RECOMMENDATION

1. Dispute identification

Complaint No. : **201506-000377**

Nature of dispute : **Cancellation fee: gym contract:**

Adjudicator : **N Melville**

Date : **25 January 2016**

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2. Summary of the complaint

The supplier did not permit the complainant to cancel his gym contract in accordance to the National Consumer Act, section 14. It told him that its contract supersedes that the Consumer Protection Act and that he is liable for the full 3 year term.

3. Details of steps taken to resolve the complaint

The complainant spoke to Y of the accounts department and her manager.

He tried to negotiate and even offered to pay the transfer fees if the supplier was able to give his contract to " a new sign-up". The supplier declined and threated to report him to ITC if he put a stop payment on his account.

4. Outcome proposed

The complainant would like the monies lost to this contract to be paid back to him as he has not even been to the gym.

5. The response of the supplier

The complainant entered a membership agreement with the supplier on 25 February 2015. His first debit order was to go off on the 30th April 2015, but he went to his bank and put a stop payment on his bank account making it impossible for the supplier to debit his account thereafter.

On the 11th May 2015, Y. was in verbal conversation with the complainant and he promised new bank details. Nothing was received. On the 15th May 2015 the

supplier left a message on his cell phone. On an unknown date he called to cancel and the process was explained to him: He could either transfer his membership to a family friend or a family member or he could pay the 50% cancellation fee. He was told he had to put his request in writing.

A cancellation letter was received from the complainant on 8 June 2015. Once again the manager spoke to him and explained the cancellation process: "According to the CPA you are entitled to cancel the membership by giving 20 days' notice which the supplier accepted. Furthermore the Act makes provision that the account has to be up to date and if there are any outstanding amounts, the arrears must be paid in full. The balance of the contract is subject to a reasonable cancellation fee. In the supplier's membership agreement, it makes provision for this and the reasonable fee it charges is 50% of the remaining membership."

The outstanding amount on arrear membership fees is: R747.

The outstanding term of the membership is 33 months x R199= R6567.
Annual levy 3x R199 = R597
The remaining fees are a total of R7164.00 with a 50% cancellation =R3582.
The total due is R747 plus R3582=R 4329.00.

6. Attempted facilitation

The CGSO staff member dealing with the file suggested to the supplier that as the gym contract was concluded for a period of 36 months, this was in contravention of the Consumer Protection Act as the maximum period prescribed for a fix term contract is 24 months.

Further, it was said that it appeared that the cancellation fee charged was excessive and not reasonable as required by the Consumer Protection Act.

An extract from CGSO's advisory note on cancelation was provided to the supplier (http://www.cgso.org.za/wp-content/uploads/2015/12/CGSO-Advisory-Note-12-Cancellations-Revision1.pdf?87ab66)
and it was concluded that charging the complainant a cancellation fee of 50% of the remaining months are not reasonable seeing that one cannot claim future losses.

The complainant advised he is only prepared to pay 10%

7. Defining of issue

It is necessary to decide whether the supplier's method of calculating a cancellation fee is reasonable in terms of the provisions of the Consumer Protection Act (CPA).

8. The law

Consumer Protection Act

The situation is governed by section 14 of the CPA, the relevant aspect of which is:

> (2) If a consumer agreement is for a fixed term—
> (a) that term must not exceed the maximum period, if any, prescribed in terms of subsection (4) with respect to that category of consumer agreement;
> (b) despite any provision of the consumer agreement to the contrary—
> (i) the consumer may cancel that agreement—
>
> > (aa) upon the expiry of its fixed term, without penalty or charge, but subject to subsection (3)(a); or
> > (bb) at any other time, by giving the supplier 20 business days' notice in writing or other recorded manner and form, subject to subsection (3)(a) and (b); or …
>
> (3) Upon cancellation of a consumer agreement as contemplated in subsection (1)(b)—
> (a) the consumer remains liable to the supplier for any amounts owed to the supplier in terms of that agreement up to the date of cancellation; and
> (b) the supplier—
> (i) may impose a reasonable cancellation penalty with respect to any goods supplied, services provided, or discounts granted, to the consumer in contemplation of the agreement enduring for its intended fixed term, if any; and
> (ii) must credit the consumer with any amount that remains the property of the consumer as of the date of cancellation, as prescribed in terms of subsection (4).
>
> (4) The Minister may, by notice in the Gazette, prescribe—
> (a) the maximum duration for fixed-term consumer agreements, generally, or for specified categories of such agreements;
> (b) the manner and form of providing notices to the consumer in terms of subsection (2)(c);
> (c) the manner, form and basis for determining the reasonableness of credits and charges contemplated in subsection (3)…

