



Ofcom review of additional charges

Including non-direct debit charges and early termination charges

Consultation

Publication date: 28 February 2008

Closing Date for Responses: 8 May 2008

Foreword

Competition in the provision of communications services is good for consumers. Greater innovation is one such benefit, lower prices are another.

While the amount that consumers pay for communications services is falling year-on-year, the full picture is not always so apparent. Charges levied on top of the headline price - for example for non-direct debit payments or late payments or for early termination of contracts - may be unclear to consumers. If so, these additional charges may not be subject to the competitive pressures which discipline headline prices.

Following complaints from consumers, Ofcom has investigated these issues in detail. We have concluded that communications providers need to do more to ensure that consumers are properly informed up front about any charges which may be incurred. Communication providers will also need to change some terms and conditions to ensure these charges are set fairly.

In this consultation we are seeking views on a new set of guidance under the existing Unfair Terms in Consumer Contract Regulations. Ofcom's draft guidance in relation to contracts for communication services is intended to help protect consumers from unfair terms in their contracts and will enable suppliers to comply more easily with the regulations. The key elements of the guidance are summarised in the Executive Summary.

At the same time, there is a concern that some additional charges may fall disproportionately on low-income consumers, increasing their costs or even excluding these consumers from some communication services altogether.

We believe some concerns over access and inclusion for low income consumers are best addressed by targeted social telephony schemes, such as BT Basic, which provides low cost rental (and an inclusive call allowance), with no additional charge for non-direct debit payments, for those in receipt of certain state benefits.

We recognise that there are broader concerns about the amounts low income groups pay for a range of services which go beyond communications services, and we are keen to engage with Government and others in an examination of these issues.

Ed Richards
Chief Executive

Contents

Section	Page
Foreword	2
1 Executive summary	4
2 Introduction	10
3 Charges for payment method (non-direct debit charges)	21
4 Late payment charges, charges for payment failure and charges for restoring service	44
5 Minimum contract periods and early termination charges (initial contract)	53
6 Minimum contract periods and early termination charges for subsequent contracts	71
7 Minimum notice periods	77
8 Itemised billing	82
9 Cease charges	89
Annex	Page
1 Responding to this consultation	91
2 Ofcom's consultation principles	93
3 Consultation response cover sheet	94
4 Consultation questions	96
5 Draft Guidance on unfair terms in contracts for communication services.	97
6 Glossary	115

Section 1

Executive summary

Background

- 1.1 Consumers of communications services (fixed voice, mobile, broadband and pay TV) have benefited from competitive markets which have helped reduce the headline prices of the services they purchase. However, Ofcom believes consumers need appropriate protection alongside the benefits of competition.
- 1.2 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.
- 1.3 Many consumers are concerned about these types of charges. Ofcom has received a high level of complaints both directly from consumers and via their MPs. While non-direct debit charges have prompted the most public debate, we note that over the last six months Ofcom has had almost as many complaints about early termination charges. We have received complaints about a number of suppliers.
- 1.4 Some stakeholders are particularly concerned that some of these additional charges end up being paid to a disproportionate extent by those on low incomes who can least afford them. This is particularly true of non-direct debit charges. Some people on low incomes cannot pay by direct debit because they do not have a bank account, or do not want to pay by direct debit because that makes it harder for them to manage their finances.

General concerns

- 1.5 Ofcom's concerns focus particularly around transparency and fairness of these additional charges. Many of these types of charges will not be at the forefront of a consumer's mind when they are choosing their supplier. Consumers are naturally far less likely to take account of additional charges contained in detailed terms and conditions (the 'small print'). There is a risk, therefore, that some of these additional charges are not constrained by competition, leaving it open to suppliers to set these charges in a way that does not reflect underlying costs and causes consumer harm.

Concerns about low income consumers

- 1.6 Even if charges are transparent and fair for consumers generally, Ofcom 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.
- 1.7 Stakeholders have also raised concerns about distributional effects – the fact that low income consumers pay more than higher income consumers. While we have considered these concerns, we note that more general issues around distributional effect are more an issue for government than Ofcom.

Ofcom's guidance

- 1.8 This consultation includes Ofcom's draft guidance on the fairness of terms providing for additional charges under the Unfair Terms in Consumer Contract Regulations ('the Regulations'). The Regulations apply to terms in consumer contracts which have not been individually negotiated and are designed to protect consumers from terms which cause a significant imbalance in the rights and obligations of the parties to the detriment of the consumer.
- 1.9 In looking at the issues raised, Ofcom has considered the policy issues that arise, and whether these can be addressed using the Regulations. Our approach has been:
- to consider whether there is a policy concern and consumer harm arising from each additional charge or contractual term;
 - to consider whether that harm is caused by unfair terms, within the meaning of the Regulations;
 - to assess whether clarity over the application of the Regulations may be expected to address the concerns identified; and
 - to consider other appropriate legal instruments to address any remaining concerns not addressed by the Regulations.

Overview of findings

- 1.10 In this consultation document Ofcom reports on its findings for each of the additional charges and contract terms which we have looked at. The full detail of the evidence we have considered and the reasons for our proposals are given in the detailed sections of this document. Our key findings are summarised below.
- 1.11 Ofcom believes suppliers of communications services need to do more to make sure consumers are properly informed and that additional charges and other contractual terms are set fairly and clearly explained at the outset. In particular:
- they need to be clear and upfront with their customers and do more to make it easy for the consumer to understand the charges they pay and to compare between providers; and
 - for charges which are not part of the main service provided, suppliers must be able to demonstrate the charges are fair.

(Our views on the individual charges are set out in Figure 1.1 below.)

- 1.12 In order to ensure this happens, we will have an active programme of enforcement. We will also continue to monitor these issues – if there is evidence that our guidance is not having an impact we will look at these issues again.

Findings relating to low income consumers

- 1.13 Ofcom has identified two reasons why we might be concerned about low income consumers, even where charges are transparent and fair: first, access and inclusion; and second, more general concerns that low income consumers pay more for a wide range of goods and services.

- 1.14 Ofcom's policy concerns regarding access and inclusion are, we believe, best addressed through targeted action to identify, and help, those at most risk of being excluded from essential services. Under the Universal Service Obligation (the 'USO'), BT and Kingston Communications ('Kingston') in the Hull area, are required to provide social telephony products. Following discussions with Ofcom, BT will offer a new service – BT Basic – from mid 2008, which offers a low cost fixed voice service to those who are in receipt of certain Government benefits. BT Basic will 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.
- 1.15 Ofcom is currently discussing with Kingston the possibility of Kingston changing its pricing for its Social Access package so there is a single price irrespective of the payment method.
- 1.16 For low income consumers who use the phone a lot and do not qualify for BT Basic or the Kingston Social Access package the added cost is not so high that it is likely to exclude them from phone services.
- 1.17 Similarly, we do not consider that the level of non-direct debit charges is a significant factor in preventing low income consumers taking up broadband services. Ofcom recognises that broadband is increasingly becoming integral to participation and is rapidly evolving towards becoming an essential service. There may be a broader long term issue about the affordability of, and access terms for, broadband services for low income households. The current scope of the USO does not allow Ofcom to take action on this issue. The scope of the USO is ultimately determined at the EU level, where the USO issue is due to be discussed during 2008.
- 1.18 We also recognise that there are broader concerns about the fact that low income consumers often pay more than higher income groups. Ofcom considers that the extra amount paid by low income groups in non-direct debit charges in the communications sector is relatively small compared to the extra amounts low income groups may pay in other sectors. There are many examples across the economy of low income consumers paying more, for example:
- charging different amounts according to payment method is widespread in the energy sector;
 - lack of access to cheap credit means low income consumers often pay more for many goods and services; and
 - insurance premiums will often be higher for those living in less affluent areas.
- 1.19 Ofcom would be happy to engage with government in looking at these issues in a wider context as we recognise that this is a factor in economy wide distributional questions.

Summary of Ofcom's guidance on transparency and fairness

- 1.20 In relation to individual charges and contract terms we have looked at, the following table provides a high level summary of what we expect in terms of transparency and fairness.

Figure 1.1: Summary of Ofcom's Guidance

Charge / contractual term	Transparency	Fairness
<p>Non-direct debit charge <i>A charge for consumers choosing not to pay by direct debit</i></p>	<p>Suppliers to do more to ensure consumers properly understand the charges they are paying. Headline prices (including any non-direct debit charge) should be very obvious to consumers within marketing material.</p>	<p>Where non-direct debit charges are not obvious (and so not part of the headline price) charges can be assessed for fairness. This would mean that only direct costs can be included. We do not consider this can include additional costs relating to bad debt.</p> <p>Where non-direct debit charges are obvious (and so are part of the headline price) it is competition, not regulation, which should determine the level of the charges and ensure that they are fair.</p>
<p>Late payment charge <i>A charge for consumers who pay late (i.e. beyond the invoice due date)</i></p> <p>Payment failure charge <i>A charge where the payment method fails (e.g. a direct debit payment fails or a cheque bounces)</i></p> <p>Charge to restore service <i>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</i></p>	<p>Information on late payment charges, payment failure charges and charges to restore service to be easily available and clear to the consumer at the point of sale.</p>	<p>These charges can be assessed for fairness. They should be directly related to costs incurred. We do not consider this can include additional costs relating to bad debt.</p>
<p>Initial minimum contract periods <i>A minimum contractual period set at the start of a contract (often for 12 to 18 months)</i></p> <p>Early termination charges <i>A charge for consumers who terminate their contract before the end of the minimum contract period</i></p>	<p>Suppliers to do more to ensure consumers fully understand their contractual commitment and that consumers understand what they will be charged if they terminate a contract early.</p>	<p>Early termination charges should never be more than the remaining payments under the contract.</p> <p>Early termination charges should be reduced below remaining payments where the supplier can save or mitigate their costs (for example, this includes wholesale charges and the costs of shared network assets).</p>

Charge / contractual term	Transparency	Fairness
<p>Subsequent minimum contract period <i>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)</i></p>	<p>Information on the circumstances under which a new minimum contract period can be imposed should be easily available and clear to the consumer at the point of sale.</p>	<p>Subsequent minimum contract periods will only be fair where there is a clear benefit to the consumer and cost to the supplier.</p> <p>Examples where a subsequent minimum contract period would be unfair include:</p> <ul style="list-style-type: none"> • an upgrade to a package (which involves little or no cost to the supplier) at any time; • a downgrade to a package (which involves little or no cost to the supplier) once the consumer is no longer in a minimum contract period.
<p>Minimum notice period <i>The notice period which a consumer must give their supplier before they can cease service or switch to an alternative supplier</i></p>	<p>Information on minimum notice periods to be easily available and clear to the consumer at the point of sale.</p>	<p>Minimum notice periods should not be longer than is necessary.</p> <p>For example, where there is an Ofcom determined or industry agreed migration process (designed to ensure that consumers taking services based on BT's wholesale services can switch suppliers easily) minimum notice periods should match the migrations process.</p>
<p>Itemised / paper billing <i>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</i></p>	<p>Suppliers to do more to ensure consumers properly understand the charges they are paying. Headline prices (including any itemised / paper billing charge) should be very obvious to consumers within marketing material. It should also be made clear to consumers what they are getting for the charge (e.g. the difference between basic and fully itemised billing).</p>	<p>Where the transparency requirements are not met, itemised / paper billing charges can be assessed for fairness. This would require that only direct costs can be included.</p> <p>Where the transparency requirements are met, it is competition, not regulation, which should determine the level of the charges and ensure that they are fair.</p>
<p>Cease charges <i>A charge for consumers ceasing their service (even where they are outside their minimum contract period)</i></p>	<p>Information on cease charges to be easily available and clear to the consumer at the point of sale.</p>	<p>Cease charges can be assessed for fairness. They should be directly related to costs incurred, such as wholesale charges.</p>

Consultation and next steps

- 1.21 Given the widespread concerns expressed about additional charges, Ofcom is consulting on the matter, including the draft Guidance, for ten weeks. Responses to the consultation are requested by 8 May 2008. See Annex 1 for details.

Section 2

Introduction

Background and Scope

- 2.1 Consumers 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 The additional charges and contractual terms which are the subject of this review are listed in Figure 2.1.

Figure 2.1: list of charges and contractual terms covered by this review

Charge or contractual term	Description
Non-direct debit charge	A charge for consumers choosing not to pay by direct debit
Late payment charge	A charge for consumers who pay late (i.e. beyond the invoice due date)
Payment failure charge	A charge where the payment method fails (e.g. a direct debit payment fails or a cheque bounces)
Charge to restore service	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.
Initial minimum contract period	A minimum contractual period set at the start of a contract (often for 12 to 18 months)
Early termination charge	A charge for consumers who terminate their contract before the end of the minimum contract period
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).
Minimum notice period	The notice period which a consumer must give their supplier before they can cease service or switch to an alternative supplier
Itemised / paper billing	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.
Cease charge	A charge for consumers ceasing their service (even where they are outside their minimum contract period)

- 2.3 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.
- 2.4 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 all standard terms in

contracts between suppliers and consumers, that is those which have not been individually negotiated, are transparent and fair.

- 2.5 On 6 June 2007 Ofcom announced the opening of a review into these additional charges and contractual terms. There were two key considerations which prompted this review.
- 2.6 Firstly, there have been a significant number of complaints to Ofcom about BT's changes to its payment processing charge, which changed in the following way from May 2007:
- BT chose to change the presentation of this charge. From being a discount to consumers paying by direct debit, it became an additional charge for those choosing a payment method other than direct debit.
 - BT also increased the differential from £1 a month to £1.50 a month so that those paying by a method other than direct debit saw a net increase of 50p a month to their monthly rental charge.
- 2.7 Secondly, Ofcom considered that a review gave us the opportunity to deal with a number of issues on an industry wide and consistent basis. Ofcom regularly receives complaints about a range of contractual terms and charges, which are dealt with individually on a case-by-case basis even though in many cases the problem and consumer harm identified may be industry wide. Non-direct debit charges are an example of this: while a high proportion of the complaints were about BT, additional charges for non-direct debit payments are widespread in the communications industry.
- 2.8 Ofcom's review was not able to cover every aspect of consumers' contracts. The areas we have listed are those we believe to be the areas where any consumer harm is likely to be most significant.
- 2.9 This review considers consumer contracts only, not contracts for business (small or otherwise). The reasons for this are:
- Ofcom believes this is where the main concerns are; and
 - Ofcom's powers are more limited with respect to business customers.

Ofcom's overall approach

- 2.10 Consumer Protection is a high priority area for Ofcom. Many of Ofcom's strategic and policy decisions are designed to create more competitive and less regulated markets. At the same time we recognise that in competitive markets, there may be an increased need for effective consumer protection.
- 2.11 Ofcom is therefore committed to monitoring consumer harm. Where we find significant harm, we will take swift, appropriate and proportionate action to address that harm.
- 2.12 Ofcom's review has considered both the policy concerns that may be raised by additional charges and the legal framework within which we can seek to address those concerns. In the following two sections we first consider our approach to identifying policy concerns, and second we explain the legal framework and our role under the Regulations.

- 2.13 It is important to understand the relationship between these two elements.
- 2.14 From a policy perspective, Ofcom's starting point in terms of regulation is to ensure effective competition that will protect consumers and deliver consumer benefits. In asking whether a particular additional charge harms consumers, we may be concerned not just with the impact on that individual consumer, but also on the impact it may have more generally on competition. In considering the evidence relating to each of the additional charges addressed in Sections 4 to 10, we have asked questions such as: whether competition is likely to constrain the level of the charges, and as such act to ensure 'fairness' for consumers; and whether the additional charges might act to reduce competition.
- 2.15 The Regulations apply to ensure fairness for individual consumers, by ensuring transparency of all terms, and applying a test of fairness to all matters except the headline price and the definition of what is being purchased (provided that the price and definition are clear). The Regulations do not start by considering whether competition may have the same overall effect. Nor do they consider broader questions, such as the impact on competition of a particular charge or term.
- 2.16 In practice, we consider that there is often a correlation between the two. The terms which are not subject to the test of fairness under the Regulations are generally going to be those where we consider that competition will act to constrain the level of the price or the nature of the term, as these are the terms which are most visible to consumers (and competitors). Similarly, applying a test of fairness under the Regulations will not only make the charge or term fair for that particular consumer, but will sometimes have more general benefits in terms of, for example, reducing the costs of switching and helping competition be more effective.
- 2.17 We make clear, however, that our analysis of fairness is not derived from, nor influenced by, concerns as to whether competition itself provides an adequate safeguard against certain terms or charges, or broader policy concerns around the effect on competition.
- 2.18 During the course of the review, Ofcom decided that providing greater clarity over the application of the Regulations, and appropriate use of our powers under them, would be likely to address our concerns relating to the additional charges considered. We have not, therefore, used other legal instruments. In a small number of areas we have flagged issues which have the potential to cause consumer harm and which are not covered by the Regulations. We have noted the possibility of revisiting these issues, using an alternative legal instrument, if evidence emerges of consumer harm.

Ofcom's policy concerns

- 2.19 In applying regulation Ofcom seeks to be a proportionate evidence-based regulator. It is important that where we intervene in markets we have a clear rationale for doing so. In this section we summarise the economic and policy framework we have used in considering individual charges and terms.
- 2.20 Markets function best when consumers are fully aware of the nature of the product they are purchasing, including all additional charges associated with it. In such cases, competition will usually ensure that price levels and price structures reflect underlying costs. These outcomes will be efficient in the sense that consumers' decisions are based on price signals that reflect the resources used in providing a particular good or service.

- 2.21 The Additional Charges Review covers charges that consumers may not always take into account when deciding on their supplier for communications services, for example non-direct debit charges, late payment charges and early termination charges.
- 2.22 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. (These terms are explained below.) 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.
- 2.23 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.
- 2.24 An additional concern which has been raised by some consumer stakeholders is that 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. We have not considered further the question of excess profits.
- 2.25 In this section we consider why additional charges might give rise to a policy concern, by looking at the following questions:
- Why is lack of transparency a concern?
 - When might charges be ‘unfair’?
 - Why might low income consumers be a concern?
 - What is the effect on competition?
 - What other concerns might there be?

Transparency

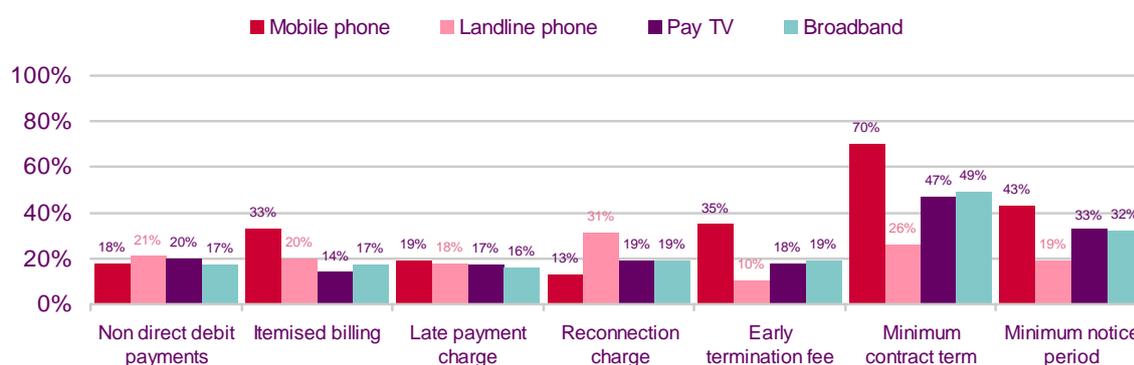
- 2.26 These types of charges may not be transparent to a consumer:

- 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.

2.27 Our market research, summarised in Figure 2.2, shows generally low awareness of additional charges (note many of these charges are common practice in the communications sector).

Figure 2.2: 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)

2.28 Low awareness may mean consumers are not making the right choice of supplier:

- even though non-direct debit charges are paid on every bill, whether monthly or quarterly, only around 1 in 5 consumers are aware that suppliers have these type of charge; and
- minimum contract periods are a key element of a contract – but many consumers are not aware of these.

2.29 In other areas, low awareness may mean consumers are faced with charges they did not expect, and hence could not avoid, for example, late payment charges.

2.30 We note that intelligibility of terms and their prominence within the contract (which we link in the concept of transparency) are key elements of the Regulations (see following section on the Legal Framework).

Fairness

2.31 Ofcom may have concerns about fairness. In most cases suppliers set contracts for consumers which are not individually negotiated with consumers.

2.32 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.

- 2.33 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.
- 2.34 We note that fairness is the central concept underlying the Regulations (see the following section on the Legal Framework). 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.

Impact on low income consumers

- 2.35 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.
- 2.36 There are two aspects to this concern – firstly, where we think that this might impact on social inclusion and access for a particular group and secondly, where the financial impact on a vulnerable group is disproportionately high.

Competition effects

- 2.37 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

- 2.38 There are other potential concerns around additional charges though we do not believe that these are 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. The current evidence doesn't suggest that these types of inefficiencies are particularly significant for the charges considered in this consultation.

Legal framework - Ofcom's role under the Regulations

- 2.39 Contracts for the supply of products and services to consumers in the UK must comply with the Regulations. The OFT, together with a number of other bodies including Ofcom, share the task of enforcement.
- 2.40 The Regulations are designed to protect consumers from contractual terms which may be 'unfair' to the consumer.
- 2.41 The following key principles underpin the Regulations and are important in understanding our recommendations:
- **Core and non-core terms.** Core terms define what are the main goods or services being purchased under the contract and the price for these. They are exempt from the test of fairness in the Regulations to the extent that they meet the requirement for transparency. They are the terms which set out the essential bargain under the contract: what the parties, but primarily the consumer, would say the consumer is buying under the contract and the price for it. Any other term is a non-core term.
 - **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 and this assessment includes the level of the charge.
 - **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 in the concept of "transparency", apply to both core and non-core terms.
- 2.42 Further background on the Regulations is contained in the draft Guidance at annex 5 of this document.
- 2.43 In carrying out our review, we have been aware that it is possible 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. For example:
- the Regulations do not explicitly distinguish between types of consumer – so do not treat low income consumers any differently to other types of consumer save insofar as a consumer's means will be part of the circumstances in which the contract was concluded and thus form part of the background against which the interests of the parties must be weighed (Regulation 6(1)); and
 - the Regulations do not refer to the impact on competition, so do not address such concerns unless there is an overlap with fairness, such as considering whether it is fair for a term to restrict a consumer's ability to choose another supplier.
- 2.44 Thus although our investigation into these terms has been informed in some cases by these policy concerns, our Guidance makes reference only to the areas in which we consider that the Regulations apply.
- 2.45 Ofcom's draft guidance shows how we intend to interpret the Regulations in relation to contracts to provide communications services. This is intended to provide suppliers with a clear understanding of where we are likely to take enforcement action and our basis for doing so. The guidance is intended to complement OFT guidance and not replace it. We are, of course, aware that certain issues under the Regulations have been the subject of High Court proceedings between the OFT and

a number of banks and building societies, and that judgment may be given during the consultation period. Whilst this document and our draft guidance set out our views and position, we will take into account of any judgment of the High Court to the extent we think appropriate.

