumers, and such that they can understand how the term affects the rights and obligations both parties have under the contract. Terms must be sufficiently clear that consumers can have a proper understanding of them for sensible and practical purposes.

Where a term does not meet the transparency requirements a matter which would otherwise be exempt under Regulation 6(2) will not be exempt, and the fairness test will apply.

24. The following parts of the Regulations are of particular relevance to this Guidance.

25. Regulation 5(1) provides that:

“A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.”

26. Regulation 6(2), which sets out matters exempt from the fairness test in Regulation 5(1), provides that:

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<sup>9</sup> Some terms may come within the exemption if they are sufficiently prominent and transparent, which may include drawing them to a consumer's specific attention, but not otherwise (See, for example, Mann J's comments at paragraph 54 of his judgment in *Office of Fair Trading v Foxtons Ltd* [2009] EWHC 1681 (Ch) and Lord Mance's at paragraph 13 of the Supreme Court's judgment in *Office of Fair Trading v Abbey National plc and others* [2009] 3 W.L.R. 1215). Some terms are also more likely to be fair the more prominent and transparent they are (see paragraphs 79, 91, 92 and 104 of the *Foxtons* judgment), though prominence and transparency alone are no guarantee of fairness.

“In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-

- (a) to the definition of the main subject matter of the contract; or
- (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.”

27. Regulation 7(1) provides that:

“A seller or supplier shall ensure that any written term of contract is expressed in plain, intelligible language....”

28. Paragraph 1 of Schedule 2 of the Regulations sets out a non-exhaustive list of terms which may be regarded as unfair. It states that terms may be unfair if, amongst other things, they have the object or effect of:

- “(b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;.....
- (d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation; [or] ....
- (h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early.”

### **Guidance on the individual charges and terms**

29. The following sections set out our guidance on contract terms which provide for each type of relevant charge. In each case there is a description of the charge, followed by the applicable guidance.

## **A. Non-Direct Debit Charges**

### **Description of the charge**

30. Consumers may pay for their services by a range of methods, including direct debit, cheque, credit card and cash (e.g. at a Post Office). Some, but not all, CPs make a charge for payment by methods other than direct debit. We refer to this as the non-direct debit (“non-DD”) charge.
31. While the non-DD charge is generally for payment by means other than direct debit, some CPs may differentiate on the basis of whether the payment is by a recurring, or non-recurring, method.
32. Some CPs only accept payments by a limited range of methods, typically direct debit and/or credit card.

### **Ofcom’s guidance**

#### Non-DD charges and the exemption

33. It will depend on the precise terms and circumstances in each case, and in particular whether the terms meet the transparency requirements referred to above, but a non-DD charge is a charge that in many cases could fall within the exemption from the fairness test.
34. A non-DD charge is likely in many cases to be part of the price the consumer must pay for the package of goods and services they receive under the relevant contract. The amount of the charge as compared to the goods and services is likely to be an exempt matter, as long as the relevant contract terms are clear enough (see Transparency above). Where this is so, the fairness test will not apply. This reflects the fact that a term providing for a charge like this will be amongst the more important terms of the contract.
35. We consider that this applies whether the non-DD charge is expressed as an additional charge or as a discount on the headline price. Either way, the consumer will incur the same liability to pay extra for payment by an alternative means.

#### The fairness test for non-DD charges where they are not exempt matters

36. Where the relevant term(s) is not expressed in plain, intelligible language and does not meet the transparency requirements, the fairness test will apply to a non-DD charge. Similarly, only the question of whether the charge is too high as against the goods and services provided under the contract is an exempt matter. The charge and the term providing for it could be challenged as unfair on other grounds.
37. One way in which we consider the fairness test could apply in relevant cases is as follows.
38. A consumer who chooses not to pay by DD may cause the CP to incur additional processing costs which are directly attributable to that method of payment. We consider that non-DD terms and charges that are subject to

the fairness test are more likely to be regarded as fair where they seek to recover only these additional costs through the non-DD charge.

