

Ofcom review of additional charges

Including non-direct debit charges and early termination charges

Statement

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Section 1

Executive Summary

Introduction

- 1.1 No one likes surprises when it comes to bills and charges. When consumers sign up for a service, they should have all the facts at their fingertips to know what it will cost – and what, if anything, might increase those costs or change the rules. And, any extra charges must be fair.
- 1.2 We believe that healthy competition is the best way to make sure consumers enjoy the benefits of new services and lower prices. However, sometimes, consumers are required to pay additional amounts of money ('additional charges'), over and above the headline prices they expect. For example, they may pay more in order to pay bills by cash or cheque, rather than by direct debit (through a 'non-direct debit' charge). Other examples include: paying an early termination charge to terminate a contract early; or paying extra to receive a fully itemised bill.
- 1.3 Ofcom has received many complaints about these additional charges. For example, we have had letters from MPs about extra charges for people who don't (or can't) use Direct Debit (DD). We also have received complaints from consumers who have been charged for cancelling a contract early.
- 1.4 An extra charge is not necessarily an unfair one. However, it is Ofcom's job to make sure that suppliers play fair, and that consumers know what to look out for.
- 1.5 Ofcom launched a review of additional charges in June 2007. We published a consultation document setting out our findings in February 2008 and requested responses by 8 May 2008.

Additional charges and the law

- 1.6 Ofcom's task has been to look at the law that is designed to protect consumers (the Unfair Terms in Consumer Contract Regulations 1999, or 'the Regulations') and say how this applies to some terms and charges in contracts for communications services between suppliers and consumers.
- 1.7 This statement sets out our consideration of, and response to, consultation responses on draft guidance we proposed about the way the Regulations apply and is accompanied by our final guidance.
- 1.8 The guidance aims to make sure that suppliers are aware of, understand and comply with their obligations under the Regulations. It sets out what Ofcom considers those obligations to be and the approach we expect to take in performing our obligations and exercising our powers under the Regulations. We expect that this guidance (together with Ofcom's enforcement activity) will help give consumers appropriate protection alongside the benefits of competition.
- 1.9 If suppliers do not comply, we can take action against them. We will monitor complaints and examine suppliers' terms to see whether they are consistent with our view of the law as set out in the guidance. Where they are not, we will consider the best way to enforce the Regulations, including taking the necessary formal enforcement action using our powers under the Regulations and/or the Enterprise

Act 2002. We expect to start doing so three months from the date of publication of this statement (plus 2 weeks, to allow for the Christmas period).

Low income consumers

- 1.10 The Regulations seek to ensure that the small print in contracts between suppliers and consumers is generally transparent and fair. That is what our guidance is about. The Regulations do not explicitly distinguish between types of consumer – so do not treat low income consumers any differently to other types of consumer.
- 1.11 However, even if charges are transparent and fair for consumers generally, we may still have concerns regarding access and inclusion for low income consumers – non-direct debit charges (or other additional charges) might exclude some consumers from access to essential services, for example.
- 1.12 Our primary concern for low income consumers is currently fixed telephony services. They are recognised as being important for social inclusion, as reflected in the Universal Service Obligations (USO) for BT and Kingston and their social telephony schemes. Following our consultation:
- BT launched BT Basic in October 2008, which does not have a non-DD charge; and
 - Kingston removed the non-DD charge from its social telephony products.
- 1.13 For those low income consumers not eligible for social telephony schemes, we believe competition and consumer choice (shopping around) will provide the appropriate protection. We are aware that since we published our consultation document at least one major supplier has removed its non-DD charge for all consumers.
- 1.14 We also recognise that there is a growing concern regarding access to broadband services. Ofcom will engage with UK Government and European institutions on whether there may be a case to extend the application of the USO to broadband services.
- 1.15 More generally across the economy, we are aware there are numerous examples of how low income consumers end up paying more for essential products and services. These wider concerns around distributional effects are more an issue for government than Ofcom and our guidance about the Regulations.

Advice for consumers

- 1.16 Alongside this statement, Ofcom has published a guide for consumers, offering advice on the type of charges to look for before signing up to a new communications service or provider. It includes information on what consumers can do if they think they have entered into a contract with an unfair term or charge¹.

Ofcom's decision

- 1.17 Ofcom has found that suppliers could be doing more to alert consumers to possible additional charges and to make those charges fair. In particular:

¹ <http://www.ofcom.org.uk/advice/guides/>

- consumers need to understand the charges they pay; and
- for charges which are not part of the price for the services being bought, suppliers must make sure they are fair.

1.18 The following table is a summary of the decisions we have made, and the final guidance we are issuing, in light of our consideration and analysis of stakeholders' views. Where we state a view, it reflects what we consider the position under the Regulations is likely to be. We recognise that only the courts can decide whether a term is unfair under the Regulations.

1.19 We are, of course, aware that certain issues under the Regulations are the subject of ongoing court proceedings between the OFT and a number of banks and a building society, and that the courts may give judgments that are relevant to our guidance. We will consider whether our guidance – which we envisage will in any case be reviewed from time to time – needs to be amended in light of any judgment(s) if and when they are issued.

Figure 1.1: Summary of Ofcom's Guidance

Charge / contractual term	Ofcom's final decision
<p>Non-direct debit (non-DD) charge</p> <p>A charge for consumers choosing not to pay by direct debit</p>	<ul style="list-style-type: none"> • Non-DD charges may be core terms exempt from the Regulations' fairness test. • In order to be likely to be considered a core term, the non-DD charge must be presented in plain intelligible language, with due clarity, prominence and transparency, so the typical consumer would regard it as part of the price he is paying for the services he is buying and not a separate, incidental additional charge. • Where they are non-core terms, the fairness test applies and is likely to mean the charge should reflect only causally related costs, not others like 'bad debt' costs. • The final guidance makes clear how we consider it may be fair to calculate and apportion the costs recoverable in what we consider a likely fair non-DD charge.
<p>Late payment charge</p> <p>A charge for consumers who pay late (i.e. beyond the invoice due date)</p> <p>Payment failure charge</p> <p>A charge where the payment method fails (e.g. a direct debit payment fails or a cheque bounces)</p> <p>Charge to restore service</p> <p>A charge for consumers who have had service restricted due to non payment (for example, having outgoing calls barred), who now wish to resume full service</p>	<ul style="list-style-type: none"> • These charges will not be core terms and are subject to the Regulations' fairness test. • Such terms are likely to be unfair where they seek to recover costs other than those directly incurred by the supplier as a result of the relevant default event/matter (e.g. late payment charges should seek to recover the limited administrative costs of chasing and collecting late payments). • Consumers who are disputing an element of their bill with their supplier and who subtract the disputed amount before settling their bill, should not face late payment charges for doing so.

Charge / contractual term	Ofcom's final decision
<p>Initial minimum contract periods (MCPs)</p> <p>A minimum (fixed term) contractual period set at the start of a contract (often for 12 to 18 months)</p> <p>Early termination charges (ETCs)</p> <p>A charge for consumers who terminate their contract before the end of the minimum contract period</p>	<ul style="list-style-type: none"> • MCPs are likely to be core terms and we would expect them to be transparent and prominent (failing which they may be assessed for fairness under the Regulations). • Terms providing for ETCs will not be core terms. • We consider that an ETC is likely to be fair where: <ul style="list-style-type: none"> - 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; - it is never greater than the amount of the (usually monthly) contractual retail payments remaining due at the date of termination; - it also takes account of any costs associated with the provision of the service which will no longer be incurred by the supplier, including any: <ul style="list-style-type: none"> - variable costs which can be avoided; and - 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); and - it reflects any ability of the supplier to reduce its loss by 'reselling' the service to a new consumer; and - it makes allowance for the supplier's accelerated receipt of any sums. • We do not consider that it is likely to be fair to include in an ETC recovery of anticipated profits from charges, or other sources of revenue, which are not themselves part of the consumer's contractual obligations. The same would normally apply to sums in respect of 'lost' revenues from incoming call termination charges for fixed voice and mobile phone services. • We also set out in the final guidance that there is an alternative basis on which, in our view, a likely fair ETC may be recovered: the recovery of a supplier's unrecouped expenditure on the early terminated contract. But this may not be greater than the amount calculated as set out above.

Charge / contractual term	Ofcom's final decision
<p>Subsequent minimum contract period (SMCP)</p> <p>A clause providing for a new minimum contract period (or extension to an existing minimum contract period) for existing consumers wishing to change their service in some way (e.g. changing their service package, or moving house)</p>	<ul style="list-style-type: none"> • There may be some circumstances where a consumer agrees to new terms and services and a new contract arises between the supplier and the consumer - on new terms - in which the MCP may be a core term. • However, SMCP terms are likely to be non-core terms. • SMCP terms may be fair where: <ul style="list-style-type: none"> - the terms explaining the events (such as a decision to upgrade), that will trigger a requirement for a SMCP are transparent to consumers within the contract at the point of sale; - the terms set out that the supplier 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 supplier will write to the consumer stating when changes to the services will result in a subsequent MCP); and - the costs incurred by the supplier and the benefits to the consumer in relation to the subsequent contract are commensurate with the subsequent MCP. • Terms providing for the automatic renewal of the MCP on its expiry raise some concerns and should not have the effect of consumers being subject to unintentionally long and recurring contracts. However, they will not always be legally unfair.
<p>Minimum notice period (MiNP)</p> <p>The notice period which a consumer must give their supplier before they can bring their contract to an end</p>	<ul style="list-style-type: none"> • MiNP terms are unlikely to be part of the main subject matter of the contract and are likely to be non core terms. • A term providing for an MiNP is likely to be fair where the MiNP is: <ul style="list-style-type: none"> - transparent to consumers within the contract at the point of sale; and - reflects a reasonable period in which to carry out the necessary administration of terminating the contract. • We consider likely fair MiNPs should be no longer than the period reasonably necessary for the administration connected with the termination of the contract: <ul style="list-style-type: none"> - for fixed voice and broadband services that reasonably necessary period should be no longer than the formal migration process; - for mobile, and in any sector where no formal migration process applies, the period should be no longer than reasonably necessary for the required administration (and this should be no longer than 30 days or one calendar month and likely much less).

Charge / contractual term	Ofcom's final decision
<p>Itemised / paper billing</p> <p>A charge for consumers wishing to receive a full call by call itemisation of the calls made, rather than a summary, or who want to receive a paper rather than an on-line bill</p>	<ul style="list-style-type: none"> • Billing charges may be considered core terms in cases where they are presented in such a way that the typical consumer would regard them as part of the price he is paying for the services he is buying, not a separate, incidental additional charge, and be aware of the level of information or billing which is provided. This is likely to be so where: <ul style="list-style-type: none"> - the contract term and any marketing material makes clear in a prominent manner whether there are any separate billing options for which there are different charges; - any such information clearly sets out what these options are, together with the price for each option (including whether the options are related to charges or discounts for receiving printed or Internet bills, and/or for different levels of billing information); - where there are different levels of billing information which incur different charges, the contract terms clearly set out what level of billing information is provided under each option; and - the contract terms and the marketing material set out the required information in such a way that the consumer who chooses itemised billing would regard that as part of the services he is buying under the contract. • We consider it may be fair for a supplier to include in these charges the reasonable additional costs it incurs which are directly attributable to the level of billing provided. • We confirm our administrative threshold (of £1.50 per bill) relating to these charges. However, the threshold is subject to review and may - for example - be changed if there is increasing evidence of consumer harm in relation to these charges.
<p>Cease charges</p> <p>A charge for consumers ceasing their service (even where they are outside their minimum contract period)</p>	<ul style="list-style-type: none"> • Terms providing for cease charges are unlikely to be core terms. • Such terms are likely to be fair where they are transparent to consumers at the point of sale and reflect only direct costs associated with ceasing service.

Section 2

Introduction

Background and scope

- 2.1 Consumers often face additional charges from their supplier above those they already pay for the service – whether home phone, mobile, broadband or Pay TV. They also face a wide range of contractual terms, which they have generally not individually negotiated.
- 2.2 In choosing their supplier for communications services, most consumers will focus on the headline price for the service, and other key contractual commitments, as well as other factors such as quality of service or supplier brand. It is not reasonable to expect consumers to take into account every contractual term and every additional charge in the small print. There are certain charges or contractual terms where competition is unlikely to have any real effect on preventing terms and charges being applied in a way that is unfair to the consumer.

Relevant legislation and Ofcom's role

- 2.3 In order for consumers to have confidence in the market place, it is important that these additional charges and contractual terms are not set in a way that harms consumers. The EU Directive 93/13/EEC on unfair terms in consumer contracts is implemented in the UK by the Unfair Terms in Consumer Contracts Regulations 1999 ('the Regulations'). The Regulations seek to ensure that standard terms in contracts between suppliers and consumers, - which have not been individually negotiated - are transparent and fair. The Regulations only apply to contracts between suppliers and consumers, not between businesses.

- 2.4 The following parts of the Regulations are of particular relevance to this statement and the guidance.

- 2.5 First, Regulation 5(1) sets out when relevant contract terms are unfair. It says:

'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.'

We refer to this as the Regulations' fairness test.

- 2.6 Second, certain terms and matters are exempt from the fairness test. Regulation 6(2) sets out this exemption. It says:

'(2) 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.'

2.7 This is often called the ‘core terms’ exemption and terms and matters falling within it are commonly called ‘core terms.’ We use that expression in this statement and the guidance. The effect of these provisions is that all standard form terms in contracts between suppliers and consumers are subject to the fairness test – they must be fair – except core terms.

2.8 Third, Regulation 6(1) says how the fairness test should be applied. It says:

‘(1) the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the 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.’

2.9 Fourth, Regulation 7(1) says:

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

This provision, and the requirement of good faith in the fairness test (above), relate to the need for terms to be in clear language and to be prominent and transparent.

2.10 Fifth, Regulation 8 says that where a term is unfair, it does not bind the consumer. He would not, for example, have to pay any additional charge that failed the fairness test. Regulation 8 says:

- ‘(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.’

2.11 Sixth, Paragraph 1 of Schedule 2 of the Regulations contains an indicative (and non-exhaustive) list of types of terms that may be unfair. Most relevant here are paragraphs 1(b), (e) and (h) which state that terms may be unfair if 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;
- (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- (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;’

- 2.12 Ofcom has a role in enforcing the Regulations, which is set against the backdrop of its functions under the Communications Act 2003 ('the 2003 Act').
- 2.13 The 2003 Act gives Ofcom functions in relation to communications matters within the UK, including the provision of a wide variety of telecommunications services. In discharging our functions, Ofcom's principal duties are to further the interests of citizens and consumers (section 3 (1) of the 2003 Act).
- 2.14 In performing these duties, Ofcom is also required to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles representing best regulatory practice (section 3(3)).
- 2.15 Where we engage in regulation, we also seek to abide by a set of principles we have developed in the light of our general duties and the principles of best practice in regulation. These are published on our website², and include:
- Ofcom will operate with a bias against intervention, but with a willingness to intervene firmly, promptly and effectively where required;
 - Ofcom will strive to ensure its interventions will be evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome;
 - Ofcom will always seek the least intrusive regulatory mechanisms to achieve its policy objectives; and
 - Ofcom will consult widely with all relevant stakeholders and assess the impact of regulatory action before imposing regulation upon a market.
- 2.16 Ofcom is required to carry out an assessment of the likely impact of regulatory measures it may propose where the proposal is carried out for the purposes of or connected with the carrying out of its statutory functions and it appears to Ofcom to be important (Section 7). For the purposes of this section a proposal is 'important'- amongst other things - if it would have a significant impact on businesses in the markets for which Ofcom has regulatory functions or on the general public in the United Kingdom. We have issued guidance on impact assessments on our website³.
- 2.17 Part of Ofcom's role is the enforcement of consumer protection laws in relation to communications matters. Under the Regulations, Ofcom has a duty to consider any complaint it receives about unfair standard terms (Regulation 11). Where we consider a term to be unfair under the Regulations, we have the power to take action on behalf of consumers in general to stop the continued use of the term, if necessary by seeking an injunction in England, Wales and Northern Ireland or an interdict in Scotland (Regulation 12).
- 2.18 In addition, Part 8 of the Enterprise Act 2002 gives us another mechanism for performing consumer protection law enforcement in communications matters. It enables Ofcom to seek enforcement orders against businesses that breach UK laws giving effect to EC Directives listed in Schedule 13 of the Enterprise Act, where the collective interests of consumers are harmed. These UK laws include EU Directive 93/13/EEC on unfair terms in consumer contracts.

² <http://www.ofcom.org.uk/about/sdrp/>

³ http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

- 2.19 Ofcom exercises its enforcement powers in accordance with its draft enforcement guidelines. These reiterate the regulatory principles referred to above. Further information about Ofcom's draft enforcement guidelines is on its website⁴.
- 2.20 We return further to these matters, and their relevance to this consultation, in later parts of this statement.

Consultation and evidence gathering

Ofcom's consultation

- 2.21 On 6 June 2007 Ofcom opened a review into these additional charges and contractual terms, prompted by regular complaints about a range of contractual terms and charges, and in particular a significant number of consumer complaints about BT's charge for not paying by direct debit.
- 2.22 On 28 February 2008, Ofcom published a consultation document and its draft guidance. The closing date for responses was 8 May 2008.
- 2.23 The consultation and draft guidance considered the additional charges and contractual terms where we considered any consumer harm was likely to be most significant. The charges and terms covered were those in figure 1.1 above.

Ofcom's concerns

- 2.24 In the consultation document, we set out our possible concerns regarding additional charges:
- Where consumers are unable to, or do not in practice, take additional charges into account in deciding on their supplier and service, we may have concerns regarding transparency and fairness. We may also have additional policy concerns around competition effects and efficiency. There is also a concern that some of these charges may fall disproportionately on low income consumers and, in extreme cases, may inhibit take up of essential services.
 - In some cases, addressing our concerns about transparency may be enough to remove other concerns. In other cases, transparency on its own may not be enough. For some of the charges we look at, even where they are transparent, consumers may still not always take them into account in choosing their supplier and service:
 - consumers may underestimate the likelihood of paying them (e.g. late payment charges or early termination charges);
 - consumers may only focus on the two or three key variables in their decision making as it may be too time consuming or too complicated to evaluate all available options;
 - consumers may systematically take more account of recent events and give little weight to events in the future. This means they may not take proper account of charges which (if incurred) take place in the future e.g. early termination fees and cease charges.

⁴ <http://www.ofcom.org.uk/consult/condocs/enforcement/enforcement.pdf>

- Suppliers may be tempted to raise certain additional charges above cost in order to increase profits. As the sectors we are concerned with are broadly competitive, we would expect much of these extra profits to be returned to consumers in the form of lower headline prices. This leads to the so-called “waterbed effect”, where the overall cost to consumers remains similar, even though the structure of prices is shifted from observable to unobservable charges.

Transparency

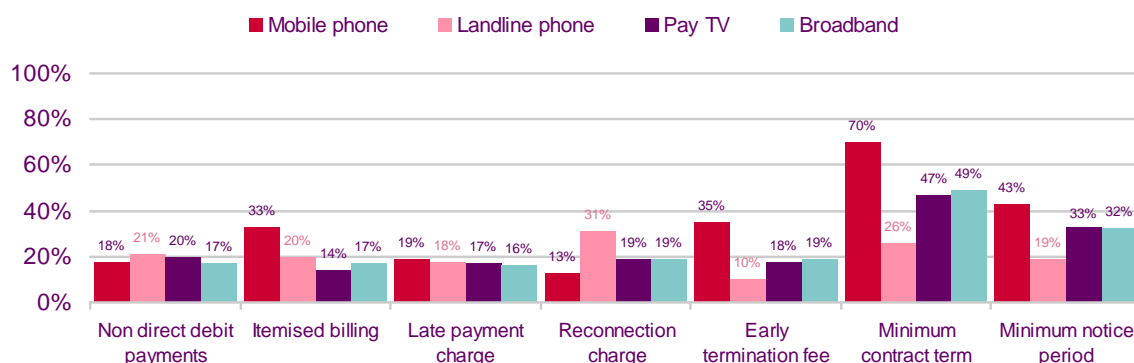
2.25 In the consultation document we gave some possible reasons why some charges may not be transparent to a consumer:

- they may not be clearly laid out in the marketing material a consumer may use in choosing their supplier;
- they may not be clearly explained at the point of sale; and
- they may not be prominently displayed in a contract.

2.26 Our market research, summarised in Figure 2.1, showed generally low awareness of additional charges (even though many of these charges are common practice in the communications sector).

Figure 2.1: Awareness of additional charges

(As far as you are aware does your supplier charge for / have a...?)



Source: Ofcom Research July 2007

Base: All with responsibility for mobile phone contract (463), landline phone (1,287), Pay TV (590), Broadband Internet (636)

2.27 We said low awareness may mean consumers are not making the right choice of supplier. For example, minimum (fixed term) contract periods are a key element of many suppliers' contracts. But, many consumers are not aware of these. Low awareness may also mean consumers are faced with charges they did not expect and could not avoid, for example, late payment charges.

Fairness

2.28 We also set out concerns Ofcom may have about the fairness of additional charges and terms relating to them. We noted that in most cases the terms of suppliers' contracts with consumers are not individually negotiated. We proposed:

- It would, for example, be unfair for a consumer to pay a charge which they had little opportunity to become aware of in advance and hence could not avoid.
- Even where the consumer is aware of the charge, there may still be concerns as to the fairness of those charges which are not part of the main price bargain struck with the supplier. Consumers may end up paying a disproportionate amount of costs, and this may be unfair. For example:
 - those paying early termination fees may contribute disproportionately more to supplier profit than those who complete their contracts; and
 - it may not be fair for suppliers to load bad debt costs onto particular groups of consumers.

2.29 We further noted that fairness is the central concept underlying the Regulations. Ofcom is plainly concerned to ensure that contractual terms do not create a significant imbalance of interest between the parties to the detriment of the consumer.

Other concerns

2.30 The consultation document also set out a number of other possible concerns:

- **Impact on low income consumers** - additional charges may be seen as particularly unfair when they fall disproportionately on a particular group in society, and particularly so if that group includes vulnerable consumers, such as those on low incomes. For example, it might be a concern that those on low incomes are more likely not to have a bank account and so are more likely to incur non-direct debit charges. We highlighted that there may be two aspects to this concern. Firstly, where we think that this might impact on social inclusion and access for a particular group. Secondly, where the financial impact on a vulnerable group is disproportionately high.
- **Competition effects** - certain charges or terms may impose switching costs on consumers. Where these charges are not easily observable at the point of sale, or not easily understood, there may be an incentive for suppliers artificially to raise switching costs above the true cost. This may dampen competition and may deter entry. For example, subsequent minimum contract terms (after the expiry of the initial minimum contract period) may be imposed even when the continuation of supply imposes few or no additional upfront costs on the supplier.
- **Other concerns** – we said there are other potential concerns around additional charges, though we also said we did not believe that these were significant. One is that consumers may be reluctant to participate in a sector if it gets a reputation for high additional charges which are not dealt with via regulatory action. Another is that changes in the structure of prices i.e. a shift from observable to non-observable charges, leads to inefficiencies and distorts behaviour. If the headline price of the product is artificially low (because suppliers are making additional charges artificially high), more consumers will purchase the service than would otherwise be the case. Similarly, where additional charges are artificially high, consumers may go to great lengths to avoid them (e.g. avoiding terminating a contract because of a high cease charge, or incurring financial penalties elsewhere to avoid a late payment charge). In both cases the distortion to behaviour is economically inefficient, though we also noted that the current

evidence did not suggest that these types of inefficiencies were particularly significant for the charges considered in the consultation.

- 2.31 We also noted, however (see paragraphs 2.43 and 2.44 of the consultation document), that, in carrying out our review, we were aware that there are areas where we have a policy concern which is not capable of being addressed, or at least not directly addressed, by using the Regulations.
- 2.32 We gave examples of the points that, firstly, the Regulations do not explicitly distinguish between types of consumer. So, they do not treat low income consumers any differently to others, save insofar as a consumer's means may be part of the circumstances in which the contract was concluded and relevant to the assessment of a term's fairness (see Regulation 6(1)).
- 2.33 The second example we gave was that the Regulations do not refer to the impact of terms on competition. So, they do not address any concerns about such matters unless there is an overlap with fairness, such as, we suggested, considering whether it is fair for a term to restrict a consumer's ability to choose another supplier.
- 2.34 Accordingly, as we said, whilst our investigation of additional charges and related terms had been informed in some cases by these sorts of policy concerns, our proposed guidance covered only areas and matters in which we proposed that the Regulations, an existing piece of legislation, apply (and a small number of related best practice matters).
- 2.35 Where we feel there are issues that cannot be sufficiently addressed by the Regulations, we will consider using other legal instruments.

Pre-consultation research

- 2.36 As part of the review Ofcom looked at evidence of consumer harm by:
- carrying out market research to understand consumers' awareness of and attitudes towards these types of charges and terms;
 - looking at the individual complaints made by consumers directly to Ofcom and complaints which have been forwarded to us by MPs on behalf of their constituents; and
 - writing to a number of consumer groups to obtain their views.
- 2.37 In looking at the evidence of consumer harm, we had particular regard to low income consumers given that:
- low income groups may be disproportionately likely to incur some of these charges. For example, low income consumers are more likely not to pay by direct debit than other groups; and
 - where a low income consumer incurs a charge, it represents a higher proportion of their income.
- 2.38 Ofcom also sent a formal information request to a number of suppliers of communications services asking for detailed information on:

- the additional charges and contractual terms they applied in their consumer contracts;
- the steps taken to ensure consumers are aware of additional charges and key contractual terms; and
- the reasons why suppliers considered these charges and contractual terms were needed, including detailed figures showing the underlying costs.

2.39 It was not possible to ask for information from all suppliers of communication services, given their large numbers. Ofcom therefore selected suppliers to ensure that the information gathered covered a large proportion of consumers.

2.40 Ofcom followed up the receipt of information with meetings to discuss issues and questions arising from suppliers' responses.

Overview of consultation responses

2.41 In the formal consultation, over 240 consultation responses were received, including:

- over 200 from individual consumers (including those forwarded by MPs)
- 10 from consumer stakeholders
- 12 from suppliers of communication services
- 7 from other companies or industry associations

2.42 Copies of all the non-confidential responses are on Ofcom's website⁵. We also received some additional information and correspondence from some suppliers, for example in response to information requests, which we have considered, and to which we respond, where appropriate, in this statement.

2.43 Responses from consumers and consumer stakeholders focused particularly on the issue of non-DD charges, with over 85% of consumers who responded commenting on this aspect. Other issues particularly mentioned by consumers included:

- Late payment charges;
- Minimum contract periods and/or early termination charges; and
- Charges for itemised billing or for paper bills.

2.44 Consumers felt Ofcom's proposals did not go far enough on non-direct debit charges. Many consumers felt these charges should be abolished, or should reflect only directly incurred administrative costs which were believed to be very low.

2.45 Responses from suppliers or industry associations have between them covered the full range of issues Ofcom consulted on. However, Ofcom proposals on early termination charges (ETCs) in particular have attracted a lot of comment, with suppliers generally disagreeing strongly with at least some aspects of Ofcom's proposals. Some suppliers were concerned that Ofcom's proposals would undermine the current market models because consumers would be able to terminate contracts

⁵ <http://www.ofcom.org.uk/consult/condocs/addcharges/responses/>

more easily. They said this would then have a fundamental impact on the market, including the ability and willingness of suppliers to:

- provide subsidised handsets for mobile services;
- subsidise connection costs for other services; and
- offer cheap deals which reflect the commitment of the consumer.

2.46 There was also concern that the proposals did not explicitly allow the recovery of suppliers' upfront costs. Some suppliers were opposed to any proposal that ETCs should not simply be the monthly retail payments outstanding on early termination.

Document outline

2.47 Section 3 below considers Ofcom's general approach on issues covered by the consultation. In particular, it considers stakeholder responses to our proposal to publish guidance and give suppliers three months to review their terms and conditions and charges, and where necessary change them. It also considers stakeholders' general comments on our proposed guidance on core terms (and transparency) and non-core terms (to which the test of fairness applies).

2.48 Sections 4 to 10 looks at each additional charge or contract term addressed by the consultation and for each considers:

- Ofcom's proposed position
- Stakeholder responses
- Ofcom's consideration and response
- Ofcom's decision

2.49 Annex 1 contains our final guidance - which will also appear on our website at www.ofcom.org.uk/telecoms/loi/

2.50 Annex 2 contains a detailed summary of stakeholder responses to the consultation.

2.51 Annex 3 provides a glossary of terms.

Section 3

Ofcom's general approach

Ofcom's proposed position

3.1 We proposed we would:

- issue final guidance on the Regulations with an accompanying explanatory statement;
- provide suppliers with three months from publication of the final guidance to comply with it, during which period they can review their terms and conditions and charges and where necessary change them; and
- following this period, if necessary open an enforcement programme if we believe that additional charges are not in line with our guidance.

3.2 We also proposed to publish a consumer check list or 'consumer guide' advising consumers what charges and terms to consider before signing up to a new service.

3.3 We consulted stakeholders on whether they agreed with the various aspects of this approach.

3.4 We also asked stakeholders whether they agreed generally with our proposed guidance on core terms under the Regulations and on transparency, and with our proposed guidance on non-core terms to which the Regulations' test of fairness applies.

3.5 In this section of this statement we focus on these broader consultation questions, setting out:

- Ofcom's proposed position (in the consultation) and the questions we consulted on;
- a summary of the relevant stakeholder consultation responses;
- Ofcom's consideration of and response to stakeholders; and
- Ofcom's decision.

Ofcom's proposal to issue guidance to communications suppliers

Ofcom's proposed position

3.6 In the consultation we proposed that Ofcom should issue guidance setting out the principles we consider likely to apply under the Regulations to contractual terms providing for certain additional charges in communications contracts; and terms we consider may be unfair applying those principles.

3.7 We asked the following question:

Do you agree that it is helpful and appropriate for Ofcom to issue guidance on the application of the Regulations to consumer contracts for communications services?

Stakeholder responses

- 3.8 There was broad agreement from suppliers and consumer stakeholders that Ofcom guidance would be helpful and appropriate. One consumer stakeholder and one supplier specifically welcomed a principles-based - not highly prescriptive - set of guidance.
- 3.9 However, one supplier said there was no evidence sector specific guidance would be helpful to suppliers and sufficient (OFT) guidance already existed. And it said any harm caused by the terms covered by the proposed guidance would also occur in other sectors where such terms are used so that, even if guidance is required on them, it should be general OFT guidance.
- 3.10 Two mobile network operators (MNOs) said our proposed guidance on early termination charges (ETCs) may favour certain suppliers, or business models or technologies used to provide the same services.
- 3.11 One supplier questioned the position in relation to terms Ofcom had previously investigated and asked what had changed since those investigations.
- 3.12 Concerns were expressed by suppliers and suppliers' associations that:
- it was unclear whether the guidance was a policy document or a legal interpretation of existing legislation;
 - the guidance's status is unclear: it suggests we think it is enforceable and not simply a statement of principles we are likely to adopt in enforcing the Regulations;
 - we go too far in setting out definitive guidance on matters which depend on the facts of any particular case (such as the wording of particular terms and the overall effect of the contract);
 - we are 'gold-plating' – the Regulations are designed to address terms far more detrimental to consumers than those we focus on;
 - we are investigating standard monthly retail charges and basic contractual terms, not just additional charges;
 - we are requiring suppliers to provide too much, or confusing, information, in marketing material, ignoring the Better Regulation Executive's and the National Consumer Council's recommendations on related matters;
 - our approach is not proportionate or evidence based;
 - the proposals pay insufficient regard to the availability of 'pay as you go' services to which many of the relevant additional charges do not apply and which offer a market based solution for low income consumers;
 - we should have done an impact assessment because our proposals are matters of 'policy' and 'regulatory intervention';

- we should explain what consideration we have given to the effect of the Consumer Protection from Unfair Trading Regulations 2008;
- the guidance should avoid conflict or uncertainty with other codes (including the Committee of Advertising Practice codes on advertising); and
- we should form a working group to determine the final content of the guidance.

Ofcom's consideration of and response to stakeholders' consultation responses

Issuing guidance

- 3.13 We note the substantial number of consultation responses agreeing that Ofcom guidance would be helpful and appropriate.
- 3.14 We have considered the single response that Ofcom guidance is unnecessary because OFT guidance exists (or should exist if guidance on relevant kinds of additional charges is required). We, like most consultation respondents, disagree:
- Ofcom has a duty to consider complaints that terms are unfair under the Regulations and the power to seek injunctions against unfair terms. We, rather than the OFT, do so in the communications sector.
 - We also have duties under the Communications Act 2003 to further the interests of citizens in relation to communications matters and of consumers in relevant markets. We must also have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.
- 3.15 We therefore think it is appropriate for us to provide guidance about how we are likely to comply with our duty, and exercise our powers, under the Regulations in the communications sector. Doing so helps us comply with our duties under the 2003 Act.
- 3.16 It will indicate to suppliers terms we consider they should be using to ensure fairness to consumers and comply with the law. It will indicate to consumers what we consider to be their rights under the Regulations. In both ways the interests of citizens and consumers in relevant markets are furthered. We return below to the regulatory principles referred to above.
- 3.17 We also note that, to complement its general guidance about the Regulations, the OFT has produced a number of pieces of sector specific guidance (e.g. on gyms and health clubs). We are doing the same in our sector.
- 3.18 In response to the comment that the Regulations are designed to address terms far more detrimental to consumers than those we focus on – that we are 'gold-plating' – we disagree.
- 3.19 That response said the terms included in the indicative list of potentially unfair terms in Schedule 2 to the Regulations shows the Regulations are designed to address terms that have far more detrimental impact on consumers than those Ofcom has identified. We agree some terms may be more detrimental to consumers than those covered in our consultation document, proposed guidance and now the final guidance. We agree also that some of the terms in Schedule 2 to the Regulations

may be more detrimental to consumers. See, for example, paragraph 1(a), which says terms having the object or effect of:

- ‘(a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier,’

may be unfair.

- 3.20 However, Schedule 2 to the Regulations is, as its heading says an, ‘INDICATIVE AND NON-EXHAUSTIVE LIST OF TERMS WHICH MAY BE REGARDED AS UNFAIR.’ And, as Recital 17 of the European Directive on which the Regulations are based says:

‘Whereas, for the purposes of this Directive, the annexed list of terms can be of indicative value only and, because of the cause of the minimal character of the Directive, the scope of these terms may be the subject of amplification or more restrictive editing by the Member States in their national laws.’

- 3.21 In other words, terms not in Schedule 2 are capable of being unfair under the Regulations. The key provision of the Regulations, with regard to fairness, is Regulation 5(1), not Schedule 2.
- 3.22 In any event, some of the terms covered in our consultation document, proposed guidance and now the final guidance do fall within terms in Schedule 2 to the Regulations, or are analogous or linked to terms therein. So, default and early termination charges fall within paragraph 1(e) of the Schedule or are analogous to terms that do. And, paragraph 1(h) is linked to terms that provide for the automatic renewal of fixed term contracts.
- 3.23 In response to the supplier who questioned what had changed since Ofcom's previous investigations into additional charges, it is important to emphasise that we have reviewed and consulted widely on our general position in relation to categories of terms. Having considered the consultation responses, we are now making decisions and giving guidance on the approach we expect to take in exercising our powers and fulfilling our duties under the Regulations (in relation to certain additional charges).

Status of the guidance

- 3.24 Nonetheless, we agree the status of our guidance must be clear. It is guidance on the principles we consider likely to apply under the Regulations to contract terms providing for certain additional charges and on terms that in our view may or are likely to be unfair. But, only the courts can decide what terms are unfair. And we recognise that any enforcement action we may take will depend on the facts of any individual case and the decision of the courts. We have made changes to the final guidance to reflect these points.
- 3.25 The guidance is, therefore, our interpretation of an existing legal instrument. It does not represent new policy or regulation by Ofcom.
- 3.26 We have considered the responses from some suppliers about whether our guidance is a policy document. Where our consultation document referred to ‘policy’ and

‘regulation’ this reflected the general approach summarised in paragraph 1.9 of that document.

- 3.27 To re-iterate that approach, for each additional charge we considered whether there were reasons why we might have concerns (as a matter of ‘policy,’ for example relating to transparency, fairness or effects on competition). Where we did have concerns, we considered whether they arose out of terms which may be unfair under the Regulations and whether providing guidance about those regulations (and applying them) would address those concerns.
- 3.28 The proposed position we reached was that the Regulations were suitable to deal with almost all our concerns (save a small number of matters of ‘best practice’). The proposed - and now the final - guidance was and is limited to our interpretation of existing law.
- 3.29 If there are other policy concerns which cannot be addressed by the Regulations, we will consider using other legal instruments.

Impact assessment

- 3.30 We have also considered the suppliers’ responses which said we should have carried out a formal impact assessment for our proposals. These came in particular from MNOs and their associations, one of whom asked for more information on what we have done to assess the impact of our proposals.
- 3.31 One particular concern expressed about the impact of our proposed guidance that might have the effect of reducing ETCs was that it would undermine the current mobile market model: consumers obtaining mobile handsets at subsidised rates in return for fixed contractual commitments to packages including ‘free’ call minutes and other services. Put broadly, this was because consumers would be able to terminate contracts more easily.
- 3.32 Another response was that we need to consider further the impact of our proposals. Another still was that our proposals would have a waterbed effect, where suppliers seek to recover lost revenues from all consumers through, for example, higher retail prices. A further response was that our proposals would produce asymmetric and discriminatory impacts on different suppliers (see below).
- 3.33 On the basis that our guidance is an interpretation of an existing legal instrument, as set out above, we do not agree a formal impact assessment is required. Any ‘regulatory intervention’ here is the publication by us of guidance on our view of existing law – how we think it is likely to apply and the approach we as the relevant sectoral enforcer are likely to take. That law gives us enforcement duties and powers, and was itself the subject of an impact assessment when it was made.
- 3.34 We do not see that we are properly required to do a formal impact assessment before we can take a view on how existing laws apply, nor before we undertake any enforcement action. This approach is consistent with our statutory obligations. In particular, with section 7(3) of the 2003 Act, which acknowledges there are cases in which an assessment is unnecessary. That sub-section also requires a statement of Ofcom’s reasons for thinking an assessment is unnecessary. That was made in paragraph 2.61 of the consultation document. The approach is also in line with our

published guidance on impact assessments on our website⁶ and to which we must have regard by virtue of section 7(6) of the 2003 Act.

- 3.35 Nonetheless, we have considered the impact of our proposals and the final guidance - on ETCs in particular. The possible impact of that guidance is discussed later in this document (see Section 6).

Evidence and proportionality

- 3.36 Some suppliers questioned whether our proposed guidance was proportionate and evidence based.
- 3.37 One MNO, for example, said we were proposing detailed intervention in pricing in the mobile market that is inappropriate because there is no evidence of market failure or lack of competition that would give Ofcom a mandate to intervene. It said it is not necessary for Ofcom to specify terms suppliers should use and any such intervention is not evidence based or proportionate, contrary to our regulatory principles.
- 3.38 Another quoted Ofcom's guidance on Impact Assessments which says Ofcom's bias against intervention means, "... a high standard of proof must be satisfied," before Ofcom will regulate.
- 3.39 Some MNOs said there is little evidence that for the mobile sector there is a need to change the existing market model. One point made, for example, was that Ofcom appears to receive only around 60 (another MNO said the figure was only 25 – 50) complaints per month about ETCs in that sector, of which it was said the number relating to the unfairness of the ETC under the Regulations must be a smaller number. Another was that consumer awareness of MCPs in the mobile sector is high.
- 3.40 One MNO referred to paragraph 5.32 of the consultation document that said:
- "The vast majority [of surveyed consumers] felt that once signed the contract should be honoured and ETCs were, by and large, accepted if the provider had kept up their side of the contracts. However, if the provider did not provide the service as originally agreed, then consumers felt they should have a right to leave the contract without penalty."
- 3.41 A number of MNOs referred to the fact additional charges do not apply to pre-pay, 'pay-as-you-go,' consumers.
- 3.42 They said 70% of mobile customers are 'pay as you go' customers to whom many of the relevant additional charges do not apply. They said consumers always have this choice of such pre-pay options, and these protect low income consumers, many of whom will be, or could choose to be, pay-as-you-go customers. They also said, "... any regulation must recognise this distinction."
- 3.43 One MNO, for example, said, "Ofcom's own evidence is that mobile communications has a wholly suitable market-based solution to those who do not want a contract – and the costs associated with that – in the pre-pay mobile option. Regulating in the interests of low income consumers where the market already addresses the issue is unhelpful and unnecessary."

⁶ See http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

- 3.44 Another said Ofcom's own research showed that 62% of consumers were aware of non-DD charges either before or when they entered their contracts and this is not 'poor awareness' of these charges (it referred to figure 3.5 of the consultation document). It also highlighted that the majority of additional charges do not impact on pre-pay customers, undermining Ofcom's argument that such charges may impact disproportionately on low income consumers. It also rejected Ofcom's argument that low income consumers on contracts may not have access to online billing – since this function is available via their handset.
- 3.45 One MNO said it was also concerned about the 'vox pop comment boxes' in the consultation which it said were 'un-evidenced', 'tendentious' and 'unrepresentative'.
- 3.46 As to these responses, we note, first, that we did not propose that there is a need to change the existing market model in the mobile sector. We merely made proposals about how we consider the Regulations apply to certain terms in consumer contracts for communications services in a range of sectors. And, we are not intervening in retail prices. On the contrary, we are concerned with additional charges that are not part of retail prices (and which, for that reason, are subject to the Regulations' fairness test).
- 3.47 Second, complaints and consumer evidence are not the only sources of concerns about the fairness of terms. In our review of relevant terms, we also sought the views of consumer groups and information from suppliers. This is set out in paragraphs 2.55-2.60 of the consultation document.
- 3.48 Neither is any number of complaints, or any amount of consumer evidence, in itself necessarily an indicator that terms and charges are fair or unfair, whether the number or amount is small or great. Consumers may, for example, see that a term is in their contract, and therefore not complain about it, even though they are adversely affected by it and it may be unfair. On this, we acknowledge what paragraph 5.32 of the consultation document said. However, for the reasons set out elsewhere in this statement, we consider ETCs equal to monthly retail payments are likely to be unfair, notwithstanding the views of some consumers.
- 3.49 Further, where suppliers use terms that are likely to be unfair under the Regulations, that is intrinsically harmful (whether consumers complain or not). Unfair terms are those that, by definition, cause a significant imbalance in parties' contractual rights and obligations to the consumer's detriment, and are contrary to the requirement of good faith. The use of such terms is itself evidence of harm to consumers which the Regulations aim to prohibit, and which our guidance seeks to address by setting out our view of the Regulations and how we will approach our enforcement duties.
- 3.50 Nonetheless, Ofcom did in any event provide evidence in the consultation document that may be indicative of suppliers' use of unfair terms and of consequent consumer harm. That was in, for example, paragraphs 5.7 to 5.35 of the consultation document, in relation to ETCs.
- 3.51 Those paragraphs indicated that, in general, consumer understanding of ETCs was not high (for mobile only 36% of consumers were aware of the ETCs and for fixed voice the figure was only 10%). In addition, complaints to Ofcom about ETCs were high: in the region of 400-500 per month (and continue to be high – 438 in November 2008). And, 80% of mobile consumers (87% for fixed voice) thought ETCs were unfair.