- 2.46 Ofcom's review of additional charges has been industry wide. We have looked at the types of charges that apply across the industry, rather than focussing on any one supplier or type of service. The outcome is a set of guidance which applies across the communications sector.
- 2.47 Ofcom considers that it is appropriate to adopt the following approach in dealing with additional charges. We plan to:
- issue final guidance under the Regulations with an accompanying explanatory statement, following this consultation process;
 - provide industry with a period of three months, after the publication of the final guidance, during which they can review their terms and conditions and charges and where necessary change them;
 - following this period, open an enforcement programme where we believe that additional charges are not in line with our guidance. Where Ofcom considers it appropriate, the guidance highlights areas on which Ofcom will place particular emphasis in its investigation and enforcement activity.
- 2.48 Although the guidance will set out the approach Ofcom expects to take, it does not have legally binding effect on Ofcom. If Ofcom decides to depart from the guidance, we will normally set out our reasons for doing so.
- 2.49 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.
- 2.50 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.
- 2.51 Ofcom recognises that ultimately a decision as to whether a term is unfair is a matter for the courts. However, given that there is very little case law to assist suppliers and consumers in this area, Ofcom considers that it is in the interests of all parties for our views as to the application of the Regulations to be clearly set out. Our guidance is intended to help suppliers to understand the Regulations and to make it easier to comply with them.
- 2.52 Ofcom considers that this approach to additional charges will achieve the following aims:
- provide clarity for the industry on what is expected and enable suppliers to comply more easily with the Regulations;

- enable a consistent Ofcom approach to these industry wide issues, and make targeting enforcement action easier; and
- ensure consumers are better informed to make decisions, and are protected where appropriate.

2.53 Ofcom believes that the above approach is the most effective and appropriate way of dealing with consumer harm arising from additional charges in consumer contracts.

2.54 We have not looked at all the additional charges which suppliers might sometimes apply. We have focussed the review on the charges we believe consumers are most concerned about. These are listed in figure 2.1. Suppliers should, of course, be aware that the Regulations apply to all terms in consumer contracts which have not been individually negotiated, not simply those terms which are highlighted in this review.

Evidence for the review

2.55 As part of the review we have gathered evidence in the ways set out below.

2.56 Ofcom has 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.

2.57 In looking at the evidence of consumer harm, we have 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.

2.58 Ofcom has 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.

- 2.59 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.
- 2.60 Ofcom followed up the receipt of information with meetings to discuss issues and questions arising from suppliers' responses.

Impact assessment

- 2.61 This consultation document does not contain an impact assessment. Ofcom is presenting guidance on our view of the application of a particular legal instrument (the Regulations) to consumer contracts for communications services. As such, it is not proposing new policy.

Document outline

- 2.62 The following sections take each of the additional charges and contractual terms (grouped as appropriate) and for each examine:
- a description of the charge / contractual term and a summary of current practice;
 - the evidence of how it impacts on consumers, including market research and evidence from consumer complaints;
 - distributional effects, in particular how the charge / term impacts on low income consumers;
 - the cost and other evidence provided by suppliers to justify the charge or term;
 - a summary of our policy concerns and our legal view; and
 - a summary of our recommendation.
- 2.63 These sections are then followed by a number of Annexes:
- Annex 1: responding to this consultation
 - Annex 2: Ofcom's consultation principles
 - Annex 3: Consultation response cover sheet
 - Annex 4: Consultation questions
 - Annex 5: The draft 'Guidance on unfair terms in contracts for communication services.'
 - Annex 6: Glossary.

Purpose of this consultation

- 2.64 Ofcom is consulting on its draft guidance under the Regulations, which are set out in Annex 5. The key questions we are consulting on are:

- 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?
- Do you agree with Ofcom's proposed guidance regarding core terms and transparency?
- 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?
- Are there any other issues that are covered by the Regulations which Ofcom should give guidance on?
- 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?

Responding to this consultation

2.65 Given the serious concerns expressed by consumers and consumer groups, Ofcom considers that this is an important matter and we are keen to obtain views from as large a number and as wide a range of stakeholders as possible about our proposals. We are consulting for a ten week period. The consultation will close on 8th May 2008.

2.66 See Annex 1 for how to respond.

Next steps

2.67 Following the close of the consultation period, we will aim to publish a summary of consultation responses within two weeks. Depending on the outcome of our consultation, we will aim to publish our final statement and guidance by autumn 2008.

2.68 In addition, Ofcom will actively seek to help inform consumers. When we publish our final statement we will also publish a 'consumer checklist' which will set out some criteria which consumers should be aware of before signing a contract, including:

- What is the headline price?
- Is the service suitable for me? (e.g. is the broadband speed what I want?)
- Are there any add-on charges if I want to pay by cash or cheque or if I want a paper and/or itemised bill?
- Is there a minimum contract period? If so, do I understand what will be charged if I have to terminate early?
- Consumers need to look out for any additional charges that they might pay – and consider how, or whether, they can be avoided.

Section 3

Charges for payment method (non-direct debit charges)

Description of the charge

- 3.1 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. We refer to this as the non-direct debit ('non-DD') charge. Some suppliers accept payments only by a limited range of methods, typically direct debit and/or credit card.
- 3.2 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.
- 3.3 Suppliers may choose to express this differential 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.
- 3.4 Currently the vast majority of suppliers choose to express this as an additional charge.
- 3.5 Figure 3.1 illustrates the range of retail charges for a selection of suppliers. This is not intended to be comprehensive and is based on a snap shot taken in Summer 2007. This shows a range of charges from zero (rare and not for all services) to £5 a month.

Figure 3.1: Monthly non-direct debit charges as at August 2007.

Company	Charge per month
BT - fixed & broadband	£1.50 for one or both services
BT - mobile and pay TV	DD only
Carphone Warehouse - AOL	£0
Carphone Warehouse - Talk Talk	£3.50
Hutchinson 3	£3.00 (for any non-recurring mandate)
Kingston	£1.00 for each service
O2	£3.00
Orange - mobile	£3.50
Orange - broadband	£1.00 for CC
Pipex - Homecall	£0
Pipex - Bulldog	£2.00 for CC payment
Pipex - Internet	£0
Pipex - Toucan	£2.00
Post Office	£1.00
Sky	£4.00 (for any non-recurring mandate)
Tesco	DD or CC only
Tiscali	£0
T-mobile	£3.00 (for other than DD/BACS)
Virgin Media (cable) - fixed line, pay TV & bundles	£5.00
Virgin Media Mobile	DD only
Virgin Media -(off-net)	DD, debit card and CC only
Vodafone – Mobile	£3.53
Vodafone – Bundled	DD only

Note: charges are for paying by any other means than DD unless otherwise stated

Source: information provided by suppliers

DD – Direct Debit; CC – Credit Card.

Evidence on how it impacts on consumers

3.6 In this section we look at the evidence we have collected regarding consumers' understanding and attitudes towards non-DD charges. We have considered evidence from:

- market research commissioned by Ofcom;
- complaints data (directly to Ofcom and via MPs) and views expressed by consumer groups; and
- evidence from our analysis of supplier practice in terms of marketing material and consumer communications.

3.7 We focus here on consumers in general, leaving to the next section a more detailed discussion of issues around consumers on low incomes.

Market research

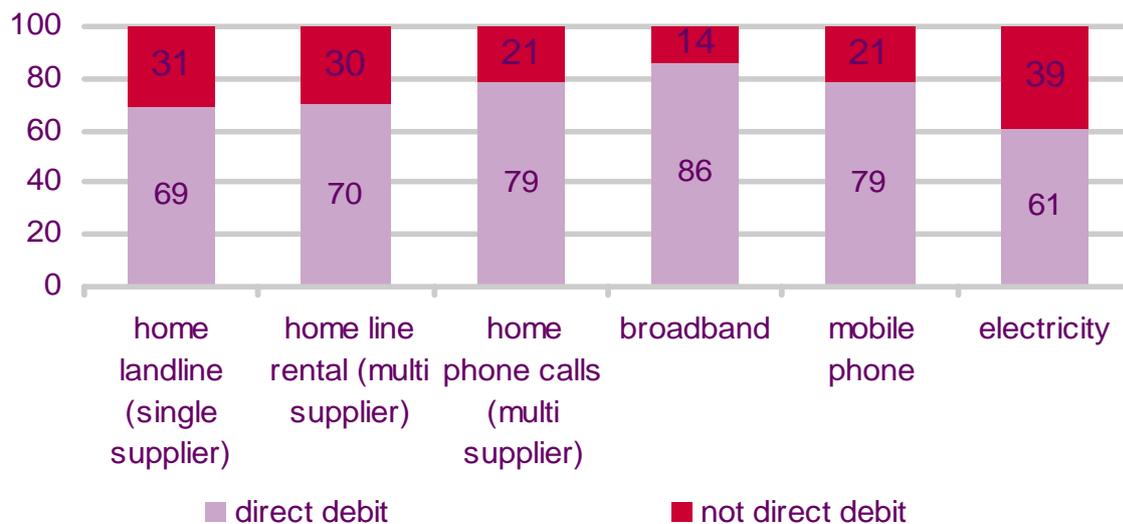
3.8 Ofcom has carried out a range of quantitative market research into non-DD charges.

3.9 In our market research we have sought to consider:

- what payment methods consumers choose for different communication services;
- why consumers choose a particular payment method;
- consumer awareness of the fact they may pay more to pay non-direct debit;
- sources of awareness of non-direct debit charges; and
- attitudes to non-DD charges.

3.10 Figure 3.2 illustrates the choice of payment method for different communications services. Payment method for electricity is shown as a comparator.

Figure 3.2: Payment method by sector



Source: Ofcom Research, May 2007

Base: landline single supplier (2270); line rental multi supplier (312); home calls multi supplier (312); broadband (564); mobile phone (473); electricity (1444). All adults aged 15+

3.11 The figure shows that payment by direct debit is a popular option, with 69% of consumers paying for their fixed line services (where there is a single supplier) by direct debit and over 85% of consumers paying for broadband in this way. Direct debit appears more popular for communications services than for electricity.

3.12 Our research also asked consumers why they chose a particular payment method. Figure 3.3 shows the responses we received from those who: a) pay by direct debit and b) do not pay by direct debit. Note that due to sample size issues we have

presented figures for fixed line (single supplier) only, however, the qualitative conclusions are similar when we look at other services.

Figure 3.3 a. Reasons for paying by direct debit (fixed line – single supplier)

Reason	Percentage
Habit- always pay bills by direct debit	50%
Convenience- don't have to think about it	35%
Never miss a payment	16%
Cost- cheaper to pay by direct debit	12%
Had to set one up with my provider	7%

Source: Ofcom Research May 2007

Base: n=803 adults aged 15+

Figure 3.3 b: Reasons for not paying by direct debit (fixed line – single supplier)

Reason	Percentage
Prefer to pay bills via bank/ post/ cash	23 %
Habit	20 %
Prefer to check bills before payment	17 %
No particular reason	12 %
Financial situation is changeable	8%
Have not got round to setting one up	5 %
Wait for final reminder	3%

Source: Ofcom Research May 2007

Base: n=355 adults aged 15+

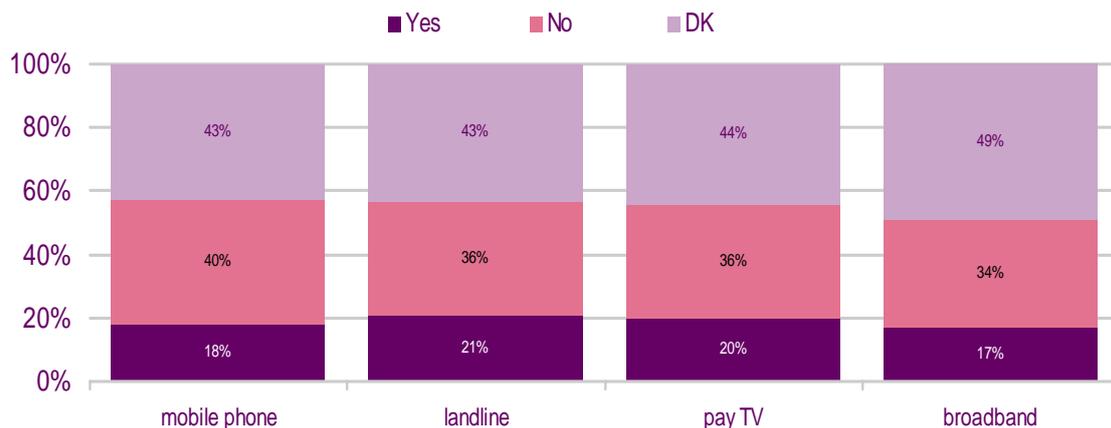
3.13 The results illustrate that:

- many consumers choose direct debit out of habit or because it is more convenient. Only 12% mention the lower cost as an important reason;
- many people choose non-DD out of habit or simple preference. Some prefer to check bills before payment (though in fact paying by direct debit also allows consumers to do this). 8% mentioned financial reasons, implying that these consumers may have little choice around payment method.

- 3.14 Our market research also asked about awareness that some companies charge less for direct debit. We found that, overall, 74% of consumers said they were aware that this could happen, compared to 19% who were not aware. We also asked those consumers aware that some companies charge less, whether any of the companies they used did this. Of these consumers 74% were aware that some of the companies they used did this. However, we did not specifically restrict this question to suppliers of communications services, so this may also reflect awareness of, for example, energy companies.
- 3.15 In further research we looked in greater depth at how charges affected a consumer individually. When asked whether their own supplier had a non-DD charge we found that over a third said no, when, for the vast majority, their supplier would in fact have such a charge. A relatively high proportion (over 40%) simply did not know. These figures are significantly lower than the broader awareness that some companies may have these charges. See Figure 3.4.

Figure 3.4: Awareness that current supplier has a non-direct debit charge

(As far as you know, does your supplier charge for non-direct debit payments?)



Source: Ofcom Research July 2007

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

- 3.16 A minority of suppliers accept only limited payment types, or do not charge for non-DD payments. We therefore checked awareness for some individual suppliers against whether there was in fact such a charge. Although due to sample size not all the results were statistically significant, this confirmed:
- for suppliers who do have such a charge, awareness was typically low (around 20%); and
 - for suppliers who do not have such a charge, some consumers (around 10%) believe that they do.

3.17 These figures indicate widespread lack of awareness of the charges imposed by a consumer’s own supplier.

3.18 We also asked consumers whether they were personally affected by the charge. Around 7% of consumers claimed to be affected by the charge for fixed voice. The proportion was lower for other services. Given our research showing that in fact around 30% of fixed voice consumers pay by non-DD (and nearly all suppliers charge for this), there appears to be a big gap between those who actually incur the charge and those who think they incur it.

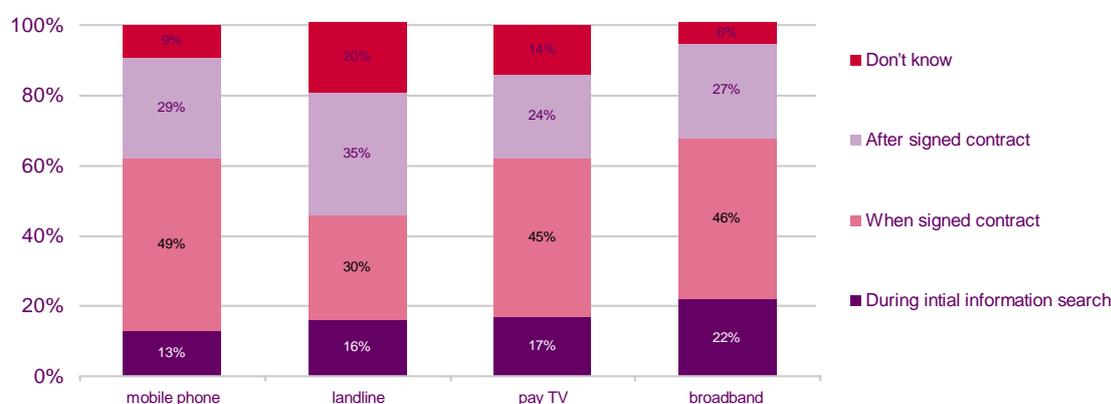
3.19 For those consumers who were aware of the charges we asked further questions regarding how and when they had become aware of it. This revealed that for fixed line services, the time at which consumers became aware was:

- 16% during the initial search for a provider;
- 30% at the point of sale;
- 35% after they had signed the contract; and
- 20% didn’t know.¹

3.20 The figures are similar for other services, as shown in Figure 3.5.

Figure 3.5: Source of initial awareness

(When did you first become aware of this charge for non-direct debit payments from your supplier?)



Source: Ofcom Research July 2007

Base : All aware of charge

3.21 This illustrates that relatively few people are aware of these charges when they are searching for a supplier. This is significant. It means that consumers who do not want to pay by direct debit are often unlikely to be making the appropriate price comparisons (i.e. including non-DD charges) when they are considering alternative suppliers. The fact that over one in three consumers claim they did not know about the charge until after they had signed the contract is also a cause for concern, particularly as they may then be locked into a fixed term contract. These findings are

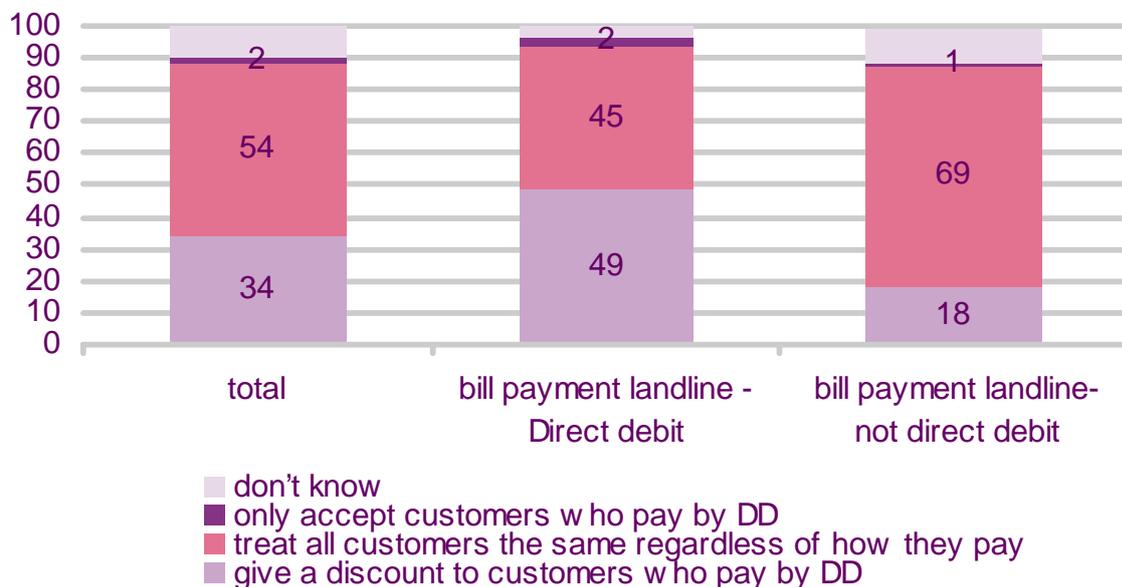
¹ Figures don’t add to 100% due to rounding.

consistent with the findings from a separate piece of consumer research focussing on consumers' behaviour when considering switching suppliers, which showed that non DD charges rarely featured in a consumer's decision to switch supplier.

- 3.22 We also asked consumers about their attitudes to non-DD charges. Only 10% of consumers felt that it was fair for suppliers to charge an additional amount depending on payment method. We asked an alternative question, in which we stated that companies have higher costs for customers who do not pay by direct debit, and asked how consumers thought companies should respond to this. Over half of consumers thought that despite the higher costs, consumers should be treated the same. This rises to 69% for those who do not pay by direct debit. The results are shown in figure 3.6.

Figure 3.6: Consumers think companies should treat them the same, irrespective of payment method

(Companies have higher costs for customers who do not pay by direct debit. Should they...?)



Source: Ofcom Research May 2007

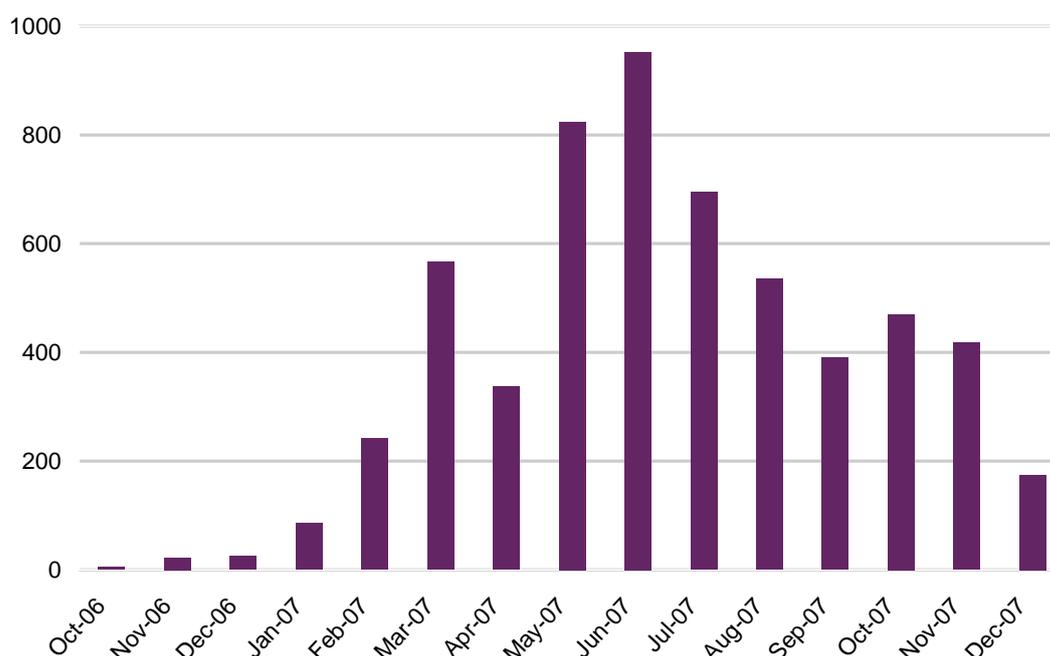
Base: n=1938 adults aged 15+; bill payment direct debit n=865; bill payment not direct debit n= 384

- 3.23 The market research presented illustrates that there is low awareness and understanding of these charges, and a strong feeling the charge is unfair, even when consumers are told there is a cost involved.

Complaints and views from consumer groups

- 3.24 Since early 2007, Ofcom has seen a big increase in the complaints received by our Advisory Team regarding non-DD charges. Numbers peaked at over 900 in June 2007 before starting to decline. Around 98% of these complaints related to fixed voice services, even though non-DD charges are routinely charged, and are often higher, in other sectors. See Figure 3.7.

Figure 3.7: Complaints made to Ofcom’s Advisory Team regarding non-direct debit charges



Source: Ofcom

3.25 This increase in complaints was triggered by BT announcing (in January 2007) the following changes to its pricing, applying from May 2007:

- BT changed the way it presented the differential by payment method from a discount for paying by direct debit, to an additional charge for paying by non-direct debit; and
- BT increased the level of the differential from £1 a month to £1.50 a month, so those paying by direct debit saw no change to their monthly charge and those not paying by direct debit saw a 50p per month increase.

3.26 Although most of the complaints have been about BT’s charge, some complaints have been about other suppliers’ charges.

3.27 We note that the figures represent not only the complaints made directly to Ofcom by individual consumers, but also a considerable number of complaints forwarded to us from MPs on behalf of their constituents.

3.28 We have also written to a number of consumer groups about this issue. Their responses reflect the serious concerns expressed to them by consumers.

3.29 From these sources, the main views expressed are as follows:

- there is a high level of outrage that suppliers charge an additional amount for paying by cash or cheque (or other non-DD method);
- consumers view an additional charge as a penalty (although a discount for paying by direct debit is sometimes seen as acceptable);

- consumers do not understand why there should be such charges at all - or do not understand why the charges are as high as they are;
- many consumers feel strongly that they are being treated unfairly;
- the charges are felt to disproportionately affect people on low incomes, many of whom pay in a timely manner by, for example, cash or cheque;
- by actively persuading people to pay by direct debit, some suppliers may be pushing customers to a payment method which is not appropriate for them (with a risk of incurring bank default charges);
- information about the level of the non-DD charges does not seem to be immediately obvious to the consumer;
- attempts to query these charges can be frustrated by poor levels of customer service;
- the imposition of charges on existing contracts is seen as a unilateral variation of terms which disadvantages the consumer (though we note that BT did provide several months notice of the change);
- the level of charges imposed seems to have increased recently. It is not clear why this should be the case.