39. Such terms and charges are more likely to be unfair if they seek to recover from consumers, as part of the charge, a cost component which does not reflect the CP's increased cost of taking payment by a means other than direct debit. For example, a non-DD charge that seeks to recover general "bad debt" costs is less likely fair.
40. In our view there is little evidence of a causal link between a consumer's choice of method of payment and the risk that the same consumer will fail to pay for the services provided. In particular, it is unclear how and why the choice of payment method will actually cause the consumer to go into bad debt. The principles applied in this context are consistent with the OFT's guidance on credit card default payments.
41. We recognise that the method of payment might affect how promptly consumers pay. Consumers who pay by an automated method will only ever pay late when that payment mechanism fails (e.g. due to insufficient funds). However, those who pay by non-DD may pay late due to a number of additional reasons, for example they may forget to pay, they may be away on holiday or they may not receive the bill in time due to postal delays.
42. So, in some circumstances it may be fair to recover as part of the non-DD charge costs associated with chasing late payment, such as reminder letters/bills (provided these costs are not being recovered by a specific late payment charge). This would be where there is evidence of a clear, causal relationship between payment method and the need to chase late payment.
43. One way in which we think it may be fair for a CP to calculate and apportion the costs recoverable in a non-DD charge is as follows. The CP could add up the overall annual costs (in line with our view above) of processing non-DD payments (of whatever method). It could then divide that total by a reasonable estimate of the total number of consumers it expects will be required to pay the charge, to give the annual costs recoverable from each relevant consumer. These can in turn be divided so as to enable their periodic collection.

Best practice

As a matter of best practice, Ofcom also considers that it is also important that:

- o bills clearly detail the level of any non direct debit charges as a separate line item; and
- o bills also provide information about alternative payment methods.

## **B. Default charges (late payment charges, charges for payment failure, charges for restoring service)**

### **Description of the charges**

44. Some CPs levy charges in the following circumstances:
- 44.1 a late payment charge where a consumer does not pay a bill by the due date for payment;
  - 44.2 a payment failure charge where, for example, a cheque 'bounces' or a call for payment under a recurring mandate fails due to insufficient funds; and
  - 44.3 a charge for restoring service where a consumer has earlier had their service suspended or restricted due to non-payment. For example, if payment is still not received after a certain period of time the CP may, before terminating the contract entirely, bar outgoing calls, and the status of the line will be set as Outgoing Calls Barred ("OCB"). The CP may continue to attempt to recover payment, and if it does so before it has disconnected the service entirely, it may reinstate the services but make a charge for doing so. This is known as the "OCB restored charge".

### **Ofcom's guidance**

#### **Default charges (late payment charges, charges for payment failure and charges for restoring service) are non-exempt**

45. The terms providing for these charges, and the charges themselves, are non-exempt matters. They are subject to the fairness test.
46. The terms provide for a charge that only arises where the consumer does not do what the contract requires, for example paying a bill on time, and so is in default. They are concerned with the consequences of that default: a charge that must be paid for the default where it arises.
47. As such, the charge is not part of the price or remuneration of the goods or services the CP supplies. Instead, it is an ancillary payment, and an assessment of its fairness does not concern whether the price or remuneration for the goods and services is too high (i.e. does not concern an exempt matter).
48. Our view on this point is supported by the decisions of the House of Lords in "the *First National Bank case*"<sup>10</sup> and of the Supreme Court in the "*OFT Bank Charges case*."<sup>11 12</sup>
49. The position is the same whether the charges are described as default charges or are presented as a form of "contractual option", such as the

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<sup>10</sup> *Director General of Fair Trading v First National Bank plc* [2002]1 AC 481

<sup>11</sup> *Office of Fair Trading v Abbey National plc and others* [2009] 3 W.L.R. 1215

<sup>12</sup> See, for example, paragraphs 12, 43 and 43 of the former and 43, 101, 102 and 113 of the latter.

“option” to pay late. The Regulations are concerned with the substance of terms, not merely their form. Accordingly, terms which impose such charges, however they are described, are, in our view, subject to the fairness test.

### **The fairness test for default charges (late payment charges, charges for payment failure and charges for restoring service)**

50. We consider terms providing for late payment charges, charges for payment failure and reconnection charges are likely to be fair where:
  - 50.1 the terms relating to these charges are transparent to consumers within the contract at the point of sale; and
  - 50.2 the charge includes only a reasonable pre-estimate of the direct costs incurred by the CP as a result of the consumer’s default.
51. Terms under which these charges seek to recover a greater sum are likely to go beyond the ordinary legal position – what would be recoverable in contractual damages law – and are liable to be unfair. They would likely fall into paragraph 1(e) of Schedule 2 to the Regulations as terms, “... requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation.”
52. So, we consider it is likely to be unfair for CPs to include within such charges any element which does not relate to the direct costs incurred as a result of the consumer’s default. In common with the approach of the OFT in relation to credit card default charges, we consider that the inclusion of generalised “bad debt” costs within these charges is likely to be unfair. It is our view that there is no evidence to suggest a sufficiently strong causal link between individual instances of default and failure to pay at all which would, for example, allow a CP to recover such sums from a consumer as damages for breach of contract.
53. For late payment charges, only costs such as those for chasing payments, postage, and loss of interest on bills unpaid should be included. For payment failure we think it likely to be fair to reflect external costs such as bank charges. For charges for restoring service, only direct costs such as the wholesale costs of restoring service should be included.
54. In addition, in relation to terms which impose charges for late payment, we consider that such terms are more likely to be unfair if CPs do not make clear in their contracts that such charges may only be levied after consumers have had a reasonable opportunity to pay their bills and have failed to do so. This should take into account possible postal delays as well as reasonable absence from home.
55. We also consider that these kinds of default charges are likely to be unfair where they deny a consumer the right of set-off, as follows.
56. Where a consumer has an arguable claim under a contract against a CP the law generally allows the deduction of the disputed sum from other sums the consumer has to pay. This is relevant, where, for example, a consumer disputes part of a bill and refuses to pay it. A term that allows a default