Regulation 5 (1)

For purposes of section 14(4)(a) of the Act, the maximum period of a fixed-term consumer agreement is 24 months from the date of signature by the consumer -
(a) unless such longer period is expressly agreed with the consumer and the supplier can show a demonstrable financial benefit to the consumer…

Regulation 5(2) [see Annexure A]

Regulation 5 (3) Notwithstanding subregulation (2) above, the supplier may not charge a charge which would have the effect of negating the consumer's right to cancel a fixed term consumer agreement as afforded to the consumer by the Act.

Section 51 of the CPA is what might be referred to as a trumping provision in that it in effect prevents anyone from using a term, condition or clause that is in conflict with the provisions of the CPA. Thus a supplier cannot rely upon a term in the agreement itself setting out a cancellation fee: it must comply with the provisions of the CPA.

Case Law

Standard Bank of South Africa Ltd v Dlamini (2877/2011) [2012] ZAKZDHC 64

This case dealt with the section of the National Credit Act that deals with plain language and is equivalent to s. 22 of the CPA.

Para 40

If such notice was important to the Bank then it should have included it in the agreement as a material procedural step not only to surrender but also to claim a refund. It should also have ensured that Mr Dlamini was aware of it.

Para 67

When the form and get-up of the agreement is inconsistent with the NCA and its regulations, and the Bank has not interpreted, translated or explained its material terms, severance is not an option. The entire agreement must be set aside.

9. Consideration of the law and facts

The first issue to decide is whether the supplier's agreement is permitted to run for 3 years. As it correctly pointed out, the consumer expressly agreed to a period longer than 24 months, as required by regulation 5(1)(a). It did not, however, put

forward any demonstrable financial benefit to the consumer, as also required by the regulation. It may not be necessary to decide on this point in view of the discussion regarding the reasonableness of the penalty that follows.

The supplier's interpretation of the CPA that it is entitled to claim any amounts owed up to date of cancellation is correct, subject to the following considerations: Clause 28 of the agreement permitted the consumer to terminate the agreement during a five day cooling off period. On the authority of the *Standard Bank* case mentioned above, this clause, which is a material term of the agreement that favours the consumer, ought to have been more conspicuous in the agreement and certainly ought to have been brought to the attention of the complainant.

The second concern is that the supplier did not make available "other recorded manner and form" of cancelling the agreement, but instead insisted upon the cancellation being in writing. This, coupled with the size and amount of the cancellation fee that the supplier insisted upon, no double prolonged the time it took to cancel the agreement.

We will now consider whether the proposed cancellation fee is reasonable or it amounts to charging a charge which would have the effect of negating the consumer's right to cancel, which is prohibited under regulation 5(3).

Section 14 of the CPA permits the supplier to impose a reasonable cancellation penalty with respect to any goods supplied, services provided, or discounts granted, to the consumer in contemplation of the agreement enduring for its intended fixed term, if any. To summarize the discussion in this regard in the advisory note, Annexure A, this provision does not permit compensation for future loss of profits.

As a regulation may not go beyond the scope of the enabling legislation under which it is made, regulation 5(2) cannot be interpreted to mean that a supplier is entitled also to consider lost future profits when calculating the damages for cancellation. Even if we are wrong in this regard, the supplier is under an obligation to mitigate its loss i.e. find someone else to replace the consumer.

As no mention has been made by the parties of goods which will remain in the possession of the consumer, the only aspects the supplier may take into consideration are: the period of time before cancellation during which the consumer was entitled to use the gym facilities and an amount proportionate to its actual costs of marketing and administration of the cancellation.

10. Conclusion

Accordingly it is recommended that the supplier charges the consumer a cancellation fee that includes the services already rendered and an amount commensurate with the actual costs associated with the cancellation.