3.30 The particularly strong feeling against non-DD charges from, and on behalf of low income consumers, is discussed in greater detail later in this Section.

Evidence on marketing and other sources of consumer information

3.31 Given the relative lack of awareness amongst consumers, Ofcom has examined a range of marketing material and consumer information produced by a range of suppliers to assess how clear and prominent non-DD charges are at present. This includes:

- supplier websites;
- information leaflets and brochures available in shops or as flyers;
- letters to new and existing consumers;
- contract terms and conditions.

3.32 We noted that the level of transparency of marketing and other material is variable. In our view, much of the material we looked at was not clear. Marketing material tends to focus on the headline price, which, in the examples we looked at, was always the lower price, i.e. that set for those paying by direct debit. We considered how easy it would be for a consumer to tell at a glance:

- that an additional charge applied for different payment methods; and
- the level of that additional charge.

3.33 Examples where we felt this was not easy to do included cases where:

- the level of the non-DD charge was contained in footnotes to the table of headline charges, but it was difficult to find this amongst a mass of other information and/or the print was very small;
 - no indicator appeared directly adjacent to the headline charge which indicated that a caveat applied; and / or
 - the footnotes simply said there was an additional charge for paying by a means other than direct debit, but did not specify the level of the non-DD charge.
- 3.34 In some cases we struggled to find the level of the charge anywhere on the suppliers' website or in their terms and conditions. When we did find it, either through our own efforts or by asking the supplier, it was sometimes in a place that was far from obvious.
- 3.35 For existing consumers the level of transparency appeared better. For the examples we looked at:
- non-DD charges were usually listed as a separate line item on bills;
 - suppliers provided examples of how they had specifically alerted non-DD consumers to the fact they could avoid the non-DD charge by changing their payment method.
- 3.36 Suppliers all claimed that explaining the level of the non-DD charge (where applicable) formed part of the script when a new customer was being signed up.

Distributional effects

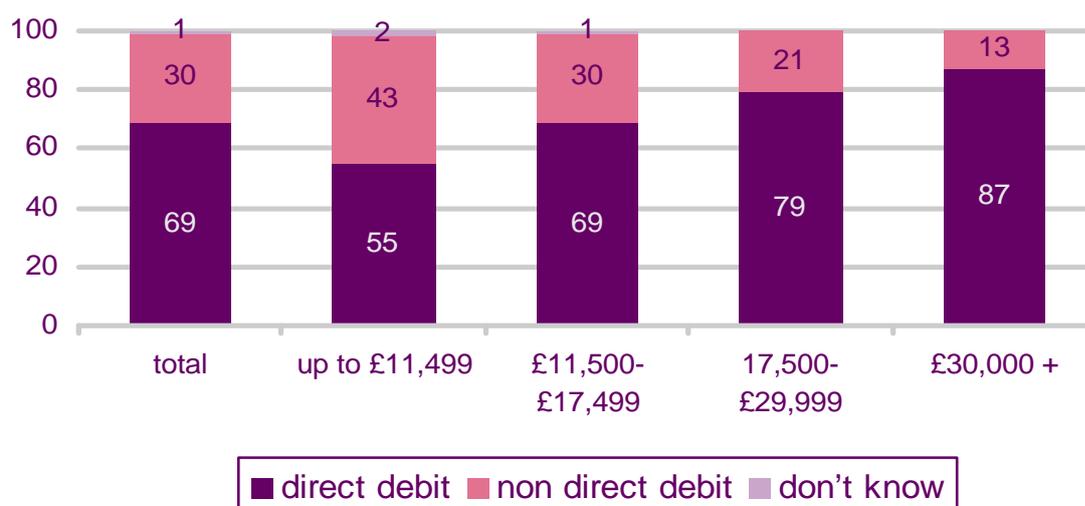
- 3.37 A key concern regarding non-DD charges is that they impact disproportionately on low income consumers because:
- low income consumers are more likely to incur the charges;
 - low income consumers can least afford the charges.
- 3.38 Low income consumers are more likely to pay by non-DD because:
- they may not have a bank account, or may have only a Post Office card account which does not allow direct debit payments to be made;
 - direct debit payments may be unhelpful in terms of financial management for consumers whose income may be irregular, or where benefits are paid on a weekly, rather than monthly basis. The possibility of incurring bank charges where insufficient funds are available for the direct debit payment is a deterrent to setting up direct debits.
- 3.39 Data published on the Poverty Site (<http://www.poverty.org.uk/intro/index.htm>), using data from official sources, shows that in 2005/06:
- 6% of households in the poorest fifth of the income distribution had no bank account – compared to 3% of households with average incomes;
 - 5% of households in the poorest fifth of the income distribution have only a Post Office card account, which has only basic functionality and does not allow direct

debit payments to be made – compared to 1% of households with average incomes.

Taken together these figures suggest that around 11% of households with incomes in the poorest fifth of the income distribution are not able to pay by direct debit.

- 3.40 As a sector specific regulator, we have a duty (through the Universal Service Obligation – ‘USO’) to ensure that consumers do not lose access to essential communications services as a result of having a low income. In considering low income issues we have focussed particularly on fixed line voice 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;
 - pay TV does not have the same issues around inclusion, and free to air services are available.
- 3.41 We have examined the results of our quantitative market research by income level. We believe income is the most important way of segmenting consumers. It is also possible to segment the results by age. However, we believe that for issues of affordability it is income that is the relevant factor, not age on its own.
- 3.42 For the purposes of our analysis we have defined ‘low-income’ to be an annual household income of £11,500 a year or less. However, we recognise that this is a relatively low threshold and have also presented results for those consumers with a household income of up to £17,500.
- 3.43 In Figure 3.8, we have analysed use of direct debit vs. non-DD by income. This demonstrates that a majority (55%) of consumers on low incomes do pay by direct debit for fixed voice, compared to 69% of consumers generally. Were non-DD charges to be removed, we expect that suppliers would rebalance their charges so those currently paying by direct debit would pay more. Many low income consumers would in fact lose out from this rebalancing.

Figure 3.8: Use of different payment methods by income group



Source: Ofcom Research, May 2007

Base: landline single supplier (2270)

3.44 Although we do not believe this is the most appropriate way to view the data, we have also produced an analysis by age. This shows that a majority (58%) of those aged 65 or above pay by direct debit, compared to 36% who do not.

3.45 We have also looked at the extent to which those who opt to pay by non-DD are in low income groups:

- 36% of non-DD customers have incomes less than £11,500 a year (compared to 13% of direct debit customers); and
- 16% of non-DD customers have incomes over £30,000 a year (compared to 36% of direct debit customers).

3.46 While the group of non-DD customers is more weighted to low income groups, such groups are still more likely to pay by direct debit. Analysis of market research data on typical spend on communications services shows that, although low income groups spend somewhat less on their services than those on higher incomes, there is not a big difference in spending levels by income groups (for those who have the service). We therefore expect that the market for serving consumers who choose not to pay by direct debit is a valuable one, which suppliers will wish to compete over.

Qualitative market research

3.47 In addition to our quantitative market research, Ofcom has carried out qualitative market research to explore how and why usage, participation in, and knowledge of the communications market might be affected by low income status. The research was conducted using in-depth interviews because it was clear that there was a need to understand the issues from an individual household perspective and the particular set of circumstances that dictated each household's needs.

- 3.48 One aspect of this qualitative market research looked at awareness and attitudes towards non-DD payments among low income consumers. A summary of findings is set out below.
- 3.49 Awareness of this charge from utility companies was common but very few consumers had heard of this charge from suppliers of communications services. In fact many pensioners refused to believe that BT would consider a charge like this.
- 3.50 Overall there was widespread outrage in response to the charge because this would penalise those without bank accounts, the majority of whom were the least well off in society – generally older people living on a state pension or younger people living on full benefits.
- 3.51 The majority of the sample was not affected by this charge as they had access to banking facilities and were already using direct debit payments. Where this was the case, consumers valued the savings they could make by using this payment method. However, just under a third of the sample, particularly the long-term unemployed and pensioners, could have been affected as they did not have a bank account and used the Post Office to receive benefits and to pay their bills.
- 3.52 Using the Post Office was attractive to many younger people as it was a transparent means of managing their finances. For many of the pensioners, this was how it had always been done.

“We go to the Post Office, draw our money, pay the bills and whatever’s left – it’s always been that way – I don’t see why I need a bank account” (Pensioner, Studley)

“I’m worried about bank accounts – I feel out of control and worry all the time that we’ll miss a payment and fall into debt” (Oldham, Young Family)

- 3.53 Pensioners, in particular, were strongly against the idea of a bank account and direct debits – banks were perceived as impersonal and associated with charges and security risks, whereas the Post Office was generally within the community and something pensioners were used to.
- 3.54 Most pensioners could not understand the rationale that they would be charged for paying with cash and others felt that operators should not be concerned how they were paid so long as they were paid.

“Why does it matter how we pay – we should be able to have the choice to pay by cash or direct debit, it’s outrageous” (Single, Oldham)

“In my day, cash was king and companies were delighted if you paid by cash as they got it quicker than by cheque. This is a ridiculous idea – none of my friends have bank accounts” (Pensioner, Glasgow)

- 3.55 The majority of low income consumers were not affected by charges from utility operators because they either had account cash cards and paid through PayPoint or they had PAYG meters, which they topped up like a mobile phone. However, this was not the case for everyone and it was possible that low income consumers could be incurring non-DD charges for more than one service, which could add significantly to their costs.

- 3.56 Overall, a £1 charge per month was felt to be affordable but £5 was not – but without exception the charge was considered wrong in principle and many would consider changing supplier. For the vast majority, affordability was not the concern rather it was the principle of being forced to pay in a certain way.

“Bank accounts are difficult to keep an eye on – it’s inevitable that we will get hit with bank charges at some point and so I’d prefer to pay the charge and keep control of what I’ve got” (Family, Oldham)

- 3.57 Many younger consumers were so against direct debits because of the risk and potential for debt, that they preferred to pay the £4.50 charge (a quarter) as this was considerably less than a £30 charge from their bank which might be incurred if the direct debit payment failed.
- 3.58 More generally the qualitative research shows that low income consumers value communications services and find them affordable. The existence of additional charges for non-DD does not push services into being unaffordable. Consumers were angry about the charge, but it did not appear to affect their decision to have a fixed line phone. This is not to say that there is not a sub-section of the low-income group who maintain their fixed line for ‘emergency’ use and have a very low usage. It is this sub-section, however, at whom USO social telephony packages are particularly aimed (see below).

Universal Service Obligation and other forms of protection

- 3.59 In considering low income groups we have also considered other forms of protection already available.
- 3.60 As a sector specific regulator, we have a duty (through the USO) to ensure that consumers do not lose access to essential communications services as a result of having a low income. Our work on access and inclusion mandates BT and Kingston to provide affordable voice telephone services to consumers with low-incomes through special pricing schemes.
- 3.61 BT currently offers the Light User Scheme and In Contact which are aimed at providing affordable services for consumers who make few calls. BT will shortly be introducing BT Basic with a line rental charge of £4.50 a month including an inclusive call allowance of £1.50 (this is expected to be launched mid 2008). It will be available for consumers in receipt of Pension Credit, Income Support or Job Seekers Allowance. Unlike the current schemes, BT Basic is targeted at consumers identified by Government as being in need to direct financial assistance and will allow consumers to take up the service even if they use mobile pre-pay services or have broadband.
- 3.62 BT’s social telephony products – including BT Basic - do not differentiate by payment method.
- 3.63 Kingston offers a range of products including the Social Access Package (which provides a lower line rental and inclusive calls, and has an additional charge of £1 a month for non-direct debit payments) and the Basic Call Package (which provides for bill payment of a lower line rental in advance and pre-payment for calls). Ofcom is currently discussing with Kingston the possibility of Kingston changing its pricing for

its Social Access package so there is a single price irrespective of the payment method.

- 3.64 Low usage consumers were also protected by the voluntary assurances provided by BT regarding limiting price increases, when Ofcom removed the retail price control in August 2006. Non-DD consumers have in effect seen an increase of 50p a month due to BT's change of charges – a total of £6 over a year. This 50p a month increase:
- is within these voluntary assurances;
 - is expected to have been within the previous retail price control; and
 - for most consumers will mean an increase which is no greater than inflation.
- 3.65 These voluntary assurances have now lapsed (end of 2007). Ofcom will be conducting a review of retail markets in 2008/09. This will include looking at whether there are concerns about pricing for low usage consumers.
- 3.66 We do not wish to dismiss sums such as £6 a year as being insignificant for people on very low incomes. Nonetheless, we note that the average fixed voice bill for consumers with incomes less than £11,500 per annum is £225 a year (only slightly less than the average for all consumers which is £245 a year). In this context:
- the extra 50p a month is less than 3%; and
 - the full £1.50 is around 8% of the monthly bill.
- 3.67 These forms of protection are currently limited to fixed voice services only.
- 3.68 For mobile services, we consider that the existence of pre-pay mobile means that intervention to secure access to mobile services is not needed.
- 3.69 Ofcom recognises that broadband is increasingly becoming integral to participation and is rapidly evolving towards becoming an essential service. We already observe the importance of broadband in access to job markets, supporting education, facilitating communications between citizens and creating valuable new social communities. There may, therefore, be a long term issue about the affordability of, and access terms for, broadband services for low income households, particularly as broadband starts to become more of a necessity for growing numbers of consumers.

Other considerations for low income consumers

- 3.70 As highlighted in Ofcom's report, *The Consumer Experience 2007* (http://www.ofcom.org.uk/media/news/2007/11/nr_10071120), Ofcom believes that affordability of communications services (including any non-DD charges) is no longer the most significant barrier preventing people in low-income groups from taking up communications services. While price is a consideration, it is by no means the key driver. Financial management (such as banking preferences and availability of pay as you go options) and personal circumstances are more likely to influence choice and take-up. Many of the solutions to these issues may not be within Ofcom's direct regulatory remit. We recognise that there are significant initiatives underway across government and by other stakeholders addressing digital inclusion including the

Digital Strategy², the Transformational Government Strategy³ and the Alliance for Digital Inclusion⁴. In seeking to understand barriers and obstacles to take-up we will work alongside these initiatives and with our stakeholders.

- 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, and this is a cause for concern. See for example 'The Poverty Premium', published by Save the Children and the Family Welfare Association in 1997, which claims that low income consumers may pay £1,000 more over a year than higher income consumers for essential goods and services.⁵ Paying more in order to settle bills by cash or cheque is common in the energy industry. More significant additional costs can arise because of the lack of access to cheap credit. This wider issue is an issue for Government and is not an issue Ofcom can resolve on our own.

Summary of consumer evidence (including low income issues)

- 3.72 Consumers feel strongly that non-DD charges are unjustified and unfair. They either do not understand why these charges exist at all, or do not understand why they are as high as they are. They feel additional charges for paying by cash or cheque penalise low income consumers who can least afford the extra amount. There is considerable confusion among consumers as to which suppliers have these charges. We think that the way in which marketing is undertaken by some suppliers is likely to have contributed to this.
- 3.73 We recognise the strength of feeling regarding non-DD charges and the fact that some low income consumers have little choice but to pay them.
- 3.74 However, social telephony schemes offered by BT and Kingston are in place specifically to ensure that low income consumers are not excluded from basic telephony services. BT's new scheme, BT Basic, will not have a non-DD charge.

Cost evidence for non-direct debit charges

- 3.75 In this section we discuss the information provided to us both in response to Ofcom's formal information request and in discussions with suppliers about their responses. Detailed cost information has been provided to us in confidence and we do not present data relating to any individual supplier.
- 3.76 Suppliers have provided evidence that payment by direct debit is a cost efficient way of receiving payment from their consumers. They believe it is important that they pass through these cost efficiencies to those consumers using direct debit. Because consumers see the benefit, they are then encouraged to use the most cost efficient method. In many cases this is a win-win outcome for consumers and suppliers.
- 3.77 We asked suppliers to provide details of how they have set their charges, in particular with reference to the underlying costs of different payment methods. While individual responses have differed, overall it appears that suppliers are likely to set these charges to take account of the following factors:

² Prime Ministers Strategy Unit (2005), Connecting the UK: The Digital Strategy, http://www.strategy.gov.uk/work_areas/digital_strategy/

³ Cabinet Office (2005), Transformational Government: Enabled by Technology, http://www.cio.gov.uk/transformational_government/strategy/

⁴ <http://www.citizenonline.org.uk/adi>

⁵ <http://pegasus.xssl.net/~admin315/assets/files/reports/The%20Poverty%20Premium.pdf>

- the additional underlying costs;
 - the market conditions, i.e. what competitors are charging; and
 - the expected consumer response, for example, whether the charge might deter the consumer from signing up at all.
- 3.78 Several suppliers made the point that allocating costs is not an exact science. In some cases it was felt that the costs identified underestimated the total costs incurred. For example, the additional IT development costs of providing for a range of payment methods might not have been included, because they were too difficult to separate out.
- 3.79 In general we have found that charges can be largely accounted for by the suppliers' own cost allocation figures. This involves a degree of supplier discretion as to what cost categories it is relevant to include. Both the level of costs incurred and the categories of costs included varied by supplier. This provides some explanation as to the variation in levels of non-DD charges observed.
- 3.80 While the identification of cost categories varied by supplier, in general the main types of cost category included were:
- the direct administrative costs of the processes involved in managing cash and cheque (and other non-DD) payments, compared to the automatic way direct debit payments are processed;
 - the additional costs of chasing payment from non-DD customers (some of whom are more likely to pay late than those paying by direct debit) and the additional interest charge implications of such late payment; and
 - the additional costs of bad debt. A number of suppliers have provided data which demonstrates that of those consumers who choose to pay by non-DD a higher proportion will end up defaulting on their bills than those consumers who pay by direct debit. For this reason some (although not all) suppliers have set non-DD charges to recover a greater proportion of bad debt.
- 3.81 Many suppliers now bill monthly, but there is still a significant number of consumers who are billed quarterly, in particular by BT. Many consumers therefore regard BT's non-DD charge not as a monthly charge, but as a charge per bill. Because of BT's wide range of payment options, payments may be made anywhere between quarterly and in some cases weekly. BT has chosen to spread the non-DD costs evenly over its consumers. So the charge is made monthly, irrespective of the bill frequency. This avoids loading costs on those who can least afford it, e.g. those who pay small amounts frequently.

Summary of supplier evidence

- 3.82 In summary:
- in general suppliers use non-DD charges to recoup the additional costs they consider are incurred to service this group of consumers;
 - the level of the charge will depend on the cost elements allocated, and in particular, whether only direct costs are included.

Summary of Ofcom's policy concerns and legal view

- 3.83 Ofcom recognises that consumers feel strongly that it is wrong for suppliers to charge an additional amount according to the method they use to pay their bill. Even those consumers who benefit from lower prices by paying by direct debit are evenly split on whether these lower prices are appropriate.
- 3.84 However, Ofcom does not believe it is appropriate to prevent suppliers from levying such charges as there are clearly additional costs involved in processing non-DD payments. There are good reasons for suppliers to seek to recover these costs from those who cause them to be incurred. Both suppliers and consumers benefit from the flexibility that a range of payment options offers. Removing suppliers' ability to levy such charges may cause some suppliers to offer a more restricted range of payment methods, which would not benefit consumers.
- 3.85 But Ofcom does have some concerns about non-DD charges.
- 3.86 Ofcom's market research shows that consumers have a poor awareness of non-direct debit charges. They often don't seem to be aware that their supplier charges an additional amount for non-direct debit payments, or that such charges apply to them.
- 3.87 Ofcom's view is that current marketing material for some suppliers does not present non-DD charges clearly.
- 3.88 Ofcom believes that it is essential that suppliers do more to ensure their consumers properly understand the charges they are paying. Headline prices (including any charge relating to payment method), should be very obvious to consumers. Unless non-DD charges are made clear to consumers:
- consumers will not be able to make rational decisions about which payment method to use; and
 - consumers will not be able to make the relevant price comparisons when choosing a supplier and competition will not act to constrain the level of these charges.
- 3.89 Greater transparency over non-DD charges may well increase consumers' acceptance of them.
- 3.90 Concerns have been expressed over the fact that there is typically an additional charge for not paying by direct debit, as opposed to a discount for paying by direct debit. Ofcom does not believe this is a material difference. If consumers are charged, for example £15 as against £18, depending on payment method, we consider it is immaterial how this is described, *provided* it is presented transparently.
- 3.91 Much of the concern expressed is around low income consumers. Consumers feel that additional charges for paying by cash or cheque penalise low income consumers more than any other group as it is they who can least afford the extra amount.
- 3.92 The evidence shows that over half of low income consumers do pay by direct debit and benefit from the savings offered. Nonetheless, it is clear that low income consumers are more likely to pay non-DD charges than higher income consumers.

- 3.93 Although we accept the concerns regarding low income consumers, we do not believe the additional amounts paid are generally sufficient to prevent access to communications services. This is confirmed by consumer research detailed above.
- 3.94 For those low income consumers who are particularly sensitive to the price of fixed voice services (particularly those for whom access may be prevented) BT's social telephony products will provide a low cost option, with no non-DD charge.
- 3.95 For broadband, any non-DD charge will only constitute a small fraction of the total cost of being online, particularly when taking account of the cost of both broadband and PC purchase. We do not, therefore, consider that the existence or level of non-DD charges constitute a barrier for low income consumers wishing to access broadband services. Nevertheless, there may be a long term issue about the affordability of, and access terms for, broadband services for low income households, particularly as broadband starts to become more of a necessity for growing numbers of consumers. The current scope of the USO does not allow Ofcom to take action on this issue. The scope of the USO is ultimately determined at EU level, where the issue is due to be discussed during 2008.
- 3.96 Ofcom may still be concerned if non-DD charges were likely to have a significant financial impact on low income consumers. However, Ofcom's view is that taken on their own, non-direct debit charges for communications services are likely to have a limited impact on the financial position for low income consumers. For example, for BT consumers (from whom we received the most complaints):
- the increase they have seen to their overall rental charge is 50p a month, or £6 a year, which is likely to be roughly in line with inflation;
 - the potential saving if non-DD charges were removed would be less than the full £1.50 a month – we would expect BT (and other suppliers) to rebalance their charges. Based on our market research on consumers' payment method, the additional amount currently paid by non-DD consumers, compared to a situation where everyone paid the same, might be around 75p - £1 a month, or £9 - £12 a year;
 - the non-DD charge is around 8% of the average bill for fixed voice services.
- 3.97 Further, the most vulnerable consumers are already protected by social telephony products from BT and Kingston, which have no, or low, non-DD charges.
- 3.98 Whilst on their own non-DD charges for communications services might not have significant impact on low income consumers, Ofcom does recognise that, taken together with other charges across different sectors of the economy, low income consumers might face significant financial burdens relative to higher income consumers. This wider view on low income consumers is outside of Ofcom's direct remit and is primarily an issue for Government.
- 3.99 Concerns about low income groups are not sufficient to outweigh our general conclusion that non-DD charges are a legitimate way for suppliers to recover certain costs.
- 3.100 This leads next to the question of whether Ofcom should and can intervene over the price level. This question becomes one of whether non-DD charges are part of the price of the service.