charge to be levied in these circumstances, with the effect that the right of set-off is effectively denied is, in our view, likely to be unfair.

57. Such a term is likely to fall within the indicative list of terms that may be unfair in Schedule 2 to the Regulations. It is likely to fall within paragraph 1(b) of that Schedule, which states that terms may be unfair if they have the object or effect of:

“Inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier....including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him.”

Best practice

As a matter of best practice, Ofcom also considers it is important that CPs make it very clear to consumers what the late payment charge is in advance of the consumer incurring the charge (i.e. at the point where the consumer can still avoid the charge). For example, we would expect any red bill, or reminder call, to provide this information.

## **C. Initial Minimum Contract Period (MCP) and Early Termination Charge (ETC)**

### **Description of the charge**

58. CPs may require consumers to commit to a contract of a fixed duration i.e. a Minimum Contract Period (“MCP”). This is common practice and is most likely when there are significant up-front costs for the CP, such as:

- 58.1 the cost of consumer equipment provided free or at a subsidised rate (e.g. a mobile handset or broadband modem); or
- 58.2 wholesale connection charges.

MCPs are often 12-24 months.

59. When a consumer terminates a contract of fixed duration before the expiry of the MCP, CPs usually levy an early termination charge (“ETC”).

60. Some CPs seek to charge ETCs comprising the total remaining monthly payments under the contract. Other CPs:

- 60.1 set the charge by reference to the price of the lowest priced package they offer for the relevant service;
- 60.2 cap the total charge at a maximum level; or
- 60.3 require consumers to pay the remaining monthly payments as well as return (or pay for) equipment which they would have been able to retain had they not terminated their contract early.

61. Some CPs, rather than setting a MCP, may levy a charge on termination of the contract which is dependent on the period for which the contract has been running. In such a case a consumer would be required to pay a sum upon termination of a contract if they terminated before, for example, 12 months, but not if they terminated later.
62. Contracts may also provide for a CP to provide a service for a fixed period on up-front payment by the consumer of a lump-sum. They may contain terms saying that, if the contract is terminated before the expiry of the fixed period, none of the lump sum payment will be refunded.
63. In both the cases in the two paragraphs immediately above the payment that must be made or forfeited is unlikely to be referred to as an ETC. But, the effect of the relevant terms is similar. Under the Regulations, we are concerned about the effect of a term, so this type of term may be regarded in a similar way to an ETC.
64. CPs may also seek to impose a charge similar to an ETC where they terminate the relevant contract early because of a breach by the consumer. A similar analysis applies to these charges as to the sorts of ETCs referred to above and below.

## **Ofcom's guidance**

### Terms providing for MCPs are likely to be exempt matters

65. The term providing for a MCP is likely to be one of the most important terms of the contract. Again, it will depend on the precise terms and circumstances in each case, and in particular whether the terms meet the transparency requirements referred to above, but the length of the MCP is likely in many cases to be an exempt matter (and not subject to the fairness test).
66. Meeting the transparency requirements is therefore very important. We expect the MCP terms to be sufficiently prominent in contractual documents and marketing materials that the MCP is clear to the consumer and easily recognisable as a key element of the contract. CPs must take care to ensure these documents do not mislead the consumer in relation to such terms.
67. Where the MCP is not expressed in a transparent and prominent manner, the exemption would not apply and the fairness test would. Under the Regulations, an unfair term is not binding on the consumer. So, a CP who fails to make the MCP sufficiently transparent and prominent will, insofar as the MCP is unfair, be unable to enforce it (nor any requirement to pay an ETC).
68. While in certain sectors the existence of MCPs is well known to consumers, in others it is not. We consider that the existence and/or duration of MCPs for fixed voice contracts may not be sufficiently well known or brought to the attention to consumers. We expect all CPs to follow the guidance above in ensuring that MCPs are made both prominent and transparent for all services.