11. Recommended resolution

In view of the above conclusion and in order to avoid further prolonging the matter, it is recommended that the supplier charges a total cancellation fee of:

The outstanding amount on arrear membership fees	R 747
Annual levy	R 199
Balancing figure for estimated actual costs	R 154
	R 1100

Extract from CGSO's advisory note on cancelation

We deal here with the cancellation termination of the contract by consumers for reasons other than a lack of performance by the supplier of its obligations (breach of contract). Thanks to the CPA , even if the gym contract is for a fixed period of time, the consumer may cancel it by giving the supplier 20 business days' notice in writing or other recorded form. The consumer remains liable to the gym, however, for any amounts owed in terms of the contract up to the date of the cancellation. Further, the supplier is entitled to impose a reasonable cancellation penalty with respect to any goods or services provided, or discounts granted, to the consumer "in contemplation of the agreement enduring for its intended fixed term".

Some guidance as to how to calculate the "reasonable cancellation penalty" is provided in Regulations 5(2). It lists the factors that must be taken into account:

(a) the amount which the consumer is still liable for to the supplier up to the date of cancellation;
(b) the value of the transaction up to cancellation;
(c) the value of the goods which will remain in the possession of the consumer after cancellation;
(d) the value of the goods that are returned to the supplier;
(e) the duration of the consumer agreement as initially agreed;
(f) losses suffered or benefits accrued by consumer as a result of the consumer entering into the consumer agreement;
(g) the nature of the goods or services that were reserved or booked;
(h) the length of notice of cancellation provided by the consumer;
(i) the reasonable potential for the service provider, acting diligently, to find an alternative consumer between the time of receiving the cancellation notice and the time of the cancelled reservation; and
(j) the general practice of the relevant industry.

The wording of these provisions creates difficulties in their interpretation as section 14(3)(b)(i) and regulation 5(2) appear to be at variance with each other. The section states that the cancellation penalty is with regard to "any goods supplied, services provided, or discounts granted, to the consumer in contemplation of the agreement enduring for its intended fixed term, if any," whereas the regulation appears to be wider than this. This is expanded upon below.

The last part of section 14(3)(b)(i), which refers to the "discounts granted", is easy enough to understand: it means that if any discount was provided on goods or services thanks to

the length of the contract, there can be a recalculation based on what the consumer would have paid had a shorter period been agreed upon initially. An example regarding goods is a newspaper subscription that has the effect of reducing the price from R 5.00 per paper if bought daily to R 3.50 per paper over the course of a year. It would work the same way for services: Thus if a once off visit to the gym would have cost R 200 but the bulk rate over 24 months was equivalent to R 100 per visit, the consumer could be held liable for a percentage of the difference in respect of the number of actual visits. The obvious practical problems with this example illustrate the danger of very broad, one-size-fits-all, legislative provisions such as those used in the CPA.

The first part of the sub-section is more difficult to understand: "the supplier may impose a reasonable cancellation penalty with respect to any goods supplied, services provided … to the consumer in contemplation of the agreement enduring for its intended fixed term". With regard to" goods supplied," it seems this would cover say a cell phone provided by a supplier in the belief that its cost would be recovered through subscription fees over a two year period, likewise a kit bag provided by a gym. It is more difficult to imagine a scenario relating to services that is not part and parcel of marketing or delivery of a product or services. Perhaps the sub-section means services such as the induction at the gym where a member of staff takes the measurements of the new member and shows them how to use the various exercise machines.

What seems clearer is that the subsection as a whole does not refer to loss of future profits. If future profits were being referred to, one would expect the CPA to use words such as "services yet to be provided/ which would have been provided in the future", or "future access to services", as is used in two places in section 63(1), and not the words "services provided" that are used.

If future profits are excluded, it is a departure from the common law in respect of a breach of contract, which provides for the assessment of damages for breach in terms of actual as well as prospective losses. In terms of the rules of the interpretation of statutes, there is a presumption that the legislation does not intend to change the existing law more that is necessary (Johannesburg Municipality v Cohen's Trustees 1909 TS 811 @823), if it is not clear that it does intend to change it (Gordon v Standard Merchant Bank 1983 (3) SA 68 (A)). The wording of section 14(3)(b)(i) is, however, clear and accordingly the so called "golden rule" of interpretation comes into play. That is that the "plain meaning" of words must be given effect to unless that would result in absurd results (Venter v R 1907 TS 910 @914), which is not the case here.

