

Guidance on unfair terms in consumer contracts

PLEASE NOTE

This guidance relates to consumer contracts entered into from 1 October 2015

Terms in consumer contracts entered into on or after 1 October 2015 are subject to the *Consumer Rights Act 2015*. Please see the [CMA Guidance](#).

Terms in consumer contracts entered into on or after the 1 July 1995 and before 1 October 2015 are subject to *the Unfair Terms in Consumer Contracts Regulations 1999*, for which Ofcom guidance can be found [here](#).

Introduction

1. This is a brief update on provisions of the law relating to unfair terms in consumer contracts and Ofcom's approach to guidance on those terms.

Background

2. Standard-form terms in contracts between businesses (including those providing communications services) and consumers beginning before 1 October 2015 are subject to the Unfair Terms in Consumer Contracts Regulations 1999 ("the UTCCRs").
3. In November 2010, Ofcom published its updated guidance ("the Ofcom Guidance") on the application of the UTCCRs to certain terms and charges in consumer contracts for communications services. These terms and charges included:
 - 3.1. default charges – such as late payment charges, charges for payment failure and charges for reconnection;
 - 3.2. early termination charges ("ETCs") – charges payable by the consumer where they terminate a contract of fixed duration before the expiry of that period; and

- 3.3. cease charges – charges made to consumers, often by passing on wholesale charges, where they cease to receive a service from a provider.
4. The UTCCRs were repealed by the Consumer Rights Act 2015 (“the CRA”) with effect from 1 October 2015. The CRA applies to terms in contracts entered into from that date (with the UTCCRs continuing to apply to terms in consumer contracts entered into before then).
5. The CRA is in similar terms to the UTCCRs. It contains the same fairness test, a similar (though not identical) exemption from that test in relation to certain aspects of certain key terms, and a ‘grey-list’ of terms that may be unfair (in Schedule 2 Part 1 of the Act). The grey-list is substantially the same as that in the UTCCRs, but with the addition of three new terms.

Guidance

6. Ofcom will continue to have regard to the Ofcom Guidance in considering the application of the UTCCRs to relevant terms in contracts entered into before 1 October 2015. We may also have regard to aspects of that guidance in relation to terms which are dealt with in a similar way under the CRA as under the UTCCRs.
7. Ofcom will not for the time being, however, produce its own sector-specific guidance on the unfair terms provisions of the CRA. The Competition and Markets Authority (“the CMA”) has produced guidance (“the CMA Guidance”) about the application of that Act to terms in contracts entered into from 1 October 2015. In considering such terms in communications contracts, Ofcom will usually have regard to that guidance.
8. The CMA Guidance covers a number of matters that are likely to be relevant to providers of communications services. Given the similarities between the UTCCRs and the CRA, some of these overlap with what we said in the Ofcom Guidance.
9. In particular, the CMA guidance covers these terms which are included in the grey-list to the CRA (in paragraphs 5 and 6 of Schedule 2 Part 1, respectively):
- “5. *A term which has the object or effect of requiring that, where the consumer decides not to conclude or perform the contract, the consumer must pay the trader a disproportionately high sum in compensation or for services which have not been supplied.*”

“6. A term which has the object or effect of requiring a consumer who fails to fulfil his obligations under the contract to pay a disproportionately high sum in compensation.”

10. Relevant parts of the CMA’s Guidance deals with these terms on pages 87 – 91. That guidance is likely to be relevant in the assessment of the fairness of terms providing for default charges, ETCs and cease charges.

Default charges

11. In relation to the term in paragraph 6 of the grey-list, paragraphs 5.14.1 – 5.14.10 of the CMA’s Guidance may be relevant in any case.

12. In particular, paragraph 5.14.1 says:

“It is unfair to impose disproportionate sanctions for breach of contract. A requirement to pay more in compensation for a breach than a reasonable pre-estimate of the loss caused to the trader is one kind of sanction that is liable to be considered disproportionate. Such a requirement may be void to the extent that it amounts to a penalty under English common law. However, (as the courts have recognised) a term may still be considered unfair independently of the common law, if it has a penal purpose or effect. ...”

13. It continues in paragraph 5.14.3 that:

“Other kinds of penal provisions which may be unfair are clauses saying that the business can:

- *claim all its costs and expenses, not just its net costs resulting directly from the breach;*
- *claim both its costs and its loss of profit where this would lead to being compensated twice over for the same loss; and*

- *claim its legal costs on an ‘indemnity’ basis, that is all costs, not just costs reasonably incurred....”*

14. When considering the fairness, under the CRA, of a CP’s terms providing for default charges, we are likely to have regard to what the CMA says. We are likely, however, to consider that guidance to be to similar effect to what we said in paragraphs 50 – 57 of the Ofcom Guidance.