## Terms relating to ETCs are non-exempt

69. Terms providing for ETCs (which are default charges or charges analogous to default charges even if they do not apply on breach of contract) are not within the exemption and are subject to the fairness test. In particular, the amount of the ETC is not an exempt matter.
70. In the contracts we are concerned with here, the consumer agrees to purchase a service for a certain minimum period. Where the consumer terminates the contract early, the CP levies a charge. That charge is payable on, and for, the termination of the contract and cessation of the service provided under it.
71. This means the charge, like the sorts of default charges referred to in section B above, is not part of the price or remuneration of the services the CP supplies. It must be paid when the CP stops providing those services, not in exchange for them (as, the often monthly (retail) price is), as a consequence of the consumer not doing what he agreed to do (fulfil the MCP). In other words, an ETC is paid as compensation for the early termination (as opposed to the goods and services). It is an ancillary payment.
72. Furthermore, assessing the fairness of a compensatory payment like an ETC does not involve assessing whether the price or remuneration of the CP's services is too high (i.e. does not concern an exempt matter). It only involves assessing, "...is £X too high as compensation for the consumer ending the contract early?" This is not an exempt matter.<sup>13 14 15</sup>

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<sup>13</sup> As we say above, a similar analysis applies to a term that provides for a charge where the CP terminates the contract because of the consumer's breach. That charge would be paid as compensation for the consumer's default, not as the price or remuneration for the CP's services. An assessment of it would consider whether it is too high as such compensation, not too high a price for those services.

<sup>14</sup> This is consistent with the Supreme Court's decision in the *OFT Bank Charges* case, in which the Court said, for example:

*"...not every provision for payment contained in a contract for the supply of goods or services is rendered immune from scrutiny under Regulation 6(2). There can be payments which do not constitute either "price or remuneration" of goods or services supplied in exchange. Further, payments which do not constitute price or remuneration in this sense can be challenged as unfair on grounds which do not relate to their appropriateness in amount as against the goods or services supplied in exchange. Heads (d), (e), (f) and (l) in the grey list of terms set out in Schedule 2 to the Regulations fall within one or both categories. Director-General of Fair Trading v First National Bank plc [2002] 1 AC 481 provides another example...."*

(Lord Mance at paragraph 101 of the judgment. For another example, see what Lord Walker said at paragraph 43).

<sup>15</sup> It does not matter that an ETC is payable where the consumer terminates the contract in a way that does not amount in law to a breach. The early termination is still of the nature of a default: a failure to do what he contracted to do. An ETC is an example of where the Supreme Court said a supplier:

*".... could not convert what were in effect penalties into "price" simply by wording their contracts so as to ensure that the contingencies that triggered liability to pay the charges did not constitute breaches of contract."*

(Lord Phillips at paragraph 83 of the *OFT Bank Charges* judgment)

## The fairness test for ETCs

73. The following sets out the principles we consider likely to apply in the assessment of fairness of ETC terms (and charges), which we consider CPs should apply in setting ETCs, and which are likely to guide us in carrying out our enforcement duties under the Regulations.
74. We consider it likely to be unfair if a CP sought to recover in an ETC a sum that would put it in a better position than if the consumer had performed his contractual obligations (and no more). This is the position the ordinary law would seek to put the CP in (by entitling it to damages for breach of contract), if the contract did not contain the term providing for the ETC and the consumer ended the contract early.
75. Put another way, it is unlikely to be fair if the ETC is more than the CP could recover in damages where the consumer breached the relevant contract. If the term providing for the ETC had this effect, it would put the CP in a better position and the consumer in a worse one, than they would be in without the term.
76. In effect, the supplier would receive a disproportionately high sum for not having to provide services under the contract and the consumer would have to pay such a sum for not receiving them. The consumer would be paying a disproportionately high sum for failing to adhere to the fixed term of his contract.
77. In our view, such a term would fall within paragraph 1(e) of Schedule 2 to the Regulations, as a term having the object or effect of, "... requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation." By doing so, it would cause a significant imbalance between the CP's rights and obligations under the contract and the consumer's, to the latter's detriment, contrary to the requirement of good faith, and would be unfair.<sup>16</sup>
78. Accordingly, in setting ETCs, we consider a CP must make a reasonable pre-estimate of the position it would have been in had the consumer done what the contract obliged him to do (and no more) (i.e. the losses it incurs because the contract is not performed for its fixed term). All we consider the CP may fairly recover in an ETC is a sum that reflects that position. That involves the CP making a reasonable pre-estimate of:
- 78.1 the costs it saves because it no longer has to perform the contract;  
and
- 78.2 the losses caused by the early termination that it can mitigate,  
and deducting those from the fixed contractual retail payments outstanding on termination.
79. That pre-estimate will include, for example, any variable costs the CP saves on the particular contract terminated (or, in practice, on contracts for the type of services concerned to the types of consumers concerned). It will

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<sup>16</sup> Again, the same analysis would apply to a term that provides for a charge where the CP terminates the contract because of the consumer's breach.

also include a reasonable pre-estimate of any network costs the CP saves in a particular, reasonable period averaged over the group of consumers terminating contracts early. We do not expect that CPs will need to calculate each individual consumer's ETC at the time of contract termination.