- 3.52 We acknowledge that the numbers who complain about ETCs in express terms relating to the Regulations – ‘this ETC term is unfair under the Regulations,’ or even, ‘the level of this charge is unfairly high’ - may be a small part of all ETC complaints. But, it is not necessary for complaints to be in such terms for us to consider them, if the essence of the complaint is about a contract term that may be unfair. If we receive such complaints, we have a duty under the Regulations to consider them. Given the number of complaints we receive and must consider, we believe that guidance setting our likely view and approach is appropriate.
- 3.53 As to the responses about pre-pay, pay-as-you-go, services that do not make additional charges, we have considered a number of points.
- 3.54 First, our consultation document did acknowledge the existence of these alternative services. We stated explicitly in paragraph 3.68 of that document that, ‘For mobile services, we consider that the existence of pre pay mobiles means that intervention to secure access to mobile services is not needed.’
- 3.55 In other words, we agree that concerns about access and inclusion for low income consumers may be less relevant in the mobile sector due to the provision of pre pay services. As set out in the consultation document, our primary concern regarding low income consumers is currently in relation to access and inclusion for fixed telephony services.
- 3.56 And, even then, as we set out in this statement, we do not consider certain terms or charges likely to be unfair simply because of their impact on certain groups of consumers, like those on low incomes. We acknowledge that the Regulations seek to ensure that terms in contracts between suppliers and consumers generally are transparent and fair. They do not distinguish between types of consumer: they do not treat low income consumers any differently to other types of consumer (save as indicated above).
- 3.57 Second, the fact pre-pay services are available, and in which relevant additional charges may not be levied, does not necessarily mean such charges may fairly be levied on post-pay contract consumers. Such terms must still be fair. Our proposed, and now our final, guidance sets out our view of where, in general, we consider certain terms and charges to be unfair under the Regulations (see further as to this point below).
- 3.58 Third, as to some of the more specific points made by the MNOs, one referred to Ofcom’s research about consumers’ awareness of non-DD charges. The MNO referred to figure 3.5 of the consultation document as showing that 62% of consumers were aware of the charges either before or when they entered their contracts. This was incorrect. Figure 3.5 referred only to those consumers who were aware their supplier had a non-DD charge (62% of them became aware of the charges at the time referred to). Figure 3.4 related to overall awareness of non-DD charges amongst all consumers, and showed just 18% of mobile consumers were aware their supplier made such charges. This is much stronger evidence of ‘poor awareness’ of these charges than the relevant MNO suggests.
- 3.59 As to the response about online billing and relevant billing charges, whilst we recognise that some consumers do have access to online billing via their handset, this is not true for all consumers. One might plausibly suppose this is less likely for low-income consumers, at least in the case of some suppliers. However, even if it is not, and whoever pays relevant billing charges, those charges must be in accordance with the Regulations.

3.60 The 'vox-pop' comments from our qualitative research were intended to highlight the concerns of a small selection of low-income consumers. But, we acknowledged in the consultation document that such research is not statistically robust and we have not proposed any guidance specifically to protect low income consumers, over and above the more general protection offered by the Regulations, nor have we relied on any 'evidence' in those comments.

3.61 We have, therefore, considered relevant evidence of harm. And, we have engaged in extensive consultation with all stakeholders. We consider, in part based on that evidence and consultation:

- the principles we think likely to apply to relevant additional charges under the Regulations; and
- the approach we are likely to take in complying with our duties and in exercising our powers under the Regulations

are transparent, accountable, proportionate, consistent and targeted at harm.

3.62 As to those principles of transparency, accountability, proportionality, consistency and targeting action at harm, we note that these are referred to in section 3 of the 2003 Act as principles relating to 'regulatory activities.' We note also they are referred to in Ofcom's draft enforcement guidelines.

3.63 Here, we are giving guidance on our view of the application of existing law. We are not 'regulating' in the sense of imposing measures on regulated persons. Nonetheless, we have taken account of these regulatory principles, not least because they are part of our draft enforcement guidelines and the issuing of guidance is part of our enforcement role.

3.64 And we consider our approach has been and is:

- transparent and accountable because we have consulted on and confirmed our view of how we think the law applies and how we are likely to approach our powers and duties under it;
- consistent because we are setting out our view of existing law, that applies generally and equally to all relevant suppliers (see below), and the approach we are likely to take to them; and
- proportionate and targeted at harm because there is evidence of consumer harm arising out of contract terms that appear to us to have the potential for unfairness. And because, rather than simply undertaking a widespread formal enforcement programme or acting on an ad-hoc basis, we are setting out our views and likely approach in guidance, for consumers and suppliers, and giving the latter the opportunity to comply with what we consider is the law.

3.65 As to the consultation responses which said our proposals - especially on ETCs - may be discriminatory (or have an asymmetric effect), we agree that the application of our proposed principles may affect different suppliers differently. But that is because they are in different positions, not because Ofcom is acting in a discriminatory way.

3.66 We are setting out principles, with regard to general consumer protection legislation, which applies equally to all suppliers. If the Regulations, and Ofcom's view of their

application, affect different suppliers differently that is not because the legislation and/or Ofcom's views are being applied in a discriminatory way.

- 3.67 In relation to ETCs, for example, if these should reflect costs saved on early termination, and we consider they should for the reasons in the consultation document and below, we acknowledge different suppliers will have different costs and so ETCs. That would reflect their different business models and infrastructures, and the amount they spend on them. And, where suppliers save those costs on early termination, we consider that the fair position the Regulations require is that they are reflected in lower ETCs. This is so even where other suppliers do not have (and save) those costs because they have adopted different business models and infrastructures.

Other consultation responses

- 3.68 As to the consultation responses that said the draft guidance required suppliers to provide too much, or confusing, information in marketing material, we acknowledge that the Better Regulation Executive's and the National Consumer Council's recommendations may have said that too much information at the point of sale does not help consumers. We note also its recommendation about road-testing with consumers any proposed new information provision requirements. And, we have seen the 5 tests it proposes before such requirements should be introduced.
- 3.69 However, we did not propose, and are not now saying, that information must be provided in a certain way, still less mandating its provision, in marketing material. We proposed, and are now, just giving guidance that in our view the presentation of certain information may affect whether terms are core terms or not.
- 3.70 As to the question of what consideration we have given to the Consumer Protection from Unfair Trading Regulations 2008 ('the CPRs'), and the need to avoid conflict with, or uncertainty about, other regulations such as the CAP Codes, these other provisions are separate from the Regulations which were the subject of our consultation. The CPRs deal with a number of unfair trading practices. The CAP Codes deal with misleading advertising. Neither are concerned with unfair contract terms.
- 3.71 We proposed, and are now giving, guidance on the latter. This is not affected by the CPRs or the CAP Codes, and our guidance does not affect the CPRs (or the CAP Codes) and any enforcement of them. Whether advertising material is, for example, misleading is determined under the CPRs and the CAP Codes. It was not covered by our consultation or our draft guidance and is not covered by our final guidance.

Ofcom's decision

- 3.72 For the reasons set out above, we will issue guidance. It will set out the high level principles we consider likely to apply under the Regulations to contractual terms providing for certain additional charges in communications contracts. It will also set out terms we consider may or are likely to be unfair applying those principles, under the Regulations.
- 3.73 That decision notwithstanding, however, the final guidance has been changed in a number of specific respects from that proposed in light of specific consultation responses. These changes, and the reasons for making them, are explained in Sections 4 to 10.

Issues covered by the Regulations which Ofcom should give guidance on

Ofcom's proposed position

3.74 Our consultation proposed that we were focusing on a number of issues which we considered to be the most important. However, we were keen to hear whether stakeholders felt there were other issues we should also be addressing.

3.75 We asked the following question:

Are there any other issues that are covered by the Regulations which Ofcom should give guidance on?

Stakeholder responses

3.76 Most respondents did not suggest other such issues for guidance.

3.77 One supplier said all major mobile network operators charge more to call 0800, 0844 and 0845 numbers than can be justified and we should address this.

3.78 Another stakeholder said it would be useful for Ofcom to clarify the position of consumers who are disputing an element of the bill with their supplier and who subtract the disputed amount before settling their bill. The stakeholder said these consumers may then find they are faced with late and missed payment charges. The OFT guidance already covers this point, and it would be useful for Ofcom to include a reference to this right of set-off in its own guidance.

3.79 Consumers commented on a number of other additional charges or contractual issues about which they were concerned. These are contained in Annex 2 (A2.12) and our response is set out in paragraph 3.90 below.

3.80 Consumer stakeholders and small business representatives suggested Ofcom take action in a number of areas by:

- issuing comparative information for consumers about prices and additional charges;
- monitoring and regularly updating the guidance and suppliers' terms, publishing compliance data, and by taking action to improve post contractual information (by amendment to the General Conditions);
- applying 'Hire Purchase' rules where equipment is provided by suppliers to consumers at the start of contracts;
- considering bringing a test case, like the OFT's on bank charges, on behalf of consumers who have paid additional charges; and
- issuing similar guidance in respect of small business customers (doing so in connection with General Condition 14).

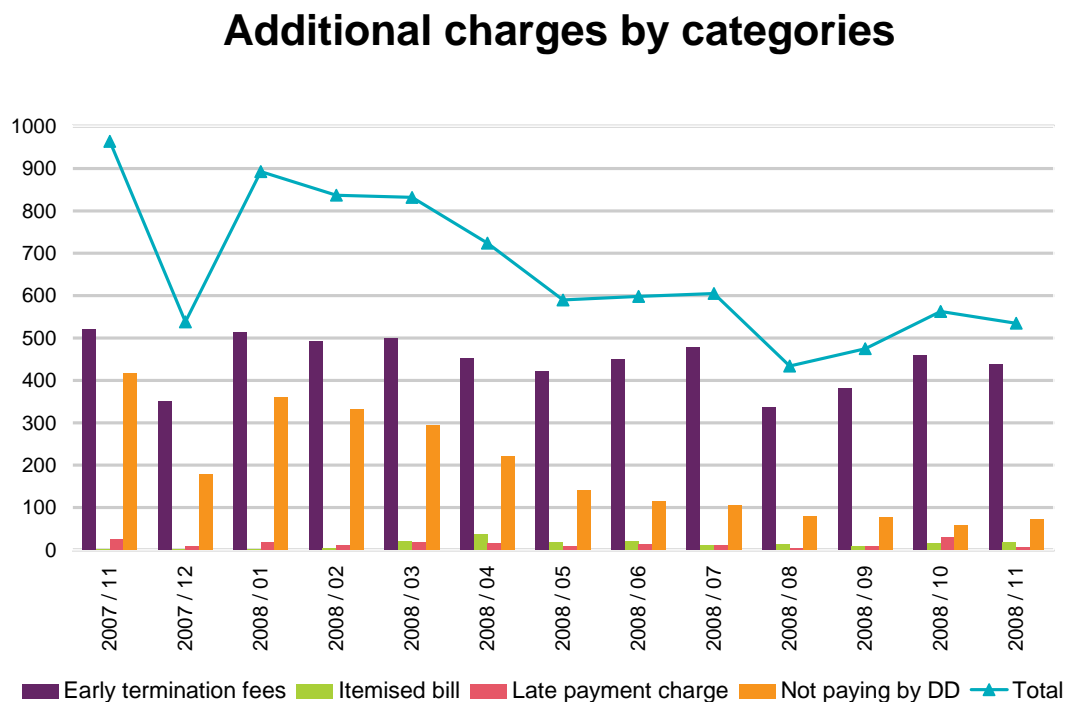
3.81 Consumer stakeholders also supported Ofcom's proposal to publish a consumer check list or 'consumer guide') advising consumers what charges and terms to consider before signing up to a new service.

- 3.82 One MNO said it assumed we had identified all those terms we consider may be unfair and are not considering investigating any other terms, and said it would consider it a matter of bad faith if we investigated any other terms.

Ofcom's consideration of and response to stakeholders' consultation responses

- 3.83 We have noted and considered the responses to this question. We have considered whether the terms and charges covered in the consultation document and the draft guidance are likely to be those causing most harm to consumers. And, we have considered whether there are other issues causing harm on which we should issue guidance.
- 3.84 Whilst we acknowledge they are not the only source of evidence of harm and unfairness, one way in which we have done this is by reference to consumer complaints. For example, we have received significant numbers of complaints regarding early termination charges and non-direct debit charges over the last 12 months. This is shown in the table below.
- 3.85 We have also directed our attention to other charges which have attracted fewer complaints, but which we consider it is important to give industry-wide guidance on. This is based on our experience of applying and enforcing the Regulations on a case by case basis, and the potential for unfairness and lack of transparency for certain charges we have identified (for example itemised billing and late payment charges).

Figure 3.1 Consumer Complaints to Ofcom



Source: Ofcom

- 3.86 We have also taken account of the following general factors. First, that there are other means by which individual issues and disputes can be resolved under the Regulations. Under the Regulations, unfair terms are not binding on a consumer.

This protects a consumer in individual contractual disputes. Second, alternative dispute resolution schemes exist for the resolution of individual disputes.

- 3.87 These points suggest there are a number of matters which may arise under the Regulations in respect of which Ofcom guidance is not required, because other forms of consumer protection exist.
- 3.88 We have also considered further the specific points raised in the consultation responses.
- 3.89 As to the stakeholder response that MNOs' charges to 0800, 0844 and 0845 numbers cannot be justified, we recognise that individual rates are often higher than for some fixed services and this may be a cause of concern for some consumers. However, such prices are likely to be within the core terms exemption and are unlikely to be subject to the test of fairness under the Regulations. Ofcom is examining issues around the price of calls to these numbers as part of its consultation 'Mobile citizens, mobile consumers'⁷.
- 3.90 In response to those issues raised by individual consumers (see A.2.12) we consider:
- It is reasonable for a supplier to charge a customer for any costs it incurs repairing a phone line, where the damage is the customer's fault. The level of these charges should be freely available to consumers along with all other prices and tariffs.
 - We recognise that some suppliers charge their customers for exceeding usage allowance on broadband. In response to concerns expressed by consumers, Ofcom and a number of ISPs have agreed a broadband code of practice which requires ISPs to provide consumers with clear and accessible information⁸ on the actions taken (including any charges imposed) should a consumer exceed the usage limit for their broadband package.
 - Ofcom is aware that an additional charge is currently levied by at least one supplier for changing the amount of rings before a customer's voicemail service answers the call (currently 3 rings). We recognise this arrangement may not be suitable for all consumers (for example some older and disabled consumers). Whilst we do not think it appropriate to address this issue in the final guidance - which is about the additional charges most commonly found in telecommunications contracts - we have raised this issue with the relevant provider separately.
 - As to the advertising of services as 'free,' but where some charges may exceptionally be made, we take the view that suppliers are justified in charging for certain services. But, where these services are generally 'free', consumers must be made aware of any circumstances in which a charge may in fact exceptionally be made. Misleading price indications are likely to be unlawful under the CPRs. They do not, however, fall within the scope of the Regulations. Where consumers have complaints about misleading price indications, in adverts for example, they should make them to the Advertising Standards Authority or Ofcom.

⁷ 'Mobile citizens, mobile consumers' <http://www.ofcom.org.uk/consult/condocs/msa08/>

⁸ <http://www.ofcom.org.uk/telecoms/loi/copbb/copbb>

- One consumer complained that mobile operators have Call and Text plans but it is difficult to work out from billing how and when the limits are exceeded (and when the limits are exceeded heavy charges are levied by some MNOs). Ofcom is considering these issues as part of its consultation 'Mobile citizens, mobile consumers'⁹.
- As to the concerns raised about multiple account holders being required by a supplier to pay multiple payment processing fees, it seems likely to us that such an account holder will have multiple contracts with the supplier. Provided the additional charges levied under each reflect the supplier's payment processing costs incurred under each, as set out in the final guidance, this practice is unlikely to cause us concerns under the Regulations.
- We accept that some suppliers may choose to provide different service levels and charge different prices for consumers signing up at different points (e.g. introductory offers for new customers or enhanced customer service for loyal customers). We consider these to be legitimate business practices and not ones covered by - still less unfair under - the Regulations (save of course we may have concerns about the fairness of additional charges under all sorts of contracts). However, we may have other concerns if we received evidence of vulnerable groups of consumers were being disadvantaged as a result.
- Ofcom is aware that credit - left on some consumers' accounts after they have terminated their contracts - will in some cases not be repaid unless they actively contact their service provider and request a refund. Some further action may be needed in this area.

As set out in our 'Next Generation New Build' statement (September 2008) (http://www.ofcom.org.uk/consult/condocs/newbuild/statement/new_build_statement.pdf) we are keen to avoid the situation where consumers in a new build development with a fibre network only have access to the services and products of a single communications provider. In order to ensure that this does not happen we want to promote competition in both infrastructure ownership and service provision, by ensuring appropriate wholesale access products are made available. In addition, in any event, and whether the issue arises in relation to new build property or to new connections at existing properties to which consumers move, the identity of the supplier from whom a consumer receives service is not a matter within the scope of the Regulations.

- As to the concerns raised about being charged for online billing services, billing charges were covered in the consultation document and draft guidance, and are now covered in the final guidance we are publishing (see Section 9).
- Sky basic channels became available to Virgin Media customers on 13 November 2008 following agreement by the two suppliers.
- The practice of 'free' calls ending after 60 minutes, and charging a connection fee, does not appear to us to be a matter for our guidance for the following reasons. First, such charges may be part of the retail price that falls within the Regulations' core terms exemption. Second, it is difficult on initial analysis to see any real consumer detriment arising, provided the charges are not advertised in a misleading way. Ofcom will deal with this issue elsewhere, should we have sufficient concerns.

⁹ 'Mobile citizens, mobile consumers' <http://www.ofcom.org.uk/consult/condocs/msa08/>

3.91 In response to the consumer who proposed that all contracts should need a signature before the contract can begin, this is not a matter falling within the Regulations. However, we refer to the following:

- verbal contracts are binding so long as there was an agreement on the services and the price. This agreement can be reached by a verbal exchange in person or via telephone (or via an email or the internet). However, there is built in consumer protection under the Consumer Protection (Distance Selling) Regulations 2000 which, amongst other things, requires the following:
 - extensive information to be given to consumers before and after consumers enter into contracts;
 - cancellation rights (minimum 7 working days) to be given, starting from the date the contract is made or of delivery of the prescribed information (if later); and
 - provisions that making demand for payment of services not ordered is a criminal offence.
- Ofcom considered the effectiveness of these safeguards in the context of work on protecting consumers from mis-selling of fixed-line voice services, and introduced additional sector specific safeguards over and above those provided by consumer protection legislation. This included requirements that both the gaining and losing providers write to notify the consumer of an impending transfer of services as well as a 10-day switchover period during which the consumer can cancel their contracts free of charge.
- Ofcom is currently considering the effectiveness of these current safeguards in the context of a review of mis-selling of fixed-line voice services, and is looking to publish a consultation document on this subject shortly.

3.92 In response to consumer stakeholders and small business representatives:

- Ofcom has accredited two price comparison services which enable consumers to compare the cost of different communications services and suppliers (www.broadbandchoices.co.uk and www.simplifydigital.co.uk). In calculating what the best deal might be, these services take into account charges such as non-DD charges.
- Ofcom has also published - in connection with this final statement - its own consumer advice guide advising consumers to consider what additional charges may apply before signing up to a service.
- If equipment is provided on 'hire purchase' terms, the relevant rules will apply. However, these do not arise under the Regulations and so fall outside Ofcom's guidance.
- Improving post contractual information by amendment to the General Conditions (as suggested by one respondent) is outside the scope of the Regulations (which relate only to contractual terms). However, we have included various methods of communication which may fall into this category in our examples of best practice in the guidance (e.g. reminder letters on subsequent minimum contract periods). We will keep the level of information being provided by suppliers to consumers under review and reconsider where we have concerns.

- On the question of ‘test case’ litigation, our position as to how we will seek to enforce the Regulations are set out in this final statement and the final guidance. This includes the possibility of formal enforcement action.
- Issuing similar guidance in respect of small business customers is a wider issue not within the scope of this review (the Regulations relate only to consumer contracts). However, we recognise there are some issues affecting small business customers that need to be addressed and we will be turning our attention to these in due course.

- 3.93 In relation to the response that said Ofcom should give guidance on a consumer’s right to set off disputed sums, notwithstanding that the OFT guidance already covers this point, for the reasons set out below (see 5.43 – 5.49 in Section 5 of this statement) we agree. In our view, a late payment charge that effectively precludes a consumer setting off (i.e. withholding) a disputed part of a bill may be unfair. We have amended the guidance accordingly.
- 3.94 As to whether there may be other terms against which Ofcom may take action under the Regulations, whilst the additional charges we are issuing guidance on reflect those we currently have greatest concerns about and which can be addressed by the Regulations, this does not assume all other terms are fair.
- 3.95 Rather, our review covers only certain additional charges. We may investigate other terms if, for example, evidence of consumer harm emerges and/or we receive complaints about them. Any decision to investigate further charges/terms would not be ‘in bad faith.’ It would be consistent with our statutory duties, including those under the Regulations to investigate complaints about unfair terms. As set out in the consultation document (paragraph 2.18), this could include using alternative legal instruments to address future issues. And, in any event, it would be for a court to decide whether any other terms are unlawful.

Ofcom’s decision

- 3.96 In light of the above, and for the time being, Ofcom does not propose to expand the guidance to cover other additional charges or other matters arising under the Regulations. We take the view that it covers the main common generic types of additional charges about which we receive complaints and where unfair terms may be harming consumers. We also take the view that other means and legal provisions exist to protect consumers in respect of other matters.
- 3.97 However, we have amended the guidance in respect of late payment charges in light of the consultation response about consumers’ right to set off disputed sums.
- 3.98 And, we will continue to monitor and consider any complaints about any matters that fall within the Regulations and consider future guidance if it appears appropriate to do so.

Deadline for compliance

Ofcom’s proposed position

- 3.99 In the consultation we proposed that we would provide suppliers with a period of three months after the publication of the final guidance, during which they could review their terms and conditions and charges where necessary. Following this

period, we would open an enforcement programme where we believe additional charges were not in line with our guidance.

3.100 We highlighted areas on which Ofcom would place particular emphasis in its investigation and enforcement activity.

3.101 We asked the following question:

Do you agree that three months is an appropriate period during which suppliers can adjust their terms and marketing practices to ensure they are in line with Ofcom's guidance?

Stakeholder responses

3.102 A number of suppliers responded to this point.

3.103 Some felt that, based on the current proposals, the changes they would need to make to their terms and conditions, marketing and sales practices were relatively small. On this basis, they felt that three months would be long enough.

3.104 However, more suppliers felt that three months was inadequate to make changes to some or all of their printed materials and processes. Some referred to the lead times involved in planning and changing commercial offers and advertising, and changing terms and conditions, all of which it was said take much longer than three months. In general, an alternative time period was not proposed. The two suppliers who proposed an alternative time suggested a period of around six to eight months would be needed.

3.105 One of these two suppliers referred to changes that would be required to billing systems in connection with changes to subsequent minimum contract periods and minimum notice periods. The other said a minimum of six months would be required to revise all terms, review all marketing materials, assess charges and costs and brief all retail channels.

Ofcom's consideration of and response to stakeholders' consultation responses

3.106 Ofcom expects that suppliers will in any event seek to comply with the law, and that our draft guidance will have caused some suppliers to think further about the extent to which they are compliant and to make necessary changes.

3.107 We continue to expect that three months should be sufficient time for most suppliers to make most of the changes they may need to make. The Regulations have been in force since 1999, and all suppliers have to comply with them. That being so, we do not see, absent good reasons, why they should have more than 3 further months to comply with what we consider is the law or face the possibility of enforcement action.

3.108 However, we recognise that there may be some areas where suppliers have held back on making changes pending Ofcom finalising its guidance and the possibility that some of the changes may take longer than three months to implement.

Ofcom's decision

3.109 We have changed our proposals to reflect the comments made in response to the consultation. We now expect to adopt the following procedure which is designed to ensure changes to terms that can happen quickly do so, whilst also taking account of

genuine timing constraints. We do not consider that any supplier is placed in a worse position as a result of this change.

- 3.110 We will write to those suppliers who responded that three months was not long enough giving a one month period to:
- confirm whether they intend to comply with our view of the law set out in the guidance;
 - identify what they need to change; and
 - identify any changes for which they will need greater than three months from the date of the statement, together with proposed actual timing and full justification for needing extra time.
- 3.111 We would also be interested in hearing from suppliers who did not choose to respond to this point, but who also disagree that the three months proposed by Ofcom is sufficient. Suppliers should make any representations in the first month following publication.
- 3.112 If a supplier advises us that they do not intend to comply with any part of the guidance, we may commence enforcement action more quickly, as the three month period is provided for compliance with our view of the law and the compliance decision will have been taken within the one month notice period.
- 3.113 Therefore, we expect that our enforcement of the Regulations based on the view of the law and the approach set out in the final guidance will start three months (plus 2 weeks, to allow for the Christmas period) from its publication, subject to:
- agreeing longer periods for some suppliers on some issues; or
 - a supplier indicating they are not going to comply with the guidance (in which case we will consider starting enforcement action earlier).
- 3.114 In considering whether to take enforcement action we will expect to apply our usual criteria for prioritising our use of resources, both across the range of additional charges and across the wider range of issues causing consumer harm where Ofcom regulates.

General comments about Ofcom's proposed guidance on core terms and transparency

- 3.115 We received a number of general comments from stakeholders about Ofcom's proposed guidance on core terms and transparency.

Stakeholder responses

- 3.116 One supplier said it was not appropriate for Ofcom to state that certain kinds of terms are, or are not, core terms, and we should instead give 'our likely opinion' of the relevant matters. It also said we should clarify references to 'point of sale' by saying we mean 'before the contract is concluded.'
- 3.117 One supplier disagreed with our proposed view that terms may be core or non-core depending on their transparency and prominence.

- 3.118 One MNO said there was no requirement for prominence under the Regulations (for core and non-core terms) and no requirements about marketing materials that are not part of contract terms. It said transparency was sufficient.
- 3.119 One MNO said the proposed guidance wrongly suggested that core terms must define the main goods and services under the contract and the price (see paragraph A5.97, for example). It also said we were wrong to focus the definition of core terms primarily on the consumer's perspective, because this requires assessment of each individual consumer's priorities.
- 3.120 Another supplier complained about 'misleading price advertising' - where attractive headline offers are off-set by increases in other tariffs.

Ofcom's consideration of response to stakeholders' consultation responses

Whether Ofcom should make definitive statements about core/non-core terms

- 3.121 We agree, in most part, with the response that said the guidance should state our view that some terms are 'in our opinion likely to be non-core terms' rather than make definitive statements about their status. We appreciate that is ultimately a question for the courts. We have amended some references in the guidance accordingly. Nonetheless, we maintain the view that default charges and ETCs will not be core terms – see Sections 5 and 6. The courts have considered the status of such terms (or similar terms) – see *Director General of Fair Trading v. First National Bank plc* [2002] 1 AC 481.
- 3.122 We also agree it is difficult to see how some terms will be anything other than core terms of a contract. An example is the term setting the headline price. We also agree a MCP term will normally be one of the core terms.

Whether the status of terms is affected by prominence and transparency

- 3.123 We disagree, however, that the status of some terms (as 'core terms' or not) is unaffected by their transparency and prominence. Similarly, we disagree that (core and non-core) terms need not be prominent, merely transparent, and that the Regulations have no impact on marketing materials.
- 3.124 In our view, this is linked to the whole purpose of the Regulations and the Directive they are based on. Clear contractual language is required, but the Regulations have the broader purpose of protecting consumers from one-sided agreements. And, the Directive says, '*...consumers should actually be given an opportunity to examine all the terms*' (Recital 20). We consider this is part of a requirement that terms should enable consumers to make informed choices. The less prominent or significant a term is, the less is the likelihood that typical consumers, presented with non-negotiable documentation, will appreciate its effects.
- 3.125 The exemption from the Regulations' fairness test for certain terms and matters – 'core terms' - is, in our view, also linked to these purposes of the Regulations and the Directive.
- 3.126 In our view, the exemption is - as the relevant case law confirms - a narrow one designed to give consumers and suppliers freedom of contract in relation to terms and matters that are at the core of the bargain between them, but to protect consumers in respect of other matters by ensuring contracts are balanced.

3.127 In the *First National Bank* case referred to above, the House of Lords said:

‘... 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 edn, 1999) p 747 (para 15–025), ‘Unfair Terms in Consumer Contracts’). 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 reg 3(2)(b) [*now regulation 6(2)*] 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.’

3.128 So, we consider, ‘core’ terms and matters should be those at the forefront of the parties’ minds - and especially the typical consumer’s – as the substance of the bargain they are making, when they enter the contract. (Hence, the reference in the draft (and now the final) guidance to the ‘point of sale.’ We consider this denotes sufficiently clearly that the relevant terms and matters should be in the parties’ contemplation at the time the contract is made.)

3.129 It follows, we further consider, that some terms and matters defining what is being purchased under the contract or potentially relating to price, may or may not be within this core terms exemption. Where these types of terms are in clear language, and are prominent and transparent in contractual and pre-contractual marketing material, we consider they can be brought to the forefront of the parties’ minds and within the core terms exemption, even where they otherwise may not be.

3.130 We take the view that will be so where relevant terms and matters are sufficiently clear, transparent and prominent that the typical consumer would regard them either as part of the main subject matter of the contract (‘what am I buying?’) or of the price of the services he is buying (‘how much is it?’) (rather than as a separate, incidental, additional charge or matter). If the typical consumer would not reasonably regard the term in such a way, it would be difficult to argue that it is a core term. Equally, in our view, if it is not in clear language, is illegible or is presented as a separate, incidental, additional charge or matter in small print, as if unimportant, a term may fall outside the narrow core terms exemption.

3.131 Similarly, there are some terms and matters which, no matter how prominent their presentation, will not come within the core terms exemption. Again, an obvious example is a term providing for a default charge (which is concerned with payment on termination of a contract, not ‘what am I buying and how much is it?’). In our view, it is a necessary but not a sufficient requirement of ‘core terms’ that they be clear, prominent and transparent.

3.132 These points are reflected in, for example, the reasoning in paragraphs 3.101 – 3.104 of our consultation document in relation to non-DD charges. One way such charges can come within the core terms exemption is if they are presented to the consumer as part of the headline price of the services they are buying, rather than as separate, incidental, additional charges. We think they would then likely be in the forefront of the typical consumer’s mind on entering the contract and likely to be within the core terms exemption. Their level would be regulated by parties’ freedom of contract and competition, not the Regulations’ fairness test.

- 3.133 As for non-core terms, we consider transparency and prominence are also part of the assessment of the term's fairness. In particular, they are linked to the Regulations' *'requirement of good faith.'* In the same *First National Bank* case, in the House of Lords, it was said:¹⁰

"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."

- 3.134 This is derived from the fifteenth and sixteenth recitals to the Directive, which say (our **emphasis**):

'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;'

Other responses

- 3.135 We consider and respond to the MNO's consultation response about the nature of the core terms exemption and paragraph A5.97 of the draft guidance in Section 9 (Itemised billing) below.
- 3.136 As to the supplier's response about 'misleading price advertising' - where attractive headline offers are off-set by increases in other tariffs – we have considered it and take this view. 'Misleading price advertising' in itself is not within the scope of the Regulations and any Ofcom guidance on them. It is subject to the CPRs. Complaints about misleading price advertising should be made to the Advertising Standards Authority and/or Ofcom. As to the amounts that may be recovered by way of additional charges, the consultation document, the draft guidance and now the final guidance set out how we think the Regulations apply to limit the amounts that may be recovered in such charges. This addresses, in part, the point made by this supplier.

¹⁰ by Lord Bingham in *Director General of Fair Trading v. First National Bank* [2002] 1 AC 481

General comments about our proposed guidance on non-core terms to which we apply the test of fairness.

- 3.137 Most of the consultation responses we received about Ofcom's proposed guidance on non-core terms, to which the Regulations' test of fairness applies, referred to those proposals in the context of specific additional charges and are considered elsewhere in this statement. There were, however, a smaller number of more general responses we consider here.

Stakeholder responses

- 3.138 One MNO said what it described as our, '...conclusion that only direct costs can (as a rule) be included in such charges' (non-core terms) is incorrect, because the Regulations are not a mechanism of price or quality control.
- 3.139 Two MNOs said our proposals did not take sufficient account of the contractual options available to consumers when choosing mobile services. One referred to the post-pay monthly contracts of various lengths, pay monthly 'SIM only' contracts and pre-pay options. These mean consumers are not in a 'take it or leave it position' and this, '... and hence the mitigation of any perceived abuse of power by the seller,' must be taken into account in the assessment of fairness. The other said our proposals ignored these choices and threaten the ability of MNOs to offer them.
- 3.140 Another stakeholder agreed that additional charges should generally reflect costs, but said they must also recognise upfront customer acquisition costs and those of special deals.
- 3.141 One stakeholder said costs recoverable in additional charges might differ between providers because in any analysis of fairness we have to consider the impact on competition.

Ofcom's consideration of and response to stakeholders' consultation responses

- 3.142 We have considered the supplier's response that we have incorrectly concluded that, as a rule, charges made under non-core terms can only recover direct costs. We note the response said the Regulations are not a mechanism of price or quality control.
- 3.143 The first point to make is that we had not 'concluded' anything at the time we consulted. We were consulting on a proposed view.
- 3.144 Nonetheless, we agree that the Regulations are not a mechanism of price or quality control. The core terms exemption in Regulations regulation 6(2)(b) exempts from an assessment of fairness the adequacy of the price received by a supplier in exchange for the goods or services he provides in exchange.
- 3.145 However, where charges are made under terms that are not core terms they are assessable for fairness under the Regulations. That is well established in the case law. And, such an assessment does not amount to using the Regulations as a mechanism of price or quality control. Such terms and charges are not in those cases the price whose adequacy is exempt from a fairness assessment. We refer in more detail to issues of whether charges arising under non-core terms must reflect only direct costs in relation to specific charges in sections 4 – 10 of this statement.

- 3.146 As to the MNO's response that our proposals did not take sufficient account of the contractual options available to consumers when choosing mobile services, we have given the following consideration.
- 3.147 One MNO said there are post-pay monthly contracts of various lengths, pay monthly 'SIM only' contracts and pre-pay contracts. These mean consumers are not in a 'take it or leave it position' and this, '... and hence the mitigation of any perceived abuse of power by the seller,' must be taken into account in the assessment of fairness.
- 3.148 We note that Regulation 6(1) says, '.... the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract'. We agree this could provide some scope for considering the choices available to consumers at the time they enter contracts in assessing the fairness of terms in those contracts.
- 3.149 However, it does not appear to us to follow that the availability of, say, different lengths of fixed-term post-pay contracts, or different contractual models such as 'pay-as-you-go' or SIM only contracts, necessarily means that post-pay contract terms that might otherwise be unfair will be fair. In other words, the existence of one contract would not necessarily justify unfair terms in another.
- 3.150 It is not clear to us, for example, why the options of 12 or 24 month fixed term contracts would mean that, say, an unfair non-DD charge or default charge (or ETC) in either or both contracts is necessarily more likely to be fair. Likewise, it is not clear that the alternatives of, say, a SIM only contract or a fixed-term post-pay contract, which are both likely to contain, say, non-DD charges, would mean that such charges are more likely to be fair.
- 3.151 Where there may be more scope to argue that choice is relevant to fairness, it seems to us, is where contracts offering the same sorts and levels of services, and similar contractual relationship and terms are available from the same supplier, and the difference is in one, or a small number of, otherwise unfair terms. That is, where there is a choice of two contracts that are substantially the same, save one contains a, or a small number of, potentially unfair term(s) – for example, providing for automatic renewal of the fixed term - that the other does not. The other might charge a higher retail price by way of a 'trade off' for not containing the automatic renewal.
- 3.152 If one thinks that one purpose of the Regulations is to enable consumers to protect their interests against abuse by suppliers of superior bargaining power, the existence of a direct and relevant choice like this might be one factor in support of the possible fairness of the otherwise unfair term (as to automatic renewal in the example given).
- 3.153 We do not see that that analysis necessarily extends to 'choices' between contracts and contractual relationships that are more significantly different, such as between fixed-term post-pay contracts and pre-pay, 'pay-as-you-go' contracts. Such choices do not, it seems to us, necessarily 'mitigate' the take it or leave it nature of terms suppliers offer for fixed-term post-pay contracts.
- 3.154 Neither do we see that such an analysis would necessarily extend to some terms such as unfair default charges and ETCs in any event. It seems to us there is scope to argue that such terms, that would amount to, or be similar in effect to, an unfair penalty in common law, would be more likely than not in most cases be unfair even if contracts without them are also available.

- 3.155 We are not aware of any authority in case law that supports the consultation response about choice, or even that says that choice is relevant in the assessment of fairness. None has been put to us by any consultation respondent.
- 3.156 So, we do not take the view that relevant choices for consumers, between contracts which contain potentially unfair terms and those which do not, will never be relevant to the assessment of fairness of terms. It may be that in any particular case one factor a supplier may be able to rely upon in support of the fairness of a particular term is the existence of such a choice.
- 3.157 But, we do not think that the existence of 'choice' between broad contractual models, as suggested by the relevant MNO, necessarily means otherwise unfair terms will be fair in the context of contracts in which those terms appear. Nor does the possibility of another contract without an unfair term necessarily mean that contract containing that term will be fair.
- 3.158 Accordingly, we do not consider this consultation response means we should not give guidance on, nor take a certain view, as to when, generally, we consider certain terms may be or are likely to be unfair under the Regulations.
- 3.159 As to the response that additional charges must also recognise upfront customer acquisition costs and those of special deals, we consider that point in more detail in the context of early termination charges below. As to the question of 'special deals,' specifically, we note that, speaking generally, the law will not protect a supplier from having made what is, in contractual terms, a bad bargain. The amount we consider a supplier is likely to be able to recover by way of, for example, an early termination charge is linked to the contractually agreed price, not what the supplier might consider the undiscounted price. Again, we consider that point in more detail in the context of early termination charges below.
- 3.160 One stakeholder said costs recoverable in additional charges might differ between providers because in any analysis of fairness we have to consider the impact on competition. We agree they might, though this is not because an analysis of fairness takes into account the effect on competition of applying the Regulations.
- 3.161 Rather, as we say elsewhere in this statement, the application of the principles and views in our guidance may affect different suppliers differently because they are in different positions.
- 3.162 In relation to ETCs, for example, if these should reflect costs saved on early termination, and we consider they should for the reasons in the consultation document and below, we acknowledge different suppliers will have different costs and so ETCs. That would reflect their different business models and infrastructures, and the amount they spend on them. And, where suppliers save those costs on early termination, we consider that the fair position the Regulations require is that they are reflected in lower ETCs. This is so even where others suppliers do not have (and save) those costs because they have adopted different business models and infrastructures.

Section 4

Charges for payment method (non-direct debit charges)

Description of charge

- 4.1 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, suppliers make a charge for payment by methods other than direct debit (DD). We refer to this as the non-direct debit ('non-DD') charge. Some suppliers accept payments only by a limited range of methods, typically DD and/or credit card.
- 4.2 While the non-DD charge is generally for payment by means other than DD, some suppliers may differentiate on the basis of whether the payment is by a recurring, or non-recurring method.
- 4.3 Suppliers may choose to express this as:
- an additional charge for those consumers not paying by direct debit; or
 - as a discount for those consumers who do pay by direct debit.
- 4.4 Currently the vast majority of suppliers choose to express this as an additional charge. Charges tend to range from £1 to £5 a month. However, some suppliers do not charge.

Ofcom's proposed guidance

- 4.5 The proposed guidance on which we consulted was:
- charges may be 'core terms' exempt from the Regulations' test of fairness where they are:
 - in plain intelligible language; and
 - presented to consumers in such a way that the typical consumer would be aware that the charge is part of the price and would consider it part of the essential bargain with the supplier; and
 - where they are not core terms the fairness test applies, and we are likely to regard them as fair where they recover the supplier's additional costs directly attributable to the method of payment used; but,
 - it may be unfair to seek to recover other costs such as general "bad debt" costs, given there is little evidence of a causal link between a consumer's choice of payment method and the risk that the same consumer will fail to pay for the services provided.

Stakeholder responses

- 4.6 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

- 4.7 In response to this consultation question, we received a large number of both positive and negative responses.

Positive responses

- 4.8 There was agreement among some suppliers to Ofcom's proposal that non-DD charges may be core terms if they are presented appropriately.
- 4.9 There was also some acceptance that greater transparency and prominence would be helpful to consumers and to competition. However, views differed as to the best way to ensure consumers understood these charges, with some suppliers believing that information at the point of sale and subsequently on bills was sufficient.
- 4.10 Some suppliers who allow non-DD payment only exceptionally (for example, where DD payments fail) accepted that charges would not be made transparent and prominent in advertising or at the point of sale and so were not core terms (one supplier made a similar point and suggested the guidance should make clear exceptional charges need not be highlighted in general marketing).

Negative responses

Ofcom proposals ignore 'pay-as-you-go' mobile services

- 4.11 Some MNOs challenged our proposals about non-DD charges on the basis they failed to take account of the availability of 'pay-as-you-go' mobile services. We have considered and responded to these elsewhere in this statement.

Non-DD charges are core terms

- 4.12 Another view was that charges are core terms irrespective of issues around transparency and prominence. One supplier said that its non-DD charges are core terms because consumers must expressly opt-out of payment by DD, at which point it is clear they pay an extra charge. It said this means the charges are part of the essential bargain with the consumer communicated to him in plain, intelligible language. Other suppliers said it is unclear why prominence and transparency are needed both in marketing and at point of sale.

Non-DD charges are non-core terms

- 4.13 One consumer noted that in the OFT/banks charges case¹¹ the judge appears to say that non-DD charges are not core terms, and are subject to the test of fairness, because they do not 'relate to the adequacy of what the consumer has to pay by way of price or remuneration for the goods or services supplied in exchange'.

Regulation of advertising

- 4.14 Some MNOs said that the draft guidance cuts across the ASA rules and seeks unnecessarily to regulate misleading advertising. One MNO also said this would stop suppliers competing on price in advertising and lead to suppliers removing payment

¹¹ OFT v Abbey National PLC & 7 ors [2008] EWHC 875 (Comm) (paragraph 12)

method options. However, another supplier proposed that where suppliers offer only a limited range of payment options this fact should be made prominent in advertising.

- 4.15 There were concerns that having to state two prices would confuse consumers rather than help them, particularly for mobile where there are a lot of different price plans. Again, the effect might be to inhibit the inclusion of pricing information in adverts.
- 4.16 One stakeholder said that radio adverts should not have to mention non-DD charges. Another said we were proposing prominence requirements that were unrealistic from a marketing perspective.

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

- 4.17 Again, we received a large number of both positive and negative responses to this question.

Positive responses

Agreement that non-DD charges should only reflect direct costs

- 4.18 One supplier agreed these charges should be based on legitimate cost recovery principles.
- 4.19 Another stakeholder said both bad debt costs and those of chasing payment should be excluded from fair charges, and said many of the costs claimed by suppliers are indirect and based on assumptions about cash payers' behaviour, not the direct costs of handling cash. One supplier agreed that charges should not include general bad debt costs on the basis that there is no causal link between a customer's payment method and the same customer becoming a bad debtor.
- 4.20 Some consumers questioned whether existing non-DD charges reflect direct costs, saying they believed such costs to be much smaller than the amounts charged. Some also questioned how there could be both a separate late payment fee and an element of the non-DD charge for chasing late payment.
- 4.21 Many consumers said they always paid on time and should not have to pay higher non-DD charges because others sometimes paid late. Some said suppliers should be able to distinguish those who always pay on time or should give discounts for prompt payment.

Negative responses

Non-DD charges are inherently unfair and should be abolished

- 4.22 Many consumer stakeholders objected to these charges in principle and raised concerns about being forced to pay by DD – or being charged more for not doing so. One described the charge as having caused 'huge hostility' among people.
- 4.23 Some consumers and consumer stakeholders felt that a discount for paying by DD might be acceptable, but objected to there being an additional charge. Some said increased transparency around the charges would not remove their unfairness given that all suppliers have a charge so there is no way to avoid them.