15. In particular, we are likely to regard the CMA’s Guidance as meaning, as we set out in paragraph 53 of the Ofcom Guidance:

“For late payment charges, only costs such as those for chasing payments, postage, and loss of interest on bills unpaid should be included. For payment failure we think it likely to be fair to reflect external costs such as bank charges. For charges for restoring service, only direct costs such as the wholesale costs of restoring service should be included.”

16. In other words, terms which provide for charges limited in these ways are more likely to be fair. We are likely to continue to regard terms which provide for default charges recovering other costs as unfair.

ETCs

17. In relation to the term in paragraph 5 of the CRA grey-list, paragraphs 5.15.1 – 5.15.7 of the CMA’s Guidance may be relevant in any case.

18. Paragraph 5.15.1, in particular, says:

“Terms are always at risk of being considered unfair if they have the effect of imposing disproportionate sanctions on the consumer who decides to end the contract early. Paragraph 5 illustrates two different kinds of terms which are calculated to have this effect – disproportionate termination fees, and requirements which can operate so as to force consumers to pay for services they have not received.”

19. Paragraph 5.15.3, meanwhile, says:

“The CMA considers that any termination charge which allows a business to recover more from the consumer than the losses it is likely reasonably to incur as a result of the consumer’s early termination will be open to scrutiny for fairness as being potentially disproportionate. A term requiring a payment for exercising a contractual right to cancel the contract early is likely to be open to challenge as excessive, in the CMA’s view, if it does not appropriately reflect:

- any savings for the business associated with no longer having to provide the goods, service or digital content;*
- any ability of the business to mitigate (reduce) its loss, for instance by finding another customer; and*
- any benefit to the business of receiving a payment earlier than it would otherwise have done.”*

20. Paragraph 5.15.5 continues that:

“A service contract does not necessarily have to provide a formal right of cancellation without liability to be fair. In the CMA’s view, however, it will be under suspicion of unfairness if the consumer who chooses to stop receiving the service is always required to pay in full or nearly in full, regardless of whether allowance could be made for savings or gains available as a result of the contracts’ early termination (see above paragraph 5.15.3). A saving may be available, for instance where there is scope to find other customers to take their place.”

21. We are likely to have regard to this guidance when considering the fairness, under the CRA, of a CP’s terms providing for ETCs. As in relation to default charges, we are likely to see this guidance as broadly similar to that set out in the relevant paragraphs of the Ofcom Guidance. We are likely to continue to adopt a similar position in respect of ETCs to that set out in paragraphs 77 – 84 of our guidance.

22. So, for example, CPs may charge ETCs based on the part of the fixed minimum contract period outstanding at the date of termination. In calculating the ETC, they should make a reasonable pre-estimate of:

- 22.1. the costs they save because they no longer have to perform the contract (such as variable costs like wholesale costs for network access, saved customer service costs and saved network costs);¹
- 22.2. the losses they can mitigate by providing services to a new customer;
- 22.3. the amount by which they benefit from the accelerated receipt of any lump sum ETC, as opposed to periodic payments spread over the term of the contract,

and deduct those from the remaining monthly retail payments the consumer was otherwise contractually bound to pay. The ETC should not include sums in respect of lost revenues from services consumers were not bound to use, nor for other revenues that would not be recoverable as damages had there been a breach of contract.

23. Alternatively, a CP may fairly seek to recover its unrecouped expenditure, like its unrecouped customer acquisition or equipment subsidy costs, on the early terminated contract. But, it may not recover the same losses twice nor charge a higher ETC on this basis than that above.
24. Ofcom is more likely regard terms providing for ETCs as fair where they are limited in these ways. We are likely to continue to regard as unfair terms that purport to charge higher ETCs than those reckoned on these bases.

Cease charges

25. A cease charge is a charge that may be made to consumers where they cease to receive a service from a provider. It is usually a charge made to CPs at the wholesale level and which they pass on to the consumer, and is usually charged separately to any ETC.
26. In line with the guidance set out above, Ofcom is likely to continue to consider that terms relating to any cease charge are more likely fair where they provide only for:

¹ On 6 May 2021 we updated this document to remove a reference to VAT as an example of a cost saving. This followed the introduction of new guidance by HMRC setting out how providers should treat VAT in the context of early termination fees and compensation payments. The guidance is available here: <https://www.gov.uk/government/publications/revenue-and-customs-brief-12-2020-vat-early-termination-fees-and-compensation-payments/revenue-and-customs-brief-12-2020-vat-early-termination-fees-and-compensation-payments>

- 26.1. the recovery of the costs (e.g. wholesale costs) the CP incurs directly as a result of a cessation of service; and
- 26.2. these costs are not recovered via another charge (such as an ETC).