80. We consider that an ETC is likely to be fair where:
- 80.1 the terms providing for it are transparent at the point of sale with sufficient prominence that the consumer is fully aware of the consequences of terminating early, and what the level of the ETC would be (or, at the very least, the method by which this would be calculated e.g. the amount that would be charged for each outstanding month);<sup>17</sup>
  - 80.2 it is never greater than the amount of the (usually monthly) contractual retail payments remaining due at the date of termination;
  - 80.3 it also takes account of any costs associated with the provision of the service which will no longer be incurred,<sup>18</sup> including any:
    - 80.3.1 VAT (where the retail price is subject to VAT but the ETC is not);
    - 80.3.2 variable costs which can be avoided;
    - 80.3.3 savings in the costs of providing customer services; and
    - 80.3.4 costs of shared network elements which the consumer is no longer using, and which can be used to provide services to another consumer (whether a new customer or increased demand from an existing customer);
  - 80.4 it reflects any ability of the CP to reduce (mitigate) its loss by 'reselling' the service to a new consumer;<sup>19</sup> and
  - 80.5 it makes allowance for the CP's accelerated receipt of any sums.<sup>20</sup>
81. We do not consider that it is likely to be fair to include in an ETC recovery of anticipated profits from charges for (optional extra) services, or other sources of revenue, which are not themselves part of the consumer's contractual obligations (assuming the consumer would not do things, and

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<sup>17</sup> The less specific the term is, the more we think it liable to a finding of unfairness.

<sup>18</sup> By deducting them from the monthly retail price when calculating the ETC.

<sup>19</sup> By deducting the amount mitigated from the monthly retail price in the calculation of the ETC. This will be particularly relevant for network elements specific to a particular property (such as a copper pair or cable connection) where early termination occurs because the consumer is moving home. These network elements may subsequently be used by a new occupant.

<sup>20</sup> We agree there may also, in theory, be costs the supplier is obliged to pay third parties on early termination of contracts and which may be recovered from terminating consumers. However, we are not aware of any such charges (other than the 'cease charges' dealt with elsewhere in this Guidance). And, we think it likely the rules on remoteness may well preclude recovery of any other such costs. Further, account would, in any event, need to be taken of costs to the third party saved. Together, these mean it is unlikely this point has practical relevance.

incur charges, where he is not required to do so under the contract). This excludes from a fair ETC, in our view, charges for calls outside any inclusive bundle on a fixed voice or mobile phone contract, for example.

82. In relation to 'lost' revenues from incoming call termination charges for fixed voice and mobile phone services our view is as follows. To be able fairly to recover them in an ETC we expect a CP to be able to show that such revenues would be recoverable from consumers in damages for breach of contract were the ETC term not in the contract. Where the CP cannot, an ETC that seeks to recover these revenues is liable to a finding of unfairness.
83. We also acknowledge there is an alternative basis on which, in our view, a likely fair ETC may be recovered. Instead of<sup>21</sup> recovering an ETC on the basis above, a CP may fairly seek to recover its unrecouped expenditure on the early terminated contract. This may include its unrecouped customer acquisition or equipment subsidy costs. But, we do not consider such recoverable costs may exceed the fair ETC that may be recovered on the first basis described above.
84. This is on the basis that, in the common law contractual damages rules, an innocent party may, broadly speaking, in response to the other party's breach of contract, claim damages in respect of either: (1) lost net profits (subject to matters such as the duty to mitigate), as set out above; or (2) wasted costs. But, it cannot claim the same losses twice. Nor can it claim more on the wasted costs basis than its lost net profits.

#### Best practice

As a matter of best practice, Ofcom also considers it is important that suppliers make very clear to consumers the level of the early termination charge at the point at which the consumer is considering terminating their contract.

## **D. Subsequent Minimum Contract Period (subsequent MCPs)**

### **Description of the term**

85. A subsequent MCP may be triggered when some aspect of the contract is changed, and in return the CP requires that consumers are committed to purchasing the services for an additional fixed, minimum period.
86. Subsequent MCPs may be triggered within the initial MCP or outside it. For mobile phone contracts, subsequent MCPs will most commonly occur when a consumer makes a new commitment for a minimum term in return for a handset upgrade. For other contracts, including fixed line, broadband and pay-TV, the main triggers are upgrading or downgrading of the service level and moving house.
87. We have also seen contracts which are automatically renewed for a subsequent MCP at the end of each existing one, without there being any change in circumstances. The trigger in these cases has simply been reaching the end of the existing MCP.