- 4.24 Some consumer stakeholders were disappointed we had not proposed prohibiting non-DD charges and called for prohibition because, for example:
- charges are unfair and punitive;
 - paying bills is not optional, and the cost of payment should be included in the main price; and
 - the costs of collecting payment are recovered in other charges.
- 4.25 One consumer stakeholder said that every supplier in the utility markets should be forced to provide the facility to pay by cash.
- 4.26 One consumer stakeholder asked for evidence that Ofcom had assessed whether the savings made by suppliers from DD customers had resulted in lower overall retail costs.

Non-DD charges impact unfairly on low income and older consumers

- 4.27 Some consumers said it was unfair that non-DD charges tended to fall on those who could least afford them and adversely impacted on the elderly. One consumer stakeholder said Ofcom should explore ways of ensuring consumers can pay their bills in a range of ways without additional charges.
- 4.28 Another said that BT Basic was not the answer to this issue as many pensioners are too proud to claim benefits or may not qualify, despite being on low incomes.
- 4.29 One stakeholder expressed concern that a higher proportion of consumers in Northern Ireland do not have bank accounts, so non-DD charges are of greater concern in this area.

Non-DD charges should be able to reflect indirect costs e.g. bad debt

- 4.30 Some suppliers disagreed that bad-debt should be excluded from fairly recoverable non-DD charges on the basis that non-DD consumers present a higher revenue/default risk than others. One provided statistical evidence in support of its view.
- 4.31 One supplier asked for greater clarification about the costs of chasing bad debt. Another disputed the view that only direct costs can be included in fair charges, saying the OFT bank charges case demonstrates that the Regulations do not regulate price/quality. Another said there is no support in the Regulations for the proposal that the charges' fairness depends on cost justification.

Proposals insufficiently detailed

- 4.32 One MNO said our proposed position on the likely fairness of non-DD charges needed to be much more detailed. For example, as to the averaging of costs of administering all payment methods across those who use them. It said this is necessary to avoid suppliers all interpreting Ofcom's view differently.

Additional consumer concerns

- 4.33 Some consumers also raised concerns falling outside the scope of our review of additional charges and/or the Regulations more generally. These concerns are summarised in Annex 2. Our response follows below.

Ofcom's consideration of and response to stakeholders' consultation responses

Core terms

Positive responses

- 4.34 We note some suppliers expressed at least broad agreement with our proposed position that charges may be 'core terms' exempt from the Regulations' test of fairness where they are in plain intelligible language and the typical consumer is aware that the charge is part of the price.

Negative responses

Non-DD charges are always core terms

- 4.35 Other suppliers disagreed and said these charges are always core terms irrespective of their transparency and prominence. We have considered, but in the most part disagree with, this, for the reasons set out in paragraphs 3.123 – 3.134 above. Those general reasons, and the consideration that lies behind them, apply in the specific case of non-DD charges.
- 4.36 For those reasons, we substantially confirm the view originally proposed that non-DD charges may be core terms, on the basis originally proposed. Otherwise, and for the same reasons, we consider they are non-core terms and subject to the Regulations' fairness test.
- 4.37 We consider this general view is unaffected by the supplier's response that *its* charge is a core term because it is part of the essential bargain communicated in plain intelligible language to consumers. That is, consumers must opt-out of payment by DD, at which point it is clear they pay an extra charge, making that charge a core term.
- 4.38 The relevant supplier's charges in these circumstances may be core terms. We do not express a view as to whether they are or not. However, the fact a consumer becomes aware of a charge before he enters a contract and/or has to pay that charge, does not, in our view, necessarily make the charge a core term. In our view, to be likely to be a core term, the charge must be presented to the consumer in such a way as he would consider it part of the price for the services he is buying in line with our view of the general principle set out in paragraphs 3.123 – 3.134 above. One way of doing so is clearly to present non-DD charges to the consumer as part of the headline price for the package of services under the contract.

Non-DD charges are non-core terms

- 4.39 As to the consumer stakeholder who said that in the OFT/banks charges case the judge appears to say that charges are not core terms, and are subject to the test of fairness, we have given the following consideration.

- 4.40 We are aware that in its judgment in that case, about unauthorised bank overdraft charges, the High Court said:

‘.... if a seller includes in his terms a surcharge if payment is made by cheque or credit card, it does not seem to me that this is exempt from assessment simply because it relates to how much the consumer has to pay: it does not relate to the adequacy of what the consumer has to pay by way of the price or remuneration for the goods or services supplied in exchange.’

- 4.41 The High Court also said:

‘.... I am far from convinced that an assessment of part of the price or remuneration (or at least for less than what is manifestly the predominant part of the price or remuneration) for goods or services would ever be covered by Regulation 6(2)(b), but since this is not an argument advanced by the OFT, I say no more about that.’

- 4.42 We agree both these statements provide some scope to argue that terms providing for non-DD charges are always non-core terms.

- 4.43 However, it appears to us that these comments were not central to the High Court’s judgment, and were not in themselves the subject of its detailed consideration such that they could simply be adopted in relation to charges in telecommunications contracts (which were not, of course, being considered by the High Court). We note, for example the qualified nature of the comments in the second quote. Similarly, we also note in connection with the first quote the High Court gave examples, ‘..... nearer to the facts of this case’ That is, the case about the bank overdraft charges under the High Court’s detailed consideration.

- 4.44 Instead, we understand the High Court’s overall judgment to have been captured in these statements it made:

‘Regulation 6(2) exempts assessment of the fairness of the balance of the essential bargain between a seller or supplier and a consumer
.....,’

and

what is exempt is an assessment of, ‘..... the adequacy of the totality of the benefits received by the [supplier] in exchange for the package of services.’

- 4.45 We consider that our proposed guidance position on charges was not inconsistent with the High Court’s overall judgment. That is, where charges are presented to the consumer in such a way that the typical consumer would regard them as part of the price for the services he is buying under the contract (the essential bargain), they will be part of the core terms and exempt from the fairness test. Where they are not, they may be subject to the fairness test.

- 4.46 We have, however, made amendments in the final guidance to make our position clearer, by contrasting the price for services with ‘an incidental, additional charge, separate from the price for the services being bought.’ We have also done so by indicating that one way this position (in paragraph 4.45) can be achieved is clearly to present non-DD charges to the consumer as part of the headline price for the

package of services under the contract. Where the charges are not so presented, they may be subject to the fairness test.

- 4.47 This is one reason why we now substantially confirm our proposed position, subject to the clarification indicated. We are, of course, aware that the High Court's judgment is under appeal. We will review our guidance if the appeal courts give a different view of the law.

Regulation of advertising

- 4.48 As to the consultation responses from suppliers that said we are proposing to regulate advertising and marketing materials in ways that cut across the ASA's regulation, impose unrealistic requirements or require consumers to be given excessive information, we have again considered what was said.
- 4.49 In the proposed draft guidance we were not seeking to regulate advertising, especially not misleading advertising falling within the ASA's jurisdiction. We did not give any guidance on how suppliers should advertise or market such charges so as to comply with any laws on misleading advertising. Neither are we in the final guidance.
- 4.50 Nor are we imposing unrealistic requirements on advertising or requiring consumers to be given excessive information. In the draft guidance we did not propose that, under the Regulations, any particular information *must* be given to the consumer in advertising. And, we do not do so in the final guidance.
- 4.51 Rather, all we proposed in the draft guidance was our view that the manner in which suppliers advertise or market some charges may have an impact on whether or not these are likely to be considered core terms under the Regulations.
- 4.52 For the reasons given above, we took the view they may be core terms if they are given sufficient clarity, transparency and prominence as to be in the forefront of the typical consumer's mind when he enters a contract as part of the price he is paying. We proposed one example of how such a charge might be a core term. But, any such charge need not be a core term (suppliers need not seek to market a charge such as to make it more likely a core term). If not, it may be subject to the Regulations' test of fairness. It must then be fair.
- 4.53 We have also considered whether our proposals would have the effect of inhibiting the inclusion of price information in advertising, or of suppliers competing on price in advertising. For similar reasons to those immediately above, we are not of the view that they would, the consultation responses notwithstanding.
- 4.54 First, as we say, the advertising of prices is substantially regulated by the CPRs. These set out what suppliers *must* say as to price in adverts.
- 4.55 Second, again, we are not *requiring* suppliers to state two prices in advertising. We only proposed guidance as to when the presentation of a charge and a price is in our view likely or unlikely to be a core term. Where it is not, it may be subject to the Regulations' test of fairness and must then be fair.
- 4.56 It does not seem to us to follow that the proposed guidance would inhibit the inclusion of prices in advertising or competition in such matters. At most, the proposed guidance meant certain charges should be presented in a certain way or should be fair. And, we would expect there is keen competition on price in the

relevant markets. Given that, and the other reasons set out above, the effect put forward in the consultation responses seems unlikely in our view. Further, any such effect, even if it did occur, would not necessarily be a reason for taking a different view of the law under the Regulations. Suppliers must comply with that law in any event.

- 4.57 For the reasons set out above, after considering the consultation responses, we remain of the view that the clarity, transparency and prominence given to charges - including in pre-contractual marketing material - can affect their status as core or non core terms.

Test of fairness

Positive responses

Non-DD charges should only reflect direct costs

- 4.58 We note that two suppliers agreed with our proposals that fair non-DD charges should reflect direct costs and not include recovery of 'bad debt' costs. And, consumers were of the view that direct costs should be very low, reflecting only the pure transaction cost (e.g. the cost of cashing a cheque, or receiving payment by direct electronic transfer).

Negative responses

Non-DD charges are inherently unfair and should be abolished

- 4.59 Ofcom acknowledges that a number of consumers and consumer groups think these charges should simply not be allowed. They believe the charges are intrinsically unfair under the Regulations, not least because according to some respondents the charges unfairly penalise low income consumers, and the elderly (see below).
- 4.60 We do not think the Regulations enable us to abolish these charges, and nor is there justification for doing so. It is not necessarily wrong or unfair, in our view, to charge customers for the convenience of paying by a certain method, where that causes a supplier greater costs.
- 4.61 Having considered the responses of the consumer stakeholders we take the view that:
- it is for competition, not regulation, to ensure that 'core' prices are set at an appropriate level;
 - where charges form part of the price, which is exempt from the test of fairness as a core term, as set out above, consumers' freedom of contract and competition will constrain that price;
 - Ofcom would not be able to ban these charges under the Regulations where costs can be demonstrated to be incurred. Nor under the Regulations could we reduce the charges below the level of such costs. Nonetheless, the guidance does set out how we consider the extent of these charges is likely to be limited under the Regulations where they are not within the core terms exemption
- 4.62 As to the latter of the points, we note, of course, that both 'banning' the charges and lowering their levels would be matters for the courts to decide. But, we think it

unlikely the courts would disagree with our view on these points. We do not see that there is any basis under the Regulations, for saying that charges that recover relevant costs, or less, are unfair. That is, for saying such terms cause a 'significant imbalance in the rights and obligations' of supplier and consumer, to the consumer's detriment, contrary to the requirement of good faith.

- 4.63 We have not made any specific assessment of whether suppliers pass on the savings they make from DD customers. Retail prices are core terms and outside the scope of the Regulations' fairness test.

Non-DD charges impact unfairly on low income and older consumers

- 4.64 Ofcom has considered the impact of charges on low income consumers carefully as part of our consultation document and in considering the responses received from consumers and consumer groups. We have considered these in the light of our obligations regarding access and inclusion, which includes ensuring the provision (via the Universal Service Obligation) of a social telephony tariff for low income consumers and a special relay service to meet the particular needs of those who are deaf or have a hearing/speech impairment. We have also considered that, as set out elsewhere in this Statement, the Regulations apply to consumer generally, not specifically to protect one group of consumers, like those on low incomes.
- 4.65 Our view is that the additional amounts involved are not sufficient that they will generally exclude consumers from taking service and those consumers most at risk of being excluded are protected through targeted schemes aimed at those in receipt of certain benefits:
- BT Basic was launched in October 2008, and does not have a non-DD charge; and
 - Kingston has removed the charge from its social telephony products, after the publication of the consultation document in February 2008.
- 4.66 For those low income consumers not eligible for social telephony schemes, we believe competition and consumer choice (shopping around) will provide the appropriate protection. We are aware that since we published our consultation document at least one major supplier has removed its non-DD charge for all consumers.
- 4.67 For elderly consumers, our primary concern is for those on low incomes/who have hearing/speech impairments – whose interests are addressed as set out above.
- 4.68 As set out in the consultation, our primary concern for low income consumers remains fixed telephony services:
- fixed voice services are recognised as being important for social inclusion, as reflected in the USO for BT and Kingston;
 - broadband services are increasingly important, but not yet subject to USO. We believe it is the overall level of the broadband charge and the fact that it is subject to a minimum contract period which is more likely to deter uptake than the level of the additional non-DD charge;
 - for many low income consumers pre-pay mobile (for which such charges are clearly not relevant) is likely to be more appropriate than mobile contract; and

- pay TV does not have the same issues around inclusion, and free to air services are available.

4.69 As further set out in the consultation document (3.70 – 3.71), more generally across the economy there are numerous examples of how low income consumers end up paying more for essential products and services. These wider concerns around distributional effects are more an issue for government than Ofcom.

Non-DD charges should be able to reflect indirect costs e.g. bad debt

- 4.70 We note also that more suppliers disagreed (than agreed) with our proposals. Some said fair non-DD charges need not reflect costs. Others said a wider range of costs are relevant, including - in particular - bad debt costs, on the basis consumers not paying by direct debit are significantly more likely to end up not paying at all and giving rise to bad debt. We have considered each in turn.
- 4.71 One MNO disputed the view that only direct costs can be included in fair non-DD charges, saying the OFT bank charges case demonstrates that the Regulations do not regulate price/quality. Another supplier said the Regulations provide no support for the proposal that non-DD charges' fairness depends on cost justification.
- 4.72 As we note above, we agree that the Regulations are not a mechanism of price or quality control. The OFT/banks case is the latest to confirm this. So, the adequacy of the price a supplier receives for the goods or services he provides in exchange are exempt from an assessment of fairness.
- 4.73 However, where charges are made under terms that are not core terms they are not part of the (exempt) price and are assessable for fairness under the Regulations. That was also most recently confirmed in the OFT/banks case. And, we set out above, and in the final guidance, the circumstances in which we consider non-DD charges are not part of the exempt price and are assessable for fairness, and the reasons why. We did not propose, and are not now giving, guidance that seeks to control (exempt) prices.
- 4.74 As to the supplier's response that the Regulations provide no support for the proposal that non-DD charges' fairness depends on cost justification, we agree that suppliers will incur additional administrative costs in processing non-DD payments. We agree recovery of those costs is justifiable from an economic and legal perspective. As we set out in the consultation, a 'non-core' non-DD charge recovering these costs is our view likely to be fair.
- 4.75 But, where non-DD charges (like other charges) are not core terms they are subject to the Regulations' fairness test. It follows that they are not unrestrained: the charges that may fairly be levied are not unlimited. The relevant terms are unfair where, contrary to the requirement of good faith, they cause a significant imbalance in the rights and interests of the parties to the contract, to the consumer's detriment.
- 4.76 Where the terms are not core terms the relevant charges are, by definition, unlikely to be at the forefront of the typical consumer's mind when he enters the contract (and not constrained by freedom of contract and competition). We accept he is likely to be aware of them, of course, because he pays them. But, we consider the consumer is likely to regard them only as separate, incidental, additional charges for the costs of his chosen payment method.

- 4.77 That is, we think it likely he would accept his choice of payment method causes the supplier certain costs for administering that payment and that the consumer should pay, and is paying. We further consider it likely, however, that were he told the non-DD charge also covers bad debt costs (or other categories of costs not related to the administration of his payment method) that would be highly surprising to the consumer, indeed contrary to his reasonable expectations about the term and the charge. This is consistent with the evidence/consultation responses we have from consumer stakeholders who believe that these charges should be small to reflect the direct administrative costs.
- 4.78 It follows from this that, because a consumer is likely to expect only costs directly associated with their choice of payment method to be reflected in the non-DD charge, a non-DD charge which recovered other costs would cause the necessary significant imbalance, and be unfair. Recovery of other costs would be outside the consumer's contemplation of the core elements of the contractual bargain and his expectation of what the charge covers. In effect, the unfair imbalance arises because the consumer reasonably expects the term would be one thing, but in reality it would be another.
- 4.79 So, as set out in the consultation document, Ofcom proposes to form a view about fairness of non-DD charges based on whether the costs recovered in that charge are caused by a consumers choice of payment method – i.e. whether there is a causal link between the costs and the method of payment.
- 4.80 In addition, if other costs were also recovered by way of the non-DD charge, the consumer would be paying the costs of services or other matters that he has not, by choosing to pay by a certain method, caused the supplier to incur. Such costs will have been incurred or caused by other consumers and other things. It would be unfair to make the non-DD consumer pay them by way of the non-DD charge, all the more so given his likely expectations of that term. This adds to the significant imbalance and unfairness the relevant term would cause.
- 4.81 It is also difficult, in our view, to reconcile a higher non-DD charge with the requirement of good faith. That is a requirement of fair and open dealing with suppliers taking into account the consumer's legitimate interests. Levying a non-core charge for payment by means other than direct debit which in fact seeks to recover sums that are not causally related to the payment method, unconstrained by free bargaining and competition and outside the consumer's likely reasonable expectation, does not seem to us to meet that requirement.
- 4.82 As to the responses about the recovery of bad debt costs specifically, one MNO said non-DD customers account for 6% of its contract customers but 38% of its bad debt. One fixed line supplier said evidence clearly shows that consumers not paying by DD are far more likely to default and cause bad debt, so that some bad debt costs are recoverable in non-DD charges. It did not, however, provide statistical support for this.
- 4.83 We acknowledge that there may be some correlation between payment method and bad debt, at least in the sense that those paying by non-DD may, taken as group, account for more bad debt than others. However, we consider that the reasoning above applies to bad debt as much as any other costs not caused by the consumer's choice of payment method.
- 4.84 We do not think there is evidence to demonstrate a causal link between paying by means other than direct debit and bad debt costs. That is, between a consumer choosing non-DD payment means and that same consumer causing bad debt.

- 4.85 The evidence we have received – whilst we agree it may show that groups of non-DD customers may be a higher risk - does not support such a causal link. It is not a basis for thinking that, if the same group of consumers who pay by non-DD means and whose accounts cause bad debt changed to direct debit payment, their accounts would not have caused bad debt. And, other evidence we collected from suppliers in our initial review of the relevant additional charges, prior to publication of our consultation document, demonstrated that a very large percentage of non-DD consumers' accounts never cause bad debt. This suggests that consumers choosing to pay by non-DD methods are likely to be a poor predictor of the small group of consumers that goes into bad debt.
- 4.86 If there is no causal link between a consumer choosing non-DD payment means and that same consumer causing bad debt, then it seems to us that requiring him to pay the costs of bad debt, caused by others, as part of non-DD charges, would be likely to be unfair. That is so even if he is part of a group some of whose members will cause such debt. The consumer would be paying the costs of matters he has not, by choosing to pay by a certain method, caused the supplier to incur. A term requiring him to do so would cause a significant imbalance in the parties' rights and obligations under the contract, to the consumer's detriment.
- 4.87 Again, it is also difficult to reconcile the recovery of bad debt costs in non-DD charges with the requirement of good faith, given that the charges are said to be charges levied for paying by a particular method (when that method is not causally connected with bad debt and given what we consider to be a consumer's likely reasonable expectations as to the charge – see above).
- 4.88 We therefore confirm the view that recovery of such bad debt costs in non-core, non-DD charges would be likely to cause the necessary significant imbalance, contrary to the requirement of good faith, so as to be unfair under the Regulations
- 4.89 We consider that the same analysis would apply to the point raised in one supplier's consultation response about the costs of chasing bad debt. We consider such costs are not caused by a consumer's choice of payment method and would be outside his reasonable expectations as to the costs recovered in non-DD charges.

Late payment costs

- 4.90 Some consumers questioned whether a supplier could charge both a non-DD charge and a late payment charge. Some said a consumer who pays by non-DD methods on time should not have to pay more because other consumers sometimes pay late (by the same methods). We confirm the view, however, proposed in paragraphs 3.109 – 3.112 of the consultation document, and in paragraph A5.45 of the draft guidance, that having two such charges may be acceptable, if:
- the supplier can show that the proportion of its consumers paying by non-DD who sometimes require a reminder to pay the bill is very high: that there is evidence of a clear link between payment method and the need to chase payment so that it may be appropriate to consider the costs of chasing some late payments as part of the cost of servicing non-DD consumers and to spread those costs over such consumers; and
 - there is no double counting between these costs and those recovered by specific late payment charges levied over all late paying consumers whatever their payment method.

- 4.91 This is because the cost evidence suppliers have provided to us suggests the large bulk of payment chasing activity is generated by non-DD customers. And, even where there is a specific late payment charge, there may be costs incurred by those consumers who pay beyond their payment due date, but have not reached the trigger to incur the late payment charge. Where there are such costs, which are not recovered in a late payment charge, it may in our view be fair for them to be part of the non-DD charge. We would, however, consider cases on their specific facts to see if, in our view, a non-DD charge recovering late payment costs is likely to be fair.

Proposals insufficiently detailed

- 4.92 As to the supplier's response that the proposed guidance on the costs that may fairly be recoverable in non-DD charges is insufficiently detailed, we agree more detail should be included in the final guidance and have amended it accordingly.
- 4.93 We did acknowledge, albeit in passing, in paragraph 3.112 of the consultation document that there is a, '....need for charging simplicity, and, 'It is often difficult to target costs precisely on the consumers who cause them, and a degree of averaging is clearly inevitable.'
- 4.94 One way in which we consider it may be fair to calculate and apportion the costs recoverable in what we consider a likely fair non-DD charge is as follows. The supplier 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. We have amended the final guidance to reflect this.

Additional consumer concerns

Concerns falling outside the scope of our review:

- 4.95 Some consumers said they had not been informed when their supplier introduced or raised non-DD charges. Others said a unilateral ability to introduce or raise charges is wrong.
- 4.96 The ability to vary contracts is regulated by provisions outside the scope of Ofcom's present additional charges review. Paragraph 1(j) of Schedule 2 to the Regulations says terms which have the object or effect of, '... enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract,' may be unfair. We take the view that terms which allow a supplier unilaterally to vary the charges it levies is likely to be unfair under the Regulations unless:
- the supplier's rights can only be exercised in a narrow range of circumstances, and for specific reasons, clearly set out in the contract;
 - the consumer is given adequate notice of the variation; and
 - a consumer who is adversely affected has a right to terminate the contract without penalty before he is so affected by the variation.

- 4.97 The General Conditions of Entitlement are also relevant to contractual variations¹². General Condition 9.3 says:

‘Where the Communications Provider intends to modify a condition in a contract with a Consumer which is likely to be of material detriment to the Consumer, the Communications Provider shall:

- (a) provide the Consumer with at least one month’s notice of its intention detailing the proposed modification; and
- (b) inform the Consumer of the ability to terminate the contract without penalty if the proposed modification is not acceptable to the Consumer.’

- 4.98 In response to consumers who questioned BT’s decision to set up a separate payment processing company, BT Payment Services (BTPS), whilst this is not an issue that we addressed in our consultation - and it is currently specific to one supplier - we feel it is useful for Ofcom to set out our view.
- 4.99 BTPS is a wholly owned subsidiary of British Telecommunications plc (BT). We understand that BT has set this company up as a vehicle to perform certain financial services operations, which includes payment processing. BTPS receives and processes all non-DD payments made by customers to settle their telephone bills (e.g. cheques, cash and credit card payments) and the customers’ contract with BTPS is for carrying out this work. Any rules relating to VAT, or any other tax matters associated with BT’s arrangements, are a matter for it and HM Revenue and Customs.
- 4.100 BT says that BTPS supplies a service - the collection and processing of non-DD payments. The charge paid to BTPS - the Payment Processing Fee - is payment for that processing service and is, according to BT, a reflection of the additional costs involved compared to the processing of direct debit payments. As explained in BT’s revised terms and conditions recently notified to customers, by choosing to pay by means other than DD or Monthly Payment Plan, customers are agreeing to enter into a contract with BTPS, and must pay the fee for the collection and processing service that BTPS provides.
- 4.101 At present, it does not appear to Ofcom that by collecting the additional charge via BTPS, BT creates any greater harm or cause for us to take action than would otherwise exist if BT levied a non-DD charge directly. In our view, structuring payments in the way BT has done does not change the regulatory or legal rules which apply (or which would apply to any other supplier doing something similar). The non-DD charges payable for BT services (or terms in consumers’ agreements which relate to such charges) may still be non-core terms and subject to the test of fairness.
- 4.102 And, that is not to say that the use of such arrangements, by BT or any other supplier, could never create any greater harm or cause for us to take action. We will review the position if it appears such harm or cause arises.

¹² http://www.ofcom.org.uk/telecoms/ioi/g_a_regime/gce/

Concerns falling outside the Regulations

- 4.103 Some consumers made responses that show they appear to be under the misconception that BT Retail has a monopoly over landlines, and fixed-voice services. It does not. It faces competition from many other suppliers. And in any event, the Regulations are not a means for regulating BT (or any other supplier) specifically.
- 4.104 Some consumers said that 'BT Basic' does not resolve the unfairness of charges: it is only available to those on specific benefits and not to low income consumers more generally, and, some complained, it has been subject to delays.
- 4.105 BT Basic is currently being rolled out by BT and became available to all those eligible on 6 October 2008. Ofcom acknowledges that not all low income consumers are eligible or will benefit. Nonetheless, we continue to consider that this is the appropriate vehicle through which to address low income concerns about access and inclusion, which is the purpose of the scheme.
- 4.106 As set out in the consultation (3.71) there are numerous examples of how low income consumers generally end up paying more for essential products and services, across the economy, and this is a cause for concern. This wider issue about low income (rather than a concern about access and inclusion, in particular) is an issue for Government and is not an issue Ofcom can resolve on our own.
- 4.107 Some consumers suggested that non-DD charges are discriminatory under the Disability Discrimination Act 1995 ('the DDA'). Ofcom recognises that disabled consumers may have lower incomes than non-disabled people and may be less willing to pay bills by DD because their cash flow is tighter. However, we do not believe that this means suppliers are discriminating against disabled consumers within the terms of the DDA. Such charges do not appear to us to treat disabled persons less favourably for a reason which relates to their disability. Neither do such charges represent a practice, policy or procedure which makes it impossible or unreasonably difficult for disabled persons to make use of a service a supplier provides.
- 4.108 Each of the matters in 4.103 – 4.107 are, in any event, as the accompanying sub-heading indicates, outside the scope of the Regulations. So, they are not matters for Ofcom's current guidance about that legislation.

Ofcom's decision

- 4.109 For the reasons set out above, in the final guidance we confirm that:
- non-DD charges may be considered core terms exempt from the Regulations' fairness test. We take the view that, in order to be likely to be considered a core term, the non-DD charge must be presented in plain intelligible language, with due clarity, prominence and transparency such that the typical consumer would regard it as part of the price paid in exchange for the services he is buying under the contract and would consider it part of the essential bargain, rather than an incidental, additional charge separate from the price for the services being bought; and
 - where they are non core, the fairness test applies and is likely to mean the charge should reflect only causally related costs, not others like 'bad debt' costs.

- 4.110 We have amended the final guidance to make clear how we consider it may be fair to calculate and apportion the costs recoverable in what we consider a likely fair non-DD charge, as set out above.

Section 5

Late payment charges, charges for payment failure and charges for restoring service

Description of the charge

- 5.1 Some suppliers levy charges in the following circumstances:
- a late payment charge where a consumer does not pay a bill by the due date for payment;
 - a payment failure charge where, for example, a cheque 'bounces' or a call for payment under a recurring mandate fails due to insufficient funds;
 - 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 supplier may, before terminating the contract entirely, bar outgoing calls while still trying to recover payment. If the consumer pays before the contract is terminated, the supplier may then reinstate the services but make a charge for doing so. This is known as the charge for restoring Outgoing Calls Barred ("OCB").
- 5.2 The existence of these types of charge varies by supplier and by service: some suppliers have these charges and others do not.
- 5.3 Where suppliers do have these charges they may waive them in certain circumstances. Some suppliers reserve the right to apply such charges but only rarely apply them in practice.
- 5.4 Late payment charges are typically either a fixed amount or are based on charging interest on the outstanding amount from the due date to the date actually paid:
- fixed amounts vary from around £5 to £10;
 - interest rates are expressed as a percentage over a specified base. In the examples we saw this varied between 2% and 4%.
- 5.5 Relatively few suppliers have charges for restoring service or for payment failure. Where they exist, both charges have in some cases been as high as £23.50.

Ofcom's proposed guidance

- 5.6 Our proposed guidance on which we consulted was that:
- these charges are not 'core terms' – they apply only on default - and are subject to the Regulations' fairness test; and

- we are likely to consider such terms unfair where they seek to recover costs other than direct costs incurred as a result of the consumer's default (for example, bad debt costs).
- 5.7 The proposed guidance said we would be likely to consider terms providing for these default charges to be fair where they:
- are transparent to consumers within the contract at the point of sale; and
 - provide for a charge that includes only the direct costs incurred (for example, in a late payment charge, the costs of chasing payments, postage and loss of interest on unpaid sums).
- 5.8 We also proposed that we would only consider terms providing for a late payment charge to be fair where they make clear the charge 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.
- 5.9 In addition to the above, Ofcom also considered it important that - as a matter of best practice, rather than one covered by the Regulations- suppliers 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. We would expect suppliers to be doing this already as a matter of good business practice – it is in a supplier's interest to ensure that consumers understand the consequences of not paying promptly.
- 5.10 As set out in paragraphs 4.44 and 4.45 of the consultation document, we put forward for consultation the view that suppliers should do more to ensure that consumers understand these types of charges and that they are only levied where appropriate. We also put forward the view that our proposed guidance would ensure consumers were better able to avoid these charges and have greater confidence that the charge levels were not unfair. We proposed this was particularly important for low income consumers who may face these charges.

Stakeholder responses

- 5.11 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Charges are not core terms

- 5.12 Where they commented, consumer stakeholders agreed these default charges should be both transparent and subject to the Regulations' fairness test.
- 5.13 Suppliers made relatively little comment on this point, perhaps reflecting the fact that not all suppliers levy these kinds of charges. None disagreed with the proposal that the charges should be considered non-core, and three expressly agreed.

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Charges should only seek to recover direct costs

- 5.14 Two suppliers agreed that these charges should only reflect direct costs.
- 5.15 Some consumers expressed concern over the fact there might be both a late payment charge and an element of costs to do with late payment within the non-DD charge. Another response was that late payment charges should reflect only the true cost of sending computer generated letters.
- 5.16 One consumer stakeholder broadly supported the proposal that fair default charges reflect only direct costs caused by the default, but said the General Conditions should be amended to require provision of post-contractual information on these charges.

Negative responses

Bad debt costs should be recoverable

- 5.17 One supplier said that bad debt costs should be recoverable in these charges because they are a legitimate element of the direct recoverable costs and which target cost recovery at the customers who have caused the problem.
- 5.18 One MNO said it is not correct that only direct costs may be recovered in these charges – the amount/magnitude of charges is not addressed in the Regulations save in a limited respect – and that the OFT bank charges case confirms this¹³.

Disputed bills

- 5.19 As is noted above, one consumer stakeholder said greater clarity was needed about circumstances where an element of the bill is in dispute and a consumer does not pay that element. It said it is not necessarily appropriate to then levy late payment charges. It pointed to OFT guidance on the right of set off and felt it would be helpful for Ofcom's guidance to cross refer to this.
- 5.20 Concern was also expressed by consumers who had refused to pay the non-DD charge element of their bill and found that they were then being charged a late payment fee (as well as steps being taken towards disconnection) on account of this.

Other responses

- 5.21 Another point made by some consumers was that the time suppliers allow for the payment of bills is too short.

¹³ OFT v Abbey National PLC & 7 ors [2008] EWHC 875 (Comm)

Ofcom's consideration of and response to stakeholders' consultation responses

Core terms

- 5.22 We note that no respondents disagreed with our proposal that these charges are not core terms. We therefore confirm that proposal.

Test of fairness

Positive responses

Charges should only seek to recover direct costs

- 5.23 We note there was some agreement with our proposed position.
- 5.24 We agree with the concerns expressed by consumers that:
- late payment charges should only be levied after consumers have had a reasonable opportunity to pay their bills, taking into account possible postal delays as well as reasonable absence from home, and have failed to pay.
 - there should not be double recovery of costs in late payment charges and non-DD charges.
 - late payment charges should only include directly related costs, but this would not necessarily be restricted to the 'true cost of sending a computer generated letter.'
- 5.25 The first of these points would seem self-evidently to be fair. The reasons for the second and third are considered in the following paragraphs.

Negative responses

Bad debt costs should be recoverable

- 5.26 We have also considered further the response that these charges should allow for recovery of bad debt costs. We reach the view, however, that normally we think it likely to be unfair in most cases for suppliers to seek to recover bad debt costs by way of late payment charges.
- 5.27 We note that Schedule 2 to the Regulations (at paragraph 1(e)), says terms which, 'have the object or effect of requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation' may be unfair. We consider that this means it is likely to be unfair to impose on a consumer disproportionate sanctions for breach of contract.
- 5.28 In other words, a default charge which provides for the recovery of a sum greater than a supplier could recover in damages at common law for breach of contract by the consumer is likely to be unfair under the Regulations. The term providing for the charge would change the position the consumer would be in, in relation to the contract, without the term, to his detriment. The sum the consumer would be required to pay would be a 'disproportionately high sum in compensation.'
- 5.29 This approach of considering the effect of a term under national law in assessing unfairness for the purposes of the Regulations and the Directive they implement has

been endorsed in both the European courts and the House of Lords. In the latter the Lords said it is helpful to compare the duty of the consumer under the term, on the one hand, and the obligations of the consumer under national law, in the absence of the term, on the other.

5.30 It follows from this, in our view, that a supplier can only fairly recover by way of these kinds of default charges sums representing a reasonable pre-estimate of the losses it incurs because the consumer has not made a payment at the due time (or defaulted under the contract in some other way). This should take into account, amongst other things, the relevant legal rules on causation of loss and remoteness of damage.

5.31 We consider that, applying these rules, there is scope for a supplier to argue that it may recover, for example, the limited administrative costs in chasing a late payment, which it incurs because the consumer missed the payment date and which it would not have incurred if the payment had been made when due. We said in paragraph 4.42 of the consultation document:

"Ofcom accepts that there may be significant costs incurred in chasing late payment and in dealing with payment failure, and that there may be wholesale costs in ceasing / restoring service to a consumer. It is reasonable for a supplier to have a charge to recover these directly incurred costs."

5.32 For the same reasons, we do not think bad debt costs are likely to be recoverable in fair default charges.

5.33 For such recovery to be fair, we consider a supplier would need to establish a causal link between those consumers who make late or failed payments, or incur OCB charges, and those who cause bad debt. That is, that the same consumer who pays late will cause bad debt, such that bad debt costs are costs caused by his default under the contract.

5.34 We have not seen any evidence that this is the case. The evidence that was provided to us (see above about non-DD charges and bad debt costs) did not show this. We think it would be implausible to suggest that all those who miss or fail a payment cause bad debt costs. Any such link for those who incur an OCB charge would seem to be even less plausible. On payment of that charge their service is being restored and their contract continued, not charged off as bad debt.

5.35 Given that lack of a causal link, it does not seem to Ofcom that it would be likely to be fair to make all late payers, for example, pay the bad debt costs of that smaller group amongst the late payers whose accounts do go into bad debt.

5.36 And, in any event, we consider the supplier would also need to be able to establish that recovery of bad debt costs would not be precluded by the relevant legal rules on remoteness of damage. We think it unlikely the supplier could do so.

5.37 Put broadly, those rules mean a party breaching a contract is liable in damages only for matters where, explicitly or implicitly, he has contracted on the basis he will be liable for them in the event of his breach. It seems to us unlikely that a consumer entering into a communications contract would be aware of or understand bad debt costs and contract on the basis he would be liable for them were he to miss a payment date, have a payment fail or incur an OCB charge. So, such bad debt costs could not be recovered at common law. It follows, in our view, they are unlikely

under the Regulations to be fairly recoverable in the default charges being considered here.

- 5.38 This view is consistent with that expressed for non-DD charges above. We also note that this view is in common and is consistent with the approach the OFT takes in its general guidance on the Regulations and took specifically in relation to credit card default charges (as, in relation to the latter, we said in the consultation document and draft guidance).¹⁴
- 5.39 As to the response that late payment charges should not be limited to costs because - as the OFT bank charges case demonstrates - the Regulations do not regulate price/quality, we take the following view in light of the considerations set out.
- 5.40 First, again, we agree that the Regulations are not a mechanism of price or quality control. Again, the OFT/banks case is the latest to confirm this. The core terms exemption in Regulation 6(2)(b) exempts from an assessment of fairness the adequacy of the price received by a supplier in exchange for the goods or services he provides under the contract.
- 5.41 However, it is similarly well established that default charges, such as late payment charges, are not core terms.¹⁵ So, they are assessable for fairness under the Regulations.
- 5.42 Moreover, that default charges may fall within the list of potentially unfair terms in Schedule 2 to the Regulations (at paragraph 1(e)) – see above - indicates they are not core terms. If they were, they could not possibly fall within that list. And, in line with the view we set out above, a late payment charge of a sum greater than the costs a supplier could recover at common law would be such a ‘disproportionately high sum in compensation,’ not a payment of a price falling within the core terms exemption.

Disputed bills and right of set-off

- 5.43 As to the stakeholder’s response that late payment charges should not exclude a consumer’s right to set off disputed sums, we made the following consideration and take the following view.
- 5.44 First, we note that paragraph 1(b) of Schedule 2 to the Regulations says terms which have the object or effect of, ‘...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,’ may be unfair.
- 5.45 In other words, where a consumer has an arguable claim under a contract against a supplier the law generally allows the deduction of the disputed sum from other sums the consumer has to pay. This is an important right. It can help prevent unnecessary legal proceedings. If the right is excluded, consumers may have (or believe they have) to pay sums in full, even when legally they are entitled to redress (which can

¹⁴ See http://www.offt.gov.uk/shared_offt/reports/unfair_contract_terms/oft311.pdf and http://www.offt.gov.uk/shared_offt/reports/financial_products/oft842.pdf

¹⁵ Lord Bingham in the First National Bank case said, ‘In my opinion the term, as part of a provision prescribing the consequences of default, plainly does not fall within it [the core terms exemption].’

effectively be provided by the right of set-off). Such redress would then only be available through the courts (or other more formal dispute resolution procedure), the costs, delays, and uncertainties of which may result in them giving up their claim, depriving them of their rights.

- 5.46 Second, we note that the OFT's general guidance on unfair terms says, 'Clauses subjecting set-off to penalty. Concerns are particularly likely, whatever the subject matter of the contract, where consumers are subject to an immediately effective penalty if they do not pay the whole contract price when demanded ...'¹⁶
- 5.47 This raises two relevant points. First, it suggests there may be grounds for taking the view that default charges that effectively deny the right of set-off may be unfair. But, second, it raises the question of whether Ofcom should also cover the point in our own guidance.
- 5.48 Considering the above points, we take the view we should include reference to this point about the right of set-off in our guidance, and we have amended the final version accordingly. The right to set-off 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 in light of paragraph 1(b) of Schedule 2 to the Regulations.
- 5.49 It seems to us appropriate to include the point in our guidance, notwithstanding its presence in the OFT's. It is, we consider, likely to reflect the correct legal position. And, we are giving guidance on our view of the law relating to default charges in communications contracts, for the benefit of both suppliers and consumers. It makes more sense to include this relevant point with other relevant points in our guidance than to rely on suppliers and consumers looking at two separate documents (ours and the OFT's). We have therefore amended the final guidance accordingly (see Annex 1).

Ofcom's decision

- 5.50 In line with the above, Ofcom's final guidance reflects our view that these charges will not be core terms and are subject to the Regulations' fairness test.
- 5.51 We set out in the final guidance that we consider such terms are likely to be unfair where they seek to recover costs other than those directly incurred by the supplier as a result of the relevant default event/matter (e.g. late payment charges should seek to recover the limited administrative costs of chasing and collecting late payments).
- 5.52 We also make clear, in response to a consultation response, our view that a late payment charge that effectively precludes a consumer's right of set-off is likely to be unfair.

¹⁶ OFT Guidance for the Unfair Terms in Consumer Contracts
http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/oft311.pdf

Section 6

Minimum contract periods and early termination charges (initial contract)

Description of the charge

- 6.1 Suppliers of communications services may require consumers to commit to a contract of a fixed duration, i.e. a minimum contract period (MCP). This is more likely when there may be significant up-front costs for the supplier, such as the cost of a mobile handset.
- 6.2 Although some MCPs may be three months, the most common duration is 12 months. Increasingly, suppliers are offering services with MCPs of 18 or 24 months duration. There is some variation by sector:
- for broadband services MCPs are typically 12-18 months;
 - for contract mobile customers in receipt of a subsidised handset MCPs are typically 12-24 months (but MCPs do not apply for pre-pay customers or, usually, for SIM only packages);
 - for pay TV MCPs are typically 12 months; and
 - for fixed voice services some suppliers have MCPs of 12-18 months, while others have shorter MCPs (e.g. 3 months) or no MCP.
- 6.3 Where a consumer terminates a contract before the expiry of the MCP, suppliers usually levy an early termination charge (ETC). This is typically the total of the remaining monthly payments. In some cases, consumers are effectively required to pay a sum greater than the total of the remaining monthly payments. For example, consumers may be required to return or pay for equipment which they would have been able to retain had they not terminated their contract early. Other exceptions to the 'remaining payments' rule are:
- suppliers 'capping' the ETC to a predetermined amount, so for example the consumer would pay remaining monthly payments or £70, whichever was the lower; and
 - suppliers charging remaining months of the contract at the lowest package price available (so all consumers other than those already on the lowest package, would pay something less than their remaining monthly payments).
- 6.4 Where the ETC is calculated as the remaining monthly payment to the end of the contract period, this means that the consumer pays the same amount over the full contractual period whether or not they continue to take the service for the full duration. So, for example, a consumer contracted to pay £15 a month for a service for 12 months, who terminates after six months, will pay 6 times £15, i.e. £90 – in order to terminate the contract. For higher priced services, ETCs can be substantially greater than this.

Minimum contracts periods (MCPs)

Ofcom's proposed guidance on MCPs

- 6.5 Our proposed position on which we consulted was that terms providing for MCPs are likely to be viewed as core terms. They are likely to be one of the most important terms for consumers. We also proposed the view that we would expect these terms to be sufficiently prominent in terms and conditions and to be easily recognised by consumers as a key element of the contract. We further proposed that where an MCP is not expressed in a transparent and prominent manner, we consider that it cannot be considered to be a core term, and may be assessed for fairness.

Stakeholder responses on MCPs

- 6.6 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Positive responses

Agreement with Ofcom's proposed guidance

- 6.7 Suppliers generally agreed with our proposed position that a MCP is a core term (six expressly did so). One consumer stakeholder also explicitly agreed.

The need for MCP terms to be prominent and transparent

- 6.8 Two consumer stakeholders said some consumers were unaware of MCPs and welcomed our guidance on the need for transparency and prominence.

Negative responses

- 6.9 Notwithstanding the above, three suppliers, two of whom expressly agreed that MCP terms are core terms, disagreed that this status is dependant upon such a term's transparency and prominence. In particular, they disagreed with Ofcom's proposals on prominence. One supplier said such prominence was unrealistic and not required given that MCPs are more the rule than the exception in its market.