- 3.101 From a policy perspective, in a competitive market it will not generally be Ofcom's policy to try to intervene and control the main headline prices (i.e. the main prices on which suppliers compete, which are part of the essential bargain between the parties and which consumers use to compare between possible suppliers) - these prices should be constrained by competition. If non-DD charges are sufficiently obvious to consumers that they form part of this headline price and essential bargain, we will not seek to intervene. In this case we also consider that non-DD charges will be core terms under the Regulations and, as such, not subject to the test of fairness.
- 3.102 We believe it is possible for consumers to take non-DD charges into account in their decision making, provided they are presented in a clear form, as they are:
- paid regularly; and
 - not particularly complex to understand.
- 3.103 Given the above, we consider our starting point should be to ensure transparency. Where a supplier can demonstrate these charges are prominently and transparently presented to consumers, and part of the essential bargain, it would be disproportionate for Ofcom to consider intervening on the price level. If this were the case, we could not intervene using the Regulations.
- 3.104 However where non-DD charges are not so obvious (and so not part of the headline price and essential bargain) competitive pressure will not act to constrain charges, the charges will be non-core, and in this situation Ofcom can and should act to ensure suppliers set these charges in a way that is fair.
- 3.105 This means Ofcom taking a view on what costs it is and is not fair to include under the Regulations. The three main cost elements we discuss are:
- direct administrative costs;
 - the additional costs of bad debt;
 - the costs of chasing late payment.
- 3.106 Ofcom accepts that direct debit is a cheap way of automatically collecting payment. Other payment methods tend to cost more to administer. It is clearly legitimate for suppliers to include these extra costs in a non-DD charge.
- 3.107 Some suppliers claim that consumers who do not pay by direct debit are more likely to end up not paying at all, and that the additional costs of bad debt should be spread over all non-DD consumers.
- 3.108 Ofcom does not accept that these bad debt costs should be recovered as part of the non-DD charge. Some suppliers' evidence suggests that there may be some correlation between different payment methods and bad debt. However, in Ofcom's view there is little evidence of a causal link between a consumer's choice of payment method and the risk that the same consumer will at some point default on their payment and generate bad debt. In particular, it is unclear how or why the choice of payment method will actually cause the consumer to go into bad debt. Ofcom's view is that bad debt is by definition a group of costs that can not be levied on consumers that have caused it, i.e. the consumers who have caused it are the consumers that are not paying for their services. As a result these bad debt costs are a group of fixed costs that need to be recovered from the generality of consumers – it would be unfair

to recover these costs more from one group of consumers relative to another. We note that this is consistent with the OFT's view in looking at credit card default charges.⁶

- 3.109 Suppliers have also provided cost evidence relating to chasing payment. Ofcom accepts that the large bulk of payment chasing activity is generated by non-DD customers. While direct debit customers will sometimes default on their bill (either by cancelling the direct debit or by there being insufficient funds available), the incidence of this is relatively rare. In contrast the number of non-DD consumers who sometimes pay late is much higher.
- 3.110 We recognise that in some cases suppliers have a separate late payment charge (see Section 5). In others suppliers choose not to have such a charge, or impose it relatively rarely. Even where there is a specific late payment charge, there are costs incurred by those consumers who pay beyond their payment due date, but have not reached the trigger to incur a late payment charge. Where there are costs incurred relating to chasing payment, which are not recovered in a late payment charge, we have considered if they may form part of the non-DD charge. Based on the evidence we have seen, suppliers do not appear to be 'double counting' costs relating to chasing payment.
- 3.111 Ofcom does not have full evidence on the proportion of consumers paying by non-direct debit who sometimes require a reminder to pay the bill. Where this proportion is sufficiently high we accept that it may be appropriate to consider these costs as part of the cost of servicing non-DD consumers and to spread the costs of chasing payment only over non-DD consumers.
- 3.112 If Ofcom was examining the costs for a particular supplier, we would look at these issues on a case by case basis to consider the appropriate balance between:
- being fair to direct debit consumers who, by the nature of their payment method, almost never need to be chased for payment;
 - being fair to the sub-set of non-DD consumers who, in practice, never need to be chased for payment; and
 - the need for charging simplicity. It is often difficult to target costs precisely on the consumers who cause them, and a degree of averaging is clearly inevitable.
- 3.113 A high proportion of complaints have been about BT's non-DD charge, even though their charge is at the lower end of the scale. In part this reflects perceptions that BT is still the main supplier of basic telephony services. In August 2006 Ofcom decided there was sufficient competition in the market that retail price controls on BT were no longer needed. Ofcom continues to be of this view – we do not consider that BT is a special case and should be treated differently on this issue to other suppliers.
- 3.114 In conclusion:
- our first concern is over pricing transparency - where these concerns are addressed, we do not think there is a case to intervene over the level of the charges (nor, insofar as such terms are core terms, is there any basis to do so under the Regulations);

⁶ Calculating fair default charges in credit card contracts (OFT 842, http://www.ofcom.gov.uk/shared_ofcom/reports/financial_products/ofcom842.pdf).

- where such terms are assessable for fairness because they are not set out with sufficient transparency, we will act to ensure charges are set at a fair level and reflect only directly incurred costs;
- we believe that concerns over access and inclusion for low income consumers are addressed by social telephony schemes (such as BT Basic) which do not distinguish by payment method;
- however, we do accept that, on an economy-wide basis, there may be a significant impact on the financial position of low income consumers – this is a wider issue for Government and outside of Ofcom's direct remit.

Recommendation and Guidance

3.115 Ofcom recognises the strong feelings this issue has provoked. We believe that:

- it is essential that suppliers do more to ensure their consumers properly understand the charges they are paying. Headline prices, including any charge relating to payment method, should be very obvious to consumers so that they can shop around and choose the best deals, allowing competition to regulate the level of the charges;
- where charges for different payment methods are not set out prominently and transparently as part of the headline price, so that they cannot be said to be part of the essential bargain between the parties, suppliers must ensure that they are set fairly. They should reflect only direct costs related to that payment method and not include, for example, any recovery of bad debt costs. Ofcom will regulate compliance with rules of fairness;
- however, where prices are obvious (and so do form part of the headline price and the essential bargain) it is competition - not Ofcom - which will determine what the level of the charges are.

3.116 As a result of our findings we expect suppliers to improve their marketing material and correspondence with consumers so that it is very clear to all consumers what they will pay for their service and will allow consumers to shop around to find the best deal for them. Where suppliers do not do this, we expect them to ensure that their charges reflect only directly incurred costs.

3.117 We do not expect that this intervention will have a big impact on a supplier's decision to offer either a full range of payment methods, or a more restricted range. However, this is something we will monitor, and if evidence emerges that choice of payment method is becoming restricted and causing consumer harm we will review how this might be addressed using sector specific powers.

3.118 Ofcom has considered whether non-DD charges affect access and inclusion for low income consumers, and whether it might be appropriate to intervene for this particular group. We do not recommend any specific action over and above the introduction of the new BT Basic social telephony product regarding non-DD charges for low income consumers, although we recognise the importance of broader initiatives to encourage access and inclusion.

3.119 Ofcom's proposed guidance states that non-DD charges should be sufficiently prominent and transparent to consumers at all stages when they are considering which services to purchase, which requirement will include the following elements:

- all marketing information should make the fact that an additional charge applies for payment methods other than direct debit, together with the level of that charge, immediately and easily apparent to consumers. We will consider this requirement is met where charges for direct debit and non-DD customers are given equal prominence, otherwise we will consider on a case by case basis; and
- non-DD charges must be made clear at point of sale.

3.120 Where non-DD charges are not sufficiently prominent and transparent, they will be subject to a test of fairness and only direct costs should be reflected.

3.121 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.

3.122 In addition to the above, Ofcom considers that it is also important that:

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

3.123 Since bills are sent out after the conclusion of the contract the above points are not covered by the Regulations. Suppliers are, however, also subject to General Conditions (GC), including GC12 on itemised bills. This requires suppliers to provide at least a basic level of itemised billing and that this 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. If we become aware that bills do not present non-DD charges sufficiently transparently we will consider opening a new review to look at GC12 and to determine if and how this can be used to achieve the above.

3.124 Ofcom recognises that this is an important area for consumers. Ofcom will actively monitor developments in the market and we may look at this issue again if we are not satisfied that supplier information, and consumer understanding have improved. If consumers remain as confused about non-DD charges as they appear to be at the moment, then we will reconsider the case for further intervention.

Section 4

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

Description of the charges

- 4.1 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").
- 4.2 The existence of these types of charge varies by supplier and by service: some suppliers have these charges and others do not.
- 4.3 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.
- 4.4 In figure 4.1 we give some examples of these types of charges based on a snapshot at August 2007.
- 4.5 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 £5 to £10;
 - interest rates are expressed as a percentage over a specified base rate (such as Barclays). In the examples we saw this varied between 2% and 4%.
- 4.6 Relatively few suppliers have charges for restoring service or for payment failure. Where they exist, both charges can be up to £23.50.

Figure 4.1: Retail charges for late payment charges, payment failure charges and charges for restoring service as at August 2007

Supplier	Late payment charge	Charge for payment failure	Charge for restoring service
BT	£7.50	£10.00	£11.75
CPW Talk Talk	£5.00	£5.00	n/a
CPW AOL	Interest on late payment at NatWest bank rate + 2%	n/a	n/a
H3G	£5.00	£5.00	n/a
Kingston	£5.00	£23.50	£23.50
O2	Interest on late payment at HSBC bank rate + 2% (reserve right to charge reasonable administration costs)	n/a	n/a
Orange	n/a	n/a	n/a
Pipex Internet	Interest on late payment at Barclays bank rate + 3%	n/a	n/a
Pipex Bulldog	Interest on late payment at Barclays bank rate + 4%	n/a	n/a
Pipex Homecall	Interest on late payment at Barclays bank rate + 4% (may make a reasonable additional charge and/or interest)	Administration charge for any third party charges and internal costs	n/a
Pipex Toucan	Interest on late payment at Barclays bank rate + 4% (may also make an administrative charge)	Administration charge for any third party charges and internal costs	n/a
Post Office	n/a	n/a	n/a
Sky	n/a	n/a	n/a
Tesco	n/a	n/a	n/a
Tiscali	n/a	n/a	n/a
T-Mobile	Interest on late payment at HSBC bank rate + 2%	£23.50	£23.50
Virgin Media	Interest on late payment at Barclays bank rate + 4% or other charges (currently £10)	n/a	n/a
Virgin Media (off-net)	n/a	n/a	n/a
Vodafone	Barclays bank rate + 2% (may also charge reasonable administration costs)	n/a	n/a

Source: information provided by suppliers

Note: the figures reflect terms and conditions – not all the charges may be applied in practice.

Evidence on how it impacts on consumers

4.7 In this section we look at the evidence we have collected regarding consumers' understanding and attitudes towards non-DD charges. We have considered evidence from:

- market research commissioned by Ofcom;

- complaints data (directly to Ofcom and via MPs) and views expressed by consumer groups; and
- evidence from our analysis of supplier practice in terms of marketing material and consumer communications.

4.8 We focus here on consumers in general, leaving to the next section a more detailed discussion of issues around consumers on low incomes.

Market research

4.9 Ofcom has carried out a range of quantitative market research around late payment fees and charges to restore service. We have not carried out specific research on charges for payment failure because we believe:

- the incidences of this are relatively small; and
- the issues are similar to the issues for the other two charges we are considering in this section.

4.10 Consumer awareness of late payment charges is around 16-19% - this is similar to awareness for non-DD charges. This is unexpected – we would expect awareness of charges which are incurred every month, and by around 30% of consumers, to be greater than awareness of late payment charges which are more one off events. The figures are shown in Figure 4.2.

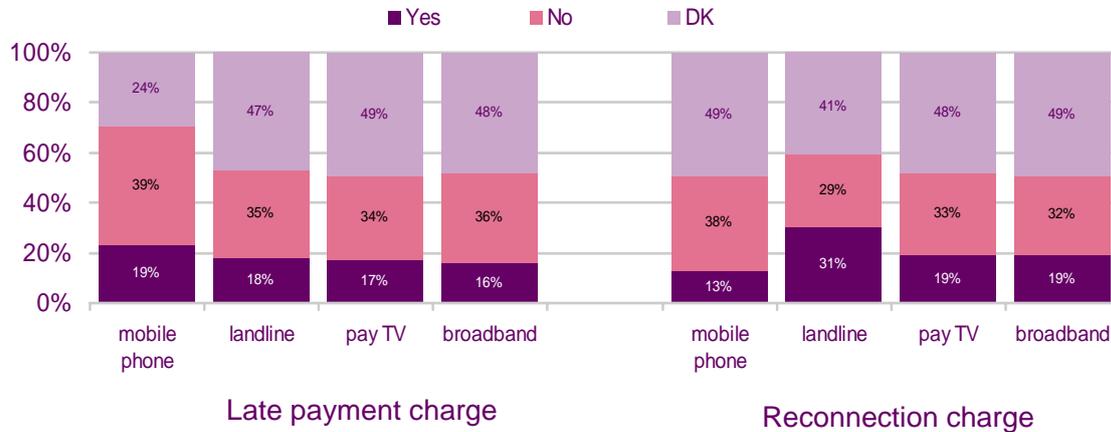
4.11 Not all suppliers have these types of charges. Examining consumer awareness figures by supplier, however, shows relatively little correlation between consumer perception that a supplier has such a charge and whether their supplier in fact has such a charge.

4.12 We believe, therefore, that the figures show a general awareness that these types of charges can occur, rather than specific awareness for a consumer's own supplier.

4.13 Awareness of reconnection charges is 31% for fixed line services but lower for other services. Again awareness is not closely linked to whether a consumer's own supplier in fact has such a charge. The figures are shown in Figure 4.2.

Figure 4.2: Awareness that current supplier has a late payment charge or a restore service charge

(As far as you know, does your supplier charge for late payment / to restore service?)



Source: Ofcom Research, July 2007

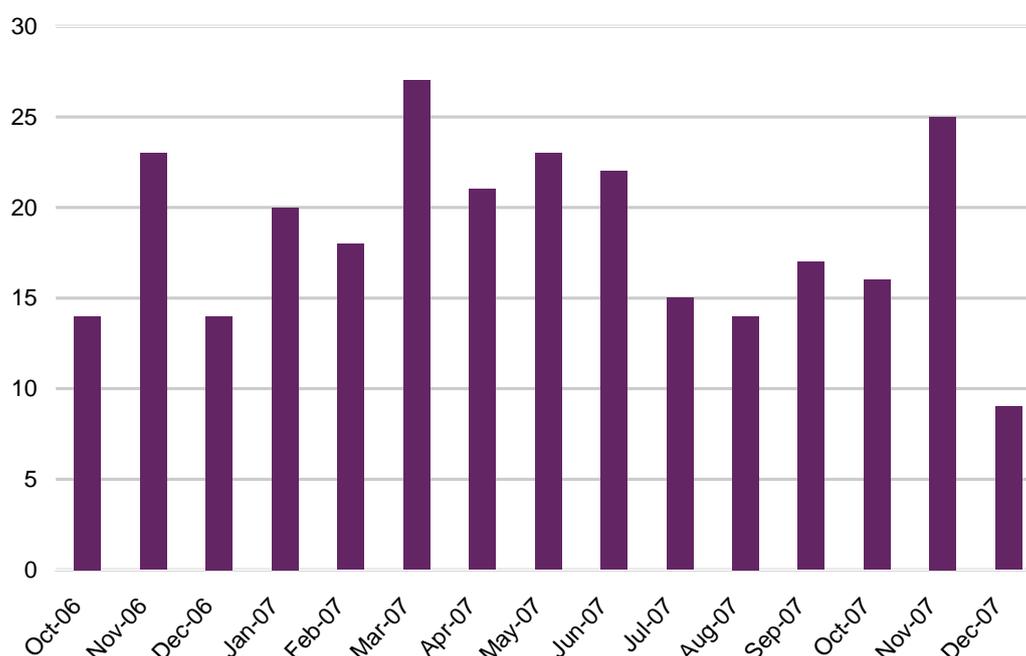
Base: All with responsibility for mobile phone contract (463), landline phone (1,287), Pay TV (590), Broadband Internet (636)

- 4.14 Only a relatively small proportion of consumers (up to 6%) claim to have been affected by a late payment charge or a restore service charge. Based on figures provided by suppliers, we believe this is something of an underestimate.
- 4.15 When asked about fairness, up to around a third of consumers are prepared to accept that late payment charges are fair – this is higher than the figures for non-DD charges (around 10%) and for charges for restoring service (around 20%).

Complaints and views from consumer groups

- 4.16 Ofcom has received around 20 complaints a month regarding late payment charges. See Figure 4.3. Complaints about payment failure charges and charges to restore service are relatively rare, reflecting in part the relatively low incidence of these. Nonetheless, we note that they raise very similar issues to late payment charges.

Figure 4.3: Complaints received by Ofcom’s Advisory Team relating to late payment charges.



Source: Ofcom

4.17 Complaints received by consumers as well as comments made by consumer groups, indicate that the main concerns are that:

- late payment charges can cause financial hardship to the most vulnerable members of society, whose lives may be chaotic and who may experience difficulties meeting deadlines. Suppliers do not always deal with such cases in a sympathetic manner;
- costs can be cumulative, e.g. charges from both the supplier and a bank for payment failure. This can result in a sum that is unaffordable for those on low incomes;
- imposition of late payment charges can occur prematurely, in situations where the consumer has had little opportunity to avoid the charges;
- with electronic exchanges the cost of reconnection / restoring service is believed to be minimal.

Evidence on marketing and other sources of consumer information

4.18 It would not generally be expected that suppliers highlight these types of charges as part of their general marketing. However, it is important that consumers can find, or are provided with, the relevant information at the point where there is a risk that the charge may be levied and consumers may be able to avoid the charge. We have seen examples where the information is clearly set out in terms and conditions – but others where it is difficult to find, or appears not to be there.

4.19 We have also seen some good examples where:

- consumer bills clearly set out what any late payment charge will be;
- reminder letters clearly set out what any late payment charge will be.

Distributional effects

- 4.20 We are unable to break down the quantitative market research results by income group. However, anecdotally (and intuitively) we expect these charges to have greater impact on low income consumers who may both be more likely to incur the charges and will find them harder to pay.
- 4.21 Our qualitative market research amongst low income households indicated the following key points.

Qualitative research - Late payment charges

- 4.22 There was limited awareness among low income consumers of late payment charges from suppliers – most consumers tended to associate these costs with credit cards and banks.
- 4.23 Overall there was a general feeling that the charges were likely to hit those who had the most financial difficulties, but there was also widespread acknowledgement that payment terms should be honoured.
- 4.24 £5-10 on the bill was considered a very heavy charge and largely unaffordable, but for most the charges were just not relevant

“This just wouldn’t affect us, we would never pay late and incur charges” (Family, Glasgow)

- 4.25 It was felt that suppliers should ensure consumers are always alerted before being charged with late payments so that consumers have the opportunity to avoid them.

Qualitative research – Restore service Fee

- 4.26 Most of the low income consumers interviewed had heard of this charge but few had had any experience of it. Overall, there was a grudging acceptance of the charge if an engineer had to come out and physically reconnect the line, but if the service was simply switched back on then the charge was felt to be too high.

Summary of consumer evidence (including low income issues)

- 4.27 Consumers have little awareness of charges related to paying late and payment failure. In part this may be because many consumers do not experience them. Where consumers say they are aware, this appears to be more a general awareness that these types of charges may apply, rather than knowledge of their own supplier’s actual practice. Only a minority of consumers consider it is fair to have these types of charge, although they are two to three times more likely to consider a late payment charge to be fair compared to non-DD charges or itemised billing.
- 4.28 These types of charges are considered high for those low income consumers who incur them.

Cost evidence for these charges

- 4.29 It is clearly in suppliers' interest that their customers pay on time. Different suppliers have different charging policies:
- some believe it is important to have late payment charges to encourage consumers to pay on time and to enable costs to be targeted at those who do not;
 - others believe that there are other ways to manage late payment, and that these types of charge may either deter payment at all (if there is genuine difficulty paying) or may encourage a consumer to switch supplier;
 - some take an intermediate position – they feel it is important to reserve the right to levy these types of charges, but in practice they tend not to impose them. However, we note in this regard that if a term is potentially unfair to consumers Ofcom's view (consistent with OFT guidance) is that it will not avail a supplier to argue that such a term is seldom enforced.
- 4.30 Where these charges are set and levied we have examined cost data from suppliers. The cost categories suppliers have used are explained below. This is based on looking at a range of information – individual suppliers may vary in the categories of cost they include.
- 4.31 Cost categories for chasing late payment may include:
- the direct costs of chasing payments, such as sending reminder letters and making calls;
 - loss of interest reflecting the late receipt of payment;
 - cost of outsourcing debt recovery to an external debt agency;
 - an element of bad debt, reflecting the view that those consumers who sometimes pay late have a greater propensity to bad debt than others. Part of this may include wholesale costs for ceasing services which are not subsequently restored.
- 4.32 Cost categories for payment failure may include:
- the same categories that apply for late payment charges, as typically the payment failure will also result in late payment;
 - the direct costs of processing the failed payment;
 - an additional element of bad debt.
- 4.33 Cost categories for restoring service may include:
- the same categories that apply for late payment charges, as typically the payment failure will also result in late payment;
 - wholesale charges incurred for ceasing / restoring service;
 - an additional element of bad debt.

Summary of supplier evidence

4.34 In summary:

- in general, suppliers have charges such as late payment charges to reflect the additional costs incurred;
- the level of that charge will depend on the cost elements allocated, and in particular, whether only direct costs are included.

Summary of Ofcom's policy concerns and legal view

4.35 Ofcom recognises that consumers are concerned about the charges made by suppliers when something goes wrong with their payments, for example when they pay late. They feel that these charges are sometimes imposed before they have had a chance to pay the bill, and that the level of the charge is too high.

4.36 Ofcom's market research shows that consumers have a poor awareness that they might face these types of charges.

4.37 Ofcom believes it is essential that suppliers ensure sufficient transparency of these charges so that consumers can avoid them. Suppliers should also not levy late payment charges before the consumer has had a reasonable opportunity to pay their bill.

4.38 However, late payment charges, charges for payment failure or charges to restore service, represent charges that are only made in certain circumstances that consumers probably regard as unlikely. Therefore, even where transparency is improved, it is unlikely that these charges would form part of a consumer's purchasing decision, and in any case consumers may well underestimate the likelihood of paying late.

4.39 From a policy perspective, there is, therefore, a real risk that competition will not constrain the levels of these charges. Without regulatory intervention, therefore, it is possible that one group of consumers (those who pay late, whether on an odd occasion or more often) will end up subsidising consumers more generally, causing consumer harm to those consumers who incur the charges.

4.40 Similarly, under the Regulations, Ofcom considers that late payment charges, charges for payment failure and charges for restoring service are default charges and are non-core terms. They are, therefore, subject to the test of fairness.

4.41 Ofcom intends to apply the Regulations to ensure that the level of late payment charges is set at a fair level. The issues relating to fairness of such charges are set out below.

4.42 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.

4.43 As with non-DD charges, some suppliers also include an element of cost relating to bad debt. Ofcom does not accept that bad debt should be recovered from this charge. We expect that the causal relationship will be relatively weak. The vast majority of late paying consumers do not default on their payments. On this basis we

do not consider that such costs should be included. We again note that the OFT has taken a similar view in looking at credit card default charges.

Recommendation and Guidance

4.44 Ofcom believes that:

- suppliers should do more to ensure that consumers understand these types of charges and that they are only levied where appropriate; and
- as these types of charges do not form part of the headline price, suppliers should ensure that they are set fairly, to reflect direct costs only.

4.45 These measures should ensure consumers are better able to avoid these charges and have greater confidence that the charge levels are not unfair. Based on current charging practices we believe our findings will have a limited impact on the charges levied by the larger suppliers. We do not believe that our guidance will have a material effect on incentives for consumers to pay on time.