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<sup>21</sup> Not in addition to

88. This Guidance is primarily concerned with terms in communications contracts that provide for the imposition of subsequent MCPs on the occurrence of “trigger” events or in “trigger” circumstances (“SMCP terms”). We acknowledge there may be some circumstances where the consumer agrees to new terms and services where what arises is a new contract between the CP and the consumer, on new terms, and in which the length of the MCP may be an exempt matter.

## **Ofcom’s guidance**

### SMCP terms are likely to be non-exempt

89. We consider that SMCP terms<sup>22</sup> are likely in most cases to be outside the exemption and subject to the Regulations’ fairness test.

90. It is important to keep in mind that exempt matters reflect the two sides of a consumer contract as set out above:

90.1 what the CP will provide - the *main* subject matter of the contract; and

90.2 the price consumers must pay in exchange.

SMCP terms are not concerned with the second. It is hard to see how they fall under the former either.

91. Looking at the way the Supreme Court referred to the first part of the exemption in *the OFT Bank Charges case*,<sup>23</sup> the main subject-matter of a contract may be goods or services. That main subject matter should be described in general terms such as, to use the Supreme Court’s examples, “... consumer goods ordered from a catalogue,” or, “...hotel services.”

92. In the contracts covered by this Guidance, the main subject matter could be described as “communications services” or perhaps, for example, “fixed voice line rental and calls services,” or “X months’ communications (or fixed voice line rental and calls) services.” Terms that provide for the triggering of a subsequent MCP are unlikely to fall within this *main* subject-matter:<sup>24</sup> all they really do is set out when certain terms of the contract could change. That is a possible future event, different from the main subject matter the CP has agreed to provide under the contract, and which might or might not happen.

### The fairness test for SMCP terms

93. In general terms, we consider it is more likely to be fair for CPs to require a commitment to a subsequent MCP where they do so transparently (the commitment is clear to the consumer) and the consumer receives a commensurate benefit in return for it. This is necessary to ensure that

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<sup>22</sup> and any term that has similar effect to a SMCP term (the effect, not the form, being what is important).

<sup>23</sup> See Lord Walker’s comments at paragraphs 39 and 40.

<sup>24</sup> Still less, “falling squarely within” the restrictively construed exemption, which is how both the House of Lords in *First National Bank* and the Supreme Court in *the OFT Bank Charges case* described the limits on the scope of the exemption.

contracts do not create a significant imbalance in the rights and obligations of the parties, to the detriment of the consumer.<sup>25</sup>

94. So, we consider the requirement for a subsequent MCP is more likely to be fair where:

94.1 any SMCP term explaining the events (such as a decision to upgrade), that will trigger a requirement for a subsequent MCP, is transparent to consumers within the contract at the point of sale;

94.2 the term sets out that the CP will make it very clear to the consumer that the event (such as a decision to upgrade) will trigger a new MCP, and the length of that new MCP, at the point that the consumer is considering the change (for example, the term says the CP will write to the consumer stating when changes to the services will result in a subsequent MCP); and

94.3 the costs incurred by the CP and the benefits to the consumer in relation to the subsequent contract are commensurate with the subsequent MCP.

95. We consider the requirement for a subsequent MCP is likely to be unfair where:

90.1 there is little benefit to the consumer arising from the relevant variation and the CP incurs no costs or costs at only a low level,<sup>26</sup>

95.2 the CP wants to change the underlying wholesale service and there is no consumer benefit. Examples of this may include where a CP wants to migrate to using LLU<sup>27</sup> to provide fixed voice and broadband services and consumers do not have a choice of staying on their original tariff and original MCP; or

95.3 there is automatic renewal upon reaching the end of an existing MCP and one or more of the conditions set out below apply.

96. Where CPs include a term providing for an ETC in respect of early termination of a subsequent MCP, we consider that such terms are, like other ETC terms, outside the exemption and subject to the fairness test. We consider that the amount of ETCs charged should be calculated in accordance with the principles set out in section C above.

### Terms providing for automatic renewal of fixed term contracts

97. Terms providing for automatic renewal of fixed term contracts are a particular category of SMCP terms providing for subsequent MCPs, where the trigger is reaching the end of the existing MCP.

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<sup>25</sup> Whether a term falls within paragraphs 1(h), (j) or (k) of Schedule 2 to the Regulations is also relevant to its fitness.

