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For the attention of Sarah Evans, Consumer Policy Manager

5 May 2008

Dear Sirs

Consultation - Ofcom review of additional charges

Thank you for inviting responses to your consultation paper dated 28 February 2008. Here are some thoughts on the subject of "additional charges" which I hope will be of assistance.

1. *The "core term" point*

- 1.1 The consultation paper approached the consultation on the basis that, if the term containing the additional charges is in plain intelligible language, then the term is exempted from any assessment of fairness because it relates "*to the adequacy of the price or remuneration...*" of the goods or services, and is therefore an exempted "core term" under regulation 6(2)(b) of the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083). This approach can be found, for example, in paragraphs 1.20 (in the table at figure 1.1), 3.101, 3.114, and 3.115, and also in paragraphs A5.25 and A5.35 of the draft Guidance.
- 1.2 The judgment of Mr Justice Andrew Smith in the case of *The Office of Fair Trading v Abbey National PLC and 7 others* [2008] EWHC 875 (Comm), which was given on 24 April 2008 (and was therefore not available when the consultation paper was published), shows that this approach is not correct. I presume that this is the case to which reference is made in paragraph 2.45 of the consultation paper, and that its effect will now be taken into account as promised.
- 1.3 Mr Justice Andrew Smith analysed regulation 6(2)(b) thoroughly and said (at paragraph 391) that it "*did not exempt all terms that relate to the price or remuneration, but only terms that relate to its "adequacy".*" Significantly, at paragraph 394, he said "*For example, if a seller or supplier includes in his terms a surcharge if payment is made by cheque or credit card, it does not seem to me that this is exempt from assessment simply because it relates to how much the consumer has to pay: it does not relate to the adequacy of what the consumer has to pay by way of price or remuneration for the goods or services supplied in exchange.*"
- 1.4 This is not an unexpected outcome. These "additional charges" are clearly not charges for the basic service. They are charges for something else (namely the purported extra cost of handling receipts otherwise than by direct debit), and that is not a service provided to the consumer at all.

- 1.5 Therefore, contrary to the approach adopted in the consultation paper, Ofcom should assess for fairness all terms which impose additional charges, regardless of whether or not they were in plain intelligible language. In view of the decision in this case, the consultation paper is wrong to say that terms imposing additional charges for paying otherwise than by direct debit can be “core terms”. Considerable changes to the draft Guidance will be needed to reflect this.

2. *The fairness test*

- 2.1 The findings described in the consultation paper (particularly at paragraphs 3.22 to 3.30) show that the overwhelming view of the public is that all customers should be treated equally, no matter how they choose to pay. Paragraph 3.83 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”.
- 2.2 The consultation paper states (in paragraphs 3.84, 3.99, 3.114, 3.115, 3.120, and paragraph A5.42 of the draft Guidance) that the only justification for these additional charges is the extra cost involved in actually dealing with the receipt of payments (although paragraph 2.5 below questions this). But the consultation paper then (a) not only omits to disclose the amount/scale of those costs (which is said to be confidential - see paragraph 3.75) but (b) also fails even to attempt to describe the extra work which supposedly generates the extra costs. Paragraph 3.76 mentions that evidence of the cost efficiency of direct debits was supplied to Ofcom, but it is not clear whether evidence of the purported extra cost of payment by non-direct debit was ever supplied. Presumably some such evidence was received by Ofcom, otherwise it could not legitimately have asked the question mentioned in paragraph 3.22 (which included the statement that “companies have higher costs for customers who do not pay by direct debit”).
- 2.3 On the information available to me, it seems that payment by cash or cheque across the counter at the customer’s own bank involves even less work for the supplier than any direct debit arrangement. The bar code on the payment-in slip means that the payment automatically reaches the suppliers bank in a form which can be readily identified, and the supplier does not even need to take the additional step of notifying the customer’s bank of the amount of the direct debit. To make an additional charge to the customer for making payment in such a way is plainly unfair.
- 2.4 I agree with paragraph 3.90 of the consultation paper. It makes no difference whether the charge for additional costs is expressed as a separate charge, or by way of a two-tier price structure with a lower price for those customers who pay by direct debit. The substance is the same, and both techniques should be subject to regulation.
- 2.5 The cost of administering payment receipts is merely one of numerous overhead costs which a supplier incurs in the course of its business. Other overhead costs include staff wages, rent, and taxes. If suppliers are free to pass on the cost of administering payment receipts, there is no logical reason to prevent suppliers also passing on other overhead costs. Such a scenario would quickly become chaotic. It is therefore questionable whether it is fair, or desirable, that suppliers should even be entitled to charge, as a separate item, the direct cost of administering payment receipts.

3. *Direct costs of processing payments*

The consultation paper shows that suppliers have sought to inflate the amount of these additional charges by including inappropriate items:

3.1 The consultation paper (at paragraph 3.77) shows that suppliers admit that they set the additional charges not only by reference to the purported underlying costs, but also other factors such as the amount charged by competitors and “expected customer response”. The consultation paper (at paragraph 2.24) admits that Ofcom has not considered the question of excess profits being generated through the use of additional costs devices.