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

- 6.10 Whilst we proposed that, where an MCP is not expressed in a transparent and prominent manner, we would consider that it cannot be considered to be a core term, and may be assessed for fairness, we did not make any specific proposals as to how such an assessment might be made. This reflected the proposed view that MCP terms are a fundamental part of any (fixed-term) contract and we would expect these to be expressed clearly and prominently to consumers.

- 6.11 Nonetheless, some stakeholders commented on this issue.

Little justification for MCPs where there is no upfront cost

- 6.12 One consumer stakeholder said our proposals did not explain why MCPs are necessary in the broadband and fixed line markets.

- 6.13 One supplier also expressed the view that direct set up costs for fixed voice services are very low so there is little justification for these terms.
- 6.14 Some consumers said MCPs should not be allowed where there is no visible upfront benefit (for example a contract for mobile services where no handset is provided). Some objected to paying both an upfront connection charge and being tied into a MCP.

Concerns about the impact of MCPs on competition

- 6.15 One consumer stakeholder said that MCPs will act as switching barriers and dampen competition. Two suppliers expressed concerns over MCPs and the effect of dampening competition, particularly in the fixed voice market.

Length of MCPs

- 6.16 Some consumer stakeholders raised concerns about the length of MCPs. One supplier also questioned how we would assess the fairness of a MCP which is not a core term.

Ofcom's consideration of and response to stakeholders' consultation responses on MCPs

Core terms

Positive responses

Agreement with Ofcom's proposed guidance

- 6.17 We note and agree with the responses' general agreement that a MCP is likely to be a core term.

Negative responses

The need for MCP terms to be prominent and transparent

- 6.18 We note some responses disputed whether the status of a MCP term depends on its transparency and prominence, and that at least one response said only plain, intelligible language is required.
- 6.19 We agree MCPs are among the most important terms in a (fixed-term) contract, and may well be core terms of that contract. However, for the reasons in Section 3 (see paragraphs 3.123 – 3.134) on core terms generally, we consider that transparency and prominence are relevant to whether MCPs have that status in any particular contract.
- 6.20 Accordingly, the final guidance confirms our proposed position.

Test of fairness

Little justification for MCPs where there is no upfront cost

- 6.21 In our consultation document Ofcom proposed that MCPs are a legitimate and useful way for suppliers to spread upfront costs. We note concerns expressed over MCPs where there is little or no up front cost, in particular in relation to fixed voice services.

- 6.22 Regarding fixed voice services, we expect that the upfront costs are likely to be lower than for either broadband and mobile, where end-user equipment (for example, modem or handset) is often provided 'free'. Nonetheless, there is some upfront cost for fixed voice services in the form of an Openreach connection charge for suppliers using BT's network.
- 6.23 Where there are such costs to suppliers, and/or benefits to consumers, it does not seem to us to be illegitimate for suppliers to require consumers to agree to MCP terms. And, given our expectation that MCPs are a fundamental part of the contract and likely to be core terms, the Regulations are unlikely to provide a basis for assessing such terms' fairness or taking the view that suppliers may not use such terms.
- 6.24 We also note that the MCP is an aspect of the service that suppliers are likely to be able to compete on and some suppliers may choose to offer no MCPs or reduced MCPs.

Concerns about the impact of MCPs on competition

- 6.25 We note that some responses commented on the impact of MCPs on competition particularly in the fixed voice market.
- 6.26 As we note elsewhere in this statement, the possible broader effects of a term on competition are not considerations that bear directly on the question of whether a term is unfair under the Regulations. Rather, that question is concerned with the fairness of terms between the supplier and the consumer to whom they apply.
- 6.27 We proposed in the consultation document and the draft guidance, and now set out in the final guidance, however, our view of when MiNPs and ETCs are likely to be unfair under the Regulations. These are matters of the unfairness between the supplier and the consumer to whom the MiNP and/or ETC applies. One consequence of this, nonetheless, may be to mitigate the effects of terms that might otherwise act as switching barriers.
- 6.28 If Ofcom were ever to find significant evidence that MCPs were damaging competition in a way we might be capable of addressing under other legislative or regulatory provisions, we would consider how best to address that effect.

Concerns that MCPs are too long

- 6.29 We note that consumer stakeholders expressed the view that MCPs are too long. In what we have treated as a response that has some links to this, one supplier questioned how we would assess the fairness of a MCP which is not a core term.
- 6.30 Our expectation is that MCPs are a fundamental part of the contract and are likely to be core terms. Where they are, the Regulations' fairness test will not apply to regulate the 'fair' length of the MCP. It does not, therefore, appear to us to be an appropriate matter to cover in our guidance, which covers matters of more common and general application.
- 6.31 Were cases to come to our attention in which suppliers' terms about MCPs are not prominent and transparent, for example, we would seek to deal with them according to their specific facts. This might occur, to continue the example, because the terms are hidden and the consumer is not aware he has entered a fixed term contract. It is

likely we would seek to take steps to address this lack of transparency either under the Regulations or under other consumer protection legislation like the CPRs.

- 6.32 We also note, as mentioned above, that the MCP is an aspect of the service that suppliers are likely to be able to compete on and some suppliers may choose to offer no MCPs or reduced MCPs. For example, we note the recent introduction of SIM only mobile phone offers, some of which do not require the consumer to sign up to a MCP. This offers at least the possibility of consumer choice and the ability to avoid being tied into what the consumer might see as an undesirably long fixed term contract.
- 6.33 These points notwithstanding, we recognise that MCPs are an area of consumer concern (and some supplier concern as to competition effects (see above)). Again, if in future there is sufficient evidence of consumer harm (or harmful competition effects) that we might be capable of addressing under other legislative or regulatory provisions, we would consider how best to address that concern (or effect). We also note that it is currently proposed that the Directives comprising the European regulatory framework for telecommunications will be amended so that initial fixed-term MCPs may not exceed 24 months.

Ofcom's decision on MCPs

- 6.34 As set out above, we confirm in the final guidance our proposed position that MCPs are likely to be core terms, and that we would expect them to be transparent and prominent (failing which they may be assessed for fairness under the Regulations).

Early termination charges (ETCs)

Ofcom's proposed guidance on ETCs

- 6.35 We consulted on the following proposed guidance, namely that ETCs are:
- default terms (or terms analogous to default terms and fall to be treated the same way);
 - charges which on entering a contract a consumer will not usually expect to pay; and
 - accordingly, not core terms (and are subject to the Regulations' fairness test).
- 6.36 We also consulted on the proposed position that we are likely to consider ETCs to be fair where the charge:
- is transparent and sufficiently prominent at the point of sale and in terms and conditions, so that every consumer is fully aware of the consequences of terminating a fixed-term contract early;
 - is not more than the remaining monthly retail payments: it should not cost a consumer more to get out of a contract (without having enjoyed the full contractual entitlement to the service) than to complete its MCP;
 - takes into account costs the supplier saves and losses it can mitigate (both variable and network costs, and taking into account the 'reselling' of services to other consumers) when it ceases providing service to a consumer;

- reflects the existing regulatory environment and the extent to which network costs are already recovered in headline prices;
 - makes allowance for the accelerated receipt of any sums; and
 - does not include recovery of anticipated profits for services outside the consumer's minimum contractual commitment (that is, only takes account of what the consumer is required to do to meet his contractual obligations in the least onerous way possible, and does not include, for example, profits from calls outside the inclusive contractual package).
- 6.37 The proposed rationale was that the ETC would be unfair under the Regulations if it put the supplier in a better position than if the contract were performed. That is (broadly) the same rationale that would apply in the assessment of a default charge payable on breach of contract.
- 6.38 In relation to network costs, the consultation document proposed that, for both mobile and vertically integrated fixed telecommunications networks, suppliers can mitigate their loss where demand on capacity is growing because the contractually inclusive call minutes, or the broadband capacity, a consumer no longer uses, in effect, frees up capacity on the core network which can be reused by another (existing or new) consumer. We proposed that this would mean that ETCs should be reduced to reflect the costs (of having to invest in additional capacity) which the supplier can avoid in this way. We further proposed that the cost mitigated could be estimated by the long run incremental cost ('LRIC') pence per minute multiplied by the number of minutes the average consumer on the relevant contractual package uses, or the LRIC per unit of broadband capacity multiplied by the average capacity used.

Stakeholder responses on ETCs

6.39 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Positive responses

Agreement with Ofcom's proposed guidance

- 6.40 Fixed line suppliers who expressed a view generally agreed with Ofcom's proposal that the ETC is a non-core term subject to the test of fairness.
- 6.41 Two consumer stakeholders welcomed Ofcom's proposals.

Negative responses

An ETC is a core term because it is based on the retail price

- 6.42 MNOs expressed the view that their ETCs are core terms, for reasons including:
- ETCs are simply remaining retail payments (in some cases with a small discount to reflect early payment), and in the same way the retail payment is a core term, so the ETC must be; and

- ETCs are simply the amount that the consumer has agreed to pay when entering into the contract. Some suggest that for this reason, Ofcom is seeking to consider and investigate standard monthly retail charges.

ETCs are a core term because they are a 'right to terminate'

- 6.43 One MNO expressed the view that ETCs are a right to terminate, not a default charge that can be characterised as 'non-core'.

ETCs are a core term because they are clearly set out in a contract

- 6.44 One MNO expressed the view that its 'ETCs are clearly set out in the contract and therefore form a core term.'

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Agreement with Ofcom's proposed guidance

- 6.45 Two consumer groups agreed with Ofcom that ETCs should never exceed retail payments and should reflect saved costs. Two others gave the proposals some support, one welcoming the guidance on the need for ETCs to be transparent at the at the point of sale, and the other saying it welcomed Ofcom's proposals (though it felt it was unclear how the proposals would work in practice). One consumer complained that he had been charged an ETC greater than the value of the contract terminated. Another consumer response was that ETCs unfairly penalize those who move house frequently.
- 6.46 In general amongst suppliers, those providing fixed voice services offered the most positive responses, with some also agreeing ETCs should not exceed outstanding retail payments. One fixed supplier accepted that an ETC should never leave the supplier better off than if a customer stayed until the end of the MCP. Another welcomed the proposed clarity in setting out certain types of mitigated costs.
- 6.47 There was some general recognition amongst suppliers that direct wholesale costs they save on early termination should be reflected in reduced ETCs. Four fixed-voice suppliers acknowledged they save wholesale costs on early termination. So did one broadband and one other supplier.

Negative responses

- 6.48 The above areas of agreement notwithstanding, a range of suppliers expressed considerable concern over and disagreement with our proposals, both from a legal point of view and more broadly in terms of the impact on the market. The specific concerns varied according to respondent and sector.
- 6.49 Some consumer stakeholders said our proposals did not go far enough, suggesting ETCs should be reduced by more than Ofcom proposed. Another said our proposals alone would not ensure a competitive market because ETCs are a substantial switching barrier. Another also wanted Ofcom to compel the provision of written terms when contracts are entered over the phone or internet.

- 6.50 The main opposition, however, came from suppliers and was to the general effect that the proposals, for many different reasons, wrongly said ETCs should be reduced by much more than is properly the case.

ETCs will continue to be a barrier to switching

- 6.51 One consumer stakeholder said our proposals would not be sufficient on their own to ensure a fully competitive market, because ETCs are a substantial switching barrier.

The ETC is no more than an agreed sum recoverable in law

- 6.52 A number of suppliers said ETCs equivalent to retail prices are just 'fair' recovery of the price the consumer agreed to pay.
- 6.53 One MNO said long term contracts help reduce costs and uncertainty for suppliers, and promote efficiency and investment, in turn enabling them to offer discounts. If consumers break their fixed term commitment they should repay some of the discount. And, it elaborated a little on the point above that ETCs are a fair recovery of the 'price,' saying it would have a legal right in ordinary contract law to claim 'a minimum term worth's of line rental' and that the Regulations cannot be used to undermine that. It also said that if Ofcom expects it to mitigate its losses in setting an ETC this is to treat the ETC as a liquidated damages clause, and this is a radical rewriting of UK law.

ETCs may recover upfront costs

- 6.54 A number of suppliers said the guidance should reflect that an ETC can fairly recover wasted upfront costs. Some said this should be allowed in any event. Some described it as an alternative to recovery of retail payments less saved costs.
- 6.55 One supplier made what appears to us to be a linked point by saying that ETCs equal to outstanding retail payments should be allowed where the supplier charges no connection fee. Another said 'ETCs may need to be increased to reflect unavoidable set-up costs,' and referred to a number of upfront costs it seeks to recover "... through billing to term."
- 6.56 Some MNOs made the similar point that upfront acquisition costs are recovered through retail prices. The mobile handset subsidy, for example, means consumers are unprofitable for much of their contract, so unrecovered costs on early termination are outweighed by recouped ones. But, our proposals ignore that, so MNOs would be forced to lose money on consumers who terminate contracts earlier than the point at which they become profitable.

Ofcom assumes suppliers are better off when contracts end early

- 6.57 Two MNOs argued that Ofcom's proposals:
- assume they are better off when customers terminate contracts early;
 - ignore the costs of early termination; and
 - would put suppliers in a worse position where they allow the right to terminate contracts early, than if they did not.

ETCs should allow for expected consumer revenues beyond the contractual minimum

- 6.58 Among fixed voice suppliers there were concerns that services are often sold so that the contract is only profitable if the consumer stays beyond the end of the contract and/or pays for services outside the minimum contractual commitment. In these cases, they said our proposals may leave suppliers not recovering initial upfront costs.
- 6.59 Three such suppliers said expected profits from services outside the contractual bundle and commitments should be included in fair ETCs (though one said we should only look at anticipated profits in services within – and not beyond – the MCP in terms of timescales). One of these said such profits are recoverable as a matter of law.
- 6.60 MNOs made a similar point. One said the proposals showed inadequate regard to the ordinary legal position that allows the recovery of lost profits on breach of contract.
- 6.61 Another linked these extra-contractual revenues to the recovery of the subsidies it provides when giving consumers handsets. It said it invests in a given contract consumer by supplying them with their handset without recovering at the point of sale either the handset cost or the cost of selling the handset. It relies on recovering this investment from income streams outside the contractual package (such as calls made when any inclusive allowance has been exceeded or calls of types outside the bundle, like international calls) and also inbound calls made to the consumer. So, it said, rather than ETCs being mitigated by any unused network costs, its ETC, which is less than the revenue streams expected from an on-going customer, is needed to mitigate the handset subsidy given to the departing customer

ETCs should allow for expected revenues from other sources such as incoming call termination revenue

- 6.62 MNOs also said our proposed methodology fails to allow for the lost opportunities to receive income from incoming call termination charges.

Costs are not saved and losses are not mitigated on early termination

- 6.63 A number of suppliers said that network costs are fixed, and are not saved when individual consumers terminate their contracts early. Or, at least, such costs are 'lumpy.' A recurring theme of the responses was that network investment, and increases in capacity, occur in large blocks or lumps, not related to individual consumers.
- 6.64 Fixed-voice suppliers, for example, expressed this concern about the lumpiness of their shared costs (whether shared wholesale costs or own network costs). Some also said they could not mitigate their network costs. One said its own such costs saved in respect of fixed voice calls are very low, if non-existent. Those costs are not directly attributable to the voice service it provides, given that it is a small proportion of the bandwidth travelling over the supplier's network (which is deployed primarily for IP data and IP video purposes). Another said its wholesale interconnection costs with other networks are not saved on early termination.
- 6.65 MNOs also made similar points. They said they do not save money or mitigate costs when a consumer terminates a fixed-term contract early for reasons including:

- the point referred to above that network costs are fixed, or at least lumpy costs, not marginal costs borne at individual consumer level and saved when a consumer terminates a contract. One MNO, for example, said radio access and core network costs are not linear with traffic levels. Increments in network capacity are only added in significant blocks and, for the reasons set out in Annex 2, save over the medium to long term, there is little scope for saving costs where consumers terminate contracts early;
 - the number of consumers terminating early is too small to have a big impact on network investment and capacity. One MNO said, for example, the number “ ... is anyway inside the likely forecast planning error and the capacity headroom and should make no practical difference to the level of network investment.” Another said an individual consumer terminating a contract early does result in a saving of capacity or costs because all the elements of the network must continue to exist and be maintained to support all the remaining subscribers. The only consequence of an individual consumer’s early termination is the freeing up of extra capacity which is so small it cannot reasonably be measured;
 - unless forgone consumer traffic is replaced immediately and with like ‘replacement traffic’ in a similar part of the network MNOs will face a cost, and there are costs of acquiring replacement customers that account must be taken of;
 - MNOs also incur opportunity and option costs in investing in networks, of which account needs to be taken;
 - mobile networks are built to have spare capacity;
 - network models, and pricing of contract packages, already allow for disconnections and demand, so crediting ‘freed up’ capacity is double counting. One MNO said, MNOs build their networks making, “.... forecasts of future traffic demand are based on assessments of usage per customer for all services and of net customer growth i.e. connections less disconnections..... In one sense therefore the network dimensioning is already allowing for early termination since existing churn calculations that drive the level of future disconnections already contain an element of early termination of new customers based on historical experience.’; and
 - one MNO said Ofcom’s proposed approach assumes demand is growing and investment in extra capacity is needed to meet it, but it may not be and the proposed approach where demand is reducing is not clear. Another said the model/proposals for saved network costs are flawed because of this assumption.
- 6.66 One MNO also said practical problems arise from the inclusion of too little detail about what costs Ofcom says are recoverable in ETCs and whether ETCs are individual to each customer or averaged over all customers.
- 6.67 As to the proposed possible use of LRIC to calculate saved network costs, MNOs’ said:
- it is not clear LRIC is the right proxy, because for example it:
 - is just one method used to determine costs and not one suppliers may use to set prices;

- includes fixed costs (and does not identify avoidable or incremental costs;
- excludes customer acquisition costs;
- assumes 'average efficient operator's costs,' not the specific operator's;
- is for determining voice call termination costs in timescales measured over decades, not other costs (which will vary depending on a consumer's location and the type of technology he uses (2 or 3G); and
- will require significant ongoing work for Ofcom and industry (primarily Ofcom);
- using LRIC ties markets: it ties retail returns (ETCs) to regulated LRIC for mobile voice call termination, which will distort pricing behaviour and markets; and
- mobile call termination rates are contested so Ofcom should not use the same methodology to set prices in relation to ETCs until/unless the termination issues are resolved. One MNO said doing so would be prejudicial to the ongoing proceedings about those issues.

6.68 One other supplier said principles of practicality and proportionality should apply – costs that are shared are not attributable to any individual customer and should not be deducted in the calculation of a 'fair' ETC. It also said the proposition that savings in network costs should be taken into account in ETCs is flawed in terms of economic logic. Such costs are fixed and do not vary with the addition or loss of individual consumers.

Costs payable to third parties on termination.

6.69 One supplier said our proposals go beyond common law principles because they say ETCs must never be higher than remaining retail payments, whereas there may be charges incurred to third parties because of early termination and which may be recoverable by way of (fair) ETCs.

ETCs are already recovered via headline prices

6.70 One MNO questioned that suppliers must, '..... consider the extent to which network costs are already recovered via headline prices, without the need for ETCs.' It did so on the basis it said that ETCs are the headline prices and consist of the same charges.

Whether Ofcom should publish ETC thresholds

6.71 A number of different suppliers commented on the proposal that we consult on and set enforcement thresholds for ETCs. Some did so in their main consultation responses. Others did so in separate correspondence about or in response to our further requests for information from them.

Possible agreement

6.72 Some suppliers made comments that did not necessarily oppose our consulting and seeking to set ETC enforcement thresholds.

6.73 Some fixed suppliers emphasised the importance of having a consistent approach. One explicitly said the proposed principles must be applied consistently and there

should be administrative thresholds for all providers (including pay TV) or for none. It said it might be fairer and simpler to have a single set of technology-neutral benchmarks by which, at a minimum, all suppliers should reduce their ETC based on average variable costs for both lines and calls per customer across the industry for fixed voice services.

- 6.74 One MNO said Ofcom must provide very clear guidance as to what costs should be taken into account and the formula to be applied to them. Otherwise there would be a high risk that different providers would apply different interpretations.

Disagreement

- 6.75 Other suppliers made comments that strongly opposed possible consultation on, and the setting of, ETC thresholds. One MNO, having set out why it opposed Ofcom's proposed principles on ETCs, said it would strongly urge Ofcom to re-consider introducing industry wide ETC thresholds.

Ofcom should only set thresholds after deciding on the legal principles

- 6.76 Some suppliers said we should not take seek to set thresholds until we have decided on the legal principles applying to ETCs, as doing otherwise suggests Ofcom has not considered the consultation responses and is imposing a pre-determined view.

Ofcom has insufficient information to set thresholds

- 6.77 A number of suppliers said they did not construct charges and/or hold costs information in the form sought by Ofcom as part of its consideration of whether to seek to set enforcement thresholds. They said detailed network costing exercises would need to be undertaken.
- 6.78 These suppliers also continued to challenge our approach to the underlying principles of saved costs and mitigated losses. They opposed particularly our proposals about saved network costs on the basis such costs are not saved when individual consumers terminate contracts early because of their small number and the nature of network investment decisions (which mean that costs in meeting alternative demand are not in fact saved when a consumer terminates his contract).

Impracticality

- 6.79 One MNO said it was unclear how Ofcom considers that it can publish any meaningful benchmarks in its guidance given the commercially sensitive nature of individual operator cost information and the need for any enforcement action to take into account an individual supplier's own costs. Another also referred to the need to take into account the facts of each case, saying costs and revenues vary from contract to contract and network to network, and each case must be considered on its own facts, so the purpose and validity of any thresholds is questionable.

Impact of Ofcom's proposals

- 6.80 Elsewhere in this statement, we have considered and responded to consultation responses about impact assessments and the discriminatory impact of Ofcom's proposals. The following responses are about consultation responses relating to another aspect of their impact: the impact on prices and market models.

- 6.81 One MNO described our proposals as ‘over-paternalistic’ (protecting some consumers to the detriment of others), operating as the ‘thin end of the wedge’ whose costs are recovered elsewhere and achieving a standardisation of the market that would be unlawful on competition grounds if agreed between industry players.
- 6.82 Another said ‘removing’ ETCs will result in a shifting of cost recovery to all consumers, including those who fulfil fixed terms, which is not fair because all consumers could experience significant price increases.
- 6.83 Three MNOs said our proposals will undermine the way the mobile contract market works (by incentivising early termination, and so undermining the fundamental nature of the fixed term/MCP contract and the revenue guarantee it provides and on which operators rely to forecast network traffic and investment, especially if ETCs are heavily reduced) and will mean:
- handset subsidies will not be offered (or will be reduced); and
 - there may be a disincentive to offer packages with bundled minutes and a move to per call/text charges.
- 6.84 One of these MNOs said Ofcom underestimates the widescale and far-reaching implications of its proposals for ETC. It said that if the guarantee that a MNO will receive the monthly charge for the duration of the fixed term contract is undermined, “... it will have the most radical impact on the market” (though it also acknowledged that if the effect of Ofcom’s proposals is that MNOs can recover the vast majority of monthly payments, “... the implications may not be great”);
- 6.85 Another of them described an ‘arbitrage’ risk to MNOs arising out of Ofcom’s proposals. That is, of consumers setting up a number of contracts with high value subsidized handsets and then terminating them early on payment of reduced ETCs. This risk would soon see MNOs charging consumers the true cost of high value handsets.
- 6.86 Another MNO response was that whilst many consumers like pre-pay services, those on post pay contracts would resent being forced onto these types of packages, should the mobile contract market no longer be commercially viable. One supplier also said it felt whilst some consumers would win, some would lose out under Ofcom’s proposals.
- 6.87 One broadband and fixed-voice supplier also said that Ofcom’s proposals could lead to higher retail prices on existing contract lengths or substantially longer fixed-term MCPs.

Proposals contradict OFT Economic discussion paper

- 6.88 Some of the MNOs also referred to a recent OFT Economic discussion paper: ‘Interactions between competition and consumer policy’¹⁷. In particular, three MNOs quoted the paragraphs of the paper referred to below.
- 6.89 One MNO said the paper shows the OFT believes that regulatory intervention should not occur in circumstances where the vendor has subsidised hardware. It quoted paragraph 3.53, which says:

¹⁷ http://www.ofcom.gov.uk/shared_ofcom/economic_research/ofcom991.pdf

‘Finally, another example of how some consumers mis-forecast their future tastes is what is termed ‘projection bias’, whereby a consumer extrapolates her current preferences too far into the future. For instance, the excitement of test-driving a new car may lead to an impulse purchase, whereas after a few days the desire may end. In such cases, a mandated ‘cooling-off period’, or a required waiting period before purchase is possible, may be a useful policy to counter-act this effect. Historically, the same reasoning applied to mandated notice periods for getting married. Likewise, excessively onerous notice periods or early contract termination payments seem a fairly clear cut area for intervention, unless the supplier has made specific durable investments which need to be recovered via a long-term contract (such as offering a free mobile handset in return for twelve months guaranteed service). There is no obvious efficiency reason why an exercise gym, for instance, needs several months’ notice for a contract to cease. As was the case earlier, projection bias is one reason why many consumers do not pay sufficient attention to contractual arrangements for ceasing service at the time they sign up, since they may not anticipate their tastes changing. (For the same reason, perhaps too few couples consider signing prenuptial contracts when they marry.)’

6.90 It noted that specific reference was made to offering a free mobile handset in return for a guaranteed contract period.

6.91 A second MNO referred to the paper’s comments on the drawbacks of controlling the level of late payment charges for credit cards versus making these charges more prominent when the consumer signs up. It referred to the paper’s paragraph 5.12, which says:

‘Consider in more detail the case of late payment charges on credit cards. As an alternative (or in addition) to an informational remedy, such as making these charges more prominent when the consumer signs the contract, one could directly control the level of such a charge. Set against the beneficial impact on those consumers who end up paying the charge and did not realize it applied to them, there are at least five drawbacks to such a policy. First, as discussed in Chapter 3 Section D, the impact will likely be to harm the careful consumers who do always pay on time, and so the benefit in terms of aggregate consumer welfare is unlikely to be great. Second, there may be consumers who actively want to have this particular charging structure. For instance, a consumer who is aware that he suffers from self-control problems might like the extra discipline that high penalty charges bring, so that the high charge acts as a commitment device.’

It said there were ‘analogous drawbacks in relation to Ofcom’s proposed approach’. It also quoted paragraphs 5.13 and 5.16 of the paper, saying these showed that any use of an adapted LRIC approach in calculating saved network costs and ‘fair’ ETCs would require significant ongoing work by Ofcom.

6.92 A third MNO quoted the paper’s comments that:

“if consumers are over-protected in their market transactions, ‘moral hazard’ may ensue and they may not pay sufficient attention to

making the best choices” and that “consumers may not develop the market skills to defend themselves against future exploitative conduct”, further that “excessive ‘consumer’ protection’ may be inimical to the development of market skills in consumers” (paragraphs 5.17 - 5.18);

and its conclusions that

“some of the more interventionist consumer policies are explicitly aimed at benefiting vulnerable consumers at the expense of sophisticated consumers. It would be worthwhile to investigate if there is indeed a valid role for redistribution via consumer policy” (paragraph 6.7).

How the guidance applies to bundles

6.93 One supplier asked for greater clarity as to how the guidance applies to bundled products.

Ofcom is issuing guidance prematurely

6.94 One MNO said we could not issue guidance whilst issues about the wider competitive picture (e.g. mobile number portability and Mobile Call Termination rates) are unresolved as any guidance could be rendered obsolete by the Competition Appeal Tribunal’s (‘CAT’) decisions. Others said we should not propose the use of the LRIC model or methodology to calculate saved network costs whilst the Mobile Call Termination Costs model is contested (one MNO referred to prejudicing proceedings before the Competition Commission (‘CC’)).

Fair contractual right to terminate a contract

6.95 One MNO said that even if its ETC is subject to the Regulations fairness test it passes because:

- it is not contrary to the Regulations’ ‘requirement of good faith,’ as it gives the customer the chance to mitigate the effect of the minimum term;’ and
- does not cause a significant imbalance as the customer is under no obligation to exercise this option.

It, and another MNO, also made the more general point that ETCs are not additional charges, but key contract provisions that are part of the wider bargain: the consumer receives benefits in return for his commitment to a long term contract. As a result, it is not unfair to charge the consumer a disclosed fee that is agreed upfront if they do not fulfil their end of the deal. This is the payment of an agreed sum to terminate, pursuant to a clear and transparent term, not a charge payable on default or an unfair penalty. It said Ofcom’s proposed approach would put it in a worse position than if it did not allow its consumers the right to terminate their contracts.

Recovery of retail price is a fair pre-estimate of loss.

6.96 One MNO said its approach is consistent with the OFT’s guidance that an ETC is fair if it reflects a real and fair pre-estimate of the lost profits on early termination. It said it makes a reasonable pre-estimate of the profitability of consumers over the lifetime

of contracts, including allowances for disconnections and that consequently its strict enforcement of the MCP (presumably by way of the ETC) is justified.

Net mitigated losses by reselling services.

- 6.97 Suppliers also said the proposed guidance on mitigation of costs by reselling services appears to apply only to customers terminating contracts early to move home. At least two suppliers also said that, in any event, mitigated sums should also take account of the acquisition costs relating to the alternative customer. In effect, that mitigated losses are net mitigated losses.

Ofcom's proposals are inconsistent with migrations processes.

- 6.98 Some suppliers said there is an inconsistency between our proposed guidance and formal service migrations processes. Our proposed guidance on 'best practice' relating to ETCs suggests it is important consumers are informed of ETCs at the point they are considering terminating contracts. But, suppliers said, gaining provider-led migrations processes do not allow for this.

Ofcom's consideration and response to stakeholders' consultation responses on ETCs

Core terms

Positive responses

Agreement with Ofcom's proposed guidance

- 6.99 We note that there was a level of general support, from those fixed voice suppliers who commented, for our proposal that ETCs are not core terms and are subject to the test of fairness. Likewise, from consumer stakeholders.

Negative responses

An ETC is a core term because it is based on the retail price

- 6.100 We have considered the responses that ETCs are no more than requirements to pay retail prices or are based on retail prices, such prices being core terms, and so themselves are core terms not subject to the test of fairness. On this basis at least, one stakeholder said that Ofcom is effectively investigating monthly retail charges.
- 6.101 Having considered those responses, and for the following reasons, we disagree. We confirm our proposed position in the final guidance, save we add to the explanation of our view in line with the following.
- 6.102 ETC terms provide for sums to be paid where a consumer terminates a contract rather than fulfils his obligation to adhere to its fixed term. They would not, in our view, be in the forefront of the typical consumer's mind at the time he enters the contract. He does not expect to pay them – he is likely to expect to fulfil the contract, not terminate it - and does not take them into account as part of the essential bargain he is making. And, they are not paid in exchange for services (prices for services). Quite the opposite: they are payable when services stop. We consider, therefore, that they are analogous to default terms (or 'disguised penalties' to use the term the OFT uses in its guidance).

- 6.103 And, we consider that just as, in line with the decision of the House of Lords in *Director General of Fair Trading v. First National Bank plc [2002] 1 AC 481*, a default charge is not a core term, neither is a term to analogous effect. They are, ‘... “incidental” (if important) terms which surround...’ the substance of the bargain between the parties.
- 6.104 We note that, in its guidance on the same legislation, the OFT describes paragraph 1(e) of the indicative list of unfair terms in Schedule 2 to the Regulations as including within its scope ‘disguised penalties.’ It describes them as including ‘... terms in contracts under which consumers agree to make regular payments for services provided over a period of months or years, which state they may cancel, but will remain liable to make all the payments agreed.’ In our view this is also indicative that such terms fall outside the core terms exemption. The view we adopt is therefore consistent with the OFT guidance.¹⁸
- 6.105 Further, in any event, the Regulations are concerned with the intention and effect of terms, not their form. Drafting a contractual term that requires a payment on termination of a contract - where the payment is the same as the retail price - does not make the term a core term (i.e. a term relating to the adequacy of the price exchanged for services). Whether or not it is a default charge, or a disguised penalty, or analogous to either, its object and effect is that it applies on termination of the contract, which is outside the limited scope of the core matters that can properly be regarded as core terms.
- 6.106 In addition, we are aware of ETCs that are both more and less than retail payments. That only serves to indicate their different nature to retail price terms.

ETCs are a core term because they are a ‘right to terminate’

- 6.107 We agree there may be a difference at common law between a default charge, which levies a sum on a party breaching a contract, and an early termination charge which, on the face of things at least, applies on termination of a contract in accordance with its terms.
- 6.108 That difference, however, does not appear to us to mean that a term providing for the former would not be a core term under the Regulations, but one providing for the latter is. Both are terms providing for payment where the contract comes to an end, not payments in exchange for services. And, in line with the analysis above, will not, in our view, be core terms.

ETCs are a core term because they are clearly set out in a contract

- 6.109 In our view, a similar analysis also applies in response to the submission that ETCs clearly set out in a contract are core terms.
- 6.110 In our further view, this analysis would be likely to apply no matter how prominently the terms relating to the ETC were presented. Such terms would remain terms concerned with payment on termination of a contract which, as set out above, the consumer is not in our view likely to contemplate paying at the time he enters the contract and are not payments in exchange for services. They would still be unlikely to be terms in the forefront of the consumer’s mind at the time he enters the contract when he considers ‘what am I buying and how much is it?’. They would still, in our view, be “incidental” (if important) terms which surround...’ the substance of the

¹⁸ See http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/ofcom311.pdf at pages 40 - 42

bargain between the parties. Again, in our view, it is a necessary but not a sufficient requirement of 'core terms' that they be clear, prominent and transparent.

Test of fairness

Positive responses

Agreement with Ofcom's proposed guidance

6.111 We note there was some support for our proposed guidance on the fairness of ETCs. We note this came primarily from consumer groups and some suppliers of fixed voice services, and a small number of individual consumers. Consumer groups' and fixed voice suppliers' support was mainly with the proposals that ETCs should not exceed retail payments and should reflect saved costs. As to those saved costs, there was some agreement from suppliers that direct wholesale costs saved on early termination should be reflected in reduced ETCs.

Negative responses

6.112 However, suppliers expressed considerably more disagreement with our proposals, both from a legal point of view and more broadly in terms of the impact on the market.

6.113 A very small number of the negative responses were to the effect that our proposals did not go far enough, suggesting ETCs should be reduced by more than we proposed. One consumer group said our proposals alone would not ensure a competitive market because ETCs are a substantial switching barrier. Another said Ofcom should compel the provision of written terms when contracts are entered into over the phone or internet.¹⁹

6.114 We note, however, that most of the disagreement was to the general effect that the proposals, for many different reasons, wrongly said 'fair' ETCs should be reduced by much more than is properly the case.

6.115 We consider first, here, the negative response about switching barriers. Those about whether our proposals went insufficiently far, or too far, are considered in the subsequent paragraphs.

ETCs will continue to be a barrier to switching

6.116 One consumer stakeholder said ETCs would continue to be a substantial switching barrier were we to adopt the proposed guidance.

6.117 Again, as we note elsewhere in this statement, the possible broader effects of a term on competition are not considerations that bear directly on the question of whether a term is unfair under the Regulations. What is relevant is the fairness of terms between the supplier and the consumer to whom they apply.

6.118 As to this fairness, we proposed when in our view ETCs are unfair. This proposal acknowledged that, under the Regulations, ETCs may be fair. When a consumer signs a fixed term contract he makes a commitment to make payments for a certain

¹⁹ This is something already dealt with by the Consumer Protection (Distance Selling) Regulations 2000, which are considered elsewhere in this statement.

period. He should not be able to resile from that commitment without the need to pay any sum.

- 6.119 The consumer would not be able to resile with impunity from that commitment in the absence of early termination provisions and an ETC in the contract. Instead, he would be liable to pay damages for breach of contract. Those damages would, broadly speaking, be the remaining retail payments less, for example, the costs a supplier saves as a result of early termination and of being relieved of his performance obligations. They would put him in the same position as if the contract had been performed.
- 6.120 Our proposals for the application of the fairness test were designed to achieve the same thing. Our proposals were to the effect that ETC terms that achieved this would not be unfair, but ETC terms that put the supplier in a better position would be. In light of the considerations, and for the reasons, that follow, we confirm that proposed view in the final guidance.

The ETC is no more than an agreed sum recoverable in law

- 6.121 As we note above, we agree that a consumer should not be able to resile from a commitment to a fixed-term contract without having to pay any sum. So, if he receives, in effect, a discount for entering that contract, he should not be able to terminate it without making a payment in the form of a 'fair' ETC.
- 6.122 That would reflect the contractual position he and the supplier agreed, and put the supplier in the position it would have been in had the contract been performed for its full term. We did not propose, and do not say in the final guidance, that there should be no ETC (nor any payment to the supplier in recognition that the consumer has not fulfilled the fixed term of the contract).
- 6.123 We also agree there is scope to argue that it is not unfair to require a consumer to pay the sum he agreed to pay (the retail price) for the time he agreed to pay it (the MCP).
- 6.124 And, we acknowledge that there is some merit in the argument put forward in one MNO's consultation response that ETCs which correspond with retail prices are no more than agreed sums recoverable in law. The MNO said the Regulations cannot remove a supplier's right to receive them.
- 6.125 Nonetheless, following the consideration set out below, and for the reasons given, we do not agree that an ETC corresponding with outstanding retail payments is necessarily a fair one and we consider that a fair ETC should take account, for example, of any costs or losses saved and mitigated by a supplier on early termination.
- 6.126 Some of the consultation responses under consideration here appear to be premised on the idea that an ETC equal to retail price does not cause a 'significant imbalance' under the Regulations because it does not put the consumer in a worse position than in ordinary contract law (i.e. if the contract did not contain the ETC term).
- 6.127 That is, in the absence of an ETC, where a consumer breaches a fixed term contract, the innocent supplier has the right to decide whether (a) to treat the contract as at an end and claim damages; or (b) to 'affirm' the contract: to treat it as continuing and continue to perform his obligations. If he chooses (b), the supplier could then recover the remaining retail payments, in due course (if the consumer does not pay them),

not as contractual damages (to which the rules on mitigation of losses apply) but as an action for the agreed sum (to which the rules on mitigation do not apply). We acknowledge there is some (controversial) case law that supports this view.

- 6.128 However, we consider that there is scope to argue that the limitations to the rules in the relevant case law apply. In particular, a supplier could not affirm the contract and claim the retail price because doing so would depend on the co-operation of the consumer (e.g. to maintain receipt of the service), in circumstances where he need not do so (indeed, is entitled to port his service to another supplier). And, it is not clear that a supplier would have any legitimate interest in continuing the contract, rather than claiming damages. Continuing the contract would mean the supplier incurs the costs of performance, meaning that a claim for the retail price leaves him no better off than were he to claim damages.
- 6.129 In other words, there is scope to argue that damages are an adequate remedy for a supplier and that continuing the contract and seeking to claim the full retail price would be unreasonable. So, the contractual damages rules, and their requirement to take into account, for example, saved costs and mitigated losses, so that the supplier is put into the position he would have been in had the contract been performed, would apply.
- 6.130 Accordingly, we consider that an ETC equivalent to outstanding retail payments, that does not take account, for example, of any saved costs and mitigated losses a supplier has, is likely to cause a 'significant imbalance' and to be unfair under the Regulations. The ETC would put the supplier in a better position, and the consumer in worse one, than if the consumer had not terminated the contract. The consumer is, apparently, bound to pay a sum higher than he would otherwise have to do in the absence of the term in circumstances where the contract is at an end and he will not receive services. In other words, the consumer would have to pay a disproportionately high sum for not receiving the services and for failing to adhere to the fixed term of his contract.
- 6.131 It also appears to us difficult to reconcile a term requiring such payment with the requirement of good faith. Again, that is a requirement of fair and open dealing with suppliers taking into account the consumer's legitimate interests. Given the above, seeking to recover a disproportionately high sum by way of the ETC does not seem to us to meet that requirement.
- 6.132 And, we consider that the Regulations may, in any event, offer greater protection for consumers than ordinary common law. The Regulations impose a legislative framework on top of the common law. And, they are concerned with the intention and effect of terms, not simply their form. A term requiring payment of an excessive sum cannot be made fair simply by making it a contractual ETC corresponding with outstanding retail payments. That would be a disguised penalty.
- 6.133 In our view, what a supplier must do is make a reasonable pre-estimate of the losses he incurs if the contract is not performed for its fixed term. That is, make a reasonable pre-estimate of the sums he saves and the losses he mitigates (for example, the wholesale costs he saves on the particular contract terminated or, more likely in practice, on contracts for the type of services concerned with the types of consumers concerned – see below), and deduct those from the fixed contractual retail payments outstanding on termination. All we consider a supplier is likely fairly to be able to recover in an ETC is that sum.

- 6.134 We are not, however, taking the view that, in doing so, a supplier needs individually to set an ETC for each consumer. We accept that, as a matter of practicality if nothing else, any saved variable costs can be determined by reference to any variable costs the supplier saves on contracts for the type of services concerned to the types of consumers concerned. Similarly, as to any saved network costs a reasonable pre-estimate of these may be determined by reference to any such costs the supplier saves in a particular, reasonable period averaged over the group of consumers terminating contracts early. We have amended the final guidance to make this point clear.
- 6.135 Again, we note paragraph 1(e) of Schedule 2 to the Regulations, which says that terms which, ‘...have the object or effect of requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation’ may be unfair. We again also note that in its guidance on the Regulations the OFT describes this paragraph 1(e) as including within its scope ‘disguised penalties.’ And, again we note it describes them as including ‘...terms in contracts under which consumers agree to make regular payments for services provided over a period of months or years, which state they may cancel, but will remain liable to make all the payments agreed.’ The view we adopt is consistent with the OFT guidance.²⁰

ETCs may recover upfront costs

- 6.136 Suppliers’ concerns appear to be that the proposed approach to ETCs in which saved costs or mitigated losses are subtracted from outstanding retail payments does not guarantee that the supplier recovers the upfront investment it has made in acquiring a customer. We have considered these responses in the light of what we consider to be the (common law) contractual position on damages.
- 6.137 As set out in the consultation document (paragraph 5.60), we recognise that suppliers face certain one-off costs when entering into a contract with a consumer. For example, the cost of supplying a mobile handset.
- 6.138 We also acknowledge that in common law contractual damages rules, an innocent party may (broadly speaking) claim damages for breach of contract in respect of either:
- lost net profits (subject to matters such as the duty to mitigate); or
 - wasted costs.
- 6.139 But, that party cannot claim the same losses twice. Nor can it claim more on the wasted costs basis than its lost net profits. The latter is the most it could recover in damages. The law will not protect a party from having made a bad bargain.
- 6.140 So, we agree a likely fair ETC could seek to recover wasted costs instead of lost net profits, subject to the former being no greater than the latter, and have amended the final guidance accordingly.
- 6.141 Again, one idea behind this is that the ETC term should not put the supplier in a better position than he would be in had the contract not contained the term. So, the supplier should be left in the same (or no better) financial position whether a consumer terminates their contract early or completes it (to the minimum extent he is

²⁰ See http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/oft311.pdf at pages 40 - 42

obliged: adhering to the contract for the MCP and purchasing only the services he is contractually obliged to and no more).

6.142 We might generally expect that a supplier sets retail prices such that over the MCP they cover:

- upfront costs;
- all variable costs involved in supplying an individual consumer;
- a contribution to fixed or shared costs; and
- a (positive) profit element.