<sup>26</sup> such as where the consumer wants to upgrade their tariff, either within or outside the initial MCP, or downgrade it outside their initial MCP, and there are no/low upfront cost implications for the CP

<sup>27</sup> Local Loop Unbundling

98. Our concern about such terms is that they may be used to bind a consumer to a series of fixed-term contracts, without the consumer intending and agreeing to be so bound and without receiving any commensurate benefit for being so. The consumer may experience only an unintended extension to his payment obligations.
99. So, an automatic renewal term may cause the necessary imbalance under the Regulations by virtue of, in the words of Lord Bingham in the *First National Bank case*, "...imposing on the consumer [of] a disadvantageous burden or risk or duty." That raises the possibility it is unfair.
100. But, we also take into account that the possible unfairness of an automatic renewal term may be counter-balanced by other terms in the same contract. And, in assessing any such term for fairness we would have regard to all the relevant terms.
101. We consider automatic renewal terms are more likely to be unfair where one or more of the following applies:
- 101.1 the renewal term itself is not transparent in the contract at the point of sale;
  - 101.2 there is no accompanying term which commits the CP to sending a clear and unambiguous reminder notice at a reasonable time before the renewal term is to take effect (and no equivalent measure like a charge-free cancellation period of reasonable duration after renewal and no contractual commitment to sending a reminder of that period at the time of renewal);
  - 101.3 the terms do not provide for a clear and easily effected opt-out (or cancellation) mechanism, without unnecessary formal or procedural requirements;
  - 101.4 there is no cost to the CP and benefit to the consumer commensurate to the renewed obligation the consumer takes on;
  - 101.5 there are other terms which seek to restrict the opt-out window or require too long a notice period,<sup>28</sup> or
  - 101.6 the ETC is unfair (or so high as to have a prohibitive effect on the consumer's right to terminate the renewed contract).
102. We also consider that, as matters of good and fair business practice, it is important that any automatic renewal reminder notice is genuinely aimed at informing the consumer and prompting them actively to consider whether they wish to commit to a renewed fixed-term contract. For example, we would expect that the reminder should:
- 102.1 be sent at an appropriate point in time (neither too close to nor too far away from the renewal date);
  - 102.2 be written in plain, intelligible language;

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<sup>28</sup> and there should in any event be a term allowing early termination of the contract by the consumer with any accompanying ETC being fair.

- 102.3 have the explanation about the automatic renewal as the only (or main) subject matter; and
  - 102.4 make it clear what the consumer needs to do to prevent the automatic renewal (which procedure should not be unduly onerous – see above).
103. In any case where it became apparent these sorts of conditions were not being adhered to, we would consider whether there was appropriate legislation under which we could take action, whether under the Regulations or other provisions, such as the Consumer Protection from Unfair Trading Regulations 2008.<sup>29</sup>

## **E. Minimum Notice Periods**

### **Description of the charge**

104. Whether or not there is a MCP, CPs usually require consumers to provide formal notification of an intention to terminate a contract for communications services.
105. Ofcom has seen contracts in which the Minimum Notice Period (“MiNP”) is 30 days or one calendar month, and consumers are required to make payments up to the end of that period even if they wish to terminate the contract (and the service) earlier. Ofcom has also seen shorter MiNPs in some contracts, especially for fixed voice services.

### **Ofcom’s guidance**

#### Terms providing for MiNPs are likely to be non-exempt

106. We consider that the MiNP is unlikely to be an exempt matter. The terms providing for a MiNP do not define the main subject matter of the contract. So, those terms, and the length of the MiNP, are likely to be subject to the fairness test.

#### The fairness test for MiNPs

107. We consider a term providing for an MiNP is likely to be fair where:
- 107.1 the MiNP is transparent to consumers within the contract at the point of sale; and
  - 107.2 the MiNP reflects a reasonable period in which to carry out the necessary administration of terminating the contract.
108. Failure to set MiNPs according to the principle in the second bullet point would be likely to lead to consumers having to bear an unjustified risk of ceasing service with the losing CP before the end of the MiNP, and of

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<sup>29</sup> Ofcom also considers that it is possible there are broader policy concerns relating to automatic renewal terms and their possible impact on the market. It is possible that a term is fair under the Regulations, but, for example, nonetheless has adverse consequences for competition. These concerns are outside the scope of this Guidance but they may be the subject of further Ofcom consideration.

having to pay two CPs for a period of time in order to ensure a sufficient degree of overlap and no loss of service.