4.46 These types of charges are likely to cause a greater problem for low income consumers than higher income consumers. It is essential that they are set fairly.

4.47 Ofcom's proposed guidance will address these issues.

4.48 The proposed guidance states that in relation to terms which impose these types of charges, we consider that such terms will only be fair if suppliers make the following clear in their contracts:

- that a late payment 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; and
- what the level of the charges will be.

4.49 Charges should be related to direct costs (we do not expect that elements such as bad debt are sufficiently causally related to be included).

4.50 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.

4.51 In addition to the above, Ofcom considers that it is also 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. 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.

4.52 Since late payment charges take place after the conclusion of the contract, the above point is not covered by the Regulations. We are not currently aware that this is a problem area. If it were to become so, we would consider the case for using sector specific regulation regarding this point.

Section 5

Minimum contract periods and early termination charges (initial contract)

Description of the charges

5.1 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, or for provisioning broadband. Although some MCPs may be three months, the most common duration is 12 months. Increasingly, however, 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;
- for fixed voice services some suppliers have MCPs of 12-18 months, while others have shorter MCPs (e.g. 3 months) or no MCP.

5.2 In the situation where a consumer terminates a contract of fixed duration 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).

5.3 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.

5.4 Figure 5.1 illustrates the range of MCP and ETC for a selection of suppliers. This is not intended to be comprehensive and is based on a snapshot taken in Summer

2007. In this section we are focussing on the MCP and ETC which apply when a consumer first signs a contract for a service. The MCP and ETC which apply when a contract is varied or renewed are considered in section 6.

Figure 5.1: Retail terms for initial MCP and ETC as at August 2007

Supplier	Fixed	Mobile	Broadband	Pay-TV	Bundles	ETC exceptions to full outstanding rental
	Contract periods offered, in months					
BT	12/18 (note 1)	12/18	12/18	One month for subscription packages – otherwise no MCP	-	Most fixed line options - rental only (not call charges), capped at £70 (note 2). BB - add £45 modem charge
CPW Talk Talk	12	-	-	-	18 (note 4)	Capped at £70
CPW AOL	-	-	18	-	-	
H3G		12/18/24	-	-	-	
Kingston	12	-	12	-	-	Fixed line – rental only (not call charges)
O2	-	12/18/24 (note 3)	12	-	-	
Orange	-	12/18/24 (note 3)	18	-	-	
Pipex Internet	-	-	12/18	-	-	
Pipex Bulldog	-	-	12	-	-	
Pipex Homecall	3	-	12/18	-	-	£30 for fixed line
Pipex Toucan	0/12	18	12/18	-	-	Notice period for Toucan Talk Line Rental 15 days but charges continue for up to 45 days
Post Office	0	-	-	-	-	
Sky	0	-	12	12	-	ETC is at price of lowest cost package
Tesco	3	-	12	-	-	£0 for fixed line. Capped at £70 for BB (£100 for "Finest")
Tiscali	0	-	12	12	12	
T-Mobile	-	12/18/24 (note 3)	-	-	-	Rebate of 4% for full payment
Virgin Media (cable and mobile)	12	12/18 (note 3)	12	12	12	ETC reduced to lesser of actual amount outstanding or £10 per month for each element

Supplier	Fixed	Mobile	Broadband	Pay-TV	Bundles	ETC exceptions to full outstanding rental
	Contract periods offered, in months					
Virgin Media (off-net)	-	-	12	-	-	Cancellation charge of £50
Vodafone	-	12/18 (note 3)	-	-	18 (note 4)	Rebate of 2% for full payment

Source: information provided by suppliers

Notes

1. BT fixed line generally 12 months except for certain Option 2 deals and special offers
2. For certain Option 2 deals the ETC is full package price
3. SIM only packages available on 30-day / one month terms
4. Voice and broadband bundle

Evidence on how it impacts on consumers

5.5 In this section we look at the evidence we have collected regarding consumers' understanding and attitudes towards non-DD charges. We have considered evidence from:

- Ofcom's market research;
- complaints data (directly to Ofcom, via MPs and from consumer groups); and
- evidence from our analysis of supplier practice in terms of marketing and consumer communication.

5.6 We focus here on consumers in general, leaving to the next section a more detailed discussion of issues around low income consumers.

Market research

5.7 Ofcom has carried out market research looking at:

- consumers' awareness of MCP and ETC
- when and how consumers become aware of these terms
- consumers' attitudes to the fairness of these charges.

5.8 Figure 5.2 illustrates how awareness of MCPs is generally significantly higher (typically twice as high) than awareness of ETCs.

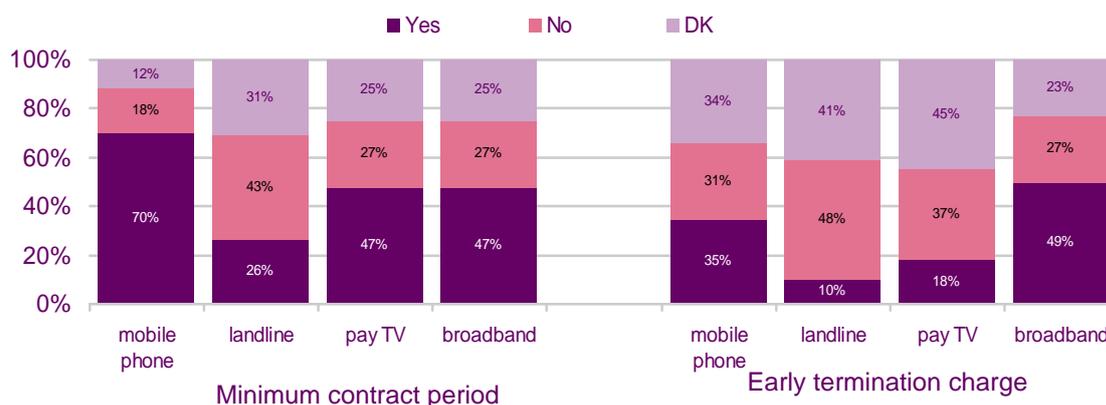
5.9 Awareness is different by sector:

- awareness is highest for mobile phone contracts at 70% for MCP and 36% for ETC;
- awareness is lowest for fixed voice services, at 26% for MCP and 10% for ETC;

- awareness for pay TV is nearly 50% for MCP and nearly 20% for ETC;
- only for broadband is awareness of MCP and ETC similar (nearly 50%).

Figure 5.2: Awareness of MCP and ETC

(As far as you know, does your supplier have a minimum contract period / early termination charge)



Source: Ofcom Research, July 2007

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

5.10 For fixed voice, we note the lower awareness could in part be due to the fact that not all suppliers in fact have MCPs. Due to sample sizes we were able to look at only a small selection of suppliers to see if lower awareness did in fact reflect supplier practice. While for some fixed voice suppliers who did indeed have MCPs and ETCs, awareness was more comparable to the figures for pay TV and broadband, for BT awareness was lower than the average.

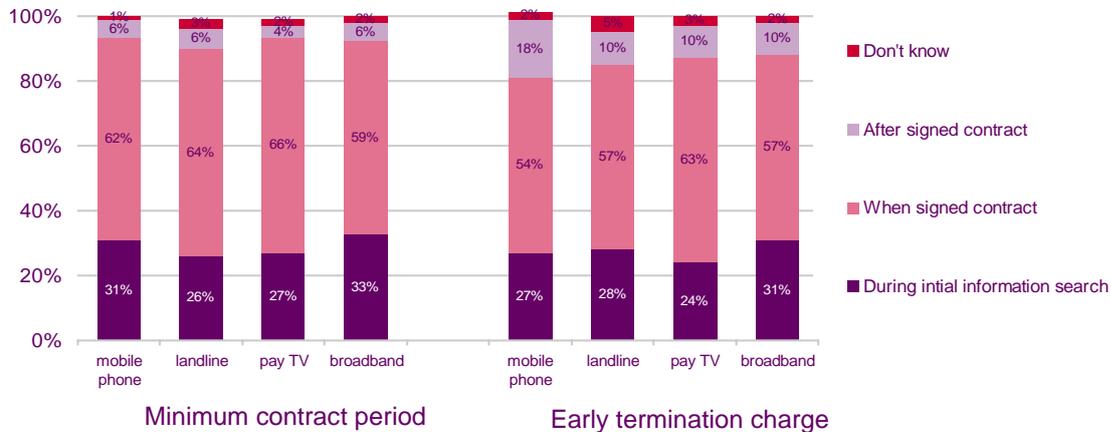
5.11 For those aware of such charges, the time at which consumers became aware was similar by sector:

- generally only a minority of consumers were aware during the search (24% to 31% for ETC and 26% to 33% for MCP);
- a significant number became aware at the point of signing the contract (59%-66% for MCP and 54%-63% for ETC); and
- a significant minority (up to 18%) only became aware of these terms after they had signed the contract.

5.12 This is illustrated in figure 5.3.

Figure 5.3: Source of initial awareness

(When did you first become aware of the minimum contract period / early termination charge from your supplier?)



Source: Ofcom Research, July 2007

Base: All aware of charge

- 5.13 More detailed questions about how consumers had become aware of these terms showed that the dominant responses were ‘told by sales person’ or ‘read in contract’ with relatively few seeing the information on the web or in marketing material.
- 5.14 Personal experience of MCP and ETC was reported at 5% to 10% for MCP and 3% to 5% for ETC. Reasons why the proportion of consumers experiencing ETC being lower than MCP could be due to ETC being waived in some circumstances, or paid by an acquiring supplier, or a consumer changing their mind about terminating.
- 5.15 These awareness figures are lower than figures from suppliers would seem to indicate, suggesting that consumers underestimate the extent to which they are liable to pay ETCs.
- 5.16 Consumers were also asked whether they considered it was fair to set MCPs and ETCs. MCPs were generally considered more fair than ETCs, although we note that without some form of ETC a MCP is not likely to have much effect. There were differences by sector:
- MCPs and ETCs were considered relatively most fair for mobile contracts (at 38% and 20% respectively) – although even here (where the benefit to consumers in terms of a subsidised handset is very tangible) this was a minority of consumers;
 - MCPs and ETCs were considered relatively least fair for fixed voice contracts (21% and 13% respectively) – here the benefit to consumers is least tangible;
 - Figures for pay-TV and broadband were intermediate between these.

5.17 Overall the figures show relatively low awareness of these terms, particularly for fixed voice services. Where consumers become aware, it is generally, at or before the point of sale.

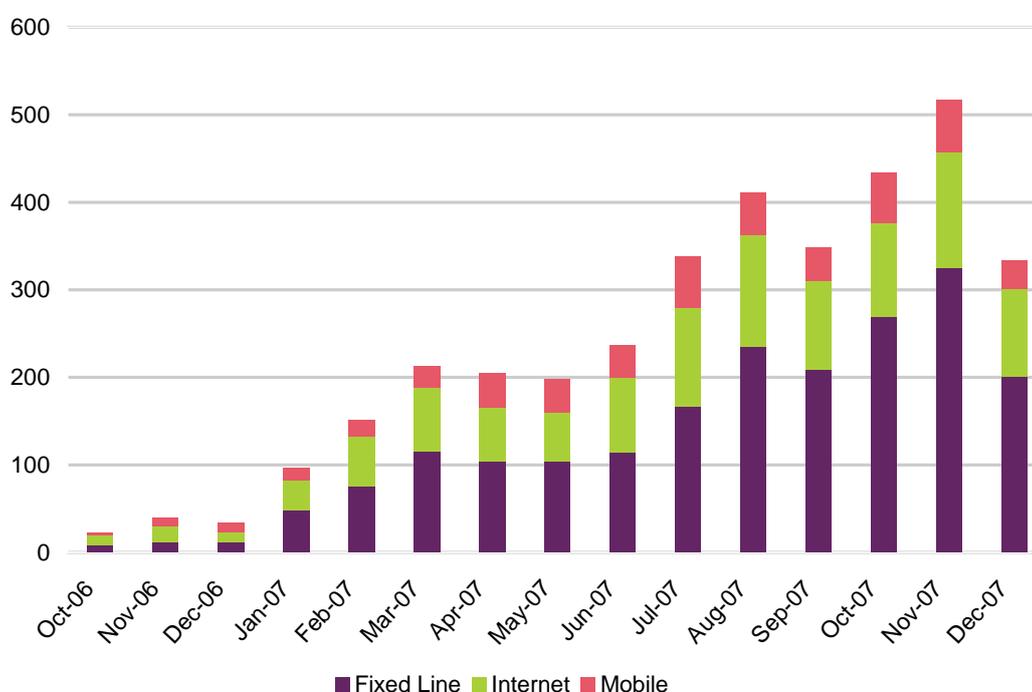
Complaints and views from consumer groups

5.18 Ofcom has received an increasing number of complaints regarding MCPs and ETCs, which are currently around 400 a month (see figure 5.4). Of these approximately half relate to fixed voice services, a third to broadband and 15% to mobile. The nature of these complaints varies, and includes cases where:

- consumers dispute the termination charge because, for example, they have received poor (or no) service from their provider;
- consumers claim they were not informed they were signing up to a contract which had a minimum contract period;
- consumers complaining about the unreasonableness of the length of the MCP.

5.19 We note that the first of these issues around whether a contract can be terminated with no penalty because of poor service are not within the scope of this review. We would expect these kinds of complaints to be subject to a supplier’s complaints procedure and, where a supplier and consumer cannot agree, ultimately to alternative dispute resolution (‘ADR’). Ofcom will shortly be consulting on Complaints Handling and Independent Dispute Resolution.

Figure 5.4: Complaints made to Ofcom’s Advisory Team regarding Minimum Contract Periods and Early Termination Charges.



Source: Ofcom

5.20 This issue has attracted much less interest from MPs and consumer groups compared to non-DD charges. As with complaints received by Ofcom’s Advisory

Team, some of the particular concerns raised to us about such terms appear to be more related to individual circumstances than the general principle. For example comments have been made regarding the legitimacy of ETCs in cases where a consumer wishes to terminate because they have received a faulty product (e.g. faulty mobile phone) or poor service. There are of course a range of situations where it may be reasonable to assume that a supplier will not in practice impose an ETC, although we note again (see paragraph 4.29 above) that a term which has the potential to be unfair will not become fair simply because a supplier may waive its entitlement to rely on it. As explained above, we would expect these kinds of complaints to be subject to a suppliers' complaints procedure and, where a supplier and consumer cannot agree, ultimately to ADR.

- 5.21 We have also had concerns expressed about the principle of MCPs and the fact that suppliers may use them to deter switching. In some cases there is little understanding of why setting an MCP may be a legitimate thing to do.
- 5.22 One consumer group expressed concern at the relatively small benefits to consumers which suppliers used to justify setting a MCP, and suggested that MCPs should only be set where there was a clear cash or quantifiable benefit (such as a mobile phone handset).

Evidence on marketing and other sources of consumer information

- 5.23 Given the relative lack of awareness amongst consumers, Ofcom has examined a range of marketing and other material (such as terms and conditions) produced by different suppliers to assess how clear and prominent MCPs and ETCs are.
- 5.24 Suppliers vary in how transparent their material is. In general, references to MCPs are much more prominent than explicit references to, or explanations of, ETCs. In the examples of marketing material we looked at we found a range of practices, including cases where:
- MCPs very clearly form part of the headline pricing table – this is particularly obvious for some mobile contracts where the consumer explicitly has the choice between packages with lower headline prices (or more call minutes / texts included in the package) and a longer MCP, vs. higher headline price and a lower MCP;
 - MCPs very clearly formed part of the commentary following the headline prices;
 - mention of MCPs was included only in the small print;
 - there appeared to be no mention of MCPs at all in the 'front page' advert.
- 5.25 In the examples we looked at for ETCs:
- marketing material may alert consumers to the fact an ETC may apply, but it is unlikely to explain how the ETC will be calculated;
 - in some cases marketing material may not refer to the ETC at all;
 - mostly, terms and conditions will explain the ETC, but in some cases this is difficult to find, or is imprecise.

Distributional effects

- 5.26 There is little direct evidence that low income consumers are particularly hard hit by MCPs and ETCs, although:
- where a low income consumer does incur an ETC the amount of money will be larger in proportion to income; and
 - it is possible that low income consumers are more likely to face a change in financial circumstances which means they are no longer able to continue monthly payments.
- 5.27 The quantitative market research reported earlier cannot be broken down by income group due to sample size.

Qualitative market research

- 5.28 Our qualitative market research amongst low income households indicated a number of key points.
- 5.29 Awareness of these terms was widespread and several low income consumers had been in dispute with operators, generally mobile operators, over these charges.
- 5.30 There was a general acknowledgement that contracts need to be of a certain length in order to cover the upfront costs of the equipment and reduced calls charges. However, pressure by operators to try to tie in consumers beyond 12 months was considered a form of coercion.

“I think 12 months is enough, they’re only trying to tie you so you don’t go elsewhere – if the service was good you wouldn’t go elsewhere so they should think about providing a quality service rather than forcing us into long contracts” (Over 60, Glasgow)

- 5.31 There was widespread concern that suppliers were offering enticing deals without giving any explanations of the contract details – and those on the lowest incomes tended to be hit the hardest. In addition, there was little perceived flexibility on the part of the suppliers when consumers did run into difficulties and there was a need to reduce the monthly payments

“They’ll quite happily put you on a higher monthly tariff, but try and reduce your payments and they’re not so helpful” (Single, Cardiff)

- 5.32 The vast majority 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

“If you sign a contract then it should be honoured. But if the operator doesn’t provide the service it has promised then we should be able to up and leave. It can’t be one way – they’ve got to keep up their end of the bargain” (Over 60, Glasgow)

Summary of consumer evidence (including low income issues)

- 5.33 Consumer understanding of MCPs and ETCs differs by sector, with better understanding for mobile contracts and poor understanding for fixed voice. Overall, consumer understanding of these terms is not high. Individual complaints reflect the fact that consumers sometimes feel they were not informed about the MCP and ETC when they entered into the contract. Poor prominence given to these terms in marketing and other material is likely to have contributed to the overall poor understanding.
- 5.34 There are not strong issues arising specifically around low income groups and MCPs / ETCs, although clearly ETCs are likely to be harder to pay for those on low incomes.
- 5.35 The fact of there being an MCP and ETC may be a deterrent to a low income user taking a service. However, as discussed below, MCPs are often the quid pro quo for low or zero connection charges, and free or subsidised mobile handsets. High connection charges would be an equal deterrent to access for low income consumers.

Cost evidence for these charges

- 5.36 In this section we discuss the information provided to us both in response to Ofcom's formal information request and in discussions with suppliers about their response. Detailed cost information has been provided to us in confidence and we have not presented data relating to any individual supplier.
- 5.37 Suppliers incur upfront costs when they sign up a new customer. These costs differ by type of service and by business model. In general suppliers have provided information on costs falling into the following categories:
- direct per customer costs incurred when a new customer is taken on;
 - more general costs related to customer acquisition, which can be allocated across new consumers; and
 - implicit costs, such as the difference between a supplier's standard price and a special offer available for new subscribers.
- 5.38 Examples of direct per customer costs may include:
- per customer equipment, such as a mobile handset, a broadband modem, a satellite dish or set-top box;
 - the cost of installing any such equipment, for example installing a satellite dish;
 - the cost of any network extension which is specific to that consumer, for example a new cable connection;
 - wholesale connection costs, typically payable to BT Wholesale or BT Openreach.
- 5.39 Examples of customer acquisition costs may include:
- sales and marketing; and

- administrative processes such as billing set up and credit vetting.
- 5.40 Some suppliers charge customers a one off connection fee, but many do not. In general, consumers do not face the full upfront costs they have caused to be incurred. Instead suppliers choose to spread the costs over a period of time, and seek to ensure a steady stream of revenue to recover both upfront and ongoing costs.
- 5.41 Suppliers have argued that minimum contract periods are set with regard to a number of factors:
- the desire to recover upfront costs;
 - the desire to have a guaranteed revenue stream; and
 - what consumers will accept (which tends to act as a limit on the length of an MCP).
- 5.42 Many suppliers have claimed that usually the total contracted revenue over the MCP will not fully recover both upfront costs and ongoing costs. Services are only profitable when:
- consumers continue taking a service beyond the MCP; and/or
 - consumers purchase additional services beyond their contractual obligation (for example make calls outside their inclusive call bundles).
- 5.43 ETCs are a key element of MCPs – without some form of ETC, MCPs would not have any meaning as consumers could simply walk away from the contract.
- 5.44 The vast majority of suppliers imposed an ETC of remaining contracted retail payments. Suppliers claimed that this was the sum of money the consumer had committed to and it was the regular stream of revenue the supplier was expecting. As such they felt they were entitled to the full amount. Some suppliers claim that, through MCPs, they can create and pass on efficiency savings associated with better management of fixed costs.
- 5.45 A small number of suppliers charged (on occasion) an amount larger than the remaining monthly payments, for example to recover the cost of a ‘free’ modem. This was intended to be a disincentive for consumers to sign up for the free equipment only. (In practice no rational consumer would do this – the total ETC would far exceed the value of the free equipment).
- 5.46 A small number of suppliers capped the ETC at some figure, typically around £70 or £100.
- 5.47 Two of the suppliers whose terms we looked at charged an ETC based on remaining months for the lowest package price available. For many consumers this would be less than the remaining charges for the package they were actually on.
- 5.48 Ofcom also received information on ongoing recurring costs. These are the costs which a supplier would save if they no longer provided service. The main example of per customer recurring cost is the wholesale charge for using BT’s network. There are some per customer recurring costs for pay TV, although these appear to be a relatively small proportion of overall package price.

- 5.49 For network owners⁷, such as mobile operators, Virgin Media and Kingston there is relatively little in the way of clear per customer costs that would be saved when a consumer ceases service, although this does not mean that costs might not be mitigated where, for example, network assets can be used to provide service to another consumer.
- 5.50 For those suppliers purchasing wholesale services, it is clear that a supplier receives a greater net revenue (i.e. revenue net of wholesale costs) from a consumer who terminates early and pays an ETC of remaining contractual payments, than from a consumer who completes their contractual term at the minimum spend allowable under the contract. Suppliers recognised that this was the case, but felt that:
- they still in many cases make a loss rather than a profit from consumers terminating early;
 - they may be foregoing additional (but non-contracted) revenue;
 - it is inevitable that some consumers are more profitable than others.
- 5.51 Suppliers claim that the purpose of ETCs is not to profit from applying the charge, but to persuade consumers to stick with the service, in the hope they will become a long term – and profitable – consumer. Data provided on revenues from ETCs confirms that these charges account for a low proportion of overall service revenues. In many cases ETCs are applied once a consumer has already defaulted on their monthly payment, and the ETC is in fact not recovered.
- 5.52 Lower ETCs would, in the opinion of many suppliers, reduce the incentive for consumers to take their MCP seriously, and hence increase churn. Increased churn would raise costs for industry generally (as upfront costs would be incurred more often) and these costs would be passed onto consumers.
- 5.53 Alternatively, to counter the tendency for increased churn, suppliers may need to reconsider their pricing and contracting strategy. Lower ETCs could result in suppliers:
- imposing longer MCPs;
 - setting higher connection charges; and / or
 - increasing headline monthly rates.
- 5.54 Suppliers felt that current business models were good for consumers: consumers benefited from being able to take up a new service without having to provide large connection charges, and in the case of mobile benefited from being able to get the latest handset without paying for it upfront. MCPs and the associated ETCs are key to making this model work.

Summary of supplier evidence

- 5.55 One of the purposes of MCPs is to spread the upfront costs of taking on a new customer. Costs which are incurred for each new customer include:

⁷ Note, due to functional separation, we are not considering BT Retail as a 'network owner' in the same sense.