6.143 In such a case, Ofcom's approach envisages that a supplier may recover more than simply the (wasted) upfront costs (i.e. lost net profits instead). But, as we note, the law of contractual damages is not designed to protect a supplier against a 'bad bargain'. The fact that some suppliers may in fact make a loss from consumers who terminate early, does not mean in our view mean our approach here is wrong. The loss that a supplier would make on early termination would be no greater than that it would make if the consumer fulfilled their contract (to the extent required).

6.144 We do not believe a likely fair ETC may recover unrecouped upfront costs where that would put the supplier in a better position than he would have been in had the consumer performed his minimum contractual commitment (again, that is, taking account of what the consumer is required to do to meet his contractual obligations and assuming he would do no more than that).

6.145 In that case, the term would place the consumer in a worse position than if there were no term in the contract and the ordinary contractual damages rules applied on early termination. So, in our view, any such ETC would fall within paragraph 1(e) of Schedule 2 to the Regulations.

Ofcom assumes suppliers are better off when contracts end early

6.146 We have considered the responses that our proposals assume suppliers are better off when contracts end early and are designed to make them worse off for allowing such termination.

6.147 We appreciate that in practice some suppliers hope to be better off when consumers remain bound by their contracts to the end of, or beyond, the MCP and purchase services outside inclusive contractual bundles. In that sense, at least, we agree suppliers may in some cases be better off.

6.148 But, we disagree that is the correct analysis under the Regulations. As we say above, our proposals were designed to ensure that - on a contractual analysis - a supplier is in no better position when a consumer terminates a fixed term contract early than when the contract is performed for the full fixed-term. We consider this to be the correct approach under the Regulations.

6.149 A supplier would - on a contractual analysis - be in a better position if, on early termination, it receives all the (retail) payments a consumer is obliged to make under a contract but (for example) saves all of its costs of having to perform that contract. On a contractual analysis, if the contract is performed the supplier would end up with

the (retail) payments the consumer is obliged to make, less (again, for example) the costs the supplier incurs in its performance of its obligations.

- 6.150 And, without the ETC term, the supplier would receive, in broad terms, the retail price less his costs of performance, and the consumer would pay that price and receive services in return. Or, the consumer would breach the contract and have to pay, and the supplier would receive, damages of, again broadly, the retail price less the supplier's saved costs (and mitigated losses).
- 6.151 So, if the term providing for the ETC had the effect of putting the supplier in a better position (and the consumer in a worse one) than they would be in without the term - by providing for it to receive the whole retail price without the cost of performance - the term would cause the supplier to receive a disproportionately high sum for not having to provide services under the contract and the consumer 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.
- 6.152 Our proposals, which we now confirm, place the supplier in the same position, in effect, on early termination as it would be in if the consumer adhered to the fixed term of his contract and did what he is obliged to do under it.

ETCs should allow for expected consumer revenues beyond the contractual minimum

- 6.153 Suppliers said that some contracts may only be profitable in the event that a consumer exceeds their minimum contractual commitment. That is, they:
- stay with the supplier beyond the MCP; and/or
 - they purchase services beyond their contractual commitment.
- 6.154 As we note above, one MNO linked these extra-contractual revenues to the recovery of the subsidies it provides when giving consumers handsets. It said it relies on these revenues to recover this subsidy and its ETC is needed to mitigate the effect of that subsidy when a consumer terminates a contract early.
- 6.155 In practice then, suppliers will often determine their commercial offerings and set the price of a contract to reflect the expectation that, on average, the consumer will exceed their contractual commitments in these ways. Given that this is how offers and prices are set, some suppliers believe it should also be possible to reflect this expectation in the calculation of the ETC. Some said they should be able to recover these 'lost profits' in line with the ordinary common law position that would apply on breach of contract.
- 6.156 As noted above, we appreciate this is how suppliers evaluate and set the prices of services they offer. However, we consider that the applicable legal rules on this point are sufficiently clear. The consumer is not obliged by the contract to pay any more than the agreed (usually monthly) retail price. And, in calculating the damages payable on breach of contract - and so by analogy the sum payable by way of a likely fair ETC - the law will not assume a (breaching) party to a contract would do more than he is legally obliged to do.
- 6.157 We are aware of cases in which the courts have said that in performing what he is legally obliged to do a party will be assumed to act reasonably, at least where he has a choice about how to perform his obligations. But that still does not mean he will be treated as doing more than the contract requires.

6.158 So, we do not consider that a likely fair ETC will include sums in respect of profits for calls or other services (or extra commitments) a consumer is not obliged to make or receive. Otherwise, the term providing for the ETC would put the supplier in a better position, on a contractual analysis, if the consumer terminates the contract than if he did not. And, the consumer would be in a worse position than he would be in were the term not in the contract. Again, the effect would be that 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.

ETCs should allow for expected revenues from other sources such as incoming call termination revenue

6.159 Some MNOs said a fair ETC must make allowance for lost termination revenues on incoming calls.

6.160 We agree that saved termination costs on outgoing calls are certainly relevant. They are a variable cost a supplier saves on early termination of a fixed term contract. We consider an ETC which does not take account of those saved costs is unlikely to be fair.

6.161 As to lost termination revenues on incoming calls, we consider it likely that they fall outside the sums that may be recovered by way of a fair ETC.

6.162 We consider that two relevant legal rules are:

- that damages for breach of contract are calculated by reference to the assumption that a (breaching) party to a contract would do no more than he is legally obliged to do; and
- the rules on remoteness of damage.

6.163 Even if the former may not preclude the recovery of call termination revenues by way of (fair) ETCs (and we consider there is scope to argue that it does preclude that recovery), we consider it likely the latter would (as it would in a contractual damages claim).

6.164 In any particular case where it were seeking damages from a consumer for breach of contract, a supplier would need to be able to establish that recovery of such revenues would not be precluded by the remoteness rules. That is, speaking broadly, that the consumer contracted on the implicit or explicit basis he would be liable for the loss of such revenues if he breached the contract. We think it unlikely the supplier could do so.

6.165 It seems to us unlikely that consumers entering into a communications contract are aware of the mechanisms by which revenues are generated between suppliers. It follows, in our view, it is unlikely consumers contract with suppliers on the basis they will be liable for losses relating to such revenues. Any supplier would, in our view, have to establish otherwise in the case of any particular contract.

6.166 And, since in our view, such revenues are unlikely to be recoverable in damages for breach of contract, we think it unlikely that an ETC that seeks to recover them would be fair. The term providing for the ETC would put the consumer in a worse position than he would be without its presence in the contract, meaning that, as a result of the

term, he would have to pay a disproportionately high sum for failing to adhere to the fixed term of the contract.

- 6.167 We do not, therefore, consider generally that ETCs that seek to recover lost incoming call termination revenues are likely to be fair. It would be for a supplier to show otherwise in any particular case.
- 6.168 In support of the above, we note that it is hard to envisage that a consumer would ever consider it acceptable that they would have to pay more in an ETC than the amount of the contractual retail price. But, this is a possible implication of accepting the point the relevant MNOs made.
- 6.169 We have made some changes to the final guidance to make our view clearer on this point.

Costs are not saved and losses are not mitigated on early termination

- 6.170 Although suppliers had concerns about the impact on their business models and their ability to recover upfront costs, there was nonetheless some acceptance that some costs - such as wholesale charges paid to BT Openreach or BT Wholesale - are saved when a single consumer terminates their service.
- 6.171 There was, however, much less acceptance of the proposal that certain shared costs can be saved or losses mitigated where consumers terminate contracts early. The relevant consultation responses are those set out in paragraphs 6.63 – 6.68 above, including those to the effects that:
- network costs are fixed or, at least, ‘lumpy’ and are not saved when individual consumers terminate their contracts, because network investment, and increases in capacity, occur in large blocks or lumps, not related to individual consumers;
 - the number of consumers terminating early is too small to have a big impact on network investment and capacity;
 - unless forgone consumer traffic is replaced immediately and with like ‘replacement traffic’ in a similar part of the network MNOs will face a cost, and there are costs of acquiring replacement customers that account must be taken of;
 - MNOs also incur opportunity and option costs in investing in networks, of which account needs to be taken;
 - mobile networks are built to have spare capacity;
 - network models, and pricing of contract packages, already allow for disconnections and demand;
 - Ofcom’s proposed approach makes the flawed assumption that demand is growing and investment in extra capacity is needed to meet it;
 - it is not clear LRIC is the right proxy for calculating saved network costs, because for example it:
 - is just one method used to determine costs and not one suppliers may use to set prices;

- includes fixed costs (and does not identify avoidable or incremental costs);
 - excludes customer acquisition costs;
 - assumes 'average efficient operator's costs,' not the specific operator's;
 - is for determining voice call termination costs in timescales measured over decades, not other costs (which will vary depending on a consumer's location and the type of technology he uses (2 or 3G); and
 - will require significant ongoing work for Ofcom and industry (primarily Ofcom);
 - using LRIC ties markets: it ties retail returns (ETCs) to regulated LRIC for mobile voice call termination, which will distort pricing behaviour and markets; and
 - mobile call termination rates are contested so Ofcom should not use the same model to set prices in relation to ETCs until/unless the termination issues are resolved. One MNO said doing so would be prejudicial to the ongoing proceedings about those issues.
- 6.172 As to the suppliers' responses that they do not, for any of the various reasons given, save shared or network costs and/or cannot mitigate losses when consumers terminate contracts early, we note each of the points they make.
- 6.173 Having considered those responses, we agree that any particular supplier may be able to demonstrate that it does not save costs and/or cannot mitigate any losses on early termination. And, it is, of course, correct that any supplier who has no such/fewer costs he can save or losses he can mitigate, will have fewer sums to be reckoned in the calculation of a fair ETC.
- 6.174 In addition, we accept that identifying saved costs or mitigated losses for network industries is not straightforward. Questions that we may need to determine in any particular case include:
- issues around the degree of spare capacity built into a network, and the process and lead times for network planning;
 - the extent to which a supplier is actively increasing their network capacity in response to growing demand;
 - questions of modularity for different network elements and the extent to which adding or removing a small fraction of the customer base results in additional costs or cost savings; and
 - the extent to which equipment installed for one consumer can in practice be reused by another, and the likely time gap that might occur in so doing.
- 6.175 However, none of the relevant consultation responses causes us to see why, *in principle*, in any case, any network costs a supplier saves (or losses he mitigates) because consumers terminate fixed term contracts early, freeing up existing network capacity to meet (any) other demand, should not fairly be attributed to those early terminating consumers and reflected in the fair ETC they pay. In our view, these are not substantially different to other costs a supplier saves (or losses he mitigates) because he no longer has to perform the terminated contract.

- 6.176 And, the Regulations are concerned with standard form contractual terms. Those standard form contractual terms here are for networked services supplied to groups of consumers contracting on substantially the same terms. So, we consider that any costs saved because of the termination of contracts by some of that group of consumers should be spread over that group.
- 6.177 Otherwise, if there are such costs saved and/or losses mitigated, we consider an ETC which failed to reflect these is unlikely to be fair under the Regulations. If they were not taken into account in the reckoning of a fair ETC, the ETC would put the supplier in a better position if the consumer terminates the contract early than if he did not. The consumer would be in a worse position than if the relevant terms were not in the contract. 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.
- 6.178 We further consider that this can apply, in principle, notwithstanding the claimed 'lumpiness' of such costs. That is, any network costs saved in a particular reasonable period can be averaged over the group of consumers terminating contracts early.
- 6.179 As we note above, we consider a supplier must make a reasonable pre-estimate of the losses it incurs because the contract is not performed for its fixed term. That involves making a reasonable pre-estimate of the sums it saves and the losses it can mitigate, and deducting those from the fixed contractual retail payments outstanding on termination. That will include, for example, a reasonable pre-estimate of any network costs it saves in a particular reasonable period averaged over the group of consumers terminating contracts early. This might occur because, for example, the supplier need invest in 'lumps' of additional network capacity less quickly, less often and/or less overall because of early terminations. If there are any such costs, we think it likely the ETC should reflect them.
- 6.180 As to the calculation of such saved network costs, we proposed the possible use of LRIC:
- "The cost mitigated could be estimated by the long run incremental cost ('LRIC') pence per minute multiplied by the number of minutes the average consumer on that package uses, or the LRIC per unit of broadband capacity multiplied by the average capacity used."
- 6.181 We have noted what suppliers have said about the Mobile Call Termination Costs model used to calculate LRIC, what that should be used for and the contested nature of its application in relation to mobile termination rates. We accept that the calls to mobile model could not be used without modification, but we consider it may be capable of adaptation for use in the calculation of saved network costs. In particular, for example, it may be adapted so that it calculates incremental costs (i.e. the changes in costs caused by relatively small variations of demand) and to explore how these costs vary as the size of the increment varies. It may also be adapted so that it is used to consider each operator's costs, not the average efficient operator's.
- 6.182 In addition, in relation to LRIC, we mean to describe the incremental cost of capacity that is mitigated by early termination. In this context, LRIC would exclude genuinely fixed costs, which do not vary with consumer demand, and which therefore cannot be mitigated. An example of a fixed cost may be mobile spectrum (to the extent this cannot be traded). And, there is no suggestion we would use LRIC to set retail

returns (our concern is with the additional charges that apply on early contract termination, not retail prices).

- 6.183 As to the response that we should not use LRIC in relation to ETCs in the same way as to mobile call termination rates, because the latter are contested, we note the following. First, as we say, we agree the Mobile Call Termination Costs model would need adapting in the present context. Second, as we return to below, the fact there is a dispute about mobile call termination rates does not suspend the operation or effect of the Regulations, or Ofcom's powers and duties under them.
- 6.184 We would, these points notwithstanding, however, consider further the appropriate method for calculating saved network costs in relation to any particular supplier whose ETC we consider may be unfair under the Regulations. And, we would consider any rulings in any proceedings about mobile call termination rates and, if necessary, amend our approach.
- 6.185 In light of the above, and in particular acknowledging that there may not be any saved or mitigated network costs in any particular case, we have amended the final guidance so that it gives an indication of the general principles we consider likely to apply and the approach we are likely to take in considering the application of the Regulations to ETCs.
- 6.186 In making such amendments, we are also mindful of the consultation responses, like that from the MNO who said our proposed guidance lacked detail and may result in inconsistent application. In the final guidance, therefore, we seek to make clearer and explain further the rationale for the principles we consider likely to apply. We also make clear that, as explained above, we are not indicating that we consider fair ETCs should be set individually for consumers. They may be set by reference to groups of consumers on the basis set out above and indicated in the final guidance.

Costs payable to third parties on termination

- 6.187 On the question of costs payable to third parties on termination, we accept in principle that a supplier may be able to recover from a consumer a charge it has to pay a third party on termination of a contract. One example of such a charge is a 'cease' charge (see Section 10). But a supplier could not recover the same sum twice, e.g. once by way of a cease charge and again in an ETC.
- 6.188 We also accept, in principle, that a fair ETC may also make allowance for any other such charge, subject to matters such as:
- there being no double recovery;
 - the rules on remoteness of damage; and
 - a deduction being made in respect of any costs to the third party saved by the supplier on early termination (i.e. no longer payable to the third party in performance of the contract).
- 6.189 However, we are not aware of any such charges (other than the 'cease charges' dealt with elsewhere in this statement and our guidance). And, we think it likely the rules on remoteness may well preclude recovery of any other costs.²¹ Further,

²¹ Consumers are unlikely to contract on the basis they would be liable for such costs in the event of a breach of contract

account would, in any event, need to be taken of (any) costs to the third party saved on early termination.

- 6.190 Together, these mean it is unlikely this point has practical significance. We do not, therefore, refer to such charges (other than 'cease charges') in the final guidance, other than to note they may in theory be recoverable.

ETCs are already recovered via headline prices

- 6.191 We have considered what one MNO said about this proposed principle . We do not agree, for the reasons above, that ETCs are headline prices. But we do agree, on further consideration, that ETCs that (in our view) are likely to be fair need not be reduced to reflect that network costs are recovered in headline prices.
- 6.192 We agree that headline retail prices will, no doubt, seek to cover such costs. But, in line with the rest of our analysis, as set out above, we consider that the appropriate measure of a likely fair ETC is a sum equivalent to that retail price less (amongst other things) any costs a supplier saves, including network costs, because the contract is terminated early.
- 6.193 There need not be a further reduction because headline prices, in part, seek to cover network costs. To the extent such costs are not saved on early termination, and would have been recovered in the headline retail prices that would have been paid absent early termination, in our view a fair ETC could seek to recover them.
- 6.194 To the extent the relevant MNO may be suggesting that the proposed principle was incorrect for saying otherwise, we agree. We have removed it from the final guidance.

Whether Ofcom should publish ETC thresholds

- 6.195 Following consultation and further discussions with, and considering information provided to it by, suppliers, Ofcom has decided not to publish thresholds.
- 6.196 We have taken account of the fact that, as set out above, there were some suppliers whose consultation responses suggested they did not necessarily oppose our consulting on and seeking to set ETC enforcement thresholds, in some cases notwithstanding their opposition to our proposed principles about the calculation of fair ETCs. However, there were more - and stronger - negative comments that we have taken account of in changing our proposed position.
- 6.197 As to the comments that indicated possible support for ETC enforcement thresholds, we acknowledge that such thresholds may - in theory at least - have offered the possibility of clear and consistent compliance with the law and enforcement activity against breaches.
- 6.198 However, we note, and give greater weight, for the time being at least, to the following points.
- 6.199 First, some suppliers questioned the appropriateness of seeking to set thresholds when we had still not made a decision on the points of principle. They submitted that we could not consult on thresholds until we had finalised the principles we consider apply.

- 6.200 Having considered those responses, we agree that we should not set thresholds at least until we have finalised what we consider the correct legal principles applying to ETCs. The principles would, after all, be the basis of any thresholds. That we do not propose for the time being to consult on and/or seek to set thresholds would not, of course, prevent us doing so at any time in the future.
- 6.201 Second, many suppliers challenged the principles that we proposed would underlie any thresholds and the effect that fair ETCs should be remaining retail payments less, for example, saved costs. They also challenged the methodology being used and how it might apply to their own circumstances.
- 6.202 We recognise that some of the issues are complex. Any particular supplier may also in practice be able to demonstrate, for example, that early termination of consumer contracts does not in its case free up capacity to meet demand that could not otherwise be met, nor result in saved costs.
- 6.203 We also accept that any enforcement action has to look at the facts of any particular case. Any enforcement threshold we set could only ever be a guide for such action. It would not preclude the fact that the 'fair' ETC for an individual supplier might be outside the threshold.
- 6.204 Given the lack of agreement to our proposals on ETCs, and the varied and sometimes supplier specific nature of the concerns, it appears to us that there would very likely be significant disagreement with any more detailed proposals we put forward (in the form of enforcement thresholds).
- 6.205 In those circumstances, we do not consider it a worthwhile use of our, or stakeholders', resources to consult on and/or seek to set ETC enforcement thresholds for now.
- 6.206 Rather, it appears to us, the appropriate course is to set out in guidance the principles we consider apply to ETCs under the Regulations, which we consider suppliers should apply in calculating fair ETCs, and the approach we are likely to take to enforcing that legislation.
- 6.207 Third, we note what two suppliers emphasised about the importance of having a consistent approach, including on shared and network costs. One said there should be administrative thresholds for all suppliers, including pay TV, or for none. We have considered these responses alongside those that said suppliers do not hold the information required to enable Ofcom to set thresholds, at least without a detailed cost modeling exercise.
- 6.208 Again, in principle we accept that setting consistent thresholds across suppliers is what we should aspire to. We acknowledge, however, that we do not have sufficient information to enable us to do so at present. This is another reason why we do not propose to seek to set enforcement thresholds for the time being.
- 6.209 We have noted that one MNO said it was unclear how we could publish any meaningful benchmark in our guidance given the commercially sensitive nature of individual operator cost information and the need for any enforcement action to take into account an individual supplier's own costs.
- 6.210 As we say above, we accept that any enforcement action has to look at the facts of the particular case. And, any enforcement threshold would not preclude the fact that the 'fair' ETC for an individual supplier might be outside the threshold. But, neither of

these points, nor the commercially sensitive nature of individual operator cost information, it seems to us would preclude us setting general thresholds to act as enforcement guides.

- 6.211 Nonetheless, for the reasons given, we have for the time being re-considered issuing industry wide benchmarks for ETCs.

Impact of Ofcom's proposals

- 6.212 Stakeholders commented that Ofcom should have conducted an impact assessment prior to publishing guidance. Elsewhere in this statement, we have considered and responded to these consultation responses. (As we said in paragraphs 3.30 – 3.35, we do not agree a formal impact assessment is required. Any 'regulatory intervention' here is the publication by us of guidance on our view of existing law. That law gives us enforcement duties and powers, and was itself the subject of an impact assessment when it was made.)
- 6.213 This section of this statement sets out the consultation responses relating the specific impact of Ofcom guidance on areas such as retail prices, market models and competition.
- 6.214 We note and have considered how one MNO described our proposals as 'over-paternalistic' (protecting some consumers to the detriment of others), which will result in suppliers recovering costs through other charges and achieving a standardisation of the market that would otherwise be unlawful on competition grounds. We also note that another said 'removing' ETCs will result in a shifting of cost recovery to all consumers, which would be unfair.
- 6.215 We have also considered that three MNOs said our proposals will undermine the way the mobile contract market works (and the reasons they gave) and will mean:
- handset subsidies will not be offered (or will be reduced); and
 - there may be a disincentive to offer packages with bundled minutes and a move to per call/text charges.
- 6.216 We note that one of these MNOs said Ofcom underestimates the widescale and far-reaching implications of its proposals for ETC, which will have the "... most radical impact on the market" (unless the effect of the proposals is that MNOs can recover the vast majority of monthly payments). We note also the 'arbitrage' risk another MNO described, which it was said would soon see MNOs charging consumers the true cost of high value handsets.
- 6.217 We acknowledge that one broadband and fixed-voice supplier made similar points about Ofcom's proposals leading to higher retail prices on existing contract lengths or substantially longer fixed-term MCPs.
- 6.218 In our view, the fact that applying the law may have a particular impact is not a reason not to so apply it nor to issue guidance on it, if that is what we properly consider to be the effect of the law. In this context, the fact that applying the Regulations may affect prices and market offerings is not a reason, in itself, for not doing so.
- 6.219 As set out in the consultation document, we acknowledge that there may be consequential effects of applying the law. But, that cannot be used to justify terms

that do not comply with it. Any terms should be lawful, even if they affect prices and business models.

- 6.220 Accordingly, we do not rely on the impact of our proposals in order to justify them, and our decisions, in the way we would be required to do, and would seek to do, in a regulatory matter, in relation to which, for example, we had to satisfy the proportionality test in section 47 of the 2003 Act and carry out an impact assessment under section 7 thereof. We have, nonetheless, considered the impact of our proposals (and final decisions) about ETCs in light of what suppliers, especially MNOs, have said about them.
- 6.221 We disagree with the response that our proposals were over-paternalistic. They simply set out what we, as the sectoral enforcer of the Regulations, consider is the likely proper application of those Regulations, just as the OFT has done in its guidance.
- 6.222 We do accept, however, that there may be a waterbed effect as a result of our proposals. In other words, if suppliers reduce their ETCs to comply with the law, they may seek to recover these foregone revenues from retail prices.
- 6.223 However, on the basis of the evidence collected from suppliers, we consider that the likely loss to their revenues would be small, which suggests that any waterbedding effect is also likely to be small. Our estimates suggest the lost collected revenue²² across all sectors is likely to be less than 1%.
- 6.224 We note from this figure that even if reduced ETCs were to deliver large savings to individual consumers in some cases and fairer ETCs, they are unlikely to result in significant losses in revenue for suppliers.
- 6.225 Further, even if the waterbedding effect led to restructuring of certain prices, the fact that the competitively constrained headline prices would rise slightly – rather than less visible additional charges – is not necessarily a bad outcome for consumers. Restructuring of prices may lead to more transparency for consumers and charges may be set in a way that more closely reflects costs.
- 6.226 We have also considered concerns that our proposals will impact on the extent to which consumers are tied to contracts, which may, in turn, impact on suppliers' willingness to spread upfront costs over the contract period. MNOs, in particular, said this would have a significant impact on business models for mobile contract services, such as the handset subsidy.
- 6.227 The extent to which a business model is likely to be affected, will depend on a number of factors: whether there is likely to be a significant increase in switching as a result of reductions in ETCs; whether the increased risk associated with greater numbers of people terminating contracts before the end of the MCP is sufficiently large that it leaves suppliers exposed to increased costs which they cannot recover; and how suppliers then respond. Possible responses could include increasing the headline price or other charges, extending the length of the MCP, or - in the case of the mobile sector - decreasing the number of bundled minutes or restructuring the handset offer into a formal loan.
- 6.228 While all of the responses listed above could occur, changes to tariffs will have to be made in the face of competition, limiting the ability of firms to increase various

²² Not all early termination charges contractually due are collected in practice.

charges or to change offers unless necessary. Furthermore, we have no reason to believe that switching will increase significantly as a result of our proposals, as even fair ETCs are likely to constitute a deterrent to switching unless rivals offer significantly better deals.

- 6.229 For example, MNOs, whose consultation responses primarily raised these concerns, have told us they do not save or mitigate network costs on early termination. For any MNO where this is the case, its saved costs on early termination may be substantially limited to the saved costs of outgoing call termination on calls included in contractual bundles. Accordingly, any reduction in its ETC to a likely fair level will be limited.
- 6.230 Even if its ETC might be reduced by up to 20%, as it may be, to reflect saved outgoing call termination costs, on a package of 500 free minutes a month this would mean an ETC of £150 on a contractual package terminated with 6 months remaining (i.e. a £25 per month package) would be reduced by £30, to £120.²³ This would still appear to be a significant, but fair, reason for consumers to fulfil MCPs. In taking this view, we note the MNO's response which said that if the effect of Ofcom's proposals is that MNOs can recover the vast majority of monthly payments, "... the implications may not be great."
- 6.231 We also note that by seeking to ensure that ETCs reflect any cost savings from wholesale costs, ETCs may be different across suppliers in the same industry and that this could have an effect on competition.
- 6.232 This may be particularly true for fixed and broadband services where suppliers using 'end to end' wholesale products (such as IPStream) may save or mitigate greater levels of cost than those using LLU and a vertically integrated supplier may save or mitigate lower levels of cost than those using BT's wholesale products.
- 6.233 We have considered this point elsewhere in this statement. As we say there, we agree that the application of our proposed, and now final, guidance may affect different suppliers differently. But, that is because they are in different positions, so the Regulations, which apply equally to all suppliers, affect different suppliers in different ways.
- 6.234 To repeat a point made elsewhere, in relation to ETCs, for example, if these should reflect costs saved on early termination, and we consider they should for the reasons in the consultation document and this Statement, we acknowledge different suppliers will have different costs and so ETCs. That would reflect their different business models and infrastructures, and the amount they spend on them. And, where suppliers save those costs on early termination, we consider that the fair position the Regulations require is that they are reflected in lower ETCs. This is so even where others suppliers do not have (and save) those costs because they have adopted different business models and infrastructures.

Proposals contradict OFT Economic discussion paper

- 6.235 Suppliers referred to paragraphs of 'Interactions between competition and consumer policy' prepared for the OFT by an independent consultant (Professor Mark

²³ This is based on the assumption that the customer would have used 60% of their 500 minutes, would have made roughly 30% of calls to off-net mobiles and that the average termination charge for these calls is taken to be 5.5pence per minute (it may of course be slightly different in practice, and would take account of any relevant rulings of the Competition Appeal Tribunal). Fixed termination charges are taken as negligible. The figures quoted are, of course, estimates and guides, not binding figures that would necessarily apply in any case

Armstrong) as part of the OFT's Economic Discussion Paper series. We are aware of this paper and have considered, in particular, the paragraphs of the report that suppliers quoted or referred to in their consultation responses (see above).

- 6.236 These paragraphs appear to us to support our view that MCPs and ETCs are not in and of themselves unfair. Paragraph 3.53 of the paper, for example, seems to indicate that a MCP (and ETC) may be justified where a supplier makes a subsidised investment in equipment like a mobile handset. Our consultation document and draft guidance acknowledged, and our final guidance confirms, that the recovery of upfront costs is a reason why MCPs and (fair) ETCs may legitimately be set.
- 6.237 But, the report does not consider in any detail what level of ETC might be considered fair or unfair (save to acknowledge that its calculation might be difficult). We do not consider that the paragraphs quoted necessarily suggest that any level of ETC would be justified (with no grounds for the law to provide for a 'fair' ETC).
- 6.238 Some of the quoted paragraphs of the paper also seem to us broadly to be concerned with the effect of applying certain legislative provisions. That is, speaking broadly, that applying the law to protect some consumers may, amongst other things, result in re-distributive effects, where suppliers seek to recover foregone revenues in other ways from other consumers. We have acknowledged and responded to this point elsewhere in this statement.
- 6.239 We also note that the OFT clearly sets out in the introduction to the paper that:
- 'The views of this paper are those of Mark Armstrong and do not necessarily reflect the views of the OFT nor the legal position under existing competition or consumer law which the OFT applies in exercise of its enforcement functions.'
- 6.240 What we are doing is giving guidance on our view of how existing law applies - the principles we think are relevant and the approach we are likely to take. We have consulted with the OFT in doing so and our proposals on ETCs do not appear to us to be not in conflict with its guidance on the Regulations.

How the guidance applies to bundles

- 6.241 In response to the stakeholder who asked for greater clarity as to how suppliers should calculate ETCs when there is a single contract covering a bundle of services, we see no reason why different principles should apply from services that are provided individually.
- 6.242 In other words, there will be a bundle of services provided under the relevant contract, and a bundle of costs the supplier incurs in doing so. Some of those costs will be saved on early termination of the contract and the relieving of the supplier's performance obligations. Any ETC charged should, in our view, reflect that.

Ofcom is issuing guidance prematurely

- 6.243 We have considered the response made by one MNO that we cannot issue guidance whilst issues about the wider competitive circumstances for the mobile sector are uncertain - in particular issues about mobile number portability and mobile call termination rates. We have considered also what other MNOs said about the disputes around the Mobile Call Termination Costs model and the suggestion that our proposals would prejudice legal processes about those rates.

- 6.244 We have considered a number of points. First, and as we allude to above, the fact there are, or have been, disputes about other matters affecting certain suppliers of communications services does not does not suspend the operation or effect of the Regulations, nor Ofcom's powers and duties under them. They continue to apply to all or any suppliers, whatever other regulatory matters relating to the 'wider competitive picture' (which is not a relevant consideration when assessing the fairness of a contract term between a supplier and a consumer) may be in issue.
- 6.245 Accordingly, we do not see how specific issues such as mobile number portability and mobile call termination rates – relating to a specific group of suppliers and services - should prohibit or delay our issuing guidance, which applies to all communications suppliers and services.
- 6.246 Second, it is also not clear to us how the determination of matters relating to mobile number portability or call termination rates, before the CAT and the CC would render obsolete guidance on the general principles we consider likely to apply to certain additional charges under the Regulations.
- 6.247 The Regulations are, as we say, about the fairness of contract terms as between a supplier and a consumer. They are not concerned with either the processes for mobile number portability or mobile call termination rates, or the competitive effects of either. And, the Regulations apply to any and all suppliers whatever the positions in relation to any of those matters.
- 6.248 On this point, we note that since publication of our consultation document on additional charges, the CAT has ruled on mobile number portability. That ruling remitted the matter back to Ofcom for further consideration. Nothing in it affects the general principles that apply to the fairness of consumer contract terms under the Regulations.
- 6.249 Third, in relation to mobile call termination rates, it is similarly difficult to see how any rulings or determinations on those issues will affect the assessment of fairness of certain contract terms between a supplier and a consumer.
- 6.250 The MNO who referred to Ofcom's proposals as being prejudicial to the CC process said it, '..... believes that for Ofcom to set retail prices with reference to (contested) mobile call termination prices may be severely prejudicial to the Competition Commission process due to complete by 31 October 2008.' We are not seeking to set retail prices at all, let alone by reference to mobile call termination rates. We proposed, and now confirm in our final guidance, the principles we consider likely to apply under the Regulations in assessing the fairness of certain additional charges, including ETCs, not prices. Doing that will not be prejudicial to the CC process.
- 6.251 We did propose that a LRIC approach, using the Mobile Call Termination Costs model, might be adapted for the purposes of one aspect of those principles under the Regulations: the calculation of possible saved network costs relevant to likely fair ETCs. As we make clear elsewhere in this statement, we agree that model/methodology would require adaptation for use in this context. And, we would also consider alternative approaches for calculating any such saved costs (including if necessary, changing our approach in light of any relevant ruling in any proceedings about mobile call termination rates). Those points being so, we do not see that what we proposed, and now confirm, would prejudice the CC process.

Fair contractual right to terminate a contract

6.252 We note that one MNO said that even if its ETC is subject to the Regulations fairness test it passes because:

- it is not contrary to the Regulations,' '.... requirement of good faith,' as it gives the customer the chance to mitigate the effect of the minimum term;' and
- does not cause a significant imbalance as the customer is under no obligation to exercise this option.

6.253 It, and another MNO, also made the more general point that ETCs are not additional charges, but key contract provisions that are part of the wider bargain. So, they said, it is not unfair to charge the consumer a disclosed fee that is agreed upfront if they do not fulfil their end of the deal. This is the payment of an agreed sum to terminate, pursuant to a clear and transparent term, not a charge payable on default or an unfair penalty. One of them said Ofcom's proposed approach would put it in a worse position than if it did not allow its consumers the right to terminate their contracts.

6.254 These points are not, in our view, correct. The Regulations are concerned with the intention and effect of terms, not their form. And, for the reasons set out above, an ETC term that put the supplier in a better position on early termination of the contract by the consumer than if he did not so terminate, and puts the supplier in a better position and the consumer in a worse than if the term were not in the contract, is in our view likely to be unfair.

6.255 Drafting the provision as a contractual option or right to terminate is not likely to save the term from a finding of unfairness. As set out above, we note (and agree with) the OFT's view in its guidance that paragraph 1(e) of the indicative list of unfair terms in Schedule 2 to the Regulations includes within its scope 'disguised penalties.' It describes them as including '... terms in contracts under which consumers agree to make regular payments for services provided over a period of months or years, which state they may cancel, but will remain liable to make all the payments agreed.'

6.256 We do not see how using a term this way to put the consumer in a worse position than he would be in if he did not terminate the contract early, and than he would be in without the term in the contract, is consistent with either the notion of balance of the parties' rights and obligations or the requirement of good faith.

6.257 For the reasons above, we take the view that such a term would require the consumer to pay a disproportionately high sum for failing to adhere to the fixed term of his contract. That causes a significant imbalance in the parties' rights and obligations, to the consumer's detriment. It does not seem to us to answer that point by saying that the consumer need not (exercise his option to) terminate the contract. That is the kind of 'take it or leave it' term ('adhere to the contract or pay a likely unfair charge') the Regulations protect consumers against.

6.258 In turn, including such a term in a standard form contract does not seem to us to represent fair and open dealing with the supplier having taken into account the consumer's legitimate interests. We do not see how it really, '... gives the customer the chance to mitigate the effect of the minimum term.' Under such a term, the consumer has to pay just as much as he would have done to adhere to the minimum term, without receiving services in return. And, without the term he could break the contract and pay a lesser sum than the ETC in damages.

- 6.259 In addition, as set out above, an ETC which we proposed, and now confirm, we consider likely to be fair would not put the supplier in a worse position than were the term not in the contract and there were no 'contractual right' for the consumer to terminate. As we say, the supplier would be in the same position: he could claim the same sum in damages as we consider he could fairly recover in an ETC.

Recovery of retail price is a fair pre-estimate of loss

- 6.260 One MNO said its approach is consistent with the OFT's guidance that an ETC is fair if it reflects a real and fair pre-estimate of the lost profits on early termination.
- 6.261 We agree an ETC would be fair if the charge were calculated on the basis referred to (in line with our view as set out above and in the final guidance). We disagree, however, if the MNO's suggestion is that a recovery of the full retail price outstanding on termination reflects the lost profits on early termination. For the reasons set out above, such sums must reflect, for example, the costs saved on early termination. These would have been deducted in the calculation of the (net) profits the supplier would have made had the contract been performed. In other words, whether the contract is terminated early or not, the supplier's profits are, broadly speaking, retail price less costs.

Net mitigated losses by reselling services

- 6.262 In response to the suppliers who said mitigated sums should also take account of the acquisition costs of the alternative customer, we have given the following consideration and take the following view.
- 6.263 We agree that the mitigated losses which should be reflected in a likely fair ETC should take into account the costs of acquiring a new customer in response to a consumer's early termination, provided those costs are not recovered from the new customer. The purpose of the contractual damages rules and, in effect, a fair ETC, is to put the supplier in the position he would have been in had the contract been performed for its fixed-term, not terminated early.

Ofcom's proposals are inconsistent with migrations processes

- 6.264 In the consultation Ofcom set out that as a matter of best practice we would expect suppliers to inform consumers of the ETC at the point that they ask to cancel their contract. Some suppliers commented that this conflicts with some migrations processes where these are gaining-provider led, and the initial consumer contact will be with the new supplier, not the current supplier.
- 6.265 For the following reasons we would generally expect that the losing provider has the opportunity to, and should, inform the consumer of any ETC they will incur:
- Fixed-line voice switching (including full LLU) uses a 'letter facilitation' process – this is straightforward for consumers, and based on consumers being well-informed of the impending switch before it happens (through receipt of letters) by both the gaining and losing providers in a 10-day switchover period. This therefore provides an opportunity for losing providers to notify their customers of all outstanding contractual liabilities (including ETCs) before the new order matures.
 - Broadband services (including shared LLU) follow a Migration Authorisations Code (MAC) process – this requires the consumer to actively obtain an

authorisation code from their existing provider and then submit it to their gaining provider before the switch can take place. This, therefore, provides an opportunity for the losing provider to notify their customers of all outstanding contractual liabilities (including ETCs) when their customer contacts them to obtain a MAC.

- Mobile services require a Port Authorising Code (PAC)²⁴ – this works along similar lines to broadband switching as it requires the consumer to actively obtain an authorisation code from their existing provider and then submit it to their gaining provider before the switch can take place. Again, this, therefore, provides an opportunity for the losing provider to notify their customers of all outstanding contractual liabilities (including ETCs) when their customer contacts them to obtain a PAC.

Ofcom's decision

- 6.266 In light of the above, the final guidance has been amended so that it gives an indication of the general principles we consider likely to apply and the approach we are likely to take in considering the application of the Regulations to ETCs.
- 6.267 The final guidance confirms our view that terms providing for ETCs (which are default charges or charges analogous to default charges even if they do not apply on breach of contract) will not be core terms.
- 6.268 It also confirms that we consider it likely to be unfair if a supplier sought to recover in an ETC a sum that would put it in a better position than if the consumer had not terminated the contract early and instead performed what would be his contractual obligations (and no more). ETC terms having this effect would put the supplier in a better position, and the consumer in a worse one, than they would be in without the term. 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.
- 6.269 So, in setting ETCs, we consider a supplier must make a reasonable pre-estimate of the position it would have been in had the consumer not terminated the contract early, and instead done what the contract otherwise obliged him to do (and no more) (i.e. the losses it incurs because the contract is not performed for its fixed term). That involves making a reasonable pre-estimate of the costs it saves and the losses it can mitigate, and deducting those from the fixed contractual retail payments outstanding on termination.
- 6.270 That will include, for example, a pre-estimate of any variable costs the supplier saves on the particular contract terminated (or, in practice, on contracts for the type of services concerned with the types of consumers concerned), and of any network costs it saves in a particular, reasonable period averaged over the group of consumers terminating contracts early.

²⁴ Ofcom is currently looking at the case for further improvements to the mobile porting process following the Competition Appeal Tribunal's decision to revert the November 2008 Mobile porting decision matter to Ofcom. There are two aspects of the mobile porting process we are reviewing. The first is changing the process from donor led to recipient led. The UK is quite unique in considering a move from a donor to recipient led process. Secondly, we are exploring whether there are genuine benefits to consumers from a faster than 2 day porting process.

6.271 So, the final guidance sets out, we consider that an ETC is likely to be fair where:

- 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 the method by which this would be calculated e.g. the amount that would be charged for each outstanding month);
- it is never greater than the amount of the (usually monthly) contractual retail payments remaining due at the date of termination;
- it also takes account of any costs associated with the provision of the service which will no longer be incurred, including any:
 - variable costs which can be avoided; and
 - 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);
- it reflects any ability of the supplier to reduce its loss by 'reselling' the service to a new consumer; and
- it makes allowance for the supplier's accelerated receipt of any sums.

6.272 The final guidance also confirms we do not consider that it is likely to be fair to include in an ETC recovery of anticipated profits from charges, or other sources of revenue, which are not themselves part of the consumer's contractual obligations (assuming the consumer would not do things, and incur costs, where he is not required to do so under the contract). It confirms we think the same would normally apply to sums in respect of 'lost' revenues from incoming call termination charges for fixed voice and mobile phone services.

6.273 We also set out in the final guidance that there is an alternative basis on which, in our view, a likely fair ETC may be recovered: the recovery of a supplier's unrecouped expenditure on the early terminated contract.

Section 7

Minimum notice periods and early termination charges for subsequent contracts

Description of the charge

- 7.1 Following the expiry of an initial MCP, most contracts will continue indefinitely until one of the parties terminates it, in which case the contractual minimum notice period will apply. There are a number of circumstances which will trigger the commencement of a subsequent MCP ('SMCP'), and these may occur either during the initial MCP, or after it has expired.
- 7.2 For mobile phones, this will most commonly happen when a consumer makes a new commitment 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 (e.g. changing broadband speed, moving to a fixed voice package with a different combination of included calls) and moving house.
- 7.3 In almost all cases where a SMCP applies before the previous MCP has ended, the consumer is not required to pay any ETC in respect of the previous MCP, no matter how early in that MCP the new MCP commences.
- 7.4 We are also aware of contracts which are automatically renewed for a SMCP at the end of each existing MCP, without there being any change in circumstances. The trigger in these cases has simply been reaching the end of the existing MCP.

Ofcom's proposed guidance

- 7.5 We consulted on the following proposed guidance:
- terms in contracts which impose SMCPs on the occurrence of certain events (hereafter 'SMCP terms') are not core terms - they are outside the main subject matter of the contract – and are subject to the fairness test;
 - we are likely to consider such SMCP terms to be fair where:
 - they are transparent to consumers within the contract at the point of sale;
 - the term sets out that the supplier will make it very clear to the consumer that the trigger event will activate a SMCP, and the length of that SMCP, at the point that the consumer is considering the event;
 - the costs incurred by the supplier in relation to the subsequent contract are the same as, analogous to, or commensurate with, those under the original contract; and
 - the benefits to the consumer under the subsequent contract and the length of the new MCP are the same as, or analogous to, or commensurate with, those under the original contract;

- amongst others, we are also likely to consider unfair terms providing for automatic renewal on reaching the end of an existing MCP, on the basis there is likely to be no cost to the supplier, and no benefit to the consumer, associated with that renewal; and
- ETCs on early termination of SMCPs must also be fair.

Stakeholder responses

7.6 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Positive responses

Agreement that terms imposing SMCPs are not core terms.

- 7.7 Two suppliers agreed that SMCP terms are not core terms. A further supplier also appeared to agree that such terms applying automatically to renew a fixed term contract - unless the consumer opts out - are not core terms (it made submissions about the unfairness of such terms which are only relevant if it accepted the terms are not core).
- 7.8 Another supplier's view was that although the SMCP terms might be core terms, the question is academic because a SMCP can only be enforced where the ETC is fair.

Negative responses

Terms are not always non-core terms subject to the test of fairness.