109. In addition, most of the communications services to which this Guidance applies are subject to formal service migration processes. These entitle consumers to change CPs in specified time periods. A contract term providing for a MiNP significantly longer than those periods risks frustrating that right, by requiring consumers to pay for services longer than they receive them. It is at risk of unfairness, especially where the MiNP is longer than the period reasonably required to administer the termination of the contract.
110. For fixed voice and broadband services, where the formal service migration processes which apply are likely to take between 5 and 10 working days, we consider this is likely to be a sufficient period for the necessary administration of terminating the contract. We consider that a longer MiNP in a contract for such services is liable to be unfair. This should mean the date the CP stops charging the consumer is not later than the date on which the service migration occurs.
111. For mobile services, and in any sector where no formal migration process applies, we consider that the MiNP should be no longer than reasonably necessary for the required administration. We see no reason why this should in any event be longer than 30 days and likely much less.
112. If the consumer gives notice of termination such that the end of the MiNP would fall within the MCP, the guidance in respect of early termination, set out in section C above, will apply.

#### Best practice

As a matter of best practice, Ofcom also considers it is important that CPs make it very clear to consumers what the minimum notice period is not only at the point of sale but also at the point at which the consumer is considering terminating their contract.

## **F. Itemised or Paper Billing**

### **Description of the charge**

113. The itemised or paper billing charge is a charge made to consumers for the provision of a fully itemised or paper bill. For broadband providers itemisation is not relevant, but some of these CPs charge for paper bills.

### **Ofcom's guidance**

#### Term providing for itemised or paper billing charges and the exemption

114. As with non-DD charges, the position of itemised and paper billing charges will depend on the precise terms and circumstances in each case. In particular, whether the terms meet the transparency requirements referred to above. But, these are charges that in many cases could fall within the exemption from the fairness test.

115. An itemised or paper billing charge is likely in many cases to be part of the price the consumer must pay for the package of goods and services they receive under the relevant contract. The amount of the charge as compared to the goods and services is likely to be an exempt matter, as long as the relevant contract terms are clear enough (see Transparency above). Where this is so, the fairness test will not apply. This reflects the fact that a term providing for charges like these will be amongst the more important terms of the contract.
116. Again as with non-DD charges, we consider that our analysis will apply whether the charges for itemised and paper bills are presented as additional charges or as discounts for non-itemised and/or paperless billing. The consumer will incur the same liability to pay more for itemised or paper bills either way.

#### The fairness test and terms providing for itemised and paper billing charges

117. Where the relevant term(s) is not expressed in plain, intelligible language and does not meet the transparency requirements, the fairness test will apply. And, only the question of whether the charge is too high as against the goods and services provided under the contract is an exempt matter. The charge and the term providing for it could be challenged as unfair on other grounds. One way in which we consider the fairness test could apply in this context is as follows.
118. A consumer who wishes to have itemised and/or paper billing may cause the CP to incur additional costs which are directly attributable to that level of billing. So, for example, we consider it may be fair for a CP to include in these billing charges the reasonable incremental costs of paper, printing, postage, and information processing (over and above those incurred for basic, or paperless, billing). We do not suggest that it is likely to be unfair for CPs to recover these additional costs through a charge for itemised and/or paper billing.

#### Best practice

As a matter of best practice, Ofcom also considers it is important that bills should clearly detail the level of any itemised or paper billing charges as a separate line item.

### **G. Cease Charges**

#### **Description of the charge**

119. These are charges made when the consumer ceases their service from the CP. Where they apply it is usually because there is a charge for ceasing service at the wholesale level and the CP passes this on to the consumer. They are unrelated to ETCs and MiNPs.

## Ofcom's guidance

### Terms providing for cease charges are likely to be non-exempt

120. Terms providing for cease charges are not within the exemption and are subject to the fairness test. In particular, the amount of the charge is not an exempt matter.
121. Like an ETC (see section C above), a cease charge is not part of the price or remuneration for the services the CP supplied under the relevant contract. It is a charge for (and on) ending the contract: an ancillary payment. Nor is an assessment of a cease charge an assessment of whether the price of the services is too high (an exempt matter). It is an assessment of whether a charge for ending the contract is too high (a non-exempt matter).

### The fairness test for cease charges

122. We consider cease charges are likely to be fair where the following conditions are fulfilled:
  - 122.1 the terms relating to cease charges are transparent to consumers within the contract at the point of sale;
  - 122.2 they reflect only the direct costs associated with ceasing service; and
  - 122.3 there is no double recovery (via a cease charge and another charge (like an ETC)).
123. We are likely to take seriously the levying of cease charges that do not meet these conditions. Artificially high cease charges can affect switching costs, which impede competition in the market.

#### Best practice

As a matter of best practice, Ofcom also considers it important that CPs make it very clear to consumers the level of any cease charge not only at the point of sale but also at the point at which the consumer is considering terminating their contract.