- the cost of any equipment that they give the consumer either for free or at a charge below the actual cost (e.g. a mobile handset, broadband modem or satellite dish);
 - the cost of any installation for that particular consumer which is not charged for, or is charged below cost (e.g. installing a satellite dish or providing a new cable connection); and
 - wholesale connection charges which the supplier incurs when they take on a new customer.
- 5.56 ETCs are a means by which a supplier ensures a guaranteed revenue stream and recoups the upfront costs that it has incurred in signing the consumer up to the contract, by either:
- ensuring the consumer stays for their MCP; or
 - ensuring the consumer pays these costs at the point of termination.

Summary of Ofcom's policy concerns and legal view

- 5.57 Ofcom recognises that consumers do not feel that setting MCPs, and the associated charges when they wish to terminate the contract early, are fair for fixed line voice services. They are more likely to accept these features are fair for mobile contracts, where they receive a definite benefit in the form of a free, or cheap, mobile handset – though even here they are regarded as fair by a minority of consumers.
- 5.58 Ofcom's market research shows that consumers have very limited awareness of these terms for fixed voice contracts. Awareness is higher for mobile contracts.
- 5.59 It is essential that suppliers ensure consumers are fully aware of their contractual obligations and of the consequences of terminating their contracts early.
- 5.60 Ofcom recognises that suppliers face certain one-off costs when entering into a contract with a consumer, for example, the cost of supplying a mobile handset. Without MCPs, suppliers would need to charge consumers upfront fees in order to be persuaded to incur these costs.
- 5.61 However, from a policy perspective, MCPs and ETCs may constitute a significant switching cost that could dampen price competition in the market. They may also reduce the incentive for firms to enter the market or introduce new innovative products. This is particularly true when MCPs are a universal feature of contracts in a particular sector. Furthermore, firms with a large number of locked-in consumers may be complacent about the quality of service they offer. It is important to consider whether transparency is enough to ensure these terms are constrained by competition.
- 5.62 With full transparency, we might expect competition to safeguard against any harm because consumers would only agree to such conditions if they were compensated in some way. However, our research shows that awareness of MCPs and ETCs is often relatively low (particularly for fixed voice services) and awareness of ETCs is generally lower than for MCPs. Therefore consumers currently enter into such contracts not understanding the extent of their obligation, or the consequences of ending their contract early.

- 5.63 We believe that an MCP is a fundamental part of any contract, and provided MCPs are sufficiently prominent and clear to consumers, MCPs will form part of the bargain consumers enter into. In this case, competition will act to constrain the length of MCPs.
- 5.64 Similarly, we would expect an MCP to be viewed as a core term under the Regulations, provided it is set out with appropriate prominence and transparency.
- 5.65 However, from a policy perspective, ETCs are something a consumer will not usually anticipate paying and we expect that consumers will not fully take them into account in choosing their supplier. We do not believe ETCs will be effectively constrained by competition, even if they are presented clearly. ETCs should not be set to deter consumers from switching or to lock them into a contract they no longer want.
- 5.66 Similarly, under the Regulations, Ofcom considers that ETCs are default terms (or terms analogous to default terms that should be treated in the same way) and are therefore non-core terms. They are accordingly subject to the test of fairness under the Regulations.
- 5.67 Ofcom accepts that any intervention to reduce the level of ETCs may give rise to suppliers reviewing other charges (such as upfront charges or monthly payments) or reviewing the length of MCPs. Ofcom accepts that this may happen and considers that transferring costs from charges which are relatively hidden, and incurred by relatively few consumers, to headline charges, which are constrained by competition, will lead to greater fairness for consumers, reducing the chance of an unpleasant surprise for those consumers.
- 5.68 Ofcom considers there are three key points regarding fairness.
- 5.69 Firstly, Ofcom does not consider that it is fair that a supplier should charge an amount greater than the remaining monthly payments in any circumstances. Neither should a supplier demand the return of equipment which the consumer would have been able to keep had they completed their MCP. It is not reasonable to assume that a consumer will ever expect that getting out of a contract (without having enjoyed the full contractual entitlement to the service) is more expensive than completing it.
- 5.70 Secondly, Ofcom does not consider that in setting the level of an ETC, suppliers should take into account any expected profit for services beyond the minimum contractual commitment (that is, it should only take account of what the consumer is required to do to meet his contractual obligations in the least onerous way possible, and should not include, for example, calls outside the service bundle). We do not consider it fair for ETCs to be being calculated on the basis of an average consumer – any individual consumer may in fact never have expected to use more than their contractual minimum, and it is not fair that they should make a contribution towards profits for services they never committed to use.
- 5.71 Thirdly, Ofcom does not consider that it is fair that payment of an ETC may leave the supplier better off compared to the situation where the consumer stays until the end of the MCP. Suppliers should take account of any costs which they save or mitigate when they cease providing service.
- 5.72 Ofcom believes that the following elements of cost should be taken into account:

- variable costs which are no longer incurred when a supplier ceases to provide service. Per customer monthly wholesale charges paid to BT for the use of its network are a clear example of this;
- shared network costs which can be mitigated by other customers of the supplier using (and hence paying for) the network;
- customer specific network costs which are mitigated because they are already recovered via headline prices; and / or
- costs of network elements specific to a particular end user, which can be reused to provide service to another customer moving in to that address.

5.73 Ofcom considers that fairness requires suppliers to reduce ETCs where there are clear variable costs which are avoided or costs that can be mitigated.

5.74 The question of what costs are avoided or can be mitigated is addressed below. We consider separately the questions that arise in respect of:

- the core network, where the capacity required to provide services is shared amongst many consumers; and
- the access network, where the network assets are unique to a particular property.⁸

Core network costs

5.75 Those suppliers using BT's network to provide voice calls pay wholesale charges based on pence per minute charges applied to volumes of calls. Where consumers terminate service, calls are no longer made and any wholesale costs are avoided. These avoided costs should be used to reduce the level of the ETC.

5.76 For vertically integrated network operators, costs are not avoided in the same way, however we consider there are costs which can be mitigated.

5.77 At an aggregate level, core network costs (including the cost of capital) may be mitigated when a consumer terminates a contract early. Where demand is growing and suppliers are adding to the capacity of the network, any unused core network due to early termination of contracts by consumers can be used by other consumers of the supplier: the early termination by some customers allows the growth in demand to be met by existing capacity, when otherwise the supplier would have had to install new capacity. Thus, a supplier can mitigate its loss.

5.78 For both mobile and vertically integrated fixed telecom networks, the points made above suggest that suppliers can mitigate their loss because the inclusive call minutes, or the broadband capacity, that a consumer no longer uses, in effect, frees up capacity on the core network which can be reused by another (existing or new) consumer. This means that ETCs should be reduced to reflect the costs which the supplier can avoid elsewhere. The cost mitigated could be estimated by the long run incremental cost ('LRIC') pence per minute multiplied by the number of minutes the

⁸ The 'access network' is the segment which connects between a consumer's home or business premise and the nearest location which houses their provider's equipment. The 'core network' is the remaining network beyond that point.

average consumer on that package uses, or the LRIC per unit of broadband capacity multiplied by the average capacity used.

- 5.79 The costs that are mitigated will depend on the network in question. Ofcom expects to work with network operators in order to better understand what these costs would be, and, if appropriate, determine a benchmark figure which would be used to help inform a decision on whether to take enforcement action. For example, for mobile operators we consider the methodology underlying the calculations for mobile termination charges to be relevant.
- 5.80 For broadband suppliers using BT's network, there are also costs that can be mitigated in a similar way. Suppliers pay wholesale charges to use capacity in BT's core network. This capacity is shared between many consumers. Where a customer terminates, this releases capacity to be used by another consumer. As in the case of vertically integrated suppliers, we consider that costs can be mitigated. Here the supplier mitigates costs by avoiding purchasing extra wholesale capacity, rather than by avoiding installing it.
- 5.81 We expect that similar principles would apply to pay TV networks.

Access network costs

- 5.82 All capacity on mobile networks is shared, and relevant costs fall to be considered in the same way as set out in the section on core networks above.
- 5.83 For fixed voice and broadband services provided over BT's network, there are clearly identifiable savings from wholesale charges paid to BT for the use of its access network which are no longer incurred. As a consequence of this proposal, we would expect the 'discount' to the monthly retail payment which should be applied in calculating ETCs to take account of (though not necessarily be limited to) the following savings in payments to BT (based on current charge levels):
- £6 a month for broadband provided using IPstream;
 - £1.30 a month for broadband provided using shared local loop unbundling;
 - £8 a month for fixed voice services provided over Wholesale Line Rental (WLR);
 - £6 a month for bundled voice and broadband products provided over full local loop unbundling;
 - £14 a month (£6 plus £8) for bundled voice and broadband products provided over IPstream and WLR.⁹
- 5.84 These would apply to all suppliers using these wholesale services, including BT Retail.
- 5.85 We also need to consider the costs mitigated for vertically integrated suppliers of fixed voice and broadband, such as Virgin Media, Kingston, and suppliers of pay TV, such as Virgin Media and BSkyB.

⁹ This is not a comprehensive set of wholesale options, but reflects the ones we believe are most frequently used.

5.86 Access network costs are individual to a particular property. Unlike the core network, the access network elements cannot be used by another consumer at a different location. There are two principles which we believe are relevant here:

- the extent to which the access network elements are reused by another consumer who takes over a property (or who subsequently resumes service);
- the extent to which the costs of unused lines are already built into the headline prices.

5.87 The first of these is particularly relevant for Kingston. In view of its monopoly position, many of Kingston's early terminating consumers will be consumers moving out of its monopoly area. We would expect that often these consumers will be replaced by new consumers moving into properties that have been vacated. The customer connection which is specific to the property is then reused, and Kingston is likely to continue to receive a revenue stream. To a lesser extent, there may also be consumers who suspend service for a period, and then wish to resume it (for example employment status may impact on the decision to take broadband service). Relevant factors for cost mitigation are likely to be:

- the proportion of terminations where there is a subsequent re-connection;
- the average length of time that passes between a customer terminating and the subsequent reconnection; and
- the actual remaining upfront per customer cost that is not recovered due to customer terminating early (and which will not be recovered from the new customer).

5.88 The principle to apply in this case would be to make Kingston financially neutral between a consumer terminating early and completing their contract. As a simple example of this we consider the following stylised case.

Scenario 1. Kingston has a consumer who stays for the full 12 month MCP. It incurs one set of upfront costs and receives revenue for the full 12 months.

Scenario 2. Kingston has two customers the first staying for only five months with a one month gap before reconnection to the second customer who stays their full term. For the first 12 months Kingston incurs two sets of upfront costs and receives only 11 months worth of revenue.

Kingston would be financially neutral between these two cases, where the ETC is the revenue for the period that there is no connection, plus the remaining upfront cost that is unrecovered by the retail payments for the first customer.¹⁰ If the upfront cost was £30, the amount unrecovered would be half of this, i.e. £15 (taking into account the five months of paid for and used service and the additional month paid for via the ETC for the gap period).

5.89 The same principle would apply to Virgin Media. However, Virgin Media will lose consumers not just via consumers moving out of its area, but also via competition. In the case of Virgin Media, the proportion of terminations where there is a subsequent

¹⁰ This assumes there is an upfront cost which has not been recovered via a customer connection charge.

reconnection would be much lower and the average length of time between reconnections would be longer.

- 5.90 For Virgin Media, we consider the main principle may be the second one highlighted in paragraph 5.86 above, i.e. the principle of not using ETCs to recover costs already recovered elsewhere (by being built into headline prices).
- 5.91 We believe that in order for us to consider the ‘fairness’ of an ETC it is important to take into account the regulatory environment in which these charges have been derived. There are two extreme examples that we might consider.
- 5.92 In the first example, we can consider a situation in which the wholesale charges for BT set by regulation assume 100% occupancy and usage of BT’s access lines. If a consumer leaves and is not immediately replaced, cost is not recovered. In this situation, an ETC at the wholesale level which recovered the remaining cost of the access line that the consumer had agreed to pay might be considered fair. This wholesale ETC would be likely then to be passed through in an ETC at the retail level.
- 5.93 In the second example, we can consider a situation in which the wholesale charges set for BT by regulation are based on an assumption that only a proportion of consumers will occupy or use BT’s access lines. In this situation, it might be considered unfair for BT to recover that cost again from the supplier whose customer cancels their contract early and gives rise to less than 100% usage of their lines. This cost has already been reflected in the calculation of BT’s main wholesale prices and so it would be unfair to recover these costs again via an ETC at the wholesale or retail level. This is in fact how BT’s wholesale prices have been set, and wholesale charges do not have an ETC.
- 5.94 Applying the concept of fairness in a regulated environment, therefore, may give gives rise to additional issues that need to be considered. In determining a ‘fair’ level of an ETC for vertically integrated networks competing in that environment, Ofcom needs similarly to consider the extent to which some costs have already been recovered through other charges and should not be recovered again at the expense of the individual consumer terminating their contract. If the operator of such a vertically integrated network (competing in a regulated environment) has made a similar assumption in setting its prices as is made in the example in paragraph 5.93, it may be that any ETC it charges should be reduced to reflect this.
- 5.95 Ofcom envisages considering this matter further as part of the consultation. For example, Virgin Media operates in the same marketplace as suppliers using BT’s network. Therefore, to some extent its pricing policies are impacted on by the regulatory environment set for BT. We consider that Virgin Media’s ETCs are fair only if they too do not allow over-recovery of costs. Ofcom does not have a detailed breakdown of Virgin Media’s costs nor how it has actually set its prices. We expect to discuss these issues further with Virgin Media as part of the consultation.
- 5.96 We expect that similar principles apply to pay TV networks.

Recommendation and Guidance

- 5.97 Ofcom accepts the principle of MCPs as a way of spreading per customer upfront costs. However, it is important that any ETCs are not set higher than they need to be, as these charges have the potential to unfairly bind consumers to a particular supplier. Ofcom believes that:

- it is essential that suppliers do more to ensure that consumers fully understand their contractual commitment and that consumers understand what they will be charged if they terminate a contract early; and
 - ETCs should be set fairly.
- 5.98 ETCs are likely to cause a greater problem for low income consumers, who will be less able to afford them than higher income consumers. It is essential that they are set fairly.
- 5.99 Ofcom's proposed guidance seeks to address these points.
- 5.100 The proposed guidance sets out that suppliers must make sure MCPs are presented sufficiently clearly that the consumer fully understands their contractual obligation. Suppliers should be particularly conscious of this for services such as fixed voice, where consumers may not expect an MCP to apply.
- 5.101 Both MCP and ETC should be fully transparent at the point of sale and in terms and conditions.
- 5.102 In no circumstances should suppliers charge an ETC which is greater than the remaining monthly payments, or require the return of equipment provided free or subsidised as part of the initial deal (not including equipment which is effectively leased – and which is required to be returned whenever the consumer ceases service).
- 5.103 ETCs should not include recovery of anticipated profits from charges which are not themselves part of the consumer's contractual commitment (e.g. call charges outside of a consumer's included calling time on a fixed voice or mobile phone contract).
- 5.104 In setting ETCs suppliers should not simply charge remaining retail payments. Remaining retail payments should be reduced by taking account of the costs a supplier saves or mitigates when it no longer provides service. One example of costs saved is any monthly wholesale charges paid to BT Wholesale or BT Openreach. These vary from £1.30 a month (for some broadband services) to £14 a month (for some combinations of fixed voice and broadband). A second example is shared network costs which can be mitigated by other customers of the supplier using the network.
- 5.105 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.
- 5.106 In addition to the above, Ofcom considers that it is also important that suppliers make it very clear to consumers the level of the ETC at the point at which the consumer is considering terminating their contract. We would expect suppliers to do this already as a matter of good business practice – it is in a supplier's interest to ensure a consumer understands the costs of terminating before they do so, as in some cases it may lead the consumer to reconsider their decision.
- 5.107 Since bills are sent out after the conclusion of the contract the above point is not covered by the Regulations. We are not currently aware that this is a problem area. If it were to become so, we would consider the case for using sector specific regulation regarding this point.

Section 6

Minimum contract periods and early termination charges for subsequent contracts

Description of the charges

- 6.1 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, and these may occur either during the initial MCP, or after it has expired.
- 6.2 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.
- 6.3 In almost all cases where a subsequent MCP is agreed 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.
- 6.4 In the following paragraphs we illustrate the range of subsequent MCP and ETC for a selection of suppliers. This is not intended to be comprehensive and is based on a snapshot taken in Summer 2007. In this section we are focussing on the MCP and ETC which apply when a contract is varied or renewed. We note that information on subsequent MCP and ETC is sometimes set out clearly in a supplier's terms and conditions. In other cases it is not - the supplier may have a standard policy of how they expect to deal with contract changes, but this will not be clear to a consumer until they wish to make such a change. We note that subsequent MCPs are generally the same length as initial MCPs.

House move

- 6.5 Most suppliers will waive existing ETCs when a consumer moves house. They will often require a new MCP, both for consumers who were within their initial MCP at their previous address, and those who had already completed it. There are some exceptions to this, for example:
- for broadband services, BT either continues with the existing MCP or requires a new MCP of 3 months, whichever is the longer;
 - some suppliers may charge costs relating to the move, but will not then impose a new MCP;
 - some suppliers will waive ETCs when a consumer moves to an area where the same service cannot be received.

Upgrade or downgrade to package

- 6.6 Some suppliers allow upgrades and downgrades without imposing new MCPs, while others do not. There are differences by sector. In general we believe:
- changes in package for fixed voice are often allowed without a new MCP, unless the consumer is signing up for a special offer which includes a discount compared to standard package prices;
 - changes to broadband packages often do require a new MCP, although there are exceptions to this;
 - changes to pay TV packages do not generally require a new MCP.

Evidence on how it impacts on consumers

- 6.7 Ofcom has not carried out market research specifically regarding awareness and attitudes to subsequent MCPs. The reasons for this are:
- the number of people entering subsequent MCPs is likely to be relatively low compared to those on an initial MCP (other than for mobile, where subsequent MCPs are very like initial MCPs) – this makes sample size difficult;
 - there is little expectation that consumers will be aware of terms for subsequent MCPs until they reach the point that they wish to vary their initial contract;
 - awareness of initial MCPs and ETCs are relatively low (particularly for services other than mobile) – it is likely that awareness of subsequent MCPs and ETCs will be even lower;
 - acceptance by consumers of MCPs and ETCs as being fair is relatively low (particularly for services other than mobile) – it is likely that acceptance of subsequent MCPs and ETCs will be even lower.
- 6.8 Ofcom does not separately record complaints about initial and subsequent MCPs. The data presented in Section 5 includes some complaints about subsequent MCPs, for example, cases where consumers are unhappy about having to renew a contract when there is a change to their situation, such as moving house.
- 6.9 As with initial MCPs and ETCs, generally consumer groups have been less concerned about these issues.
- 6.10 Ofcom would not expect these types of term to feature in general marketing. We have done some research to look at suppliers' terms and conditions. Based on our sample, we have found:
- some suppliers do set out 'variation' clauses clearly in terms and conditions;
 - in other cases we were unable to find this information.

Distributional effects

- 6.11 We do not believe there are strong issues arising specifically around low income groups and subsequent MCPs and ETCs. We did not specifically investigate this

issue as part of our qualitative research. Nonetheless, as with initial contracts, ETCs are likely to be harder to pay for those on low incomes.

Cost evidence for these charges

6.12 In this section we discuss the information provided to us both in response to Ofcom's formal information request and in discussions with suppliers about their response. Detailed cost information has been provided to us in confidence and we have not presented data relating to any individual supplier.

6.13 As with initial MCPs and ETCs we are interested in:

- the justification for setting a subsequent MCP in terms of the upfront per customer costs; and
- the justification for setting an ETC, in terms of the recurring costs that are saved.

6.14 Our main focus in this section is on the former, as recurring costs tend to be the same whether the contract is an initial or subsequent one.

6.15 There are different circumstances in which subsequent MCP / ETC are applied. The different circumstances all have different upfront costs and consumer benefits.

a. High or medium upfront costs – and a benefit for the consumer

6.16 In some circumstances, the costs of a contractual change for an existing customer are not dissimilar to those for signing up a new customer. A good example of this is a mobile customer who wishes to have a new mobile handset. In these cases the evidence on costs is similar to that for the initial MCP.

6.17 There are circumstances in which the supplier incurs some additional costs, but these are not as high as for a new customer. Examples are:

- a significant upgrade to a broadband service, in which there are additional wholesale charges; and
- a house move, where a new connection charge will apply, but there will generally not, for example, be the need for a new modem.

b. Low upfront costs

6.18 There are circumstances in which any additional cost is minimal, for example:

- a mobile customer wants to change their package, but does not require a new handset;
- a fixed voice customer want to change to a different voice package;
- a broadband customer wants to change speed (relatively small change), or move to a package with a different usage allowance;
- a pay TV customer wishes to change their package.

6.19 In some cases suppliers accepted that they were imposing new MCPs even where there was little in the way of additional upfront costs. They argued that, given

consumers were often unprofitable even over their initial MCP, this was simply part of the overall strategy to build a profitable business. They claimed that the consumer did 'benefit' in terms of the additional flexibility that was being provided to change to another package.

- 6.20 Suppliers also argued that even if there were no specific per customer costs, there might be broader costs of a marketing campaign, aimed at informing existing consumers that a range of different packages existed, and that these costs should be allocated to new customers.
- 6.21 Ofcom notes that there is a difference between upgrades and downgrades in some cases. Where a consumer is within their initial MCP and requests a downgrade, there is in effect a consumer 'benefit' to being allowed to do so without incurring an ETC (as the consumer is not fulfilling their original commitment), and hence a greater justification for a subsequent MCP.

c. Upfront cost for supplier but no visible consumer benefit

- 6.22 A supplier may want to change the wholesale delivery mechanism, for example change from IPStream to LLU. There will be wholesale charges for doing this, as well as own network investment. We are not aware that suppliers use this to set a new MCP, but it is possible a supplier may seek to do this and to justify the new MCP on the basis of the costs it has incurred.

Summary of Ofcom's policy concerns and legal view

- 6.23 Consumers are unlikely to be aware when they sign up to an initial contract that they may in future face additional MCPs (and associated ETCs) when they change some aspect of their contract. They may well feel it is unfair that they should be locked into a subsequent minimum contract period.
- 6.24 Transparency about subsequent MCPs is clearly important to ensure a consumer makes an informed choice at the point when they want to change their contract, especially as decisions about a contract change are likely to be made fairly quickly, for example, over the phone.
- 6.25 Ofcom accepts that, as with initial MCPs, there may be cases where the supplier incurs additional upfront costs in order to provide some variation to the original contract. Suppliers may wish to use subsequent MCPs to spread out the additional upfront costs (where these are not charged directly to the consumer).
- 6.26 However, from a policy perspective, subsequent MCPs can impose significant switching costs on consumers, and it is unlikely that competition will always deliver a fair outcome. Even if the possibility of future upgrades is set out transparently in the initial contract, consumers are unlikely to take this into account in choosing their supplier.
- 6.27 We do not believe that subsequent MCPs will be effectively constrained by competition and it is appropriate for Ofcom to consider intervening.
- 6.28 Similarly, under the Regulations we consider that trigger terms in contracts which impose subsequent MCPs are not part of the main subject matter of the contract and are therefore non core terms. Accordingly we have considered the circumstances in which setting a subsequent MCP will be fair under the Regulations and where it will not.