- 7.9 One supplier said the guidance should distinguish between:
- SMCP terms that extend or re-start contracts on the happening of standard events like moving home or service upgrades; and
 - scenarios where consumers enter whole new contracts on different terms (e.g. on expiry of minimum terms or in response to special offers where there is no SMCP term in the original contract).
- 7.10 It said that, in the former case, the SMCP terms may be core terms, maybe not. It said that if terms providing for automatic renewal of a contract are sufficiently clear, there is a strong argument they are core terms. It said that in the latter case the MCP would be a core term of a new contract.
- 7.11 MNOs also disagreed with the guidance. They appeared in some cases to dispute even the possibility of the fairness test applying:
- One MNO said our proposals seem to assume consumers have a unilateral right to vary the terms of their contracts.
 - Another agreed that SMCP terms relating to automatic renewal and service downgrades are probably not core terms, but said where a consumer signs a new contract for a new handset on a new tariff any new MCP is a core term.

- Another MNO said there is no basis for treating a SMCP differently to a MCP: the SMCP is merely another bargain and the consumer is free to choose another provider.
- A fourth MNO also disagreed that SMCP terms are non-core, especially in relation to handset upgrades. It submitted that Ofcom is wrong to say it is unrealistic that a reasonable consumer would consider the SMCP as part of the contract's main subject matter, because the ability to upgrade is often one of the most important considerations for consumers.

Ofcom is assessing adequacy of price

- 7.12 One MNO said there is no basis for assessing the adequacy of the remuneration for the SMCP or considering the fairness of the SMCP by investigating the cost to the supplier (these matters, or the first at least, are exempt from the fairness test by virtue of Regulation 6(2)(b)). We have referred to this response here as a 'core terms' response, though we acknowledge it may also go to our proposed position on the fairness test.

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Agreement with Ofcom's proposals on fairness

- 7.13 One consumer stakeholder agreed with our, '... approach that these contract terms should be transparent and fair.' Another agreed SMCPs may be necessary where there is a tangible benefit to the consumer and cost to the supplier, but not otherwise.
- 7.14 There was agreement among some suppliers (five of them) with the principle that there should be a benefit to the consumer (or a cost to the supplier) and that in some cases SMCPs would not be fair.
- 7.15 One of these suppliers agreed SMCPs will only be fair where the supplier has to make new investment or incur additional cost, or there is a tangible benefit to the consumer which he would not enjoy without the SMCP.

Partial agreement with Ofcom's fairness proposals

- 7.16 One MNO agreed (in part) with our proposals about when a SMCP will be unfair, but disagreed with the proposed conditions for a SMCP to be fair. It said:
- many offers, which change regularly, can trigger SMCPs, and not all will be known or exist at the time the original contract is entered into;
 - there is no logic to the position that the costs and benefits under the SMCP must be the same as, or commensurate with, those under the original contract;
 - instead, a SMCP should be (fairly) imposed only where it is commensurate with the benefit given to the consumer;
 - we should clarify what we mean by 'costs' to the supplier (does it include loss of revenue?); and

- we should consider the impact of our proposals – if they meant offers to consumers are withdrawn that would not be in the best interests of consumers or competition.

Negative responses

No justification for SMCP

- 7.17 Some consumers expressed concern over the requirement to enter into SMCPs on moving home. Similarly, one consumer stakeholder said it could see no justification for locking existing customers into new contracts because they move home or up/down-grade services.

Automatically renewed contracts are unfair - more clarification is needed

- 7.18 One supplier said the guidance needs to address separately SMCPs arising by negative opt-out and those arising ‘conventionally’ through an opt-in. The guidance should be clearer about renewable contracts involving opt outs (rather than opt ins). Its view was that opt out mechanisms in fixed-term communications contracts are unfair because:

- they do not require the consumer’s positive consent to renewal at the relevant time;
- instead, they require the consumer to take positive steps to prevent the renewal of a fixed-term, which may be an unreasonable burden on the consumer that exploits an imbalance between the contracting parties;
- no measures provide a consumer with the legal certainty and protection that a requirement for positive consent (or “opt-in”) provides; and
- opt-out clauses are liable to fall foul of paragraphs 1i-k of Schedule 2 to the Regulations which refer to terms:
 - ‘(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
 - (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract; and
 - (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided.’

- 7.19 Another supplier also said terms providing for automatic renewal of MCPs - unless consumers opt-out - are unfair.

Automatically renewed contracts may be fair

- 7.20 We have also received submissions from one supplier that contract terms providing for automatic renewal of fixed term contracts are fair where:

- consumers make a positive choice to ‘opt-in’ to the automatic renewal terms;

- there is no limited, or unreasonably early, 'window' within which notice of termination must be given; and
- the supplier undertakes to issue consumers with reminder notices.

It also said the context of the contractual offering is important in the assessment of fairness.

Ofcom's consideration of and response to stakeholders' consultation responses

Core terms

Positive responses

Agreement that terms imposing SMCPs are not core terms

- 7.21 Ofcom notes that there was not universal agreement over whether such terms are core or non-core. A small number of suppliers agreed they are non-core. More, however, disagreed.

Negative responses

Terms are not always non-core terms subject to the test of fairness

- 7.22 It appears to us that a number of suppliers' responses were concerned with the same general point: that in some cases what will arise where a consumer agrees to changes in terms or services is a whole new contract on new terms, in which the MCP is a core term, not a continuing contract with a non-core SMCP term.
- 7.23 We agree there are some cases where it is likely the correct analysis is that an existing consumer has entered into a new contract with their supplier and its fixed term will be a core term of that contract. An example would be where such a consumer, part way through one fixed term contract, responds to an offer from the supplier of a new free handset and a new inclusive contractual package and to which a new set of terms and conditions apply. In that case, there may well be a new contract, with a new initial MCP which is likely to be a core term of that contract.
- 7.24 Our proposals, however, were principally concerned with terms of existing contracts that provide for changes to aspects of the contract, such as a change of package/tariff or moving home, but impose a SMCP in return²⁵. We have amended the final guidance to make this distinction clearer (and have called the relevant terms 'SMCP terms,' not 'trigger terms').
- 7.25 We have also considered the response that said SMCP terms are often core terms - especially in relation to handset upgrades - because the ability to upgrade is often one of the most important considerations for consumers. Alongside this, we have considered whether terms providing for automatic renewal of a contract which are sufficiently clear may be core terms. That question appears to us to go to the same or a similar point.

²⁵ In proposing guidance on these issues, we do not assume that consumers have unilateral rights to vary their contracts. We are concerned with terms that apply where they request such variations.

- 7.26 We acknowledge that the ability to upgrade handsets (or other services) may well be important to particular consumers. However, it does not seem to us to follow that terms to the effect that 'where a handset is upgraded, a new MCP of X months will apply' are – or are likely to be – core terms (even though they may be fair terms). Likewise, terms providing for automatic renewal of a MCP.
- 7.27 Again, we note the courts have made clear that the core terms exemption in Regulation 6(2) is to be construed narrowly. And, we note again what the House of Lords said in the *First National Bank* case about:
- '...[the] important 'distinction between the term or terms which express the substance of the bargain and "incidental" (if important) terms which surround them'.....;' and
- that Regulation 6(2) should not be, '....so broadly interpreted as to cover any terms other than those falling squarely within it.'
- 7.28 We consider this sort of analysis is likely to apply to terms imposing SMCPs, including automatic renewal terms, so as to mean they fall outside the core terms exemption. Those terms are 'incidental (if important)' to the bargain concerned. They are about what happens when one of the details of the relevant contract changes (or the agreed MCP ends) and the fixed term is extended or renewed. That is not part of the substance of the bargain under the contract in the restrictive sense envisaged by the core terms exemption and confirmed by the House of Lords. We therefore confirm our proposed position that SMCP terms are likely to be non-core terms.
- 7.29 We have also considered the response that there is no basis for treating a SMCP differently to a MCP: the SMCP is merely another bargain and the consumer is free to choose another provider. We take the view a similar analysis applies here also.
- 7.30 As we say above, we are concerned here with terms that provide for changes to aspects of the contract, such as a change of package/tariff or moving home, but impose a SMCP in return. Given the restrictive sense in which the courts have interpreted the core terms exemption (see above), the terms which impose a SMCP on the happening of certain events or in certain circumstances are not the same as the terms providing for the initial fixed MCP that applies to the contract. The latter is in our view likely to be a core term. The former, however, are unlikely in our view to be terms which express the substance of the bargain. Rather, they are likely to be incidental (if important) terms which surround that substance. Such terms are unlikely to fall squarely within the core terms exemption.

Ofcom is assessing adequacy of price

- 7.31 One MNO said there was no basis for assessing the adequacy of the remuneration for the SMCP or considering the fairness of the SMCP by investigating the cost to the supplier (these matters, or the first at least, are exempt from the fairness test by virtue of Regulation 6(2)(b)).
- 7.32 As we have noted elsewhere in this statement, we agree that what is exempt from the test of fairness under Regulation 6(2)(b) (the core terms exemption) is an assessment of the adequacy of the price received by a supplier for the goods or services he provides in exchange. The Regulations are not a mechanism for price or quality control.

- 7.33 But, that 'price' is not what we proposed should be assessed for fairness in relation to SMCP terms. We proposed, first, that SMCP terms are not core terms because they are outside the main subject matter of the contract. We now note (above), the restrictive interpretation the courts have placed on the core terms exemption.
- 7.34 And, we proposed that SMCP terms may be fair where - amongst other things - there is a certain cost to the supplier or benefit to the consumer in connection with the SMCP. That, we consider, is not an assessment of the price under the contract in the restrictive sense with which the courts have said the core terms exemption must be construed, or at all. It is part of an assessment of terms that we consider are likely to be incidental (if important) terms which surround the substance of the contractual bargain, not terms falling squarely within the core terms exemption.

Test of fairness

Positive responses

Agreement with Ofcom's proposals on fairness

- 7.35 We note that five suppliers agreed that these terms may be unfair where there is not a tangible benefit to consumers and/or suppliers do not have to make new investment in return for a SMCP. Two of the three consumer stakeholders who commented also offered at least some support for Ofcom's proposals as to the fairness of SMCP terms.

Partial agreement with Ofcom's fairness proposals

- 7.36 We note also one MNO agreed in part with our proposal, but said the logical position is that a SMCP term may be fair where the benefits to the consumer are commensurate with the SMCP (rather than, necessarily, with the costs and benefits under the original MCP).
- 7.37 We agree with the logic proposed in this response. What is key to the likely fairness of the SMCP term is that the supplier incurs a cost (which would include foregoing revenue by, for example, offering a discount) and the consumer receives a benefit commensurate with the burden of the SMCP imposed on him. That way there is less likely a significant imbalance, to the consumer's detriment, caused by the SMCP terms. That was the logic we sought to capture in our proposed position. We accept this consultation response achieves that better and have amended the final guidance accordingly.
- 7.38 That means, in our view, the costs and benefits under the SMCP should be at least the same as, analogous to, or commensurate with, those under the original contract, where the SMCP is the same as the MCP. But, they need not be so where the SMCP is shorter.
- 7.39 We have considered one stakeholder's suggestion that our proposals would lead to commercial offerings being withdrawn and that this would not be in the best interests of consumers or competition. We do not see why this will necessarily be the case, for two reasons. First, as we acknowledge, where a new commercial offer is made to a consumer, on new terms, what may arise is a new contract in which the MCP is a core term, exempt from the fairness test. Second, our view of the fairness test is that a SMCP term may be fair where the supplier incurs a cost and the consumer receives a benefit commensurate with the burden of the SMCP imposed on him. One might suppose that may well be the case with commercial offerings made to

consumers. We also re-iterate the point made elsewhere in this statement that, in any event, the fact the law has a particular impact does not mean that impact could be used to justify terms that, in our view, do not comply with that law.

Negative responses

No justification for SMCP

- 7.40 As to the consumer stakeholder which said there is no justification for SMCPs where consumers move home or up/down-grade services, we disagree. Where a supplier incurs costs and provides benefits to a consumer we consider a fixed term commitment in which the costs may be recovered, may be fair.

Automatically renewed contracts are unfair - more clarification is needed

- 7.41 Two suppliers raised concerns about, or requested clarification of, our proposed guidance on terms providing for automatic renewal (where the consumer must opt-out, not in, to the renewal). They said such terms are unfair, one for the detailed reasons set out above. By contrast, one supplier has made submissions to us that contract terms providing for automatic renewal of fixed term contracts may be fair, as outlined above.
- 7.42 Ofcom's proposed guidance said we are likely to consider the requirement for a SMCP to be unfair where there is automatic renewal of a contract on expiry of the MCP, on the basis there is unlikely to be any associated cost to the supplier or benefit to the consumer. It was intended to indicate a proposed position that terms providing simply for the automatic renewal of a contract on the expiry of a fixed term, without any accompanying benefits and safeguards for the consumer (such as those proposed in paragraph A5.80 of the draft guidance), would be unfair.
- 7.43 In other words, it was intended to indicate that such a renewal term will raise concerns about fairness. And, in this connection, we note that paragraph 1(h) of Schedule 2 to the UTCCRs gives one example of when automatic renewal terms may be unfair (which appears to us a more relevant provision of that Schedule than those referred to by one supplier). It was not intended to indicate that such a term will necessarily and automatically be unfair in every case.
- 7.44 In our view, it is an important principle that parties should choose to enter contracts freely (which also normally means actively) rather than finding themselves bound as a result of doing nothing. That is true even where freedom of contract is unrestrained, and all the more so where that freedom is constrained by the Regulations.
- 7.45 Our concern about automatic renewal terms is that they may be used to exploit a consumer's ignorance or inertia to tie him to a series of fixed-term contracts, where otherwise he would have to 'opt-in,' without him necessarily receiving any commensurate benefit. As the OFT's general guidance on the Regulations states, the concern with automatic renewal terms is that they may have the effect of consumers experiencing an unintended extension to their payment obligations²⁶.
- 7.46 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.*'

²⁶ http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/oft311.pdf (paragraph 8.3)

Namely, the burden of having to take steps to avoid a contract that is otherwise imposed on him - when in fact his 'fair' right is only to be bound by contracts he takes active steps to enter - without receiving any counter-balancing benefit.

7.47 However, we also consider that the possible unfairness of automatic renewal terms may be counter-balanced by a number of other terms and conditions in the same contract and we would assess whether these sufficiently redressed the potentially significant imbalance identified above, in a similar way to other SMCP terms.

7.48 In assessing any such term for fairness we would expect to have regard to the full set of conditions which relate to the automatic renewal term. We would consider:

- whether the term itself is transparent, so that a consumer signing up to the contract could be expected to understand the automatic renewal aspect of the contract and be in a position to protect his rights and interests;
- whether there is a term which ensures that the consumer will be aware that the automatic renewal is going to happen at a stage when they can still prevent this (or provides for some equivalent measure like a charge-free cancellation period of reasonable duration and to sending a reminder of that period at the time of renewal). For example, we might expect there to be a term which commits the supplier to sending a clear and unambiguous reminder notice at the appropriate time. That is, a contractual term providing a mechanism to go towards countering the possible unfair imbalance under the contract arising out of the automatic binding nature of the renewal term. It would do so if it gave contractual and practical effect to the possibility of ensuring the consumer's awareness of the impending renewal and effect to his right to avoid it;
- whether the terms provide for an opt-out mechanism that is clear and easily effected by the consumer, without any unnecessary formal or procedural requirements: we see no reason why an opt-out would need to be written, still less subject to any other formal requirements (such as use of registered post);
- whether there is a commensurate benefit to the consumer and a cost to the supplier, i.e. whether the consumer is getting a commensurate benefit in return for their renewed commitment, again going towards balancing the possible unfair imbalance the renewal term may otherwise cause;
- whether there are any other terms which seek to restrict the opt-out window or require too long a notice period: consumers should not have an unduly short time to opt-out of any renewal nor have to decide whether to do so at a time before they can properly assess and determine their needs and interests (there should also, in any event, be a term allowing early termination at any time on payment of a 'fair' ETC). Otherwise, the unfair imbalance in the contract may remain; and
- it would also be relevant to ensure that the ETC was likely to be fair, according to our guidance (and any concerns we may have about automatic renewal would also be reduced where the fair ETC also happened to be a relatively low amount, so that a consumer could, in any event, have a fair and effective right to avoid the effect of the renewed term).

7.49 We consider that such renewal terms are more likely to be unfair where one or more of the following applies:

- the renewal term itself is not transparent in the contract at the point of sale;

- there is no accompanying term which commits the supplier to sending a clear and unambiguous reminder notice at a reasonable time before the renewal term is to take effect (or to some equivalent measure like a charge-free cancellation period of reasonable duration and to sending a reminder of that period at the time of renewal);
- the terms do not provide for a clear and easily effected opt-out mechanism, without unnecessary formal or procedural requirements;
- there is no cost to the supplier and no benefit to the consumer commensurate to the renewed obligation the consumer takes on;
- there are other terms which seek to restrict the opt-out window or require too long a notice period; and/or
- the ETC is unfair (or so high as to have a prohibitive effect on the consumer's right to terminate).

7.50 We have changed the final guidance accordingly to make these views clear.

7.51 We also consider that it is important any reminder notice relating to automatic renewal 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:

- be sent at an appropriate point in time (neither too close nor too far away from the renewal date);
- be written in plain, intelligible language;
- should have the explanation about the automatic renewal as the only (or main) subject of the letter; and
- should make it clear what the consumer needs to do to prevent the automatic renewal (which opt-out mechanism should be clear and easy to effect in line with the contract terms).

7.52 Even if the above points would not generally be covered by the Regulations, we would expect them to be matters of good and fair business practice. We will refer to them in our final guidance. In any case where it became apparent these 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.

7.53 Ofcom also considers that it is possible that 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 nonetheless has adverse consequences for competition. These concerns are outside the scope of our guidance but they may be the subject of further Ofcom consideration.

7.54 There is significant evidence from other contexts that consumers are subject to a 'default bias'²⁷. In other words, they are significantly influenced by the manner in

²⁷ For example, in the case of pensions, see Madrian, B. C. and D. F. Shea (2001) "The power of suggestion: inertia in 401(k) participation and savings behaviour", *Quarterly Journal of Economics*

which options are put to them and are far more likely to go with the 'default' option. If the default bias affects consumer behaviour in the context of this term then there is a risk the opt-out clause steers more people into a renewed contract even when this is not in their best interests.

7.55 Where this occurs there may be two effects:

- consumers might have a reduced ability to switch suppliers or services preventing them from selecting the most appropriate offer in the market; and
- competition may be softened leading to higher prices and lower innovation generally.

7.56 Our concerns about these effects are difficult to quantify and Ofcom may need to undertake further research and seek further evidence of the effects of these kinds of terms. It is possible concerns about the impact on competition will be less in cases where the relevant ETC is low enough such that consumers switching decisions are not impacted by the ETC.

7.57 It is also possible – as with any other terms covered in our guidance – that the use and/or advertising and marketing of automatic renewal terms may cause concerns under other consumer protection laws, such as the CPRs, even if they are fair under the Regulations. We may, of course, consider that further in future.

Ofcom's decision

7.58 In light of the above, we have amended our proposed guidance as indicated, and confirm in the final guidance the following:

- the guidance is principally concerned with terms that provide for changes to aspects of the contract, such as a change of package/tariff or moving home, but impose a SMCP in return;
- we acknowledge there may be some circumstances where a consumer agrees to new terms and services and what arises is a new contract between the supplier and the consumer, on new terms, and in which the MCP may be a core term;
- we consider that SMCP terms are likely to be non-core terms;
- we have amended the conditions under which we consider SMCP terms may be fair, to say that they may be fair where, amongst other things, the benefit to the consumer and/or cost to the supplier is commensurate with the SMCP (rather than costs or benefits under the original contract) (otherwise, those conditions are unchanged);
- we clarify our position in relation to automatic renewal terms (including that these terms raise some concerns, but will not always be legally unfair), and, as set out above, have included conditions under which we consider such terms are more likely to be unfair; and
- have added to the guidance some additional points in relation to transparency around automatic renewal terms and opt-out mechanisms (again, as set out above).

Section 8

Minimum notice periods

Description of the charge

- 8.1 Even where there is no MCP, suppliers require consumers to provide formal notification of an intention to terminate a contract where regular payments are made directly to the supplier (as opposed, for example, to pre-pay mobile telephony and narrowband Internet services). The minimum notice period (MiNP)²⁸ is usually either 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 earlier.
- 8.2 There are some exceptions to the one month notice period, particularly for fixed voice services, where suppliers often either have a 15 day MiNP or say that the notice period will follow the migrations process for fixed voice (which is 10 working days – so similar to 15 calendar days).

Ofcom's proposed guidance

- 8.3 In the consultation we proposed the following view:
- Long MiNPs increase the risk of paying twice for a service. Low income consumers can least afford this additional amount. It is essential that MiNPs are no longer than they need to be.
 - Suppliers should not set MiNPs for a period longer than needed to perform some basic administrative processes and to manage the underlying transfer of wholesale services.
 - Some MiNPs set by suppliers need to be reduced, especially for broadband services.
- 8.4 We also proposed that MiNPs can have the effect of deterring switching, if the consumer perceives that co-ordinating start and leave dates is too complex and they risk either a period of paying for a service twice, or a period when they may have no service at all.
- 8.5 Ofcom proposed this draft guidance:
- any term providing for a MiNP is not part of the main subject matter of the contract, so is not a core term and is subject to the fairness test;
 - we are likely to consider such terms fair where:
 - they are transparent to consumers within the contract at the point of sale;
 - the MiNP reflects a reasonable period to carry out the necessary administration of terminating the service; and
 - the MiNP is no longer than any formal service migration process that applies.

²⁸ In the consultation we referred to 'MNP's'. In this statement we have changed this to 'MiNPs' to avoid any confusion with Mobile Number Portability (widely known as 'MNP').

- 8.6 We also proposed that, provided a formal migration process does not apply, we would be unlikely to consider taking action against MiNPs of less than 30 days or one calendar month.
- 8.7 We further proposed that it is important that suppliers make it very clear to consumers what the MiNP is at the point at which the consumer is considering terminating their contract. We said we would expect that suppliers already do this as a matter of good business practice – it is in a supplier's interest to ensure a consumer understands the implications of terminating their contract.
- 8.8 Since termination plainly takes place after the conclusion of the contract, the above point is not covered by the Regulations, and we proposed it as a matter of best practice. We further proposed that if this became a problem area, we would consider the case for using sector specific regulation regarding this point.

Stakeholder responses

- 8.9 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Positive responses

MiNP terms are not core terms.

- 8.10 Two consumer stakeholders agreed that MiNPs are not core terms and so subject to the fairness test. No suppliers disagreed with Ofcom's proposal that the MiNP term is non-core.
- 8.11 One supplier said it would be reviewing its MiNP against the guidance.

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Agreement with Ofcom's proposals on fairness.

- 8.12 Two consumer stakeholders agreed that these contract terms should be transparent and fair (though one also said the General Conditions should be amended to require provision of post-contractual information on MiNPs).
- 8.13 Another consumer stakeholder also agreed MiNPs should be no longer than the administrative processes required to terminate contracts.
- 8.14 One consumer stakeholder thought one month was unlikely to be unreasonable.
- 8.15 Four suppliers agreed with our proposed position (though one also said 'alignment' with wholesale suppliers is required). One MNO agreed a MiNP which is unduly long for no good reason is unfair. And, another supplier said MiNPs should only be used where there are 'genuine operational reasons.'

Negative responses

The processes for migration and terminating contracts are separate and there is no coincidence

- 8.16 The main area where greater clarity was requested was over MiNPs in mobile contracts: MNOs wanted to understand how the guidance applied to mobile number portability where the time to port a number was expected to reduce to two hours in 2009.
- 8.17 One MNO queried whether we propose that notice periods of more than two hours are unfair for MNOs. It said a two hour period would contravene the principle of technology neutrality. It also said the processes for porting - which are automated - and for administration of termination of contracts - which involve manual administration - are separate and the latter take longer. Another MNO made the same point about the distinction between migration and termination processes.
- 8.18 One supplier asked for greater clarity as to what happens where there are different migrations processes for different parts of the service.

MiNPs as a barrier to switching

- 8.19 One MNO said MiNPs could not possibly be a switching barrier where migrations must occur within set timescales.
- 8.20 However, another supplier argued that MiNPs are part of the terms used to deter switching between providers.

Comments on Ofcom's best practice proposals

- 8.21 Some suppliers also commented that Ofcom's 'best practice' proposals need to be consistent with migrations processes, and recognise that losing providers may not have the opportunity to inform the consumer of the MiNP.

Ofcom's consideration of and response to stakeholders' consultation responses

Core terms

Positive responses

MiNP terms are not core terms.

- 8.22 We note the consultation responses' general agreement (as far any view was expressed) with our proposed guidance that MiNP terms are not core terms, and the lack of disagreement with that guidance. Accordingly, we substantially confirm that position in our final guidance, amending it only slightly so as to refer to our view that MiNP terms are 'unlikely' to be part of the main subject matter of the contract and that terms providing for a MiNP are 'likely' to be non core terms.

Test of fairness

Positive responses

Agreement with Ofcom's proposals on fairness.

- 8.23 We note that to the extent they responded, consumer stakeholders and fixed voice and broadband suppliers tended to agree with our proposed position. We also note that, amongst MNOs, one agreed that unduly long MiNPs are unfair.
- 8.24 As set out in paragraph 3.80, we acknowledge that one consumer stakeholder who agreed with our proposals also said we should improve post contractual information by amendment to the General Conditions. But, that is outside the scope of the Regulations, which relate only to contractual terms (see paragraph 3.92).

Negative responses

The processes for migration and terminating contracts are separate and there is no coincidence)

- 8.25 We note also that MNOs questioned how our proposal that MiNPs correspond with time periods for service migration under formal migration processes could work where mobile number portability was expected to reduce to two hours in 2009. We note two MNOs also said the processes for porting are automated and separate from the manual processes for administration of the termination of contracts, and the latter take longer.
- 8.26 The current period for mobile number portability under the formal migrations process is 48 hours. We accept that, in any event, however, the administrative processes around a consumer giving notice and contract termination will not necessarily coincide with the period required for migrations processes. We accept also that a fair MiNP need not be as little as two hours, even if the formal service migrations process is that short. We accept that, on the face of it, such a short MiNP would also be impractical. We have, therefore, further considered our position.
- 8.27 We also note, nonetheless, that fixed voice and broadband suppliers, to whom formal migrations processes likely to take 5+ working days apply, did not disagree with our proposals as far as they are concerned. That period appears to us, and it seems to relevant stakeholders, to be long enough, notwithstanding that processes for service migration and contract termination are separate.
- 8.28 In the case of bundled products, the same key principle will apply – likely fair MiNPs should be no longer than the period reasonably necessary for the administration connected with the termination of the contract. In practice, this may mean a fair MiNP should reflect the longer of the periods that would (fairly) apply were the services provided individually.

MiNPs as a barrier to switching

- 8.29 We agree MiNPs could have the effect of deterring switching where they are too long. That - and the possible broader effects of a term on competition - are not, however, considerations that bear directly on the question of whether a term is unfair under the Regulations.

- 8.30 That question is concerned with the fairness of terms between the supplier and the consumer to whom they apply. We proposed in the consultation document and the draft guidance, and now set out in the final guidance, our view of when a MiNP is likely to be unfair (as an excessive period). We note that one consequence of this may be to reduce the effect of MiNPs as a switching barrier.

Comments on Ofcom's best practice proposals

- 8.31 In the consultation Ofcom set out that as a matter of best practice we would expect suppliers to inform consumers of the MiNP at the point that they ask to cancel their contract. Some suppliers commented that this conflicts with some migrations processes where these are gaining-provider led, and the initial consumer contact will be with the new supplier, not the current supplier.
- 8.32 For the reasons set out in Section 6 (on ETCs – see paragraph 6.264) we would generally expect that the losing provider has the opportunity to, and should, inform the consumer of any MiNP they will be subject to.

Ofcom's decision

- 8.33 In light of the stakeholder consultation responses, and our consideration of them, as set out above, we confirm in the final guidance the position on core terms described above. Namely, that MiNP terms are unlikely to be part of the main subject matter of the contract and unlikely to be core terms.
- 8.34 As to fairness, we have changed the final guidance in some ways, so it is as follows:
- we consider a term providing for an MiNP is likely to be fair where the MiNP:
 - is transparent to consumers within the contract at the point of sale; and
 - reflects a reasonable period in which to carry out the necessary administration of terminating the contract;
 - the key principle, which is substantially unchanged, is that we consider likely fair MiNPs should be no longer than the period reasonably necessary for the administration connected with the termination of the contract. We note that this is accepted even by one MNO which otherwise questioned our proposed position;
 - for fixed voice and broadband services that reasonably necessary period should be no longer than the formal migration process;
 - for mobile, and in any sector where no formal migration process applies, the period should be no longer than reasonably necessary for the required administration, and we see no reason why this should in any event ever be longer than 30 days or one calendar month; and
 - we have removed the reference to our enforcement priorities so that there is no discrimination in favour of suppliers providing particular types of services.

Section 9

Itemised and paper billing

Description of the charge

- 9.1 While most suppliers provide at least a basic level of billing free by post, some make a charge for providing full or enhanced bills by that means. However, most suppliers who make a specific charge for itemised billing by post also provide online itemised bills for no extra charge.
- 9.2 Although some suppliers make a charge for sending any level of bill by post, of those we examined during the consultation the only ones to do so were those who provided broadband services and where - by definition - consumers have access to online bills.
- 9.3 Charges tend to range from 50 pence up to around £1.50 a month. However, not all consumers will pay these charges (e.g. consumers on legacy contracts may not pay them, or the charges may be waived for consumers on higher value packages).
- 9.4 We are aware that, since the consultation began, more suppliers have introduced itemised billing charges, particularly for fixed voice services.

Ofcom's proposed guidance

- 9.5 We consulted on the following proposed position in the draft guidance:
- such charges may be core terms exempt from the Regulations' fairness test where they are:
 - in plain intelligible language;
 - are part of the price for the main service(s) and the essential bargain under the relevant contract because they are set out in such a way that the consumer would be aware:
 - they are part of the price for a package of services under the contract; and
 - of the level of information or billing provided by comparison with the basic, or standard, level of billing.
 - where such charges are not core terms and the fairness test applies, it may be fair for them to seek to recover suppliers' additional costs directly attributable to the relevant type of billing (e.g. reasonable incremental costs of paper, printing, postage, and information processing, over and above those incurred for basic, or paperless, billing).
- 9.6 In addition to the above, Ofcom proposed that it is important that bills should clearly detail the level of any such charges as a separate line item. However, since bills are sent out after the conclusion of the contract, this is not covered by the Regulations and this was proposed as a matter of best practice.
- 9.7 We also noted that suppliers are subject to the General Conditions, including GC12 on itemised bills. This requires suppliers to provide at least a basic level of itemised

billing, which should have a sufficient level of detail to allow consumers to verify and control the charges incurred. Ofcom has not previously determined what minimum level of itemisation is required to meet this condition. But, if we became aware that bills did not present itemised billing charges sufficiently transparently we said we would consider opening a new review to look at GC12 and to determine if and how this could be used to achieve the 'best practice' proposed.

Stakeholder responses

9.8 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

9.9 Most stakeholders did not comment on whether these charges were core or non-core terms.

Positive responses

Terms may be core or non-core.

9.10 Generally, suppliers agreed that these charges should be clear. One MNO agreed these charges may be core or non-core terms. Another supplier agreed with our approach and conclusions.

9.11 Consumers and consumer stakeholders did not comment expressly on whether these terms are core terms. Some did respond on their fairness (see below), which, presumably, suggests they would not regard these terms as core.

Negative responses

Such terms are always core terms

9.12 One supplier said its charge for itemised billing is a core term. It said the charge is part of the essential bargain communicated in plain intelligible language to the consumer because the consumer must opt-in to receiving an itemised paper bill (at which point it is clear they pay an extra charge).

Disagreement with Ofcom's proposals for prominence

9.13 Some suppliers said these terms are already clear to consumers and, as with non-DD charges, disputed the need for prominence. One MNO also said the information we proposed should be in marketing material to make the terms core was excessive and impractical.

Core terms need not define the main goods and services under the contract and be part of the price

9.14 One MNO said the proposed guidance wrongly suggested core terms must define the main goods and services under the contract and be part of the headline price for them (see paragraph A5.97 of the draft guidance).

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Agreement with Ofcom's proposals on fairness

- 9.15 Two suppliers indicated agreement with our proposals. One said it is not, '... fair and transparent to display line rental prices which make paper billing an additional charge.' The other said it agreed with our approach and conclusions.
- 9.16 Otherwise, some suppliers merely agreed with our proposal that there is little evidence of a need for further intervention in relation to these charges.

Negative responses

Such a charges are inherently unfair

- 9.17 Some consumers expressed concerns that offering lower charges for those who take paperless billing discriminates against those without computers/internet access (many of whom will be on lower incomes) and disabled customers who cannot use a computer.
- 9.18 Concerns were also expressed at charges for itemised billing (whether in paper or paperless form) as consumers receiving summary bills are unable to check charges are accurate and have no way of querying the bill.
- 9.19 Three consumer stakeholders suggested that all suppliers should be required to offer free itemised paper bills. One other said Ofcom should make a clear statement that all consumers should be given a free non-itemised paper bill. However, one also added that suppliers should be able to offer discounts where consumers choose paperless and/or non-itemised bills.
- 9.20 Another consumer stakeholder said we should undertake an immediate review of GC12 to lay down specific requirements for itemised bills.

Ofcom's consideration of and response to stakeholders' consultation responses

Core terms

Positive responses

Terms may be core or non-core

- 9.21 We note some of the consultation responses' general agreement with our proposals about when the relevant billing terms are core terms. For the reasons given above (about non-core terms generally in Section 3 and about non-DD charges in Section 4) and those that follow, we confirm the view that these charges may be core or non-core terms depending on their presentation to the consumer. As in relation to non-DD charges, we have also amended the final guidance about billing charges to contrast (1) those which are part of the price that is a core term with (2) incidental, additional charges that are separate from that price.

Negative responses

Such terms are core terms

- 9.22 We consider the general view in the paragraph immediately above is unaffected by the response from one supplier that its itemised billing charge is a core term because it is part of the essential bargain communicated in plain intelligible language to consumers (since consumers must opt-in to receiving an itemised bill, at which point it is clear they pay an extra charge).
- 9.23 As in relation to the same supplier's non-DD charge, we agree its itemised billing charge in these circumstances *may* be a core term. We do not express a view as to whether it is or not. However, in our view, the fact a consumer becomes aware of a charge before he enters a contract and/or has to pay that charge, does not necessarily make the term giving rise to it a core term. In our view, to be likely to be a core term, the charge must be presented to the consumer in such a way as he would consider it part of the price for the services he is buying, in line with our view of the general principles set out in paragraphs 3.123 – 3.134 above, rather than as a separate, incidental, additional charge.

Disagreement with Ofcom's proposals for prominence

- 9.24 Having considered what the consultation responses said about the need for prominence, we take the view, for the reasons given in paragraphs 3.123 – 3.134 above about non-core terms generally, that the prominence (and transparency) of terms is relevant to whether they are core terms.

Core terms need not define the main goods and services under the contract and be part of the price

- 9.25 As to the specific response that our proposed guidance wrongly suggested core terms must define the main goods and services under the contract and the price, we have considered this, and looked at particular points in the High Court's judgment in the case brought by the OFT about bank charges.
- 9.26 We acknowledge that following the publication of the consultation document in February 2008, the High Court said the two parts of the core terms exemption in Regulation 6(2) (a) and (b) are to be interpreted disjunctively. To be a core term, a term must either define the main subject matter of the contract *or* relate to the adequacy of the price in exchange for goods or services. It need not do both.
- 9.27 So we agree that, to the extent our guidance suggests a relevant billing charge must both define the subject matter of the contract and relate to the adequacy of the price, it requires amendment. We have therefore made changes to the latter part of what was paragraph A5.96 of the draft guidance explaining why we consider billing charges must meet certain requirements to be core terms. We have also removed from what were paragraphs A5.95 and A5.96 references to the price for the 'main' services under the contract and replaced them with references to the price for the 'services under the relevant contract'.
- 9.28 However, we take the view that to be core terms the relevant billing charges must be presented in such a way that the typical consumer would regard them as part of the price for the services he is buying under the contract and set out the level of billing information that that price buys. That requirement, we take the view on further

consideration in the light of this specific consultation response, arises out of the need for plain, intelligible language.

- 9.29 We note that in the OFT/banks case on overdraft charges the High Court said of the plain, intelligible language requirement that:

‘Regulation 6(2), as the OFT submits and as I accept, requires not only that the actual wording of individual clauses or conditions be comprehensible to consumers, but that the typical consumer can understand how the term affects the rights and obligations that he and the seller or supplier have under the contract.’

- 9.30 We consider this means that, in order the benefit from the Regulations’ core terms exemption, as terms relating to the adequacy of the price, relevant billing charges must be presented as part of that price and the consumer must know what is he getting for it. If he does not, the plain, intelligible language requirement is not met and the core terms exemption cannot apply.
- 9.31 We have also further considered, in light of the consultation response, the conditions we consider should be met before the relevant billing charges are likely to be core terms. We acknowledge that, whilst as a result of the plain, intelligible language requirement the contractual terms themselves should contain details of the level of billing information under each billing option, it is unlikely marketing material need do so.
- 9.32 Accordingly, we have amended the third and fourth conditions we set out in what was paragraph A5.97 of the draft guidance. We take the view, however, that other requirements relating to marketing material should be met before we consider these charges would at the forefront of the consumer’s mind when contracting and would be part of the price exempt, as a core term, from the Regulations’ fairness test. The same reasons apply here as in relation to other terms described elsewhere in this statement.

Test of fairness

Positive responses

Agreement with Ofcom’s proposals on fairness.

- 9.33 We note there was some agreement, and little opposition, from suppliers to our proposed guidance. Their responses were focused on agreeing with our proposed view that the current level of these charges means there is little need at present for enforcement action against them.

Negative responses

Such charges are inherently unfair

- 9.34 Ofcom acknowledges that some consumers and consumer groups are of the view that these billing charges should simply not be allowed. These stakeholders believe the charges are intrinsically unfair under the Regulations, because they unfairly penalise low income consumers, particularly the elderly.
- 9.35 We also recognise that there have been some changes in the market since we published our draft guidance for consultation, meaning that discounts/additional

charges for paperless/paper bills have in some cases been introduced or the level increased, particularly for fixed voice contracts. We acknowledge that the higher amount payable to receive a paper bill may be paid disproportionately by those on low incomes, as a group less likely to have internet access at home, or to have internet access at all. And, the impact of any charges we might consider unfair on low income consumers may be one factor in deciding whether action against those charges is an enforcement priority.

9.36 However, we take the view, as with non-DD charges, that:

- it is for competition, not regulation, to ensure that ‘core’ prices are set at an appropriate level;
- where charges form part of the price which is exempt from the test of fairness as a core term, consumers’ freedom of contract and competition will constrain that price; and
- Ofcom would not be able to ban these charges under the Regulations where costs can be demonstrated to be incurred. Nor under the Regulations could we reduce the charges below the level of such costs. Nonetheless, the guidance does set out how we consider the extent of these charges is likely to be limited under the Regulations where they are not within the core terms exemption.

9.37 As to the latter of the points above, we note, of course, that both ‘banning’ the charges and lowering their levels would be matters for the courts to decide. But, we think it unlikely the courts would disagree with our view on these points. We do not see that there is any basis under the Regulations, for saying that charges that recover relevant costs, or less, are likely to be unfair. That is, for saying such terms are likely to cause a ‘significant imbalance in the rights and obligations’ of supplier and consumer, to the consumer’s detriment, ‘contrary to the requirement of good faith.’

9.38 These points notwithstanding, we note there is also a general condition (GC 12) which relates to billing. In the event that concerns about billing charges increased, and could not be resolved under the Regulations, it would be open to Ofcom to review, and consult on possible variations to, that GC in order to address those concerns. We will consider this as a possible future option.

Ofcom’s decision

9.39 In light of the above, in the final guidance we confirm the view that the relevant billing charges may be considered core terms in some cases.

9.40 We make some changes:

- in light of the response about disjunctive nature of the Regulations’ core terms exemption and the plain, intelligible language requirement (as described above); and
- to the conditions we consider should be met before the relevant billing charges are likely to be core terms (again as described above), so that they read as follows:

‘To fulfil these requirements, we consider it likely the following conditions must all be met:

- the contract term and any marketing material must make clear in a prominent manner whether there are any separate billing options for which there are different charges;
- any such information must clearly set out what these options are, together with the price for each option. This must include whether the options are related to charges or discounts for receiving printed or Internet bills, and/or for different levels of billing information;
- where there are different levels of billing information which incur different charges, **the contract terms** must clearly set out what level of billing information is provided under each option; and
- the contract terms and the marketing material must set out **the required information** in such a way that the consumer who chooses itemised billing would regard that as part of the services he is buying under the contract.'

9.41 Also, in light of the above (the lack of disagreement by suppliers with our proposals, in particular), we substantially confirm our proposed guidance on the fairness test for these billing charges. We confirm we consider it may be fair for a supplier to include in these charges the reasonable additional costs it incurs which are directly attributable to the level of billing provided.

9.42 We also do not consider there is anything in the consultation responses suggesting we should alter our administrative threshold (of £1.50 per bill) relating to these charges. The threshold is, of course, subject to review. It may, for example, be changed if there is increasing evidence of consumer harm in relation to these charges.

Section 10

Cease charges

Description of the charge

10.1 These are charges levied by broadband suppliers when consumers stop taking the service (and do not transfer to another supplier who also uses BT's network). In general, these charges reflect wholesale charges levied by BT Openreach on termination of its wholesale agreement with the relevant broadband suppliers.

Ofcom's proposed guidance

10.2 We consulted on proposed guidance that we consider terms providing for cease charges are:

- not core terms – they are not part of what a reasonable consumer would consider to be the main subject matter of the contract or the price of the service – and so are subject to the test of fairness; and
- likely to be fair where they:
 - are transparent to consumers within the contract at the point of sale; and
 - reflect only the direct costs associated with ceasing service.

10.3 We note that at the time we published the consultation document the only cease charges we were aware of were suppliers passing on Openreach wholesale charges (of around £5) where the consumer completely ceases to receive broadband service (but not for a MAC²⁹ transfer). This wholesale charge has since increased to around £20 and we have started to see this charge passed through to consumers by some suppliers.

Stakeholder responses

10.4 Below is a summary of stakeholder responses. Annex 2 includes a fuller summary.

Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Positive responses

Agreement with Ofcom's proposed guidance.

10.5 Few responses were received to this question about this charge. One consumer stakeholder explicitly agreed these charges are not core terms. Only three suppliers expressed a view. They, too, agreed these charges are non-core terms.

²⁹ Migration Authorisation Code

Do you agree with Ofcom's proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

Positive responses

Agreement with Ofcom's proposed guidance.

- 10.6 Only five suppliers expressed a view. They agreed that these charges may fairly recover only direct costs.
- 10.7 Only two consumer stakeholders expressed a view (no consumers did). One of these agreed with our approach to fairness, though it added that such charges should not be made where consumers die, and that Ofcom should compel provision of post-contract information about the charges by amending General Condition 10.

Negative responses

Insufficient evidence provided to justify the level of the charge

- 10.8 The other consumer stakeholder who expressed a view said Ofcom had not provided enough information to justify the cost of these charges and that we should consider them again.

Ofcom's consideration of, and response to, stakeholders' consultation responses

Core terms

Positive responses

Agreement with Ofcom's proposed guidance

- 10.9 Those stakeholders who commented on Ofcom's proposed guidance regarding core terms and transparency agreed with our approach.