3.2 The consultation paper (at paragraph 3.80) shows that some suppliers give a very wide meaning to the expression “costs”, and seek to include not only the administrative costs of processing the payment, but also (a) the additional cost of chasing for late payment and (b) the additional cost of bad debt. The conclusion (at paragraph 3.108 and in paragraph A5.43 of the draft Guidance) that the cost of bad debt should not form part of these additional costs, or otherwise be loaded onto any particular category of innocent customer, is welcomed. It ought to be possible for suppliers to charge the relevant defaulting customer for all the extra costs of his/her default, rather than passing those costs on to other innocent customers (or a class of them). It would seem fair and logical that the test for bad debts should also apply to the cost of chasing for late payment, and I therefore disagree with the conclusion (in paragraph 3.114 and in paragraph A5.45 of the draft Guidance) that sometimes the cost of chasing for payment should be capable of being passed on to any particular category of innocent customer. It should be a simple matter for a supplier to add an appropriate extra charge on the next invoice for a customer who has not paid the previous invoice, without seeking to pass the cost on to other innocent customers. Ofcom’s Guidance should also address the tendency of some suppliers to send reminders within only a few days of the original invoice, thus generating additional costs unnecessarily.

4. *Imbalance to consumers*

4.1 If suppliers are permitted to levy these additional charges, and customers are therefore pressurised into paying only by direct debit, a significant imbalance against consumers will occur:

4.1.1 Inevitably, mistakes can happen and sometimes consumers do not receive the service to which they are entitled. It is well known that it is difficult to communicate with communications suppliers (this is hinted at in the pre-penultimate bullet point in paragraph 3.29). An unsatisfied consumer who pays by cash or cheque is free to decide to withhold payment until the problem is resolved, while a customer paying by direct debit is less likely to go to the additional trouble of making arrangements with the bank to cancel or suspend the direct debit. Sometimes consumers may be frightened to cancel the direct debit because they think it might be a wrongful act on their part. If payment is made when it is not properly due, it can be difficult and time-consuming for a consumer to obtain repayment. The supplier is therefore more likely to continue to receive payments even when providing a poor quality of service, and there is little incentive on the supplier to remedy its breaches. It has been reported that the quality of telecommunications services is likely to deteriorate in the near future because of massive overload; so this problem could become much more widespread, thereby causing significant consumer harm.

4.1.2 In order to achieve a situation where as many consumers as possible pay by direct debit, suppliers may be tempted to continue to raise the level of these additional charges until they become prohibitively expensive. Because this would benefit every supplier in the industry, it is unlikely that the competition factor would protect the consumer. The consultation paper recognises that the level of these additional

charges has already started to increase (the final bullet point in paragraph 3.29), but passes over the issue with the comment that “it is not clear why this should be the case”.

4.2 As described in paragraph 2.3 above, in many cases the supplier will incur no additional cost from receiving payment otherwise than by direct debit, and so the concern about suppliers “rebalancing” those (non-existent) costs to the detriment of other consumers (in paragraphs 3.43 and 3.96) does not arise.

4.3 The concern about consumers on low incomes seems to arise from the absence of bank accounts in those cases. But if their bills are paid in cash then the supplier incurs no additional cost anyway (see paragraph 2.3 above). There should therefore be no question of any additional charges being made in these cases, nor any need for the cost of introducing special schemes such as those described in paragraph 3.61. It would be unnecessarily intrusive for a telephone company to check whether a customer is on benefits.

5. *Plain intelligible language*

An additional level of regulation is about to come into force under the Consumer Protection from Unfair Trading Regulations 2008 (based on EU Directive 2005/29/EC). Regulation 6(1)(c) deals with terms which are “unclear, unintelligible, ambiguous or untimely”. Ofcom might wish to consider including a reference to these regulations in paragraph A5.7 of the draft Guidance.

6. *Consultation questions*

My answers to the questions in Annex 4 are:

1. Yes.

2. No (see paragraph 1 above).

3. Not entirely (see paragraphs 2 to 4).

4. No comment, but much of the subject matter of this consultation applies equally to other suppliers (such as electricity and gas), and so it would be desirable (at least for the sake of consistency) if the Office of Fair Trading itself was to endorse Ofcom’s conclusions and Guidance.

5. Yes, as far as Ofcom’s powers against suppliers are concerned (the 3 month period is described in paragraphs 2.47 and 2.66). But consumers’ rights to recover unlawful charges must remain unaffected, even in respect of payments made by them before the publication of the new Guidance. [The on-line response form did not cater for a reply to this question.]

The signed response cover sheet (in Appendix3) accompanies the hard copy of this letter.

Yours faithfully,

Koger Hawkins