- 6.29 Where the supplier has to make a new investment, such as providing a new handset, subsequent MCPs may be justified, as a way of spreading these upfront costs.
- 6.30 However, not all variations to a contract involve the supplier in additional direct costs. In general we would expect that the consumer should see some tangible benefit if they are to be expected to sign up for a new MCP.
- 6.31 Ofcom does not accept that broader costs, such as marketing, are relevant to this issue.
- 6.32 Ofcom's recommendations look at a range of different circumstances.

Recommendation and Guidance

- 6.33 Ofcom accepts that where there are new per customer costs involved, subsequent MCPs may be justified. However, it is important that consumers are locked into a new contract period only in cases where they receive a clear benefit from doing so, otherwise subsequent MCPs act as an unfair barrier to switching supplier and should not be set.
- 6.34 This will have most impact for fixed voice and broadband services, where subsequent MCPs are currently sometimes set for a change of broadband speed, or for a change in the included calls for a fixed voice contract.
- 6.35 As with initial MCPs, subsequent MCPs are likely to cause a greater problem for low income consumers, who will be less able to afford the resulting ETCs than higher income consumers. It is essential that new MCPs are set fairly.
- 6.36 Ofcom's proposed guidance sets out that:
- it is important that information on which events will trigger a requirement for a new MCP is easily available to a consumer at the point of sale;
 - any such trigger term should set out that the supplier will make it very clear to the consumer, at the point that the consumer is considering the change, that the event (such as a decision to upgrade) will trigger a new MCP, and the length of that new MCP;
 - new MCPs should only be imposed when there is a clear benefit to consumers and costs to the supplier;
 - any new ETC should follow the same principles of fairness as for the initial ETC;
 - new MCPs should not be imposed for an upgrade to a package (which involves little or no cost to the suppliers) at any time;
 - subsequent MCPs should not be imposed for a downgrade to a package (which involves little or no cost to the suppliers) once the consumer has completed their initial MCP.
- 6.37 There are a number of different circumstances which are set out in figure 6.1.

Figure 6.1: Different circumstances for subsequent MCP and how we propose to apply the test of fairness

Circumstance	Explanation and recommendation
a. High or medium upfront costs – and a benefit for the consumer	<p>Situations where a new MCP can fairly be set include:</p> <ul style="list-style-type: none"> • addition of a new service to an existing service bundle; • upgrade of an existing service where there are substantial upfront costs (similar to those for a new customer); • renewal of a mobile contract in which a new handset is provided; • house move where there are additional upfront costs (e.g. new satellite dish installed, new wholesale connection charge incurred); • supplier offers a discount in return for a time commitment; • downgrade within an initial MCP. <p>In these cases we consider that new MCPs can fairly be set, but where the upfront cost is less than for a new contract we would expect the new MCP to be shorter than the initial one. ETCs should be in line with the principles for the initial ETC.</p>
b. Low or no upfront cost	<p>Situations where we feel there is not a balance of interests, and no new MCP should be imposed, include where:</p> <ul style="list-style-type: none"> • a consumer wants to upgrade their package (at any time), and there are no (or very low) upfront per customer cost implications for supplier; • a consumer is outside their initial MCP and wants to downgrade their package, and there are no (or very low) upfront per customer cost implications for supplier <p>In this case there should be no new MCP.</p>
c. Upfront cost for supplier but no visible consumer benefit	<p>Where the supplier wants to change the underlying wholesale service and uses this to impose a new MCP, there would need to be a consumer benefit and for the consumer to agree to the change. E.g. if at the point a supplier converts to LLU they start to offer 'free' broadband' then this is covered by case a. (see paragraphs 6.16-6.17). If there is no new benefit to the consumer, there should not be a new MCP.</p>

6.38 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.

Section 7

Minimum notice periods

Description of the charges

- 7.1 Even where there is no MCP, suppliers require consumers to provide formal notification of an intention to terminate a service 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 ('MNP') 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 service earlier.
- 7.2 There are some exceptions to the one month notice period, particularly for fixed voice, where suppliers often either have a 15 day MNP 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).
- 7.3 MNPs 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.

Evidence on how it impacts on consumers

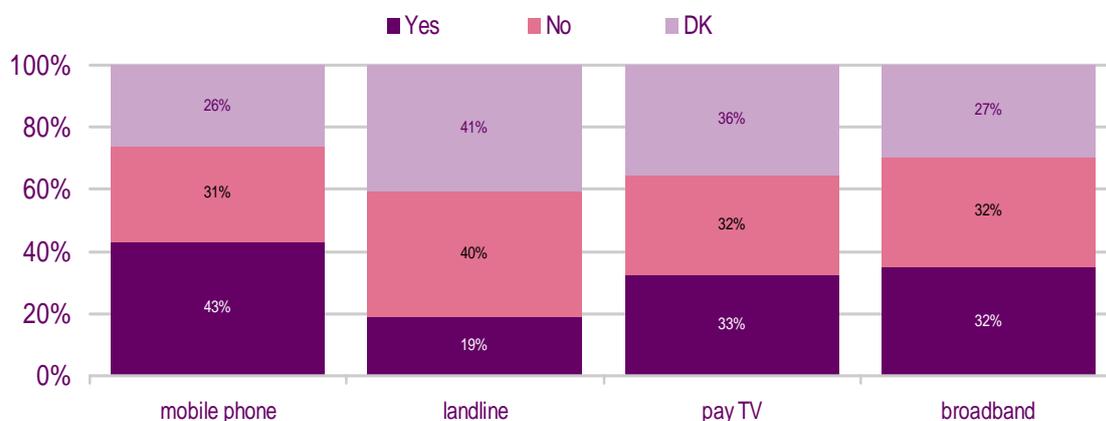
- 7.4 In this section we look at the evidence we have collected regarding consumers' understanding and attitudes towards MNPs. We have considered evidence from:
- Ofcom's market research;
 - complaints data (directly to Ofcom and via MPs) and from consumer groups; and
 - evidence from our analysis of supplier practice in terms of marketing and consumer communication.
- 7.5 We focus here on consumers in general, leaving a discussion of issues around low income consumers to the next section.

Market research

- 7.6 Ofcom's market research asked consumers about their awareness of minimum notice periods. Awareness varies by sector, with 43% of consumers aware that a MNP would apply for mobile contracts, 19% of consumers aware of this for fixed voice and around a third of consumers aware for pay TV and broadband (see figure 7.1). From the information we have seen, we believe the vast majority of suppliers do in fact have some form of MNP.

Figure 7.1: Awareness of minimum notice period

(As far as you know, does your supplier have a minimum notice period?)

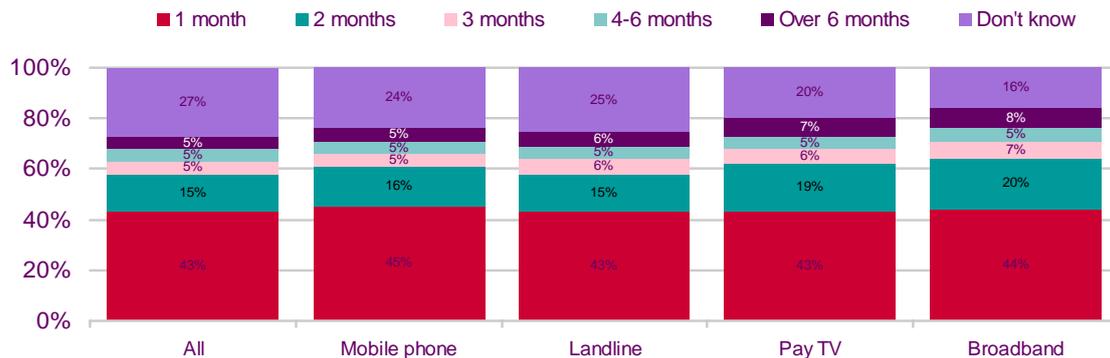


Source: Ofcom Research, July 2007

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

- 7.7 Although not high, these awareness figures are higher than for all the other additional charges and contractual terms that we have looked at, apart from MCPs. We would not expect that MNP is something that a consumer is likely to use to help them decide on supplier, or something they need to be aware of on a regular basis.
- 7.8 Only a small proportion of consumers (around 5%) claim to have been personally affected by an MNP. This appears low given the level of switching.
- 7.9 As part of the market research we also asked people what notice period would deter them from switching. The results are shown in Figure 7.2 below, and indicate that over 40% of consumers claim that even a one month MNP is a deterrent to switching.

Figure 7.2: Minimum notice period that would deter consumers from switching supplier.



Source: Ofcom Research, July 2007

Base : All with responsibility for any bill (1,685), mobile phone bill (1,290), landline phone (1,287), Pay TV (590), broadband internet (636)

Complaints and views from consumer groups

7.10 MNPs have not attracted a large number of consumer complaints or comments from consumer groups.

Evidence on marketing and other sources of consumer information

7.11 MNPs are not something we would generally expect suppliers to include in marketing material. We would expect them to be clearly laid out in terms and conditions (and from the examples we have looked at believe they usually are) and easily available to consumers at the point where they are considering cancelling their service. Ofcom also believes that it is appropriate for suppliers to inform consumers of the MNP at the point at which the consumer is cancelling their service.

Distributional effects

7.12 We do not expect that this issue has particular consequence for those on a low income, although we note that the possibility of having to pay for a service twice for a period (due to difficulty co-ordinating start and end dates) may be a bigger deterrent to switching for low income consumers.

7.13 The quantitative market research on awareness reported earlier cannot be broken down by income group due to sample size.

7.14 We are, however, able to look at whether the deterrent to switching reported by consumers varies by income. The figures do not suggest that an MNP of a month is more of a deterrent to switching for low income consumers compared to higher income consumers.

Qualitative market research

7.15 Our qualitative market research amongst low income households indicated the following key points.

7.16 Overall, a notification period was seen as acceptable if consumers were under contract, and 10 days was expected to be a sufficient amount of time for suppliers.

- 7.17 However, if consumers were not under contract, then this notification period was seen as completely unacceptable by almost all.

“If you’re not within contract, you should be able to leave when you like – who do they think they are?” (Single, London)

Cost evidence for these terms

- 7.18 Ofcom has not considered the processes suppliers need to go through in order to terminate service for a consumer in any detail as part of this review. Other work by Ofcom and industry on migrations process for fixed voice and broadband have determined timescales for the physical migrations process to take place. We believe that the administrative processes for terminating service should not be any longer than the migrations process. Where suppliers have evidence that they need longer periods than this, they should include it as part of their response to this consultation document.

Summary of Ofcom’s policy concerns and legal view

- 7.19 Ofcom recognises that over 40% of consumers feel that even a notice period of one month acts as a deterrent to switching supplier. Consumers are generally not aware that minimum notice periods apply, especially for fixed line voice services, and consider them to be unfair.
- 7.20 Ofcom accepts that suppliers may require a period of time to perform some basic administrative processes and to manage the underlying transfer of wholesale services. However, from a policy perspective, we do not consider suppliers need to set MNPs in excess of this.
- 7.21 MNPs constitute a switching cost because consumers may be reluctant to wait before moving provider. They may also have trouble coordinating the end of one contract and the start of another, leading to expensive overlaps or a period without service.
- 7.22 MNPs may reduce competition pressure because consumers who suffer some adverse event that is caused by their supplier, for example an incorrect bill, may be put off taking any action if forced to wait for a significant period. This can make suppliers complacent about maintaining their standards.
- 7.23 We consider that consumers are highly unlikely to take MNPs into account when they select their supplier. Likewise, under the Regulations, we consider that the MNP is not part of the main subject matter of the contract and therefore terms providing for a MNP are non core terms. The MNP is then subject to the test of fairness under the Regulations.
- 7.24 At present those suppliers that have MNPs tend to impose a notification requirement of one month. We believe this may be excessive in many cases.

Recommendation and Guidance

- 7.25 Long MNPs increase the risk of paying twice for a service. Low income consumers can least afford this additional amount. It is essential that MNPs are no longer than they need to be.

- 7.26 Suppliers should not set MNPs for a period longer than needed to perform some basic administrative processes and to manage the underlying transfer of wholesale services.
- 7.27 We believe some MNPs set by suppliers need to be reduced, especially for broadband services.
- 7.28 Ofcom's proposed guidance sets out the following:
- the terms relating to MNPs must be transparent to consumers within the contract at the point of sale;
 - where Ofcom has previously set out a migrations process (designed to ensure that consumers taking services based on BT's wholesale services can switch suppliers easily), or where industry has agreed its own migrations process, MNPs should match the migrations process, and should not be any longer;
 - where there is no Ofcom or industry agreed process, MNPs should not generally exceed a reasonable period to deal with the necessary administration. We would not expect to investigate where this is one month or less.
- 7.29 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.
- 7.30 In addition to the above, Ofcom considers that it is also important that suppliers make it very clear to consumers what the MNP is at the point at which the consumer is considering terminating their contract. 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.
- 7.31 Since termination plainly takes place after the conclusion of the contract the above point is not covered by the Regulations. We are not currently aware that this is a problem area. If it were to become so, we would consider the case for using sector specific regulation regarding this point.

Section 8

Itemised billing

Description of the charges

- 8.1 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 post. However, of the suppliers that we looked at, all who made a specific charge for itemised billing by post would provide online itemised bills for no extra charge.
- 8.2 Although some suppliers make a charge for sending any level of bill by post, of those we examined the only ones to do so were those which provided broadband services (whether or not they also provided voice telephony services), and where by definition the consumers had access to online bills.
- 8.3 This is felt to be a particular issue for mobile operators:
- all mobile operators charge for paper itemised billing (except for one operator whose terms and conditions indicate they may charge, but who in practice do not); and
 - the level of basic billing has greatly aggregated call categories, which will often not allow a consumer to fully understand how costs have been incurred.
- 8.4 Figure 8.1 illustrates the range of retail charges for a selection of suppliers. This is not intended to be comprehensive and is based on a snapshot taken in Summer 2007. This shows a range of charges from zero up to around £1.50 a month.¹¹ Note the table shows the charges applying to new customers. 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).
- 8.5 Suppliers operate a variety of practices in relation to billing charges. All the suppliers listed in Figure 8.1 provide fully itemised bills online for no charge, but some charge for a paper bill whatever the level of itemisation. Others provide a free basic paper bill but charge for a fully itemised one.

¹¹ In one case it is higher, but we understand the higher charge is due to be reduced.

Figure 8.1: Monthly charges for paper bills (fully itemised and basic) as at August 2007 (including discounts for paperless billing)

Company	Fee for fully itemised paper billing	Fee for basic paper billing
BT	None (50p discount per month for e-billing)*	Fully itemised only
Carphone Warehouse - AOL	None	None
Carphone Warehouse - Talk Talk (broadband)	None	£1.00 (free online)
Carphone Warehouse - Talk Talk (fixed, bundled)	£1.00	None
Hutchinson 3	£1.00	None
Kingston	None	Fully itemised only
O2	£1- £2.50 (free for tariffs above £35)	None
Orange	£1.50	None
Pipex - Homecall	None	None
Pipex - Bulldog	None	None
Pipex - Internet	£1.00	None
Pipex - Toucan	None	Fully itemised only
Post Office	None	Fully itemised only
Sky	None	Fully itemised only
Tesco	None	Fully itemised only
Tiscali	None	Fully itemised only
T-mobile	£1.50	None
Virgin Media	£1.00	None
Vodafone - mobile	£1.50	None
Vodafone - bundles	£1.50	None

*Equates to £1.50 a bill for consumers billed on a quarterly basis

Source: information provided by suppliers

Evidence on how it impacts on consumers

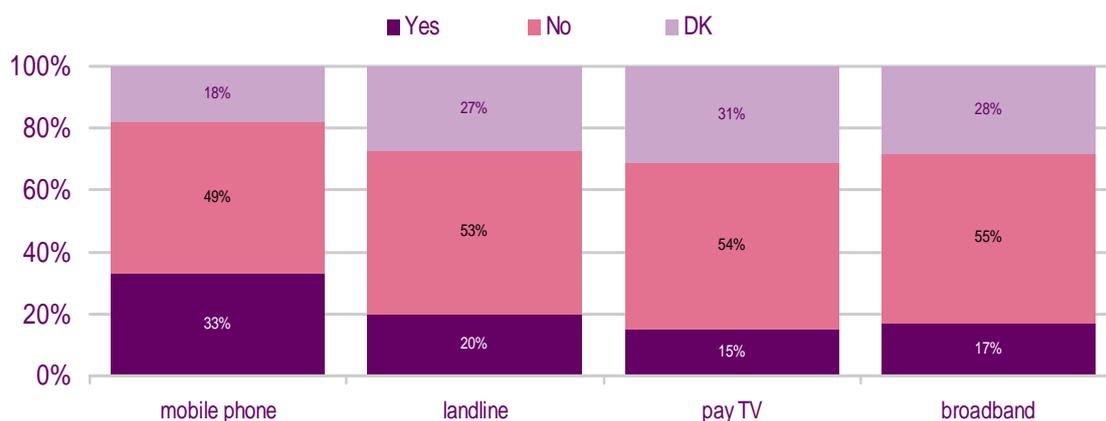
- 8.6 In this section we look at the evidence we have collected regarding consumers' understanding and attitudes towards itemised billing. We have considered evidence from:
- Ofcom's market research;
 - complaints data (directly to Ofcom and via MPs) and from consumer groups; and
 - evidence from our analysis of supplier practice in terms of marketing and consumer communication.
- 8.7 We focus here on consumers in general, leaving to the next section a more detailed discussion of issues around low income consumers.

Market research

8.8 Ofcom’s market research asked about consumers’ awareness of itemised billing. Awareness differs by sector, with awareness highest for the mobile sector at 33%, consistent with the fact this is the sector where charges are most common. See Figure 8.2.

Figure 8.2: Awareness of charges for itemised billing

(As far as you know, does your supplier have an itemised billing charge?)



Source: Ofcom Research, July 2007

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

8.9 Many suppliers do not have charges for itemised billing and we observe that there is not a good correlation between consumers being aware of the charge and whether their supplier actually has such a charge. We believe there are two possible explanations for this:

- consumers may be thinking of charges (or discounts) for paper (or paperless) billing;
- consumers may have a general awareness that these types of charges may apply, but not be aware whether their own supplier has such charges.

8.10 Around 15% of mobile consumers on monthly contracts claim they are currently personally affected by charges for itemised billing. Comparing figures by supplier against the numbers of consumers suppliers say are actually paying these charges shows there is little correlation between consumers’ perceptions and what actually happens, with consumers underestimating in some cases and overestimating in others. A similar number of fixed voice consumers claim to be personally affected by these charges, even though we believe the number actually affected is much lower than for mobile. For broadband and pay TV sectors – where itemised billing is rare - 7% and 4% of consumers respectively claim to be personally affected.

8.11 Only 17% of mobile consumers felt such a charge was fair.

8.12 We carried out some further research specifically regarding itemised billing for mobile contracts. This showed:

- around 75% of mobile contract customers receive an itemised bill;
- only 10% of consumers receive their itemised bill purely on-line, so 90% receive a paper itemised bill. We note that a significant number of consumers are not in fact charged for this itemisation;
- 25% of those receiving a paper bill were aware that there was a charge for this (note this is higher than the previous piece of research); and
- 50% of consumers were aware they could receive a free on-line bill.

8.13 The situation regarding whether or not those receiving a paper itemised bill are charged for it is relatively complex. Consumers on older contracts, or on certain tariffs, may in fact not be charged. The use of the free alternative appears relatively low.

Complaints and views from consumer groups

8.14 Ofcom's Advisory Team has received a low level of complaints about itemised billing (approximately 70 complaints over a twelve month period). One consumer group has expressed its concern about these charges, believing they disadvantage low income groups who may not have access to the internet.

Evidence on marketing and other sources of consumer information

8.15 Looking at marketing material, the clarity of these charges was variable. We observed examples where additional charges for itemised billing (or discounts for paperless billing):

- were clearly stated in the text immediately following tables of headline charges;
- were stated in the small print;
- were referred to in the small print, but the levels were not given;
- were not referred to at all.

8.16 Where there is a charge, we note that this is generally stated as a separate line item in consumers' bills.

Distributional effects

8.17 We do not believe low-income groups are seriously affected by itemised billing charges for mobile phone contracts. Only 14% of low income consumers have a (post-payment) mobile phone contract, compared to 86% who opt for pre-pay phones. However, those consumers on low incomes who do have mobile phone contracts may be more affected by these charges than those on higher incomes as they may be less likely to have access to on-line billing alternatives.

8.18 The quantitative market research reported earlier cannot be broken down by income group due to sample size.

Qualitative market research

- 8.19 Our qualitative market research amongst low income households indicated the following key points.
- 8.20 Awareness of itemised billing charges varied across the sample – generally only those who had switched fixed lines had heard of this charge.
- 8.21 Responses varied. Most rejected the charge, commenting that this had always been part of the service and should remain so. Some segments, families in particular, needed a breakdown to keep tabs on who was making calls in the household and felt the charge was completely unacceptable

“This is just another charge – we’ve always had this as part of the service. It’s like a receipt of goods, our way of checking they haven’t made mistakes. We don’t have to pay for a receipt in a restaurant, it’s outrageous they should try and charge” (Family, Oldham)

- 8.22 But for a large minority of the sample, an itemised bill was not important - mobile only customers were not affected, and many fixed line users only made calls in free periods and these were not itemised anyway.
- 8.23 £1 per bill was considered affordable by almost everyone but £3 was not, particularly for those on the lowest incomes. As with direct debit payment, it was not the cost but the principle that was felt to be wrong.

“It’s the equivalent of some shopping – if you’re on a state pension, every penny counts and you don’t want to be giving your pennies to these big companies” (Pensioner, Oldham)

Summary of consumer evidence (including low income issues)

- 8.24 Consumers appear to be confused as to whether they are paying these charges or not. A significant number of consumers who could avoid these charges by using an on-line alternative do not do so.
- 8.25 Any additional monthly amount will be relatively less affordable for low income consumers. However, we do not expect that additional charges for itemised billing are usually paid by low income consumers.

Cost evidence for these charges

- 8.26 Suppliers incur additional costs of paper and postage for fully itemised bills compared to shorter summarised bills. However in setting charges, suppliers had a view not only to the additional costs but also to wider factors such as what competitors charge and what charge was thought to be acceptable to consumers. In practice we found that charges of typically £1.50 a month were in excess of the direct costs incurred.

Summary of Ofcom’s policy concerns and legal view

- 8.27 Ofcom recognises the considerable confusion among consumers as to which suppliers have charges for itemised billing, and that consumers consider these

charges to be unfair. Based on our information, these charges are mainly of concern in the mobile sector.

- 8.28 From a policy perspective, the current variable level of transparency raises the possibility that consumers are paying these charges without realising it or are unable to take them into account when choosing a supplier. If some consumers do not realise they are paying for the service there will be economic efficiency losses where they do not value the service. If charges are above cost, there will also be efficiency losses where some customers avoid itemised billing who would have chosen it were it priced at cost.
- 8.29 Current information suggests these charges are above cost.
- 8.30 Like non-DD charges, itemised billing charges are a recurring charge rather than one that is contingent on some unlikely event. Hence, it may be possible for consumers to take them into account in choosing a supplier, meaning that, with transparency, the level of charge will be constrained by competition. An additional factor here, unlike non-DD charges, is that it may be harder for a consumer to compare what the charge buys them (because basic levels of billing may differ by supplier) and hence it may be less likely that competition will act to constrain prices. Transparency on charge alone is not likely to be sufficient to remove our policy concern.
- 8.31 Nonetheless, where charges for itemised billing (both the level of such charges and the explanation as to the availability and content of basic billing) are sufficiently transparent, it will be for competition, not Ofcom, to determine what the level of these charges is.
- 8.32 Under the Regulations, we likewise consider that there may be circumstances in which the charge for itemised or paper billing may be considered to be part of the price for the main service(s) under the contract and part of the essential bargain between the parties, i.e. to be a core term. This will require both the level of the charge and what it is the charge buys them, to be prominent and transparent.
- 8.33 Ofcom believes suppliers should do more to inform consumers about these charges.
- 8.34 Where terms providing for an itemised billing or paper billing charge are not sufficiently prominent and transparent, the test of fairness will apply, and only directly incurred costs should be included.
- 8.35 Ofcom accepts that there are additional direct costs in producing fully itemised paper bills compared to a more basic bill, or an on-line bill. These costs include additional paper and postage costs. It is fair under the Regulations for suppliers to recover direct costs such as these through an itemised billing charge.