Test of fairness

Positive responses

Agreement with Ofcom's proposed guidance.

- 10.10 There was also a significant level of agreement (from those who expressed a view) with our proposed guidance on how we should apply the test of fairness.

Negative responses

Insufficient evidence provided to justify the level of the charge

- 10.11 We note that when we published our consultation document Openreach had not fully implemented the cease processes and accordingly only levied a nominal administration fee of £4.90 (ex VAT) for ceases. However, since then Openreach has implemented processes that allow broadband suppliers to disconnect ceased lines within the local exchange ('remove jumpers'). There is a cost reflective charge associated with these processes which only applies when there is a complete cessation of a broadband service (but not for a MAC transfer) and where the

broadband supplier wants the connections in the exchange to be physically disconnected. These processes have the potential to increase the overall charge associated with ceases. Information about these processes and the associated charges are available on Openreach's web site³⁰.

- 10.12 We recognise that there is a cost associated with ceasing a line. Accordingly, Openreach has historically levied a charge on providers. Before the introduction of the current processes, where the broadband supplier can decide whether to physically disconnect or not, there was only one option available and the cost of this was £33.75 (ex VAT). The current processes therefore represent a significant improvement.
- 10.13 Where a supplier simply passes on a directly incurred cost it would not appear to be unfair under the Regulations, provided of course, any terms providing for a variation of the relevant contract, and under which any charges are introduced or increased, are themselves fair and the supplier complies with General Condition 9.3. That seems to us unlikely in general to cause the necessary significant imbalance to the parties' rights and obligations under the contract, to the consumer's detriment, and contrary to the requirement of good faith.
- 10.14 The history of these charges is as follows. In early 2007 some providers decided to rebalance their tariff structures – rental charges were reduced but an explicit cease charge was introduced. Nevertheless, the overall effect was a net reduction in retail charges. This resulted in greater scrutiny of the then cease charge of £33.75 (ex VAT). In response, Ofcom worked with industry to see if the existing processes for ceasing a line could be made more efficient. During this time we agreed a holding position with Openreach wherein a £4.90 (ex VAT) administration charge was levied. In some cases this was passed on to retail customers.
- 10.15 As a result of this work, two options are now available to broadband suppliers: a replica (but more efficient) version of the original £33.75 process with a total charge of about £25 (ex VAT) or a charge of £4.90 (ex VAT), for an option that requires the supplier to take on a greater responsibility for managing the cease. Both options have been introduced and providers are taking a view on whether and how to pass on any costs to customers.
- 10.16 We are aware that, following this, a small number of retail suppliers have introduced/increased their cease charge to consumers in the range of £5 to £20. We have received some consumer complaints and will need to keep these charges under review.
- 10.17 We also note that the Openreach charge is one which comes under the Openreach Financial Framework Review, and so is subject to regulatory oversight, for example, whether it is efficiently incurred and cost orientated and whether it is having a negative effect on competition. We do not at present consider that these cease charges, which apply in limited circumstances, have a significant impact on competition. If Ofcom were subsequently to have evidence of an adverse effect then we would need to consider how we could address the issue

Ofcom's decision

- 10.18 As those stakeholders who commented agreed with Ofcom's proposed guidance regarding core terms and transparency, we confirm in the final guidance our view that

³⁰ <http://www.openreach.co.uk/orpg/home/home.do>

terms providing for cease charges are likely to be non-core terms. The only amendment we have made in the final guidance is to change the reference to the 'reasonable' consumer to the 'typical' consumer, for consistency with the rest of the document.

- 10.19 Similarly, as there was also a significant level of agreement (from those who expressed a view) with our proposed guidance on fairness, we confirm in the final guidance our view that such terms are likely to be fair where they are transparent to consumers at the point of sale and reflect only direct costs associated with ceasing service.

Annex 1

Guidance on unfair terms in contracts for communications services

Introduction

- A1.1 Contracts for the supply of products 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 in relation to the consideration of complaints about contracts in organisations which fall within Ofcom’s regulatory scope.
- A1.2 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. While in many cases this has been helpful for consumer contracts within communications markets, it does not directly address some of the contractual situations which are particularly common in contracts for communications services.
- A1.3 Ofcom believes that sector-specific guidance on a limited range of such issues will benefit suppliers and consumers of services that it regulates. 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.
- A1.4 Ofcom expects suppliers of communications services to review their conditions in light of the Guidance and to amend or remove any unfair terms. Unfair terms are not legally enforceable against consumers (see Regulation 8(1)), and it is therefore in the interests of suppliers as well as consumers to ensure that terms are fair.

Aims of the guidance

- A1.5 Ofcom recognises that the decision as to whether a term is unfair is a matter ultimately for the courts.
- A1.6 However, given that there is very little case law to assist suppliers and consumers in this area, and no guidance which directly addresses terms in contracts for communications services, Ofcom considers that it is in the interests of all parties for our views as to the likely application of the Regulations to be clearly set out.
- A1.7 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 suppliers of communications services to meet the requirements of the Regulations, as well as assisting Ofcom and any other bodies which have powers to enforce the Regulations. It complements OFT guidance and does not replace it.

- A1.8 We recognise that enforcement action we may take will depend on the facts of any individual case. But the Guidance sets out the approach we expect to take in performing our obligations and exercising our powers under the Regulations.
- A1.9 We expect to take an active role in enforcing the Regulations. We will monitor complaint levels and examine suppliers' standard terms to see whether they are consistent with our view of the law as set out in the Guidance. Where they are not, we will consider the best way to enforce the Regulations, including taking the necessary formal enforcement action using our powers under the Regulations and/or the Enterprise Act 2002.
- A1.10 Whilst it sets out the approach we are likely to take, this guidance is not binding on Ofcom. We may depart from it where there are good reasons for doing so. If, in any given situation, we decide to depart from the principles set out in this Guidance, we will normally set out our reasons for doing so.
- A1.11 We note that in addition to the Regulations, suppliers are also subject to General Conditions (under the Communications Act 2003), including GC 10 on transparency and publication of information and GC 12 on itemised bills.

Scope of the Guidance

- A1.12 While the Regulations apply to all suppliers of services or products to consumers, this Guidance relates in particular to all suppliers of services in sectors that Ofcom regulates. In this document we use the term 'services' to include fixed and mobile telephony services, broadband, and pay-TV; and we use the term 'suppliers' to cover all those who provide such services.
- A1.13 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 here do not usually apply.
- A1.14 The Guidance covers the following terms and charges provided for by them:
- A. Non-direct debit ("non-DD") charges (i.e. charges imposed by suppliers on customers who do not pay their bills by direct debit or a similar method)
 - B. Default charges (i.e. late payment charges, charges for payment failure and charges for reconnection)
 - C. Initial Minimum Contract Periods ("MCPs") and Early Termination Charges ("ETCs")
 - D. Subsequent Minimum Contract Period ("subsequent MCPs")
 - E. Minimum notice periods ("MiNPs")
 - F. Itemised or paper billing charges
 - G. Cease charges
- A1.15 Although we have not examined all of the types of terms in suppliers' contracts in this Guidance, 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 term. 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.

- A1.16 In addition to providing 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 suppliers take. These aspects cannot 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

- A1.17 All suppliers using standard contract terms with 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).
- A1.18 The OFT has issued extensive guidance on the Regulations, both general and sector-specific. The two documents below provide general guidance:
- the briefing note *Unfair standard terms* (OFT143, http://www.ofcom.gov.uk/shared_ofcom/business_leaflets/unfair_contract_terms/ofcom143.pdf);
 - the comprehensive *Unfair contract terms guidance* (OFT311, http://www.ofcom.gov.uk/shared_ofcom/reports/unfair_contract_terms/ofcom311.pdf).
- A1.19 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* (OFT 842, http://www.ofcom.gov.uk/shared_ofcom/reports/financial_products/ofcom842.pdf).
- A1.20 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. Where that body considers a term to be unfair, it has the power to take action on behalf of consumers in general to stop the continued use of the term, if necessary by seeking an injunction in England, Wales and Northern Ireland or an interdict in Scotland.
- A1.21 In addition, Part 8 of the Enterprise Act 2002, which came into force on 20 June 2003, gives the OFT and other bodies including Ofcom another enforcement mechanism against traders that breach consumer legislation.
- A1.22 The legal framework introduced by Part 8 of the 2002 Act enables the OFT and other enforcers to seek enforcement 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. In addition, the Enterprise Act gives the OFT a co-ordinating role to ensure that action is taken by the most appropriate enforcement body. More information on the Enterprise Act can be found at http://www.opsi.gov.uk/acts/acts2002/ukpga_20020040_en_1

- A1.23 Ofcom exercises its enforcement powers in accordance with its draft enforcement guidelines. For example, while Ofcom will operate with a bias against intervention, we will intervene firmly, promptly and effectively where required, and we will strive to ensure that our interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome. You can find further information about Ofcom's draft enforcement guidelines at <http://www.ofcom.org.uk/consult/condocs/enforcement/>.
- A1.24 Ofcom may take action against unfair terms under either the Regulations or the Enterprise Act (or both) and may accept an undertaking from the business concerned that it will stop the infringing conduct (for example, using or recommending for use an unfair term drawn up for general use in contracts with consumers).
- A1.25 If the concerns are not satisfactorily addressed by this means or otherwise, Ofcom can 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 that an enforcement order should be sought immediately, we can start court proceedings without entering into consultation as ordinarily required. If we do propose to take such urgent action, we must first obtain the OFT's agreement that an application for an order should be made without delay.
- A1.26 There are a number of key elements to the Regulations, to which we shall refer specifically in this Guidance.
- **Core and non-core terms.** Terms which define the main subject matter of the contract are exempt from the test of fairness, provided that they are in plain, intelligible language (Regulation 6(2)(a)). Similarly the test of fairness does not apply to the adequacy of the price as against the goods or services provided in exchange, again provided that plain, intelligible language is used (Regulation 6(2)(b)). These are the terms and matters which reflect the essential bargain between the parties – what they, but primarily the consumer, would say the consumer is buying under the contract and the price for it – and which are often referred to as “core terms” and will be referred to as such in this Guidance. Any other term is a “non-core” term.
 - **Test of fairness.** If a term is not a core term, or is not expressed in plain intelligible language, it is subject to assessment as to its fairness. The test of fairness is set out in Regulation 5(1).
 - **Transparency.** All terms are required to be expressed in plain, intelligible language (Regulation 7(1)). Terms must also, in our view, be set out with due prominence which reflects their importance to the parties. These requirements, which we link in the concept of “transparency”, apply to both core and non-core terms.
 - Schedule 2 of the Regulations sets out a non-exhaustive list of terms which may be regarded as unfair.

A1.27 The following parts of the Regulations are of particular relevance to this Guidance.

A1.28 Regulation 6(2) provides that:

- “(2) 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.”

A1.29 Regulation 7 provides that:

- “(1) A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language.
- (2) If there is doubt about the meaning of a written term, the interpretation which is most favourable to the consumer shall prevail ...”

A1.30 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.”

A1.31 Paragraph 1 of Schedule 2 of the Regulations 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;.....
- (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

A1.32 This section sets out our guidance on contract terms which provide for each type of charge. In each case there is a description of the charge, followed by the applicable guidance and, where Ofcom considers it appropriate, the areas on which Ofcom will place particular emphasis in its investigation and enforcement activity. The absence of any such indication in relation to a particular type of term should not be taken to indicate that Ofcom does not intend to undertake investigation and enforcement

work in that area. Priorities have been identified based on our research into current market conditions and those priorities are subject to review.

A. Non-Direct Debit Charges

A description of the charge

- A1.33 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, suppliers make a charge for payment by methods other than direct debit. We refer to this as the non-direct debit (“non-DD”) charge.
- A1.34 While the non-DD charge is generally for payment by means other than direct debit, some suppliers may differentiate on the basis of whether the payment is by a recurring, or non-recurring method.
- A1.35 Some suppliers only accept payments by a limited range of methods, typically direct debit and/or credit card.

Ofcom’s guidance

Instances when a non-DD charge may be a core term

- A1.36 We consider that there may be circumstances in which a contract for communications services is structured so that a non-DD charge may be considered to be a core term and therefore not subject to the test of fairness, provided it is in plain and intelligible language.
- A1.37 We take the view that, in order to be likely to be considered a core term, the non-DD charge must be set out in such a way that the typical consumer would regard it as part of the price paid in exchange for the services he is buying under the contract and would consider it part of the essential bargain with the supplier, rather than as an incidental, additional charge, separate from that price.
- A1.38 We consider that core terms must also be given the prominence and transparency which reflect their importance to the consumer. If the typical consumer would not readily appreciate that a term defines the main subject matter of the contract, or sets out the price to be paid, it is our view that such a term is unlikely to be considered to be a core term.
- A1.39 In the context of non-DD charges, we consider these requirements as to prominence and transparency are likely to be satisfied where both of the following elements are present:
- the contract term and any marketing material clearly set out to the consumer the prices of the different services being bought so that consumers will readily appreciate that the non-DD charge is part of the price for them.

For example, if the prices are set out with equal prominence as follows:

- ‘contract A - £11 per month paying by non-DD; or
- contract B - £10 per month paying by direct debit’;

- consumers are fully aware of and informed of the price that they will be required to pay when they buy a service if they are unable to pay by DD, or choose to pay by a method other than DD.

A1.40 In other words, one way in which we consider a non-DD charge is likely to be a core term is if it is clearly presented to consumers as part of the headline price for the services under the contract.

A1.41 We consider that the analysis set out above will apply whether the non-DD charge is expressed as an additional charge or as a discount on the headline price. The consumer will incur the same liability to pay extra for payment by an alternative means whether the charge is expressed as a discount for DD payment or an additional charge for a different payment method.

The fairness test for non-DD charges where they are not a core term

A1.42 Where a non-DD charge is not expressed as part of the price in the transparent and prominent manner described above, we consider that it is unlikely to be a core term. As such, it may be assessed for fairness. Similarly, if such a term is not expressed in plain, intelligible language, it will be subject to the same assessment. The way in which we consider the fairness test is likely to apply in this context is set out below.

A1.43 A consumer who chooses not to pay by DD may cause the supplier to incur additional processing costs which are directly attributable to that method of payment. We consider it is likely to be regarded as fair for suppliers to recover these additional costs through the non-DD charge.

A1.44 However, we consider that it may be unfair for consumers to pay, as part of the charge, a cost component which does not reflect the suppliers' increased cost of taking payment by a means other than direct debit. So, for example, we believe it is unlikely to be fair for suppliers to include as a component of the non-DD charge the recovery of general "bad debt" costs.

A1.45 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.

A1.46 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.

A1.47 We believe that in some circumstances it may be fair to recover costs associated with chasing late payment, such as reminder letters/bills, as part of the non-DD charge (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.

A1.48 One way in which we think it may be fair for a supplier to calculate and apportion the costs recoverable in what we consider a likely fair non-DD charge is as follows.

The supplier 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:

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

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

A description of the charges

A1.49 Some suppliers levy charges in the following circumstances:

- a late payment charge where a consumer does not pay a bill by the due date for payment;
- a payment failure charge where, for example, a cheque 'bounces' or a call for payment under a recurring mandate fails due to insufficient funds;
- 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 supplier may, before terminating the contract entirely, bar outgoing calls, and the status of the line will be set as Outgoing Calls Barred ("OCB"). The supplier 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-core terms

A1.50 These charges are only incurred where the consumer is in default. It is our view, supported by the decision of the House of Lords in *Director General of Fair Trading v. First National Bank plc* [2002]1 AC 481, that default charges will not be core terms. Consumers entering into a contract with a supplier would not as a matter of course expect to pay any of these charges, which are all associated with a failure to do something which they are contractually obliged to do, e.g. to pay a bill by the due date. This will be the case whether the charges are described as default charges or are presented as a form of "contractual option", such as the "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 review for fairness.

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

- A1.51 We consider it is likely to be unfair for suppliers 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 supplier to recover such sums from a consumer as damages for breach of contract.
- A1.52 We consider terms providing for late payment charges, charges for payment failure and reconnection charges are likely to be fair where:
- the terms relating to these charges are transparent to consumers within the contract at the point of sale; and
 - the charge includes only the direct costs incurred.
- A1.53 So, for late payment charges, only costs such as the costs 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 (as well as the cost categories for late payment).
- A1.54 In addition, in relation to terms which impose charges for late payment, we consider that such terms will only be fair if suppliers 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.
- A1.55 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.
- A1.56 Where a consumer has an arguable claim under a contract against a supplier 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.
- A1.57 Such a term is likely to fall within the indicative list of terms that maybe unfair set out 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 suppliers 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)

A description of the charge

- A1.58 Suppliers of communications services 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 supplier, such as:
- the cost of consumer equipment provided free or at a subsidised rate (e.g. a mobile handset or broadband modem); or
 - wholesale connection charges.
- A1.59 Most MCPs are currently 12-18 months. However, suppliers also offer services with no MCP, or three months MCP (such as for fixed voice) or 24 months (for mobile).
- A1.60 When a consumer terminates a contract of fixed duration before the expiry of the MCP, suppliers usually levy an early termination charge ("ETC").
- A1.61 The ETC is typically the total of the remaining monthly payments. There are some exceptions, in which suppliers:
- set the outstanding rental at the level of the lowest priced package;
 - cap the total charge at a maximum level; or
 - in some cases, 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.
- A1.62 Some suppliers, rather than setting a MCP, may instead levy a charge on termination of the contract which is dependent on the period for which the contract has been running. While this is not expressed as an ETC, its effect is the same. In such a case a consumer would be required to pay a sum upon termination of a contract if he terminated before, say, 12 months but not if he terminated later. Under the Regulations, we are concerned about the effect of a term and therefore this type of term may be regarded as an ETC.

Ofcom's guidance

Terms providing for MCPs are likely to be core terms

- A1.63 We consider that the term providing for a MCP is likely to be viewed as a core term. It is also one of the most important terms for consumers.
- A1.64 As stated above, all core terms must be set out with appropriate prominence and transparency. We would expect this term to be sufficiently prominent in terms and conditions and to be easily recognised by consumers as a key element of the contract. Suppliers must also take care to ensure that any marketing material is expressed with sufficient clarity that it does not mislead the consumer in relation to such terms. Such material may, in our view, fall to be considered as part of "the circumstances attending the conclusion of the contract" as set out in Regulation 6(1). We would expect such material to make clear the duration of any minimum term.
- A1.65 Where an MCP is not expressed in a transparent and prominent manner, we consider that it may not be a core term. As such, it may be assessed for fairness. Under the Regulations, an unfair term shall not be binding on the consumer, and therefore a supplier which fails to make the MCP sufficiently transparent and prominent will, insofar as the MCP is unfair, be unable to enforce the MCP and any requirement to pay an ETC.
- A1.66 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 currently be sufficiently well known or brought to the attention to consumers. We expect suppliers to follow the guidance above in ensuring that MCPs are made both prominent and transparent for all services.

Terms relating to ETCs are non-core terms

- A1.67 In our view, terms providing for ETCs (which are default charges or charges analogous to default charges even if they do not apply on breach of contract) will not be core terms.
- A1.68 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 supplier levies a charge. That charge, the ETC, is paid on termination of the contract and cessation of service, not, as it would need to be in order to be a core term, in exchange for services. We consider that a similar analysis to that set out in paragraph A1.50 above applies. So, we consider ETCs will not be core terms and will be subject to the test of fairness.

The fairness test for ETCs

- A1.69 The following sets out the principles we consider likely to apply in the assessment of fairness of ETCs, which we consider suppliers should apply in setting ETCs, and which are likely to guide us in carrying out our enforcement duties under the Regulations.
- A1.70 We consider it likely to be unfair if a supplier 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). Put another way, in our view it is unlikely to

be fair if the ETC is more than the supplier could recover in damages at common law where the consumer breached the relevant contract.

- A1.71 If the term providing for the ETC had the effect in [A1.70] it would put the supplier in a better position, and the consumer in a worse one, than they would be in without the term. 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.³¹
- A1.72 So, in our view, such a term would cause a significant imbalance between the supplier's rights and obligations and the consumer's, to the latter's detriment, and contrary to the requirement of good faith.
- A1.73 Accordingly, in setting ETCs, we consider a supplier 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 supplier may fairly recover in an ETC is a sum that reflects that position. That involves making a reasonable pre-estimate of the costs it saves and the losses it can mitigate, and deducting those from the fixed contractual retail payments outstanding on termination.
- A1.74 That pre-estimate will include, for example, any variable costs the supplier 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 also include a reasonable pre-estimate of any network costs the supplier saves in a particular, reasonable period averaged over the group of consumers terminating contracts early. We do not expect that suppliers will need to calculate each individual consumer's ETC at the time of contract termination.
- A1.75 We consider that an ETC is likely to be fair where:
- 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 the method by which this would be calculated e.g. the amount that would be charged for each outstanding month);
 - it is never greater than the amount of the (usually monthly) contractual retail payments remaining due at the date of termination;
 - it also takes account of any costs associated with the provision of the service which will no longer be incurred, including any:
 - variable costs which can be avoided; and
 - 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);

³¹ We note that paragraph 1(e) of Schedule 2 to the Regulations says terms may be unfair if they have the object or effect of, 'requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation.'

- it reflects any ability of the supplier to reduce its loss by 'reselling' the service to a new consumer;³² and
- it makes allowance for the supplier's accelerated receipt of any sums.³³

A1.76 We do not consider that it is likely to be fair to include in an ETC recovery of anticipated profits from charges, or other sources of revenue, which are not themselves part of the consumer's contractual obligations (assuming the consumer would not do things, and 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.

A1.77 We also take the view it is unlikely a fair ETC will normally include sums in respect of 'lost' revenues from incoming call termination charges for fixed voice and mobile phone services. We think it is unlikely, on the grounds of remoteness, that they would normally be recoverable from consumers as a matter of common law contractual damages. It is unlikely in most cases that a consumer contracts with a supplier on the basis he will be liable for the loss of such revenues were he not to fulfil his contractual obligations. A supplier would need to show otherwise in any particular case(s).

A1.78 We also acknowledge there is an alternative basis on which, in our view, a likely fair ETC may be recovered. Instead of recovering an ETC on the basis above, a supplier 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.

A1.79 This 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); 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)

A description of the term

A1.80 A subsequent MCP may be triggered when some aspect of the contract is changed, and in return the supplier requires that consumers are committed to purchasing the services for an additional fixed, minimum duration.

³² This will be particularly relevant for network elements specific to a particular property (such as a copper pair or cable connection) where the elements may subsequently be used by a new occupant

³³ 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 our 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.

- A1.81 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.
- A1.82 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.
- A1.83 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 supplier and the consumer, on new terms, and in which the MCP may be a core term.

Ofcom’s proposed guidance

SMCP terms are likely to be non-core terms

- A1.84 We consider that SMCP terms are likely to be non core terms. This is because we consider that it is unrealistic to expect a reasonable consumer to consider the trigger for a subsequent minimum term to be part of the main subject matter of the contract.
- A1.85 We believe that any term that has the same effect as a SMCP term should be treated in the same way i.e. it is the effect, not the form that is important.
- A1.86 We consider, therefore, that SMCP terms, and terms to the same effect, imposing subsequent MCPs are likely to be subject to the test of fairness under the Regulations.

The fairness test for SMCP terms

- A1.87 In general terms, we consider it is likely to be fair for suppliers to require a commitment to a subsequent MCP where consumers get a commensurate benefit in return for that commitment and the commitment is clear to the consumer. This is necessary to ensure that contracts do not create a significant imbalance in the rights and obligations of the parties, to the detriment of the consumer.
- A1.88 So, we consider the requirement for a subsequent MCP is likely to be fair where:
- 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;
 - the term sets out that the supplier 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 supplier will write to the consumer stating when changes to the services will result in a subsequent MCP);

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

A1.89 We consider the requirement for a subsequent MCP is likely to be unfair where:

- there is little benefit to the consumer arising from the relevant variation and the supplier incurs no costs or costs at only a low level. Examples of this may include where:
 - a consumer wants to upgrade their tariff, (either within or outside the initial MCP) and there are no/low upfront cost implications for the supplier; or
 - where a consumer wants to downgrade their tariff outside the initial MCP and there are no/low upfront cost implications for the supplier;
- the supplier wants to change the underlying wholesale service and there is no consumer benefit. Examples of this may include where a supplier wants to migrate to using LLU and consumers do not have a choice of staying on their original tariff and original MCP; or
- there is automatic renewal upon reaching the end of an existing MCP and one or more of the conditions set out below applies.

A1.90 Where suppliers include a term providing for an ETC in respect of early termination of a subsequent MCP, we consider that such terms are also unlikely to be core terms and likely to be subject to the test of fairness. We consider that the amount of ETCs charged should be calculated in accordance with the principles set out in paragraphs A1.69 – A1.79 above.

Terms providing for automatic renewal of fixed term contracts

A1.91 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.

A1.92 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.

A1.93 So, an automatic renewal term may cause the necessary imbalance under the Regulations by virtue of, in the words of Lord Bingham in *Director General of Fair Trading v. First National Bank plc [2002] 1 AC 481*, ‘...imposing on the consumer [of] a disadvantageous burden or risk or duty.’

A1.94 However, we also consider 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 expect to have regard to all the relevant terms.

A1.95 We consider automatic renewal terms are more likely to be unfair where one or more of the following applies:

- the renewal term itself is not transparent in the contract at the point of sale;

- there is no accompanying term which commits the supplier 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);
- the terms do not provide for a clear and easily effected opt-out (or cancellation) mechanism, without unnecessary formal or procedural requirements;
- there is no cost to the supplier and benefit to the consumer commensurate to the renewed obligation the consumer takes on;
- there are other terms which seek to restrict the opt-out window or require too long a notice period;³⁴ or
- the ETC is unfair (or so high as to have a prohibitive effect on the consumer's right to terminate the renewed contract).

A1.96 We also consider that, as matters of good and fair business practice, it is important 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:

- be sent at an appropriate point in time (neither too close to nor too far away from the renewal date);
- be written in plain, intelligible language;
- have the explanation about the automatic renewal as the only (or main) subject matter; and
- make it clear what the consumer needs to do to prevent the automatic renewal (which procedure should not be unduly onerous – see above).

A1.97 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.

The areas on which Ofcom will focus in investigations

A1.98 We are likely to focus on circumstances where there are no (or very low) additional upfront cost implications for the supplier, in particular, tariff upgrades and downgrades, and on terms providing for automatic renewal that we consider are likely to be unfair as set out above.

³⁴ and there should in any event be a term allowing early termination of the contract by the consumer with any accompanying ETC being fair.

E. Minimum Notice Period (MiNP)

A description of the charge

- A1.99 Even where there is no MCP, suppliers usually require consumers to provide formal notification of an intention to terminate a contract where regular payments are made directly to the supplier.
- A1.100 The Minimum Notice Period (“MiNP”) is often either 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. Lesser MiNPs are generally applied to fixed voice services.

Ofcom’s guidance

Terms providing for MiNPs are likely to be non-core terms

- A1.101 We consider that the MiNP is unlikely to be part of the main subject matter of the contract and that terms providing for a MiNP are likely to be non core terms.
- A1.102 In our view, consumers entering into a contract for services would not consider the manner in which they are required to terminate that contract as part of the service they are buying. As such, these terms cannot be regarded as part of the main subject matter of the contract. MiNPs are therefore subject to the test of fairness.

The fairness test for MiNPs

- A1.103 We consider a term providing for an MiNP is likely to be fair where the following conditions are fulfilled:
- the MiNP is transparent to consumers within the contract at the point of sale; and
 - the MiNP reflects a reasonable period in which to carry out the necessary administration of terminating the contract.
- A1.104 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 supplier before the end of the MiNP or of having to pay two suppliers for a period of time in order to ensure a sufficient degree of overlap and no loss of service.
- A1.105 For fixed voice and broadband services, where formal service migration processes apply which 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 likely to be unfair. This should mean the cessation date for charging by the supplier does not go beyond the date on which the migration occurs.
- A1.106 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.

- A1.107 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 above, will apply.

Best practice

As a matter of best practice, Ofcom also considers it is important that suppliers make it very clear to consumers what the minimum notice period is at the point at which the consumer is considering terminating their contract.

F. Itemised or Paper Billing

A description of the charge

- A1.108 The itemised or paper billing charge is a charge made to consumers for the provision of a fully itemised or paper bill. For broadband suppliers itemisation is not relevant, but some of these suppliers charge for paper bills.
- A1.109 Our research indicates that as at August 2007, about half of non broadband suppliers charged for itemised paper bills – generally between 50p and £1.50 per bill. BT offers a discount of 50p a month from the headline service price for paperless billing (i.e. £1.50 per bill for those billed quarterly).
- A1.110 All the suppliers we looked at provided at least a basic level of paper billing for no extra charge for voice or mobile telephony services. (Since by definition broadband users have online access, the fact that some suppliers charge for any level of paper billing is less of a concern to us.) Some provided a free paper bill for tariffs above a certain level. However, all the suppliers that we looked at provide online itemised bills at no charge.

Ofcom's guidance

Instances where a term providing for an itemised or paper billing charge may be a core term

- A1.111 An itemised bill is a means by which the supplier sets out the nature of the service that has been provided under the contractual agreement, enabling the consumer to verify this.
- A1.112 As with the non-DD charge, we consider that there may be circumstances where the charge for itemised or paper billing may be considered a core term and therefore not subject to the test of fairness, provided it is in plain and intelligible language.
- A1.113 We take the view that, in order to be likely to be considered a core term, any term which provides for an itemised or paper billing charge must be set out in such a way that the typical consumer would: (1) regard it as part of the price paid in exchange for the services he is buying under the contract and part of the essential bargain with the supplier, rather than as an incidental, additional charge, separate from that price; and (2) would be aware of the level of information or billing which is thereby provided by comparison with the basic, or standard, level of billing.
- A1.114 We consider that the latter requirement arises from the fact that, in order to benefit from the Regulations' core terms exemption, as terms relating to the adequacy of

the price, relevant billing charges must be presented as part of that price and the consumer must know what is he getting for it. If he does not, the plain, intelligible language requirement is not met and the core terms exemption cannot apply.

A1.115 To fulfil these requirements, we consider it likely the following conditions must all be met:

- the contract term and any marketing material must make clear in a prominent manner whether there are any separate billing options for which there are different charges;
- any such information must clearly set out what these options are, together with the price for each option. This must include whether the options are related to charges or discounts for receiving printed or Internet bills, and/or for different levels of billing information;
- where there are different levels of billing information which incur different charges, the contract terms must clearly set out what level of billing information is being provided under each option; and
- the contract terms and the marketing material must set out the required information in such a way that the consumer who chooses itemised billing would regard that as part of the services he is buying under the contract.

A1.116 We consider that the analysis above will apply whether the options are presented as additional charges or as discounts on the headline price. If suppliers do not meet all of these conditions, the term providing for itemised or paper billing charge is likely in our view to be subject to the test of fairness.

The fairness test for terms providing for itemised or paper billing charges where they are not a core term

A1.117 Where an itemised or paper billing charge is not expressed as part of the price in the transparent and prominent manner set out above, we consider that it is unlikely to be a core term. As such, it may be assessed for fairness. Similarly, if such a term is not expressed in plain, intelligible language, it will be subject to the same assessment. The way in which we consider the fairness test is likely to apply in this context is set out below.

A1.118 A consumer who wishes to have itemised and/or paper billing may cause the supplier to incur additional costs which are directly attributable to that level of billing. So, for example, we consider it may be fair for a supplier 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 suppliers to recover these additional costs through a charge for itemised and/or paper billing.

The areas on which Ofcom will focus in investigations

A1.119 As an administrative priority, where the test for fairness applies, we would not propose to take action on the basis of the level of charges observed as at August 2007 and costs we have observed.

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

A description of the charge

A1.120 These are charges made when the consumer ceases its service from the supplier. They are unrelated to the ETCs and MiNPs.

A1.121 During our review the clearest example we noted of a cease charge was that made to consumers in respect of suppliers passing on wholesale charges levied by BT Openreach upon termination of wholesale broadband agreements. However, this applies only in limited circumstances where the consumer is ceasing to use a broadband service altogether or is moving to a cable service such as Virgin Media or to Kingston Communications.

Ofcom's guidance

Terms providing for cease charges are likely to be non-core terms

A1.122 We consider that terms providing for cease charges are unlikely to be core terms. Such charges are not, in our view, part of what a typical consumer would consider to be the main subject matter of the contract or the price of the service. Accordingly, they are subject to the test of fairness.

The fairness test for cease charges

A1.123 We consider cease charges are likely to be fair where of the following conditions are fulfilled:

- the terms relating to cease charges are transparent to consumers within the contract at the point of sale; and
- they reflect only the direct costs associated with ceasing service.

The areas on which Ofcom will focus in investigations

A1.124 We are likely to take seriously any deviation from actual, specific direct costs incurred. This is because 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 is important that suppliers make it very clear to consumers the level of any cease charge at the point at which the consumer is considering terminating their contract.

Annex 2

Responses to the consultation

Overview of stakeholders responding to the consultation

- A2.1 The consultation opened on 28 February 2008 and closed on 8 May 2008. Over 240 consultation responses were received:
- over 200 from (individual) consumers (including those forwarded by MPs)
 - 10 from consumer stakeholders
 - 12 from suppliers of communication services
 - 7 from other companies or industry associations
- A2.2 Responses from consumers and consumer stakeholders focussed particularly on non-direct debit charges (over 85% of consumer respondents commented on these). Other issues particularly mentioned by consumers were:
- Late payment charges;
 - Minimum contract periods and/or early termination charges; and
 - Charges for itemised billing or for paper bills.
- A2.3 Responses from suppliers or industry associations between them covered all the consultation issues. Our proposals on early termination charges attracted most comment, with suppliers generally disagreeing strongly with at least some of them.

High level consultation questions

Do you agree that it is helpful and appropriate for Ofcom to issue guidance on the application of the Regulations to consumer contracts for communications services?

- A2.4 There was broad agreement from suppliers and consumer stakeholders that Ofcom guidance would be helpful and appropriate. One consumer stakeholder expressly welcomed a principles-based, rather than highly prescriptive, approach. One supplier also made a similar point, and another welcomed the initiative to ensure industry does what is right for consumers.
- A2.5 One MNO said there was no evidence sector specific guidance would be helpful to suppliers and sufficient (OFT) guidance already exists. And it said any harm caused by the terms covered by the proposed guidance would also occur in other sectors where such terms are used so that, even if guidance is required on them, it should be general OFT guidance. It also said our proposed guidance on ETCs would discriminate against some suppliers. Another MNO made a similar point: that our ETC proposals may favour certain business models or technologies used to provide the same services.
- A2.6 One MNO commented that it currently does not levy default charges on consumers, but may do now as a result of the review.

A2.7 One supplier questioned the position in relation to terms Ofcom had previously investigated and asked what had changed since those investigations.

A2.8 And, concerns were expressed that:

- it is unclear over whether the guidance is a policy document or a legal interpretation of existing legislation;
- the guidance's status is unclear (it suggests we think it is enforceable and not simply a statement of principles we are likely to adopt in enforcing the Regulations);
- we go too far in setting out definitive guidance on matters which depend on the facts of any particular case (the wording of particular terms and the overall effect of the contract);
- we are 'gold-plating' – the Regulations are designed to address terms far more detrimental to consumers than those we focus on;
- we are investigating standard monthly retail charges and basic contractual terms, not just additional charges;
- we are requiring suppliers to provide too much, or confusing information, in marketing material and have not considered the Better Regulation Executive's and the National Consumer Council's recommendations, which suggest too much information at the point of sale does not help consumers and that any proposals to introduce information provision requirements should first be road-tested with consumers;
- we should have done an impact assessment because our proposals are matters of 'policy' and 'regulatory intervention';
- our approach is not proportionate or evidence based (one MNO, for example, said we were proposing detailed intervention in pricing in the mobile market that is inappropriate because there is no evidence of market failure or lack of competition giving Ofcom a mandate to intervene. It said it is not necessary for Ofcom to specify terms suppliers should use and any such intervention is not evidence based intervention or proportionate, contrary to Ofcom's regulatory principles. Another referred to Ofcom's impact assessment guidance that says we will only regulate where a high standard of proof is satisfied.);
- the proposals pay insufficient regard to the fact 70% of mobile customers are 'pay as you go' customers to whom many of the relevant additional charges do not apply and are irrelevant; consumers always have a choice of such pre-pay options; this protects low income consumers, many of whom will be, or could choose to be, pay-as-you-go customers; and any regulation must recognise this distinction. (One MNO, for example, said, "Ofcom's own evidence is that mobile communications has a wholly suitable market-based solution to those who do not want a contract – and the costs associated with that – in the pre-pay mobile option. Regulating in the interests of low income consumers where the market already addresses the issue is unhelpful and unnecessary.");
- we should explain what consideration we have given to the effect of the Consumer Protection from Unfair Trading Regulations 2008, with which our guidance should not conflict;

- the guidance should avoid conflict or uncertainty with other codes (including the Committee of Advertising Practice codes on advertising); and
- we should form a working group to determine the final content of the guidance.

Are there any other issues that are covered by the Regulations which Ofcom should give guidance on?

A2.9 Most respondents did not suggest other such issues for guidance.

A2.10 One stakeholder said all major mobile network operators charge more to call 0800, 0844 and 0845 numbers than can be justified and we should address this.

A2.11 One consumer stakeholder said it would be useful for Ofcom to clarify the position of consumers who are disputing an element of the bill with their supplier and who subtract the disputed amount before settling their bill. These consumers may then find they are faced with late and missed payment charges. The OFT guidance already covers this point, and this stakeholder believed it would be useful for Ofcom to include a reference to this right of set-off in its own guidance.

A2.12 Other additional charges or contractual issues which consumers commented on included:

- unexpected additional charges incurred when a phone line is repaired;
- additional charges for exceeding usage allowance on broadband;
- an additional charge levied by a supplier for changing the amount of rings before the voicemail service answers the call (currently 3 rings);
- services which are said to be 'free' but which may then be charged for, with the reasons for charging hidden in the small print;
- mobile operators have Call and Text plans but it is difficult to work out from billing how and when the limits are exceeded. When the limits are exceeded heavy charges are levied;
- the position of multiple account holders where BT refuses to accept combined payment and charges two payment processing fees;
- providing different service levels and costs for consumers signing up at different points;
- being owed money when contracts end part way through a month: where consumers have to pay for the full month and then claim the extra payment back (which had to be done in writing);
- having to sign up with a particular provider when moving into a new property even when the intention is to use another provider, and being locked into a contract with BT;
- being charged for on-line itemised billing;
- Sky basic channels not being available on Virgin Media's cable service;

- practice of 'free' calls ending after 60 minutes, and charging a connection fee;
 - a proposal that all contracts should need a signature before the contract can begin.
- A2.13 One consumer stakeholder said we should issue comparative information for consumers about prices and additional charges.
- A2.14 Another consumer stakeholder said we should monitor and regularly update the guidance and suppliers' terms, publish compliance data, and take action to improve post contractual information (by amendment to the General Conditions).
- A2.15 One consumer stakeholder said that we should consider applying the rules on 'Hire Purchase' where equipment is provided by suppliers to consumers at the start of contracts;
- A2.16 Another consumer stakeholder said Ofcom should consider bringing a test case, like the OFT's on bank charges, on behalf of consumers who have paid additional charges.
- A2.17 Consumer stakeholders supported Ofcom's proposal to publish a consumer check list (or 'consumer guide') advising consumers what charges and terms to consider before signing up to a new service. One said we should make the advice available to consumers without Internet access. Another said we should develop our consumer information further, via TopComm.
- A2.18 One stakeholder said we should also issue similar guidance in respect of small business customers (doing so in connection with General Condition 14).
- A2.19 A MNO said it assumed we had identified all those terms we consider may be unfair and are not considering investigating any other terms, and said it would consider it a matter of bad faith if we investigated any other terms.

Do you agree that three months is an appropriate period during which suppliers can adjust their terms and marketing practices to ensure they are in line with Ofcom's guidance?

- A2.20 A number of suppliers responded on this point.
- A2.21 Some said, based on our proposals, the changes they would need to make to their terms, marketing and sales practices were relatively small. They felt 3 months would be long enough.
- A2.22 A larger number felt 3 months was inadequate but in general did not propose an alternative time period. The two suppliers who did said around 6 to 8 months would be needed.
- A2.23 One MNO referred, for example, to the changes that would be required to billing systems in connection with changes to SMCPs and MiNPs.
- A2.24 Another MNO said a minimum of 6 months would be required to revise all terms, review all marketing materials, assess charges and costs and brief all retail channels.
- A2.25 Another MNO said it could not control how discounts are presented by independent retailers in marketing material.

- A2.26 A number of suppliers referred to the lead times involved in planning and changing commercial offers and advertising, and changing terms and conditions, all of which it was said take much longer than three months.

General responses on core terms and transparency

- A2.27 One supplier disagreed terms may be core or non-core depending on their transparency and prominence.
- A2.28 One MNO said there is no requirement for prominence under the Regulations (for core and non-core terms) – transparency is sufficient - nor any requirements about marketing materials that are not part of contract terms.
- A2.29 Another MNO said the proposed guidance wrongly suggests in places that core terms must define the main goods and services under the contract and the price (see paragraph A5.97 of the draft guidance, for example).
- A2.30 It also said we are wrong to focus the definition of core terms primarily on the consumer's perspective, because this requires assessment of each individual consumer's priorities.
- A2.31 One supplier said it is not appropriate for Ofcom to state that certain kinds of terms are, or are not, core terms, and we should instead give 'our likely opinion' of the relevant matters.
- A2.32 It also said we should clarify references to 'point of sale' by saying we mean 'before the contract is concluded.'
- A2.33 Another supplier complained about what it said was misleading price advertising, where attractive headline offers are off-set by increases in other tariffs.
- A2.34 One MNO commented that Ofcom did not provide an illustrative example of what an advert for mobile services might look like (including headline prices, and charges for non-DD payment and itemised billing).

General responses on fairness

- A2.35 One MNO said our proposal that, as a rule, charges made under non-core terms can only recover direct costs is incorrect, because the Regulations are not a mechanism of price or quality control.
- A2.36 Two MNOs said our proposals did not take sufficient account of consumer choice in the proposed assessment of fairness.
- A2.37 One referred to the post-pay monthly contracts of various lengths, pay monthly 'SIM only' contracts and pre-pay options available to consumers. It said these mean consumers are not in a 'take it or leave it position' and this, '... and hence the mitigation of any perceived abuse of power by the seller,' must be taken into account in the assessment of fairness.
- A2.38 The other said our proposals ignored these choices and threaten the ability of MNOs to offer them.
- A2.39 Another stakeholder agreed additional charges should generally reflect costs, but also recognise upfront acquisition costs and those of special deals.

- A2.40 One industry stakeholder said allowable costs might differ between providers because in any analysis of fairness we have to consider the impact on competition.