Even were it to be found that the exclusion of future profits is not clear and there is a possible meaning that includes future losses, the CPA itself instructs that If any of its provisions, read in their context, can reasonably be construed to have more than one meaning, the Tribunal or court must prefer the meaning that best promotes the CPA's spirit and purposes, and will best improve the realisation and enjoyment of consumer

rights generally, and in particular by persons contemplated in section 3(1)(b)(the previously disadvantaged).

Elsewhere the CPA refers to resolving any ambiguity or conflict in favour of the consumer. As it would obviously favour the consumer not to be bound into a long term contract by virtue of a penalty clause relating to the loss of future fees, if there is any ambiguity in section 14(3)(b)(ii), the section must be construed to exclude the possibility of a supplier claiming for lost future earnings upon the consumer cancelling the agreement.

Regulation 5(2) is to an extent in apparent conflict with section 14(3)(b)(i) as its provisions are on the whole more appropriate to the calculation of a penalty in respect of future losses and the mitigation of those losses. Sub-regulations (g)- (j) have if fact been "cut and pasted" from section 17(4) of the CPA, which relates to the consumer's right to cancel an advance reservation, booking or order. As they refer then to future losses, they go beyond the scope of section 14(3)(b)(i) and accordingly a court could rule that they are ultra vires (i.e. that they exceed the scope of the power to make regulations and are invalid).

As to the other sub-regulations:

Regulation 5(2)
(a) the amount which the consumer is still liable for to the supplier up to the date of cancellation.

This seems to go further than section 14(3)(a):

"[T]he consumer remains liable to the supplier for any amounts owed to the supplier in terms of that agreement up to the date of cancellation."

The regulation appears to be ambiguous as it could refer both to liability for goods or services already received by the consumer by the time of the breach but for which they have not yet paid, or to liability flowing from the contractual commitment to purchase future or further goods and services. The section on the other hand seems, as explained above, only to apply to liability already incurred.

Naturally, suppliers prefer an interpretation that permits them to claim for future income in terms of a contract. In the United Kingdom, a court put a stop to this approach in the case of The Office of Fair Trading v Ashbourne Management Services Ltd [2011] EWHC 1237 (Ch).

In that case the Office of Fair Trading (the "OFT") claimed that that Ashbourne had engaged in practices which contravened the Consumer Credit Act 1974 (the "CCA"), the

Unfair Terms in Consumer Contracts Regulations 1999 (the "UTCCR") and the Consumer Protection from Unfair Trading Regulations 2008 (the "CPR").

The gym contract in issue provided:

“You are liable to pay the agreed monthly membership subscriptions for the ‘minimum membership period’ and may be obliged to do so even if you would prefer to cancel your membership,” and

“In the event that this agreement is terminated before the minimum membership period has ended, all sums due to us plus the balance of the monthly subscriptions that would otherwise have fallen due will become payable immediately less 5%."

In its judgment the court stated:

“In all these circumstances I believe that the defendants' business model is designed and calculated to take advantage of the naivety and inexperience of the average consumer using gym clubs at the lower end of the market. As the many complaints received by the OFT show, the defendants' standard form agreements contain a trap into which the average consumer is likely to fall.”

The court concluded that:

“In accordance with well established principle, if a clause of a membership agreement permits a gym club to terminate in the event of a non repudiatory breach by a member then, upon termination pursuant to that provision, it is entitled to claim sums due and damages for losses suffered up to the date of termination but not beyond.”

In a similar vein, in the United States, it was held in Mau v. L.A. Fitness International [2010 U.S. Dist. LEXIS 119576] that health clubs must ensure that cancellation clauses are not unfairly punitive. The court determined that a contract clause is unreasonable, and therefore unenforceable against the member, when the amount of the termination fee has no relationship to the injury suffered by the club. Put another way, the court held that the reason most liquidated damages clauses are deemed unenforceable is because they specify the same amount of damages, regardless of the severity of the breach or even who is at fault.

Under the Australian Consumer Law, a term in a standard form contract may be declared unfair if it penalises consumers for terminating memberships.

Returning to the consideration of the interpretation of section 14(3)(a), its plain meaning, that a consumer is liable only for debts already incurred (and by implication not for future obligations or commitments) is consistent with the international approach with respect to

fair contractual terms. This means that to the extent that regulation 5(2)(a) goes further than that, it is not only ultra vires but also in itself unfair and it is unlikely to be applied by a court or tribunal.