Recommendation and Guidance

- 8.36 Ofcom believes that:
- suppliers should ensure that consumers are fully aware of any additional charges for itemised billing, such that they would regard them as part of the essential bargain under the contract, and that they are aware of alternatives, such as free on-line billing before entering into the contract; and

- consumers should also be made aware of what it is that the charge for itemised billing provides, i.e. what the difference is between a basic bill and an itemised bill.
- 8.37 Where suppliers fail to make consumers aware of the above, we do not believe that itemised billing charges can be considered to be a core term. In this case we consider that fairness requires suppliers to ensure that charges reflect only the direct underlying costs.
- 8.38 Charges for itemised billing are most frequent in the mobile contract sector. Most low income consumers choose pre-pay mobile services, rather than mobile contracts. We believe this issue is relatively unimportant for low income consumers.
- 8.39 Based on current levels of charges (as at August 2007), and having examined a number of suppliers' costs, Ofcom does not believe that there is a particular concern with itemised billing charges and consumer harm is relatively low. Charges for itemised billing are therefore, unlikely to be a high priority for enforcement action at current levels.
- 8.40 Ofcom's proposed guidance sets out that where fully itemised billing is available at an additional charge, suppliers need to ensure consumers are aware of:
- the amount of the charge
 - what they get for it (i.e. the difference in information provided in a basic bill relative to a fully itemised bill);
 - the availability of free more basic billing; and
 - the availability of free on-line alternatives.
- 8.41 We would expect all of this information to be clearly and prominently presented in contract terms and in marketing material.
- 8.42 Where charges are not sufficiently transparent that they form part of the headline price and the essential bargain between the parties, charges should be related only to direct costs.
- 8.43 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.
- 8.44 In addition to the above, Ofcom considers that it is also important that bills should clearly detail the level of any such charges as a separate line item.
- 8.45 Since bills are sent out after the conclusion of the contract the above point is not covered by the Regulations. Suppliers are, however, also 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. If we become aware that bills do not present itemised billing charges sufficiently transparently we will consider opening a new review to look at GC12 and to determine if and how this can be used to achieve the above.

Section 9

Cease charges

Description of the charges

- 9.1 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 the wholesale agreement with BT Openreach. However, this is only in limited circumstances where the wholesale service is being terminated entirely, for example because the consumer is ceasing to use a broadband service altogether or is moving to a cable service such as Virgin Media.
- 9.2 The current level of the BT Openreach cease charge is £4.90 (excluding VAT). Based on the information we received in Summer 2007, cease charges imposed by suppliers on retail customers (where applied) appeared to be close to this figure (with VAT added).

Evidence on how it impacts on consumers

- 9.3 Because broadband cease charges are applied in limited circumstances we have relatively little evidence as to how they impact on consumers. Ofcom's Advisory Team has received a small number of complaints – some of these around May 2007 relating to suppliers introducing a £40 cease charge, reflecting the BT Openreach cease charge at the time. The wholesale charges have since reduced to £4.90, resulting in a retail charge of around £6 after the inclusion of VAT.
- 9.4 Earlier in 2007 BT Retail had proposed to introduce a cease charge of £5 for its fixed voice services. Ofcom received a small number of complaints about this, though the charge was not in practice introduced.

Distributional effects

- 9.5 At current levels (around £6) we do not believe there is a strong impact on low income consumers.

Cost evidence for these charges

- 9.6 Current cease charges apply to broadband ceases only and reflect the BT Openreach wholesale charge.

Summary of Ofcom's policy concerns and legal view

- 9.7 From a policy perspective, Ofcom is concerned that cease charges can act as a deterrent to switching supplier and can harm competition by increasing switching costs. They are unlikely to be constrained by competition as consumers are unlikely to take them into account when choosing a supplier. Consumers who incur the charges may be harmed if cease charges are set at a level which exceeds costs.
- 9.8 Similarly, under the Regulations we consider that cease charges are not part of what a reasonable consumer would consider to be the main subject matter of the contract and are therefore non-core terms. This means that the test of fairness applies.

- 9.9 It will clearly be fair under the Regulations for firms to pass through to a consumer the wholesale charges they incur.
- 9.10 We believe that currently few suppliers impose cease charges and that where they do exist they represent a pass through of a wholesale charge. Given this, we do not regard the issue as a priority for enforcement action.

Recommendation and Guidance

- 9.11 Ofcom's proposed guidance sets out that it is fair for cease charges to reflect a pass through of wholesale charges incurred. The terms relating to cease charges should also be transparent to consumers within the contract at the point of sale.
- 9.12 These conclusions are reflected in our draft guidance in Annex 5, which also sets out our legal reasoning.
- 9.13 In addition to the above, Ofcom considers that it is also 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. 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.
- 9.14 Since termination plainly occurs after the conclusion of the contract the above point is not covered by the Regulations. We are not currently aware that this is a problem area. If it were to become so, we would consider the case for using sector specific regulation regarding this point.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 8 May 2008**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://www.ofcom.org.uk/consult/condocs/addcharges/howtorespond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email additional.charges@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Sarah Evans
Consumer Policy Manager
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7981 3706
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Sarah Evans on 020 7981 3761.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in autumn 2008.
- A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

Annex 4

Consultation questions

Question 1: 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?

Question 2: Do you agree with Ofcom's proposed guidance regarding core terms and transparency?

Question 3: 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?

Question 4: Are there any other issues that are covered by the Regulations which Ofcom should give guidance on?

Question 5: 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 guidance?

Annex 5

Draft Guidance on unfair terms in contracts for communication services.

Introduction

- A5.1 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.
- A5.2 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.
- A5.3 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.
- A5.4 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.
- A5.5 Although this Guidance does not have binding legal effect, it does set out the approach Ofcom expects to take in performing its obligations and exercising its powers under the Regulations. Ofcom expects to take an active role in enforcing the principles set out in this Guidance. We will monitor complaint levels and examine suppliers’ standard terms to ensure compliance. Where suppliers do not comply with the Guidance we will take the necessary enforcement action, using our powers under the Regulations and/or the Enterprise Act 2002.
- A5.6 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.
- A5.7 We note that in addition to this Guidance, 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.

Aims of the guidance

- A5.8 This Guidance is intended to complement OFT guidance and not replace it. It aims 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.

- A5.9 This Guidance explains why Ofcom considers certain standard terms in contracts for the supply of communications services to be potentially unfair under the Regulations. It represents our views following our recent review of additional charges¹², and explains the basis on which we are likely to take enforcement action.
- A5.10 Ofcom recognises that the decision as to whether a term is unfair is a matter ultimately for the courts. However, given that there is very little case law to assist suppliers and consumers in this area, Ofcom considers that it is in the interests of all parties for our views as to the application of the Regulations to be clearly set out. This Guidance is accordingly intended to help suppliers to understand the Regulations and to make it easier to comply with them.

Scope of the Guidance

- A5.11 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.
- A5.12 This Guidance relates to standard terms and conditions for the provision of services where there is an ongoing monthly liability and does not therefore cover, for example, pre-pay mobile telephony or pay on demand TV. Contracts for such services are also subject to the Regulations but the charges addressed here do not apply.
- A5.13 In this review we have examined a number of charges and terms:
- 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 Period (“MCP”) and Early Termination Charge (“ETC”)
 - D. Subsequent Minimum Contract Period
 - E. Minimum notice period (“MNP”)
 - F. Itemised or paper billing
 - G. Cease charges
- A5.14 Although we have not examined all of the types of terms in suppliers’ contracts in this Guidance, they are of course 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 where this may be helpful in supplementing or clarifying existing guidance. We will also apply the

¹² *Web link to be added in final version to refer to consultation document.*

principles set out in this Guidance insofar as they are relevant to any other types of term.

- A5.15 In addition to providing Guidance in 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 sector-specific powers to address that harm..

The Regulations and Enforcement

- A5.16 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).
- A5.17 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.offt.gov.uk/shared_offt/business_leaflets/unfair_contract_terms/offt143.pdf);
 - the comprehensive *Unfair contract terms guidance* (OFT311, http://www.offt.gov.uk/advice_and_resources/resource_base/legal/unfair-terms/guidance).
- A5.18 These documents give a fuller explanation of certain points made below about the Regulations and consumer contract terms in general. Reference will also be made to the OFT's guidance on *Calculating fair default charges in credit card contracts* (OFT 842, http://www.offt.gov.uk/shared_offt/reports/financial_products/offt842.pdf).
- A5.19 Unfair terms are not binding on consumers and it is open to consumers themselves to challenge in court terms they consider unfair. In addition, under the Regulations the OFT, or a qualifying body such as Ofcom, has a duty to consider any complaint it receives about unfair standard terms. 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.
- A5.20 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.
- A5.21 The legal framework introduced by Part 8 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, where the collective interests of consumers are harmed. These 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 on the OFT's website www.offt.gov.uk.

A5.22 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/>.

A5.23 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.

A5.24 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.

A5.25 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 main goods or services provided, again provided that plain, intelligible language is used (Regulation 6(2)(b)). These are the terms 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 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.
- The Regulations set out a non-exhaustive list of terms which may be regarded as unfair in Schedule 2.

A5.26 The following parts of the Regulations are of particular relevance to this Guidance.

A5.27 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.

A5.28 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 ...

A5.29 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.

A5.30 Paragraph 1 of Schedule 2 of the Regulations states that terms may be unfair if they have the object or effect of:

- (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

A5.31 This section sets out the 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

A5.32 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.

- A5.33 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.
- A5.34 Some suppliers only accept payments by a limited range of methods, typically direct debit and/or credit card.

Ofcom's proposed guidance

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

- A5.35 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 part of the price for the main services under the contract – the essential bargain between the parties. As such a term providing for the non-DD charge would be a core term and therefore not subject to the test of fairness, provided it is in plain and intelligible language.
- A5.36 In order to be considered a core term, we take the view that the non-DD charge must be set out in such a way that the typical consumer would be aware that it is part of the price and would consider it part of the essential bargain with the supplier.
- A5.37 Core terms must be given the prominence and transparency which reflect their importance to the consumer.
- A5.38 If a 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 cannot be considered to be a core term.
- A5.39 In the context of non-DD charges, we are likely to consider these requirements as to prominence and transparency 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 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.
- A5.40 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

- A5.41 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 cannot be considered 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 will apply the fairness test in this context is set out below.
- A5.42 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.
- A5.43 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. Thus, for example, we believe it would not be fair for suppliers to include as a component of the non-DD charge the recovery of general "bad debt" costs. 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.
- A5.44 We recognise that the method of payment might affect how promptly consumers pay. Customers who pay by an automated method will only ever pay late when that payment mechanism fails (e.g. due to insufficient funds). However, customers 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.
- A5.45 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.

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;
- 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

- A5.46 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 proposed guidance

Default charges (late payment charges, charges for payment failure and charges for restoring service) are non-core terms

A5.47 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 cannot 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 subject to review for fairness.

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

A5.48 We are likely to consider it 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 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.

A5.49 We are likely to consider terms providing for late payment charges, charges for payment failure and reconnection charges 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.

A5.50 Thus 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

it would 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).

- A5.51 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.

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

- A5.52 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.
- A5.53 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).
- A5.54 When a consumer terminates a contract of fixed duration before the expiry of the minimum contract period (“MCP”), suppliers usually levy an early termination charge (“ETC”).
- A5.55 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; or
 - 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.
- A5.56 Some suppliers, rather than setting an 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 proposed guidance

Terms providing for MCPs are likely to be core terms

- A5.57 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.
- A5.58 As stated above, all core terms must be set out with appropriate prominence and transparency. We would expect this core 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.
- A5.59 Where an MCP is not expressed as part of the price in a transparent and prominent manner, we consider that it cannot be considered to 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.
- A5.60 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

- A5.61 Terms providing for levying of ETCs (which are default charges or charges analogous to default charges even if they do not apply on breach of contract) are non-core. The consumer agrees to commit to purchase a service for a certain minimum period and therefore if the consumer decides to terminate the contract early, the supplier levies the consumer with a charge. We consider that the analysis set out in paragraph A5.46 above applies and thus ETCs are non-core terms and are subject to the test of fairness.

The fairness test for ETCs

- A5.62 We are likely to consider that an ETC is fair where all of the following requirements are satisfied:
- the terms of the ETCs are transparent at the point of sale with sufficient prominence so that every consumer is fully aware of the consequences of terminating early, and what the ETC would be for them (or the method by which

this would be calculated e.g. the amount that would be charged for each outstanding month);

- the ETC is never greater than the amount of the monthly payments remaining due at the date of termination. When a consumer signs up to a contract it would not be reasonable to expect that it would cost them more to get out of the contract, as compared to a situation where they received the service. That does not mean, however, that it will always be fair for suppliers to set the ETC at a level equivalent to the remaining monthly payments. In order to be fair, the ETC must also;
 - take account of any costs associated with the provision of the service which will no longer be incurred, including both variable costs which can be avoided immediately, and the costs of shared network elements which the consumer is no longer using, and where the cost of the network elements can be mitigated by using them to provide service to another consumer;
 - reflect the ability of a supplier to reduce his loss by 'reselling' the service to a new consumer. 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;
 - reflect the existing regulatory environment, and consider the extent to which network costs are already recovered via headline prices, without the need for ETCs; and
 - make allowance for the accelerated receipt of any sums;
- the ETC must not include recovery of anticipated profits from charges which are not themselves part of the consumer's minimum contractual commitment (that is, what the consumer is required to do to meet his contractual obligations in the least onerous way possible, and excluding, for example, call charges outside of a consumers included calling time on a fixed voice or mobile phone contract).

A5.63 The rationale for the transparency and prominence requirements is set out above. In relation to the level of the ETC, we take the view that it is unfair for a supplier to include a profit element within the ETC which it would not have recovered if the contract had been performed. Thus if costs have been avoided or mitigated, and sums received early the amount of the ETC should reflect that.

A5.64 In relation to anticipated profits, we consider that it would create a significant imbalance in the rights and obligations of the parties, to the consumer's detriment, if the consumer was expected to pay an amount which covered profits of services which the consumer was not contractually obliged to purchase. We consider that inclusion of such anticipated profits would inevitably be arrived at on the basis of an average charge across all users. The imposition of such a charge on a below average user would require the payment by that user of a disproportionately high sum in compensation.

Ofcom's administrative priorities

A5.65 We will take account of all the above factors in deciding whether to investigate the fairness of a particular term.

- A5.66 In relation to costs which may be avoided as a result of early termination, we recognise that there are a range of wholesale charges which may be incurred (including the various discounts which may be available), and each supplier will have slightly different costs.
- A5.67 Suppliers provide services via a range of delivery mechanisms. Customers using BT's network all have a line between their property and the exchange known as the local loop. Suppliers using BT's network purchase wholesale services from BT Wholesale or BT Openreach. There is no single way of delivering the services via the local loop. For example, earlier broadband services not supplied by BT Retail were provided using BT Wholesale's Datastream and IPstream facilities. More recently, Wholesale Line Rental ("WLR") has enabled suppliers to rent the local loop from BT to provide both voice and broadband services, and divert traffic onto their own network.
- A5.68 In addition to WLR, there are separate services whereby suppliers can take over the local loop, either on a full or shared basis. The correct term for the local loop is the Metallic Path Facility ("MPF"). The MPF can be rented from BT Openreach either fully, or on the basis of sharing it with BT, known as Shared MPF ("SMPF"). However, because the term is more generally understood and commonly used, we shall for the purposes of this Guidance refer to this as Local Loop Unbundling ("LLU"). While WLR can be used in any of BT's exchanges, LLU can be used only in selected exchanges, generally the larger ones in more populated areas.
- A5.69 Where suppliers purchase LLU services on a full basis, they can be used to provide both voice and broadband facilities. Alternatively, suppliers can purchase LLU services on a shared basis to provide broadband only, and BT will continue to supply voice services. Where LLU is used, the local loop is connected not to BT's network at the exchange, but to equipment installed by the supplier.
- A5.70 Where a consumer terminates a retail service, the supplier would then be expected to terminate the wholesale service it purchases from BT Wholesale or Openreach. The period of notice for termination of these wholesale services is never more than seven days, which is less than the notice period required of the consumer. The supplier is therefore always able to avoid these charges, and would be expected to do so.
- A5.71 For the purposes of administrative priority we do not expect to investigate where the 'discount' per customer per month on the calculation of the ETC is in the region of:
- £5.50 a month for broadband using Datastream;
 - £6 a month for broadband using IPstream;
 - £6 a month for full LLU;
 - £8 a month for fixed voice products (WLR); and
 - £1.30 for shared LLU.
- A5.72 *[Note: during consultation Ofcom will be seeking to develop benchmark figures for other categories of costs which are avoided or mitigated, which we will use in informing our enforcement priorities. We expect our final Guidance will include these.]*

- A5.73 On the basis of our current knowledge and experience we would be unlikely, on the basis of administrative priority, under the Regulations, to investigate ETCs for pay-TV services.

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 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

- A5.74 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.
- A5.75 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.
- A5.76 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.

Ofcom's proposed guidance

Terms triggering subsequent MCPs are non-core terms

- A5.77 We consider that trigger terms in contracts which impose subsequent MCPs on the occurrence of such events ("trigger terms") are 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.
- A5.78 We believe that any term that has the same effect as a trigger term should be treated in the same way i.e. it is the effect, not the form that is important. Trigger terms imposing subsequent MCPs are therefore subject to the test of fairness under the Regulations.

The fairness test for subsequent MCPs

- A5.79 In general terms, we consider it 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.
- A5.80 Thus we are likely to consider the requirement for a subsequent MCP to be fair where:

- any trigger term explaining the events (such as a decision to upgrade), that will trigger a requirement for a new 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;
- 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.

A5.81 We are likely to consider the requirement for a subsequent MCP 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. We consider that there is likely to be no cost to the supplier, and no benefit to the consumer, associated with that renewal.

A5.82 Where suppliers include a term providing for an ETC in respect of early termination of a subsequent MCP, such terms are non-core terms and as such are subject to the test of fairness. We consider that the amount of ETCs charged must be calculated in accordance with the principles set out in paragraphs A5.61-A5.63 above.

The areas on which Ofcom will focus in investigations

A5.83 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.

E. Minimum Notice Period (MNP)

A description of the charge

- A5.84 Even where there is no MCP, suppliers require consumers to provide formal notification of an intention to terminate a service where regular payments are made directly to the supplier.
- A5.85 The Minimum Notice Period (“MNP”) 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 service earlier. Lesser MNPs are generally applied to fixed voice services.

Ofcom’s proposed guidance

Terms providing for MNPs are non-core terms

- A5.86 We consider that the MNP is not part of the main subject matter of the contract and therefore terms providing for a MNP are non core terms. 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 and MNPs are therefore subject to the test of fairness.

The fairness test for MNPs

- A5.87 We are likely to consider a term providing for an MNP fair where all of the following conditions are fulfilled:
- where the MNP is transparent to consumers within the contract at the point of sale;
 - where the MNP reflects a reasonable period in which to carry out the necessary administration of terminating the service. Failure to set MNPs according to this principle 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 MNP or to potentially pay two suppliers for a period of time in order to ensure a sufficient degree of overlap and no loss of service; and
 - where the MNP, in effect, was no longer than a formal migration process, where this was applicable. This would mean the cessation date for charging by the supplier does not go beyond the date on which the migration occurs.
- A5.88 If the consumer gives notice of termination such that the end of the MNP would fall within the MCP, the guidance in respect of early termination, set out above, will apply.

The areas on which Ofcom will focus in investigations

- A5.89 Provided a formal migration process is not relevant, we are likely to consider taking action on the basis of an MNP which exceeds 30 days or one calendar month.
- A5.90 We are likely to consider taking action where MNPs in effect are longer than formal migration processes.

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

- A5.91 The itemised or 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.
- A5.92 Our research indicates that as at August 2007, about half of non broadband suppliers charge 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).
- A5.93 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 proposed guidance

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

- A5.94 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 be able to verify this.
- A5.95 As with the non-DD charge, we consider that there may be circumstances where the charge for itemised or paper billing may be considered to be part of the price for the main service(s) under the contract and part of the essential bargain between the parties. As such it would be a core term and therefore not subject to the test of fairness.
- A5.96 In order to be considered to be part of the price for the main service(s) and the essential bargain, and accordingly a core term, our view is that any term which provides for an itemised or paper billing charge must be set out in such a way that the consumer would be aware: (1) that it is part of the price for a package of services under the contract; and (2) the level of information or billing which is thereby provided by comparison with the basic, or standard, level of billing. The latter requirement arises from the fact that if itemised billing is part of the main subject matter of the contract, it must be set out in such a way that the consumer can understand the nature of the purchase, which he cannot do if no information is given as to the extent to which a “free” billing service may meet his needs. Similarly, if itemised billing is to be viewed as a separate “service”, the nature of that service needs to be set out transparently.

A5.97 To fulfil these requirements, 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, any such information 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 this information in such a way that the consumer who chooses itemised billing would regard that as part of the package of main services he is buying under the contract.

A5.98 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 will in our view 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

A5.99 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 cannot be considered 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 will apply the fairness test in this context is set out below.

A5.100 A consumer who wishes to have itemised and/or paper billing may cause the supplier to incur additional charges which are directly attributable to that level of billing. For example, it may be fair for a supplier to include 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 unfair for suppliers to recover these additional charges through a charge for itemised and/or paper billing.

The areas on which Ofcom will focus in investigations

A5.101 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

A5.102 These are charges made when the consumer ceases its service from the supplier. They are unrelated to the ETCs and MNPs.

A5.103 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 the wholesale broadband agreement with BT Openreach. However, this is 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 proposed guidance

Terms providing for cease charges as non-core terms

A5.104 We consider that terms providing for cease charges cannot be regarded as core terms. Such charges are not, in our view, part of what a reasonable 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

A5.105 We are likely to consider cease charges fair where all 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

A5.106 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 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 6

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.
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. From mid 2008, BT will offer a new service – BT Basic – which 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 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	Core terms define what are the main goods or services being purchased under the contract and the price for these. They are exempt from the test of fairness in the Regulations to the extent that they meet the requirement for transparency. They are the terms which set out the essential bargain under the contract: what the parties, but primarily the consumer, would say the consumer is buying under the contract and the price for it. Any other term is a non-core term.
Enforcement order	An order obtained from the courts under Part 8 of the Enterprise Act to stop conduct by suppliers which breaches consumer law (for example, using terms which are unfair under the Regulations).

Enterprise Act 2002	A6.1	Legislation which provides an additional mechanism for enforcing the Regulations. As well or instead of seeking an injunction under the Regulations, under Part 8 of the Enterprise Act 2002 the OFT and other bodies including Ofcom can obtain from the courts enforcement orders against traders who breach consumer legislation like the Regulations. More information on the Enterprise Act can be found on the OFT's website www.offt.gov.uk .
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 all terms, and applying a test of fairness to all terms except core terms that meet the requirement for transparency.
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 GC12		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 contractual period set at the start of a contract (often for 12 to 18 months).
MNP		Minimum Notice Period. The notice period which a consumer must give their supplier before they can cease service or switch to an alternative supplier.
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, 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.