Charges for payment method (non-direct debit charges)

Consumers

- A2.41 Over 85% of the responses from consumers and consumer stakeholders were about non-DD charges. Consumers especially felt our proposals did not go far enough and that these charges should be abolished or reflect only directly incurred administrative costs which were believed to be very low.
- A2.42 Many objected to these charges in principle: it is wrong that a company can charge for the ability to pay a bill. Some consumers also said it is unfair that these charges tended to fall on those who could least afford them and adversely impacted on the elderly. Others raised concerns about being forced to pay by direct debit DD – or being charged more for not doing so. One described the charge as having caused ‘huge hostility’ among people.
- A2.43 One consumer stakeholder said that every supplier in the utility markets should be forced to provide the facility to pay by cash.
- A2.44 Another said that BT Basic was not the answer to this issue as many pensioners are too proud to claim benefits or may not qualify, despite being on low incomes.
- A2.45 One consumer noted that in the OFT/banks charges case the judge appears to say that non-DD charges are not core terms, and are subject to the test of fairness, because they do, ‘.....not relate to the adequacy of what the consumer has to pay by way of price or remuneration for the goods or services supplied in exchange.’
- A2.46 Other consumers objected to the level of the charge. Specifically:
- costs were believed to be small (figures of around 50p for processing a cheque were quoted and some claimed there was no or virtually no cost involved for direct on-line transfers);
 - some consumers questioned how there could be both a separate late payment fee and an element of the non-DD charge for chasing late payment;
 - many non-DD payers said they always paid on time and should not have to pay more because others sometimes paid late. Some said suppliers should be able to distinguish those who always pay on time or give discounts for prompt payment; and
 - some submitted the charge should be ‘per bill,’ not ‘per month,’ and questioned that BT’s charge of £4.50 for a quarterly bill reflected costs.
- A2.47 Some consumers and consumer stakeholders felt that a discount for paying by direct debit might be acceptable, but objected to there being an additional charge. Increased transparency was not felt to be useful given that all suppliers have a charge so there is no way to avoid the charges.
- A2.48 Some consumers also raised concerns falling outside:
- the scope of our review of additional charges; and/or

- the Regulations more generally.

A2.49 Concerns falling outside the scope of our review:

- some consumers said they had not been informed when their supplier introduced or raised non-direct debit charges. Others said a unilateral ability to introduce or raise charges is wrong;
- some questioned BT's decision to set up a separate payment processing company, BT Payment Services (BTPS), which consumers not paying by direct debit are required to pay (rather than BT itself);
- they did not understand how they could be required to pay a company they had not contracted with, or how BT could require them to enter a contract with another party (in some cases unilaterally and without warning);
- they were concerned that this is VAT avoidance and may be illegal; and
- they claimed some of the contract terms with BTPS were unfair, such as a term purporting to exclude consumers' rights to seek ADR.

A2.50 Concerns falling outside the Regulations more generally::

- BT was in a monopoly situation or faced no competition for landline services;
- BT Basic does not resolve the unfairness of non-DD charges: it is only available to those on specific benefits and not to low income consumers more generally, and, some complained, it has been subject to delays;
- that non-DD charges are discriminatory under the Disability Discrimination Act.

Consumer stakeholders

A2.51 The views expressed by consumer stakeholders generally reflected those of individual consumers. Some disappointment was expressed that Ofcom's proposals did not go further:

- One stakeholder was disappointed more weight (it said) was given to suppliers' ability to make cost-reflective charges than consumers' views that such charges are unfair;
- Another was disappointed we had not proposed prohibiting non-DD (and early termination) charges. Likewise, one consumer stakeholder (who also said charges for itemised billing and early termination should be prohibited) and another which called for prohibition because, for example:
 - charges are unfair and punitive;
 - paying bills is not optional, and the cost of payment should be included in the main price; and
 - the costs of collecting payment are recovered in other charges.
- One consumer stakeholder said non-DD charges are unfair on low income consumers (who may not be able to pay by DD or do not wish to for budgetary

reasons) and Ofcom should explore ways of ensuring consumers can pay their bills in a range of ways without additional charges.

- Another felt that there was poor consumer awareness of BT Basic.
- A2.52 There was, however, recognition of the importance of transparency (though some stakeholders said this itself will not resolve unfairness) and of the fact that some of the issues around low-income may go beyond what Ofcom can be expected to resolve and be more matters for government.
- A2.53 Consumer groups representing Northern Ireland expressed concern that a higher proportion of consumers there do not have bank accounts, so non-direct debit charges are of greater concern there.
- A2.54 One consumer stakeholder asked for evidence that Ofcom had assessed whether the savings made by suppliers from DD customers had lowered overall retail costs.

Suppliers – core terms

- A2.55 There was agreement among some suppliers to Ofcom's proposal that non-DD charges may be core terms if they are presented appropriately.
- A2.56 There was also some acceptance that greater transparency and prominence would be helpful to consumers and to competition (suppliers accepted the principle that non-direct debit charges should be transparent to consumers, and some felt their terms are already very clear and are core terms).
- A2.57 Views differed as to the best way to ensure consumers understood these charges, with some suppliers believing that information at the point of sale and subsequently on bills was sufficient.
- A2.58 Other views expressed were that:
- charges are core terms irrespective of issues around transparency and prominence;
 - the charge is a core term: it is part of the essential bargain communicated in plain intelligible language to consumers (they must opt-out of payment by DD, at which point it is clear they pay an extra charge);
 - it is unclear why prominence and transparency are needed both in marketing and at point of sale – one is sufficient;
 - our draft guidance cuts across the ASA rules – we are regulating misleading advertising and it is unclear why we need to do this (one MNO also says we are making rules around advertising, which rules which would lead advertisers away from competing on price in advertising and removing the option to pay by non-DD methods).
- A2.59 Another response was that the prominence requirements we are said to propose are unrealistic from a marketing perspective.
- A2.60 There were concerns that having to state two prices would confuse consumers rather than help them, particularly for mobile where there are a lot of different price plans. The effect might be to inhibit the inclusion of pricing information in adverts.

- A2.61 One supplier proposed that where suppliers offer only a limited range of payment options this fact should be made prominent in advertising.
- A2.62 Another stakeholder expressed the view that radio adverts should not have to mention non-DD charges.
- A2.63 Some suppliers who allow payment exceptionally (for example, where DD payments fail) accepted that charges would not be made transparent and prominent in advertising or at the point of sale and so were not core terms (one supplier made a similar point and suggested the guidance should make clear exceptional charges need not be highlighted in general marketing).

Suppliers - fairness

- A2.64 Given that some suppliers did not accept that non-DD charges could be non-core, or believed that their own charges were core terms, there was less comment on this point. Where views were expressed they varied.
- A2.65 One supplier agreed that the charges should be based on legitimate cost recovery principles.
- A2.66 One stakeholder said both bad debt costs and those of chasing payment should be excluded from fair non-DD charges, and said many of the costs claimed by suppliers are indirect and based on assumptions about cash payers' behaviour, not the direct costs of handling cash. It also said suppliers should do more to offer cash payment options and there should be pre-pay fixed line services.
- A2.67 One supplier agreed non-DD charges should not include general bad debt costs on the basis that there is no causal link between a customer's payment method and the same customer becoming a bad debtor.
- A2.68 Some suppliers disagreed that bad-debt should be excluded on the basis that non-DD consumers do present a higher revenue/default risk than others and figures were provided to support this.
- A2.69 One supplier asked for greater clarification about the costs of chasing bad debt (as opposed to the bad debt itself).
- A2.70 One MNO felt that the fairness rules needed to be much more detailed (for example, as to the averaging of costs of administering all payment methods across those who use them) to avoid suppliers all interpreting them differently.
- A2.71 Another MNO disputed the view that only direct costs can be included in fair non-DD charges, saying the OFT bank charges case demonstrates that the Regulations do not regulate price/quality. One supplier also said there is no support for the proposal that non-DD charges' fairness depends on cost justification.

Late payment charges, charges for payment failure and charges for restoring service

Consumers

- A2.72 Consumers made relatively little comment on these charges, and did not tend to comment separately on the core terms and fairness issues. But, some concern was expressed:

- that the amount of time given to pay bills is too short;
- over the fact there might be both a late payment charge and an element of costs to do with late payment within the non-DD charge;
- by consumers who had refused to pay the non-DD charge element of their bill and found that they were then being charged a late payment fee (as well as steps being taken towards disconnection) on account of this; and
- that late payment charges should reflect only the true cost of sending computer generated letters.

A2.73 One consumer stakeholder agreed these default charges should be both transparent and subject to the Regulations' fairness test.

A2.74 Another consumer stakeholder agreed default charges are not core terms. It also broadly supported the proposal that fair default charges reflect only direct costs caused by the default, but said the General Conditions should be amended to require provision of post-contractual information on these charges.

Suppliers – core terms

A2.75 Suppliers made relatively little comment on this point, perhaps reflecting that these charges are not as common as some of the others in the proposed guidance. None disagreed with the proposal that the charges should be considered non-core (three expressly agreed).

Suppliers - fairness

A2.76 Again there was relatively little comment. Those views expressed were mixed.

A2.77 There was some agreement (from 2 suppliers) that the charge should only reflect direct cost.

A2.78 But one supplier said that bad debt costs should be recoverable in these charges because they are a legitimate element of the direct recoverable costs and which target cost recovery at the customers who have caused the problem.

A2.79 One MNO said it is not correct that only direct costs may be recovered in these charges – the amount/magnitude of charges is not addressed in the Regulations save in a limited respect – and that the OFT bank charges case confirms this.

Minimum contract periods and early termination charges (initial contract)

Consumers - MCPs

A2.80 Few consumers expressed views on these terms. Some said MCPs should not be allowed where there is no visible upfront benefit (for example, a mobile contract where no handset is provided). Some objected to paying both an upfront connection charge and being tied into a MCP.

Consumer stakeholders - MCPs

A2.81 Some consumer stakeholders were concerned about the length of MCPs and the lack of understanding among consumers.

- A2.82 One agreed with our proposed position.
- A2.83 Another said suppliers must be more transparent about MCPs and reported cases where complainants to it were unaware of MCP terms.
- A2.84 A third consumer stakeholder noted that it deals with many cases where consumers claim they were not told about MCPs and welcomed our guidance on the need for transparency and prominence.
- A2.85 Another still said our proposals do not explain why MCPs are necessary in the broadband and fixed line markets and will not be sufficient to stop MCPs acting as switching barriers and dampening competition.

Suppliers - MCPs

- A2.86 Suppliers generally agreed that the MCP is a core term.
- A2.87 However, some suppliers disagreed that this is a function of transparency and prominence (one, for example, said only plain, intelligible language is required).
- A2.88 In particular, there was some disagreement over Ofcom's proposals on prominence. One supplier said such prominence is unrealistic and not required given that MCPs are more the rule than the exception. It also questioned how we would assess the fairness of a MCP which is not a core term.
- A2.89 Two suppliers expressed concerns over MCPs and the effect of dampening competition, particularly in the fixed voice market. One said direct set up costs for fixed voice services are very low so there is little justification for these terms. These views were expressed in policy, as opposed to legal, terms.

Consumers - ETCs

- A2.90 Relatively few consumers expressed views. Those expressed included that:
- ETCs are too high and do not reflect set-up costs;
 - they penalize people who move house frequently; and
 - one consumer claimed they were not made aware they were entering into an 18 month contract – and the ETC was more than the value of the contract.

Consumer stakeholders - ETCs

- A2.91 Consumer groups gave these responses:
- one welcomed the proposals, but felt it was unclear how they would work in practice;
 - another felt the proposals did not go far enough;
 - others agreed ETCs should never exceed retail payments and should reflect saved costs;

- one welcomed the guidance that MCPs and ETCs should be transparent at point of sale (it also wanted Ofcom to compel the provision of written terms when contracts are entered over the phone or internet); and
- one said our proposals will not be sufficient on their own to ensure a fully competitive market, because ETCs are a substantial switching barrier.

Suppliers – ETCs core terms

A2.92 Suppliers' responses are summarised as follows:

- fixed line suppliers who expressed a view generally agreed with Ofcom's proposal that the ETC is a non-core term and hence subject to the test of fairness;
- MNOs, however, expressed the view that their ETCs are core terms, for reasons including:
 - ETCs are simply remaining retail payments (in some cases with a small discount to reflect early payment), and in the same way the monthly charge is core, so the ETC based thereon must be;
 - ETCs are simply the amount that the consumer has agreed to pay when entering into the contract (some even go as far as expressly to suggest that Ofcom is seeking to consider and investigate standard monthly retail charges and seeking to tie them to regulated wholesale prices);
 - ETCs are a right to terminate, not a default charge that can be characterized as 'non-core;' and
 - One MNO expressed the view that its, 'ETCs are clearly set out in the contract and therefore form a core term.'

A2.93 One supplier also said Ofcom should not make definitive statements about what terms are core or non-core as this can only be determined case by case.

Suppliers – ETCs fairness

General

- A2.94 Considerable concern and disagreement was expressed by suppliers over our proposals, both from a legal point of view and more broadly in terms of the impact on the market. The exact concerns varied according to respondent and sector.
- A2.95 There was some general recognition that direct wholesale charges suppliers save on early termination should be reflected in reduced ETCs.
- A2.96 Some suppliers also highlighted an alleged inconsistency with migrations processes: our proposed guidance on 'best practice' relating to ETCs suggests it is important consumers are informed of ETCs at the point they are considering terminating contracts, but, they said, gaining provider-led migrations processes do not allow for this.

Fixed-line suppliers

A2.97 In general, fixed-line suppliers offered more positive responses:

- some agreed ETCs should not exceed outstanding retail payments;
- four agreed they save wholesale costs on early termination
- one of these, for example, agreed the principle of loss mitigation should apply, welcomed the clarity in setting out certain types of mitigated costs and acknowledged that on early termination it saves the pure (wholesale) costs of call conveyance;
- another of them acknowledged that, ‘... if a customer is not active then naturally we do not incur inclusive minute costs;’.and
- one also accepted that an ETC should not leave the supplier better off than if a customer stays until the end of the MCP.

A2.98 However, even among fixed-line suppliers:

- there were concerns about the practical impact of our proposals: particularly that fixed line services are often sold so that the contract is only profitable if the consumer stays beyond the end of the contract and/or pays for services outside the minimum contractual commitment, and that in these cases our proposals may leave suppliers not recovering initial upfront costs;
- three said expected profits from services outside the contractual bundle and commitments should be included in fair ETCs (though one said we should only look at anticipated profits in services within – and not beyond – the MCP in terms of timescales). One of these said such profits are recoverable as a matter of law; and;
- some suppliers said the guidance should reflect that an ETC can fairly recover either remaining retail payments less saved costs or wasted upfront costs.

A2.99 Fixed-line suppliers also expressed these concerns about shared costs (whether shared wholesale costs or own network costs):

- they tend to be ‘lumpy’ – so it cannot be said they are avoided when ‘single connections are terminated;’
- where costs structures are different; a supplier could not mitigate its network costs;
- one said its own network costs saved in respect of fixed voice calls are very low, if not non-existent. Those costs are not directly attributable to the voice service given that it is a small proportion of the bandwidth travelling over the supplier’s network (which is deployed primarily for IP data and IP video purposes); and
- another said its wholesale interconnection costs with other networks are not saved on early termination.

A2.100 More generally, including on such shared costs, some fixed-line suppliers emphasised the importance of having a consistent approach: one said the proposed

principles must be applied consistently and there should be administrative thresholds for all suppliers, including pay TV, or for none, and the guidance should be clearer about our position on ETCs for bundles.

MNOs

A2.101 Generally, the MNOs said our economic and legal analysis was wrong. As noted and considered above, several questioned why there was no impact assessment. Our proposals were said to be assertions of policy not an interpretation of a legal instrument.

A2.102 Other general points raised included:

- One MNO said practical problems arise from the inclusion of too little detail about, for example, what costs Ofcom says are recoverable in ETCs and whether ETCs are individual to each customer or averaged over all customers;
- a number of MNOs said there is insufficient evidence of any problem with ETCs: even our research shows 70% of people are aware of mobile MCPs, the vast majority of consumers feel contracts should be honoured once signed and that ETCs are by and large acceptable, and Ofcom complaint data suggests a relatively low level of complaints for ETCs (less than 60 a month);
- some suppliers referred to the availability of pre-pay alternatives to post-paid fixed-term contracts (and different kinds of post-paid contracts) both as relevant to the question of whether there is any real problem with ETCs and relevant to the assessment of their fairness (including 'good faith') under the Regulations;
- two MNOs also said any intervention in ETCs will have an asymmetric impact if suppliers end up with different ETCs, which would favour certain providers, technologies and/or business models;
- another MNO also questioned that suppliers must, '...consider the extent to which network costs are already recovered via headline prices, without the need for ETCs.' It did so on the basis that ETCs are the headline prices and consist of the same charges;
- one MNO also described our proposals as 'over-paternalistic' (protecting some consumers to the detriment of others), operating as the 'thin end of the wedge' whose costs are recovered elsewhere and achieving a standardization of the market that would be unlawful on competition grounds if agreed between industry players;
- another said 'removing' ETCs will result in a shifting of cost recovery to all consumers, including those who fulfil fixed terms, which is not fair because all consumers could experience significant price increases;
- three MNOs said our proposals will undermine the way the mobile contract market works (by incentivising early termination, and so undermining the fundamental nature of the fixed term/MCP contract and the revenue guarantee it provides and on which operators rely to forecast network traffic and investment, especially if ETCs are heavily reduced) and will mean:
 - handset subsidies will not be offered (or will be reduced); and

- there may be a disincentive to offer packages with bundled minutes and a move to per call/text charges.
- One of these MNOs said Ofcom underestimates the widescale and far-reaching implications of its proposals for ETC. It said that if the guarantee that a MNO will receive the monthly charge for the duration of the fixed term contract is undermined, "... it will have the most radical impact on the market" (though it also acknowledged that if the effect of Ofcom's proposals is that MNOs can recover the vast majority of monthly payments, "... the implications may not be great");
- Another of them described an 'arbitrage' risk to MNOs arising out of Ofcom's proposals. That is, of consumers setting up a number of contracts with high value subsidized handsets and then terminating them early on payment of reduced ETCs. This risk would soon see MNOs charging consumers the true cost of high value handsets.
- One MNO said we cannot 'institute the proposed changes' whilst issues about the wider competitive picture (e.g. mobile number portability and MCT rates) are unresolved (before the CAT), as this will exacerbate the wider problems with competition in the mobile market (and any guidance could be rendered obsolete by the CAT decisions).

A2.103 MNOs also made specific points to the effect that our proposed methodology is flawed:

- it proceeds on the (flawed) assumption that MNOs are better off when customers terminate contracts early and ignores the costs of early termination, and would put suppliers in a worse position because they allow the right to terminate contracts early, than if they did not;
- ETCs equivalent to retail prices are just 'fair' recovery of the price the consumer agreed to pay;
- one MNO said long term contracts help reduce costs and uncertainty for suppliers, and promote efficiency and investment, in turn enabling them to offer discounts. If consumers break their fixed term commitment they should repay some of the discount. And, it elaborated a little on the point above that ETCs are a fair recovery of the 'price,' saying they would have a legal right in ordinary contract law to claim 'a minimum term worth's of line rental' and that the Regulations cannot be used to undermine that;
- the same MNO also said that if Ofcom expects it to mitigate its losses this is to treat the ETC as a liquidated damages clause, and this is a radical rewriting of UK law;
- it fails to allow for the lost opportunities to receive termination revenue from inbound calls and to receive income from calls and services outside the contractual bundle, having inadequate regard to the ordinary legal position that allows the recovery of lost profit on breach of contract;
- one MNO linked these revenues to the recovery of the subsidies it provides when giving consumers handsets. It said it invests in a given contract consumer by supplying them with their handset without recovering at the point of sale either the handset cost or the cost of selling the handset. It relies on recovering this investment from income streams outside the contractual

package (such as calls made when any inclusive allowance has been exceeded or calls of types outside the bundle, like international calls) and also inbound calls made to the consumer. So, it said, rather than ETCs being mitigated by any unused network costs, its ETC, which is less than the revenue streams expected from an on-going customer, is needed to mitigate the handset subsidy given to the departing customer;

- other MNOs made the similar point that upfront acquisition costs are recovered through retail prices. The mobile handset subsidy, for example, means consumers are unprofitable for much of their contract, so unrecovered costs on early termination are outweighed by recouped ones. But, our proposals ignore that, so MNOs would be forced to lose money on consumers who terminate contracts earlier than the point at which they become profitable;
- it (the proposed methodology) discriminates against suppliers who have more outgoing than incoming traffic (and so, presumably, more saved costs by which ETCs should be reduced); and
- another MNO also made a similar point about discrimination: that our proposals may favour certain business models or technologies used to provide the same services (that is, against broadband providers using certain technology as against some others using different technology).

A2.104 In addition, MNOs submitted that they do not save money or mitigate costs when a consumer terminates a fixed-term contract early, for reasons including:

- network costs are fixed costs, not marginal costs relating to each consumer, or are at least lumpy costs not borne at individual consumer level and saved when a consumer terminates a contract;
- one MNO, for example, said radio access and core network costs are not linear with traffic levels. Increments in network capacity are only added in significant blocks. And, MNOs will already have made significant investments for coming years based on expected traffic. Long term contracts allow for this long term planning and making the required lumpy investments. And, predicted early terminations will already have been taken into account. Investment could only be reduced (and savings made) if reduced capacity requirements are predictable in advance, but uncertainty over termination levels (given any new ETCs resulting from Ofcom's proposals) would mean such prediction would be difficult. So, save over the medium to long term, there is little scope for saving costs where consumers terminate contracts early;
- the number of consumers terminating early is too small to have a big impact on network investment and capacity. One MNO said, for example, the number " ... is anyway inside the likely forecast planning error and the capacity headroom and should make no practical difference to the level of network investment." Another said an individual consumer terminating a contract early does result in a saving of capacity or costs. All of the elements of the network must continue to exist and be maintained in order to support all of the remaining millions of subscribers. If an individual subscriber terminates their contract early, the only consequence is that an infinitesimally small amount of extra capacity is created on the network, which cannot reasonably be measured and which will not directly be compensated for by any additional subscriber;

- unless forgone consumer traffic is replaced immediately and with like 'replacement traffic' in a similar part of the network MNOs will face a cost, and there are costs of acquiring replacement customers that account must be taken of;
- MNOs also incur opportunity and option costs in investing in networks, of which account needs to be taken;
- mobile networks are built to have spare capacity;
- network models, and pricing of contract packages, already allow for disconnections and demand, so crediting 'freed up' capacity is double counting. One MNO said, MNOs build their networks making,".... forecasts of future traffic demand are based on assessments of usage per customer for all services and of net customer growth i.e. connections less disconnections..... In one sense therefore the network dimensioning is already allowing for early termination since existing churn calculations that drive the level of future disconnections already contain an element of early termination of new customers based on historical experience.';
- one MNO said Ofcom's proposed approach assumes demand is growing, but it may not be and the proposed approach where demand is reducing is not clear. Another said the proposals for saved network costs are flawed because they assume networks are at capacity and 'at scale' so that early termination frees up capacity to meet other demand. But, where a network is built to capacity, there is no adding of it when a new consumer enters a contract nor any re-distribution when one leaves, and so no saved network costs to be reckoned in calculating fair ETCs.

A2.105 As to the proposed possible use of LRIC to calculate saved network costs, MNOs said:

- it is not clear LRIC is the right proxy, because for example it:
 - is just one method used to determine costs and not one suppliers may use to set prices;
 - includes fixed costs (and does not identify avoidable or incremental costs);
 - excludes customer acquisition costs;
 - assumes 'average efficient operator's costs,' not the specific operator's;
 - is for determining voice call termination costs in timescales measured over decades, not other costs (which will vary depending on a consumer's location and the type of technology he uses (2 or 3G)); and
 - will require significant ongoing work for Ofcom and industry (primarily Ofcom);
- using LRIC ties markets (tying retail returns (ETCs) to regulated LRIC for mobile call termination, distorting pricing behaviour and markets);
- mobile call termination rates are contested so Ofcom should not use the same methodology ('to set retail prices') in relation to ETCs until/unless the termination

issues are resolved. One MNO said doing so would be prejudicial to the ongoing proceedings about those issues.

A2.106 Some MNOs also gave responses that might be seen as more specific to their particular ETCs:

- one said that even if its ETC is subject to the Regulations fairness test it passes because:
 - it is not contrary to the Regulations' 'requirement of good faith,' '...as it gives the customer the chance to mitigate the effect of the minimum term;' and
 - does not cause a significant imbalance etc 'as it does not detract from the customer's rights and the customer is under no obligation to exercise this option'.

It, and another MNO, also made the more general point that ETCs are not additional charges, but key contract provisions that are part of the wider bargain: the consumer receives benefits in return for his commitment to a long term contract. As a result, it is not unfair to charge the consumer a disclosed fee that is agreed upfront if they do not fulfil their end of the deal. This is the payment of an agreed sum to terminate, pursuant to a clear and transparent term, not a charge payable on default or an unfair penalty. It said Ofcom's proposed approach would put it in a worse position than if it did not allow its consumers the right to terminate their contracts.

- another said its approach is consistent with the OFT's guidance that an ETC is fair if it reflects a real and fair pre-estimate of the lost profits on early termination. It said it makes a reasonable pre-estimate of the profitability of consumers over the lifetime of contracts, including allowances for disconnections and that consequently its strict enforcement of the MCP (presumably by way of the ETC) is justified.

A2.107 Some of the MNOs also referred to a recent OFT Economic discussion paper: 'Interactions between competition and consumer policy' http://www.ofcom.gov.uk/shared_ofcom/economic_research/ofcom991.pdf. They said this suggested the OFT believes that intervention should not occur in circumstances where the vendor has subsidised hardware and noted that specific reference was made to offering a free mobile handset in return for a guaranteed contract period.

Broadband suppliers

A2.108 A small number of broadband suppliers made the following responses:

- one acknowledged that (only) wholesale end user costs are saved on early termination, but also said costs like backhaul, ports, exchange space, power charges and tie cables are fixed costs not saved on early termination, and that ETCs may need to be increased to reflect unavoidable set-up costs;
- it also said it seeks to recover other upfront costs in retail prices, 'and indeed the recovery of cost through billing to term' (ETCs). Examples it gave were:
 - marketing acquisition costs (marketing spend and promotional discounts);
 - Openreach jumpering costs;

- upfront CPE costs (modems/router, set top boxes for IPTV);
- installation costs for IPTV; and
- set-up charges for CPS/MPF calls;
- it went on that if all those costs Ofcom proposed may fairly be recoverable must be recovered within the contract period this could lead to higher prices on existing contract lengths or substantially longer contracts;
- another supplier made a similar point about fixed costs, though it also acknowledged that backhaul costs are ultimately driven by the size of the overall customer base, albeit they are lumpy, and port costs may be saved if ports are re-used; and
- another still said ETCs equal to outstanding retail payments should be allowed where there is no connection fee.

Other suppliers' responses

A2.109 One supplier made the following points:

- our proposals go beyond common law principles because they say ETCs must never be higher than remaining retail payments, whereas there may be charges incurred to third parties because of early termination and which may be recoverable by way of ETCs;
- the proposed guidance on mitigation of costs by reselling services appears to apply only to customers terminating contracts early to move home and that, in any event, mitigated sums should also take account of the acquisition costs of the alternative customer; and
- the guidance should also reflect that an ETC can fairly recover either remaining retail payments less saved costs or wasted upfront costs;
- principles of practicality and proportionality should apply – costs that are shared are not attributable to any individual customer and should not be deducted in the calculation of a 'fair' ETC; and
- the proposition that savings in shared network costs should be taken into account in ETCs is flawed in terms of economic logic. Network costs are fixed costs and do not vary with the addition or loss of individual customers, even if significant numbers terminate contracts early.

A2.110 Another did acknowledge that on early termination it would save some wholesale costs.

ETC thresholds

A2.111 A number of different suppliers also commented on the proposal that we consult on and set enforcement thresholds for ETCs. Some did so in their main consultation responses. Others did so in separate correspondence about or in response to our further requests for information from them.

A2.112 Some suppliers made comments that did not necessarily oppose our consulting on and seeking to set ETC enforcement thresholds.

A2.113 One MNO said:

‘Ofcom’s guidance contains little detail or explanation as to how it expects this to work in practice. We understand that a further consultation on this point is due in the summer, which will hopefully provide a much greater level of detail upon which we can comment;’
and

‘If Ofcom does not provide very clear guidance as to what costs should be taken into account and the formula to be applied to them there is obviously an extremely high risk that different providers will apply different interpretations.’

A2.114 One supplier said there should be thresholds for all suppliers, including pay TV, or for none. It also said it might be fairer and simpler to have a single set of technology-neutral benchmarks by which at a minimum, all suppliers should reduce their ETC based on average variable costs for both lines and calls per customer across the industry for fixed voice services.

A2.115 Other suppliers made comments that strongly opposed possible consultation on, and the setting of, ETC thresholds.

A2.116 Some said we should not take seek to set thresholds until we have decided on the legal principles applying to ETCs, as doing otherwise suggests Ofcom has not considered the consultation responses and is imposing a pre-determined view. One MNO expressly said Ofcom is proceeding with little regard to stakeholders’ substantive comments on the consultation.

A2.117 A number of suppliers said they did not construct charges and/or hold costs information in the form sought by Ofcom as part of its consideration of whether to seek to set enforcement thresholds. They said detailed network costing exercises would need to be undertaken. They also continued to challenge our approach to the underlying principles of saved costs and mitigated losses. They challenged our position on saved network costs in particular, on the basis such costs are not saved when individual consumers terminate contracts early because of their small number and the nature of network investment decisions (which mean that costs in meeting alternative demand are not in fact saved).

A2.118 One MNO said that it was unclear how Ofcom considers that it can publish any meaningful benchmark in its guidance given the commercially sensitive nature of individual operator cost information and the need for any enforcement action to take into account an individual supplier’s own costs. Another also referred to the need to take into account the facts of each case, saying costs and revenues vary from contract to contract and network to network, and each case must be considered on its own facts, so the purpose and validity of any thresholds is questionable.

A2.119 Having set out why it opposed Ofcom’s proposed principles on ETCs, one MNO said it would strongly urge Ofcom to re-consider introducing industry wide ETC thresholds.

Minimum contract periods and early termination charges for subsequent contracts

Consumers

A2.120 Some consumers expressed concern over the requirement to enter into new MCPs on moving home.

Consumer stakeholders

A2.121 One consumer stakeholder agreed with our, '... approach that these contract terms should be transparent and fair.' Another agreed SMCPs may be necessary where there is tangible benefit to the consumer and cost to the supplier, but not otherwise.

A2.122 However, one consumer stakeholder disagreed, saying it could see no justification for locking existing customers into new contracts because they move home or up- or down-grade services.

Suppliers - general comments

A2.123 One MNO said our proposals seem to assume consumers have a unilateral right to vary the terms of their contracts.

A2.124 One supplier said the guidance needs to address separately SMCPs arising by negative opt-out and those arising 'conventionally' through an opt-in.

A2.125 Another supplier said the guidance should distinguish between:

- SMCP terms that provide for the extension or re-starting of contracts on the happening of (standard) events like moving home or up or down-grading services; and
- scenarios where consumers enter whole new contracts on different terms (e.g. on expiry of minimum terms or in response to special offers), where there is no SMCP term in the original contract.

It said the MCP in the latter case at least will be a core term of a new contract.

A2.126 One supplier accepted its current terms and conditions on SMCPs do not comply with the proposed guidance and agreed it would be looking to change them.

Suppliers - core/non-core

A2.127 Different views were expressed on Ofcom's proposals.

A2.128 Two suppliers agreed terms triggering SMCPs are core terms.

A2.129 By implication at least, one supplier also agreed that SMCP trigger terms applying automatically to renew a fixed term contract unless the consumer opts out are not core terms.

A2.130 One supplier's view was that the terms might be core terms, but the question is academic because a SMCP can only be enforced where the ETC is fair.

- A2.131 Another disagreed that SMCP terms are always non-core. It said that if terms providing for automatic renewal of a contract are sufficiently clear, there is a strong argument the term is core.
- A2.132 MNOs appeared to disagree with the proposed guidance. They appeared to dispute even the possibility of the fairness test applying. They made the following specific comments:
- One MNO disagreed that terms triggering SMCPs are always non-core terms and their status will differ according to the relevant commercial offer. So, it agreed trigger terms relating to automatic renewal and service downgrades are probably not core terms. But, it said where a consumer signs a new contract for a new handset on a new tariff any new MCP is a core term.
 - Another MNO said there is no basis for treating a SMCP differently to a MCP: the SMCP is merely another bargain and the consumer is free to choose another provider.
 - A third MNO also disagreed that SMCP trigger terms are non-core, especially in relation to handset upgrades. It said we are wrong to say it is unrealistic that a reasonable consumer would not consider the SMCP as part of the contract's main subject matter, because the ability to upgrade is often one of the most important considerations for consumers.

Suppliers - test of fairness

- A2.133 There was agreement among some (five) fixed-voice and broadband suppliers with the principle that there should be a benefit to the consumer (or a cost to the supplier e.g. a significant change to the services) and that in some cases subsequent MCPs would not be fair.
- A2.134 One, for example, agreed SMCPs will only be fair where the supplier has to make new investment or incur additional cost, or there is a tangible benefit to the consumer which he would not enjoy without the SMCP.
- A2.135 One MNO agreed at least in part with our proposals about when a SMCP will be unfair, but disagreed with the conditions required for a SMCP to be fair:
- many offers, which change regularly, can trigger SMCPs, and not all will be known or exist at the time the original contract is entered into;
 - there is no logic to the position that the costs and benefits under the SMCP must be the same as, or commensurate to, those under the original contract;
 - instead, a SMCP should be (fairly) imposed only where it is commensurate to the benefit given to the consumer;
 - we should clarify what we mean by 'costs' to the supplier (does it include loss of revenue?); and
 - we should consider the impact of our proposals – if they meant offers to consumers are withdrawn that would not be in the best interests of consumers or competition.

- A2.136 Another MNO said there is no basis for assessing the adequacy of the remuneration for the SMCP or considering the fairness of the SMCP by investigating the cost to the supplier (these matters, or the first at least, are exempt from the fairness test by virtue of UTCCRs Regulation 6(2)(b)).
- A2.137 One supplier said the guidance should be clearer on the fairness of renewable contracts involving opt outs (rather than opt ins). Its view was that opt out mechanisms in fixed telecommunications contracts are unfair.
- A2.138 Another also said terms providing for automatic renewal of MCPs unless consumers opt-out are unfair.

Minimum notice periods

Consumers

- A2.139 Consumers made no express comment on these terms

Consumer stakeholders

- A2.140 One consumer stakeholder agreed with our, ‘...approach that these contract terms should be transparent and fair.’
- A2.141 Another stakeholder agreed MiNPs are not core terms and are subject to the fairness test, and with our proposals about how that test applies, but also said the General Conditions should be amended to require provision of post-contractual information on MiNPs.
- A2.142 One stakeholder also agreed MiNPs should be no longer than the administrative processes required to terminate contracts.
- A2.143 One consumer stakeholder thought one month was unlikely to be unreasonable.

Suppliers – core terms

- A2.144 No suppliers disagreed with Ofcom’s proposal that the MiNP term is non-core.

Suppliers - fairness test

- A2.145 There was some agreement with Ofcom’s proposals.
- A2.146 Several fixed-voice and broadband suppliers agreed with our proposed position (though one said ‘alignment’ with wholesale suppliers is required).
- A2.147 One MNO agreed a MiNP which is unduly long for no good reason is unfair. And, one supplier said MiNPs should only be used where there are ‘genuine operational reasons.’
- A2.148 Another supplier said it would look at its MiNP against the guidance.
- A2.149 The main area where greater clarity was requested was over MiNPs in mobile contracts: MNOs wanted to understand how the guidance applied to mobile number portability where the time to port a number was expected to reduce to 2 hours in 2009.

- A2.150 One MNO queried whether we propose that notice periods of more than 2 hours are unfair for MNOs. It said a two hour period would contravene the principle of technology neutrality. It also said the processes for porting, which are automated, and for administration of termination of contracts, which involve manual administration, are separate and the latter take longer (and requiring notice is not unfair).
- A2.151 Another MNO made the same point about separate migration and termination processes and said MiNPs could not possibly be a switching barrier where migrations must occur within set timescales.
- A2.152 One supplier asked for greater clarity as to what happens where there are different migrations processes for different parts of the service.
- A2.153 One supplier said MiNPs are part of the terms used to deter switching amongst suppliers.
- A2.154 Some suppliers also commented that our 'best practice' proposals need to be consistent with migrations processes, and recognize that losing providers may be unable to inform the consumer of the MiNP.

Itemised and paper billing

Consumers

- A2.155 Some consumers expressed concerns that offering lower charges for those who take paperless billing discriminates against:
- those without computers/internet access, many of whom will be on lower incomes; and
 - disabled customers who cannot use a computer.
- A2.156 Concerns were also expressed at charges for itemised billing (whether in paper or paperless form) as consumers receiving summary bills are unable to check charges are accurate and have no way of querying the bill.

Consumer stakeholders

- A2.157 Consumer groups expressed similar concerns.
- A2.158 One consumer stakeholder submitted that Ofcom should make a clear statement that everyone should get a free non-itemised paper bill. Another also said we should instruct suppliers that these charges are no longer permitted.
- A2.159 Another stakeholder disagreed with our proposals: it said believes there should be no additional charges for paper and itemized bills (though it also said suppliers should be able to offer discounts where consumers choose paperless and/or non-itemised bills).
- A2.160 One stakeholder said both paper and itemised bills should be free, so consumers can check their usage of services and that bills are accurate: 'no-one would accept restaurants charging for bills; Suppliers should be no different.' It says such free bills should be required by the General Conditions.

- A2.161 One stakeholder said we should undertake an immediate review of GC12 to lay down specific requirements for itemised bills.

Suppliers – core/non core

- A2.162 Generally, suppliers agree that these charges should be clear (some said they are already clear with consumers and, as with non-direct debit charges, some suppliers disputed the need for prominence).
- A2.163 One supplier agreed with our approach and conclusions.
- A2.164 One MNO agreed these charges may be core or non-core terms and made the same comments on these charges as non-DD charges. It also said the information we propose should be in marketing material to make the terms core is excessive and impractical.
- A2.165 Another supplier said the proposed guidance wrongly suggested core terms must define the main goods and services under the contract **and** be part of the headline price (see paragraph A5.97 of the draft guidance).
- A2.166 One other supplier said its charge for itemised billing is a core term: it is part of the essential bargain communicated in plain intelligible language to consumers because consumers must opt-in to receiving an itemised paper bill, at which point it is clear they pay an extra charge.

Suppliers - fairness test

- A2.167 Two suppliers indicated agreement with our proposals.
- A2.168 One said it is not, ‘...fair and transparent to display line rental prices which make paper billing an additional charge.’
- A2.169 Another agreed with our approach and conclusions.
- A2.170 Otherwise, some suppliers merely agreed with our proposal that there is little evidence of a need for further intervention by Ofcom in these charges.

Cease charges

Consumers

- A2.171 Consumers made no express comments on these charges.

Consumer stakeholders

- A2.172 One consumer stakeholder said we had not provided enough information to justify the cost of these charges and should consider them again.
- A2.173 Another stakeholder agreed these charges are not core terms and with our proposed approach to the fairness test, but said the charges should not be made where consumers die. It also says we should compel provision of post-contract information about them by amending General Condition 10.

Suppliers – core/non core

A2.174 Very few suppliers expressed a view, and where they did so there was agreement these are non-core terms.

Suppliers - test of fairness

A2.175 Again, very few suppliers expressed a view, and where they did so there was agreement that these charges may recover only direct costs.

Annex 3

Glossary

Additional charges	Consumers are sometimes required to pay additional amounts of money ('additional charges'), over and above the headline prices they expect. For example, they may pay more in order to pay bills by cash or cheque, rather than by direct debit (through a 'non-direct debit' charge). Other examples include: paying an early termination charge to terminate a contract early, or paying extra to receive a fully itemised bill.
ADR	Alternative Dispute Resolution.
Automatic renewal terms	Terms providing for automatic renewal of a contract on expiry of the MCP
BT Basic	Under the Universal Service Obligation (the 'USO'), BT and, in the Hull area, Kingston Communications ('Kingston'), are required to provide social telephony products. BT Basic – available from October 2008 - offers a low cost fixed voice service to those who are in receipt of certain Government benefits. BT Basic does not have a non-direct debit charge and, in contrast to previous social telephony products, will be available to consumers who have prepay mobile phones and / or broadband services.
Cease charges	A charge for consumers ceasing their service from a broadband supplier (even where they are outside their Minimum Contract Period)
Charge to restore service	A charge for consumers who have had service restricted by their supplier (for example, having outgoing calls barred) due to non payment and who now wish to resume full service.
Core terms	Terms which define the main subject matter of the contract are exempt from the test of fairness, provided that they are in plain, intelligible language. Similarly, the test of fairness does not apply to the adequacy of the price as against the goods or services provided in exchange, again provided that plain, intelligible language is used (Regulation 6(2)(b)). These are the terms and matters which reflect the essential bargain between the parties – what they, but primarily the consumer, would say the consumer is buying under the contract and the price for it – and which are often referred to as "core terms." Any other term is a "non-core" term.

Enforcement order	An order obtained from the courts under Part 8 of the Enterprise Act 2002 to stop conduct by suppliers which breaches consumer law (for example, using terms which are unfair under the Regulations).
Enterprise Act 2002	<p>Legislation which provides an additional mechanism for enforcing the Regulations, as well or instead of seeking an injunction under the Regulations.</p> <p>Under Part 8 of this Act, the OFT and other bodies including Ofcom can obtain from the courts enforcement orders against traders who breach consumer legislation like the Regulations.</p> <p>More information on the Enterprise Act can be found on the OFT's website at www.ofcom.gov.uk.</p>
ETC	Early Termination Charge. A charge for consumers who terminate their contract before the end of any Minimum Contract Period (or Subsequent Minimum Contract Period).
Fairness	The Regulations apply to ensure fairness for individual consumers, by ensuring transparency of terms, and applying a test of fairness to all terms except core terms that meet the requirement for transparency (see below).
GC	General Condition. The General Conditions of Entitlement apply to anyone who provides an electronic communication service or an electronic communications network.
GC 10 and GC 12	General Conditions 10 (on transparency and publication of information) and 12 (on itemised billing).
Injunction	A court order obtained under the Regulations stopping the use or the recommendation for use by a supplier of terms which are unfair under the Regulations.
Late payment charge	A charge for consumers who make late payments of sums owing to their supplier under a contract (i.e. beyond the invoice due date).
MCP	Minimum Contract Period. A minimum (fixed-term) contractual period set at the start of a contract (often for 12 to 18 months).
MiNP	Minimum Notice Period. The notice period which a consumer must give their supplier before they can bring their contract to an end.
Non-core	See 'core' above. Any term that is not core is non-core.

Non-DD	Non-direct debit. A charge for consumers choosing not to pay by direct debit.
Payment failure charge	A charge where the consumer's method of payment to the supplier fails (e.g. a direct debit payment fails or a cheque bounces).
The Regulations	The Unfair Terms in Consumer Contracts Regulations 1999, which apply to terms which have not been individually negotiated in contracts between suppliers and consumers. They apply the test of fairness described below.
Subsequent MCP	Subsequent Minimum Contract Period. A clause providing for a new Minimum Contract Period (or extension to an existing Minimum Contract Period) for existing consumers wishing to change their service in some way (e.g. changing their service package, or moving house) and/or on the expiry of the original Minimum Contract Period.
Test of fairness	If a term is not a core term it will be subject to assessment as to whether it is fair or unfair under the Regulations (including whether the level of the charge is fair or not). Terms which would otherwise be core terms, but which do not meet the requirement for transparency (see below), are also subject to this test. Core terms which meet the requirement for transparency are not subject to the fairness test.
Transparency	All terms are required to be expressed in plain, intelligible language. Terms must also, in our view, be set out with due prominence which reflects their importance to the parties. These requirements, which we link to the concept of "transparency", apply to both core and non-core terms.
Undertakings	Promises by suppliers to stop breaches of consumer law, such as using or recommending for use terms which are unfair under the Regulations, which Ofcom may accept in lieu of seeking an injunction or enforcement order.
USO	Universal Service Obligation. This is a series of requirements, currently upon BT and Kingston Communications, to provide every household in the UK with access to a landline telephone.