Regulation 5(2)
(b) the value of the transaction up to cancellation;
(c) the value of the goods which will remain in the possession of the consumer after cancellation;
(d) the value of the goods that are returned to the supplier;
(e) the duration of the consumer agreement as initially agreed;

These provisions seem to apply to calculating a penalty for loss of future profits, but they could also be used to calculate the adjustment in respect of discounts provided, so they are valid regulations and should be taken into consideration when calculating a penalty in respect of any goods supplied, services provided, or discounts granted.

Regulation 5(2)
(f) losses suffered or benefits accrued by consumer as a result of the consumer entering into the consumer agreement;

It is not clear what the intention of this sub-regulation is or how "benefits accrued" differs from "the value of the transaction" in sub regulation (a). If the consumer has suffered losses, it would be more appropriate to cancel the contract for breach, in which case there would be no penalty payable by the consumer.

* * *

Calculation of penalty

From the above discussion, it is clear that the scope for recovering a penalty is limited. Further, the guidelines provided in regulation 5(2) imply that a supplier may not merely predetermine a set penalty, say a percentage of the outstanding value of the contract. Rather, the supplier must treat each case on its merits in terms of the variables set out in the regulation.

This does not prevent it from agreeing a sliding scale in respect of permitted penalty charges that relates to the period of the contract and the point at which it is cancelled. So long as, in accordance with the Conventional Penalties Act, the penalty is not out of proportion to the harm suffered by the supplier. To further protect itself, the supplier could indicate in the contract that stipulated goods and services that are provided free in anticipation that the contract will run the full term agreed upon will be charged for if the contract is cancelled without justification within a stated period of time.

Once the penalty is calculated, it must be deducted from any amount paid in advance by the consumer and the balance paid over to the consumer in terms of section 14(3)(b)(ii). Regulation 5(3) prevents the supplier from charging a charge which would have the effect of negating the consumer's CPA right to cancel the agreement. Even where the CPA permits a penalty to be charged, this is subject to the supplier being under an obligation to mitigate its losses. This is elaborated upon by the UK Office of Fair Trading (OFT) in its "Guidance on unfair terms in health and fitness club agreements":

Mitigation
5.3 Such terms are open to challenge because they take no account of the club's duty to mitigate its loss. In law, the club has a legal duty to do so, for example by seeking replacement business. If the club has a closed membership with a waiting list of potential new members, each new member could count as a replacement. This would not necessarily be the case where the club's membership is not full.

* * *

Although it is now easier to escape a gym contract, it does seem harsh, if not a poor approach to customer relations, when the operators of gyms do not release from their contracts without any form of penalty those consumers/ members who move elsewhere, hit hard times or fall ill. We endorse the following view expressed by the OFT in its guidance note referred to above:

Circumstances beyond a member's control
5.5 The fairest terms allow members to transfer their membership or to cancel the contract without penalty if the member, for example, has to relocate, or has suffered redundancy, or has a medical condition that prevents his use of the gym. Such terms take positive account of the interests of the member.

The New Zealand Consumer Commission expressed a similar view in one of its decisions.

Conclusion

From the above discussion, it seems that a consumer may escape a fixed term gym contract with relative ease and without the threat of excessive penalties being imposed, particularly those associated with the loss of profits from the balance of the agreement: Future losses are not provided for in section 14 of the CPA.

All a consumer need do is give the supplier 20 business days' notice in writing or other recorded manner and form. They will still be liable for any outstanding fees up to the date of cancellation and the payment of a reasonable cancellation penalty with respect to any

goods supplied, services provided, or discounts granted, to the consumer in anticipation of the agreement running for the full period.

In calculating the penalty, the supplier must take into consideration:

(b) the value of the transaction up to cancellation;
(c) the value of the goods which will remain in the possession of the consumer after cancellation;
(d) the value of the goods that are returned to the supplier;
(e) the duration of the consumer agreement as initially agreed.

It may be permissible for a supplier to agree up front with the consumer a sliding scale in respect of permitted penalty charges that relates to the period of the contract and the point at which it is cancelled, so long as the penalty is not out of proportion to the harm suffered by the supplier.