EU telecom reform

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Editorial

As we look forward to the final Digital Britain report and wonder whether the blooming of tulips and bluebells presage green shoots in the wider economy, we have another bumper update for you, kicking off with an overview of the recent implementation of the data retention rules. For those fascinated by the sometimes labyrinthine European legislative process, we have an update on the telecoms package from a member of our Brussels telecoms team. After a quick review of the proposed Digital Right Agency, we review a couple of recent Ofcom consultations, as well as the extension of the Roaming Regulation to data.

And finally, we have a round-up of some interesting commercial decisions in the Court of Appeal on issues relating to termination rights, letters of intent and VAT liability.

As ever, we welcome any feedback on the update, and please let us know if there are any topics of particular interest you would like us to cover.

Rob Bratby and Lucy Hollis

New communications data retention regime now in force - and more on the horizon!

In April the Data Retention (EC Directive) Regulations 2009 came into force, completing the UK's transition from a voluntary to a mandatory regime for the retention of telephony, email and internet usage data. For now, only major service providers will be directly affected and much of the practical detail of the regime is still to be negotiated between the Home Office, law enforcement agencies and the industry. But that is not all; the Government has also unveiled plans to significantly extend service providers' obligations– to include further data types and data relating to third party services crossing their networks.

The new Regulations – an overview

The Data Retention (EC Directive) Regulations 2009 came into force on 6 April. These Regulations complete the UK's transposition of the EU Data Retention Directive by providing a fully mandatory regime for all communications data – the "who, when and where" of fixed and mobile calls, emails and internet usage for use by the police and other authorities for the prevention and investigation of terrorism and serious crime. (See this article for an overview of the Directive). The UK has opted for a retention period of 12 months for all data types (the middle ground between the six month minimum and 24 month maximum imposed by the Directive). The requirements of the Directive regarding fixed and mobile call data were brought into force in the UK in October 2007, so what is new is the requirement to retain internet and email data. Despite the recent press hype, the retention of such data by ISPs is not new, although it has been placed on a different legal footing. The regime replaces a voluntary code of practice, established under the Anti Terrorism Crime and Security Act 2001, which has been in operation since 2004. The content of calls and emails may not be retained under the Regulations – interception of message content is dealt with under a separate regime, the Regulation of Investigatory Powers Act 2000 (RIPA).

Since most aspects of the Directive are mandatory, the Regulations mostly "copy out" the Directive. However, the UK was able to fine tune certain aspects of the legislation in response to the industry's consultation submissions. For our coverage of last year's consultation, see our October 2008 article.

Much of the practical detail of how the regime will operate is still to be thrashed out by an Implementation Group comprising representatives of the Government, the law enforcement agencies and the industry.

Who is subject to the Regulations?

All "public communications providers", as defined, are potentially subject to the Regulations. This encompasses providers of public electronic communications networks or services. However, the Regulations will only apply to a service provider if they have been given notice in writing by the Secretary of State – this is to prevent duplicated storage of the same data by more than one service provider.

Details of notifications will not be made public, but the Government plans an "incremental approach" building on existing service level agreements which were established under the voluntary regime. No

notification will be made without prior discussion with the relevant service provider to determine whether or not it already meets the retention obligations, the best method of storing the data and the timetable for compliance. We understand that in practice only a handful of major service providers, who account for the bulk of the UK market, are likely to be subject to notifications in the near future and that they will pool data from smaller resellers.

What type of data is covered?

The Regulations apply to communications data "if, or to the extent that, the data are generated or processed in the United Kingdom by public communications providers in the process of supplying the communications services concerned". In other words, service providers are not required to generate data for compliance with the Regulations which they would not otherwise generate for operational needs. Some key definitions include the following:

- "Communications data" comprises "traffic data and location data and the related data necessary to identify the subscriber or user".
- Traffic data means "data processed for the purpose of conveyance of a communication on an electronic communications network or for the billing in respect that communication and includes data relating to the routing, duration or time of a communication".
- Location data means "data processed in an electronic communications network indicating the geographical position of the terminal equipment of a user of a public electronic communications service, including data relating to: (i) the latitude, longitude or altitude of the terminal equipment, (ii) the direction of travel of the user; or (iii) the time the location information was recorded".

The Schedule to the Regulations sets out in more detail the data types to be retained in relation to fixed network telephony, mobile telephony and internet access, internet email and internet telephony respectively.

There has been much criticism that certain of the data types listed in the Directive, particularly in relation to internet services, do not make complete sense in operational terms. This is one issue on which the Implementation Group will need to reach agreement on what it is feasible for service providers to retain. Another area where there is still work to do is in developing a uniform standard for the handover of data – the Retained Data Handover Interface – which is being developed by the European Telecommunications Standards Institute.

Other obligations

Service providers must meet various storage and data protection standards in order to safeguard the retained data. Access to retained data is restricted to specific cases and only as required by law, i.e. under RIPA. Retained data must be kept in such a way that it can be transmitted "without undue delay in response to requests". Service providers must report annually on the number of disclosures of retained data, the age of such data and the number of requests which could not be met.

Cost arrangements

The Directive is silent in the issue of cost reimbursement. Under the Regulations, the costs of compliance with the Regulations 'may' be reimbursed by the Secretary of State. That reimbursement may also be conditional on expenses having been notified to the Secretary of State and agreed in advance and the public communication provider complying with any audit that may be reasonably required to monitor a claim for reimbursement. However, the Government has emphasised that "no service provider need commit its own expenditure to implementing data retention solutions without such agreement."

Sanctions

Service providers who fail to comply will face civil proceedings by the Secretary of State for an injunction, or for specific performance of a statutory duty. An equally, if not more, compelling reason for compliance is the risk of adverse PR consequences of failure to assist where matters of national security or serious crime are concerned.

Future reform: the latest UK proposals on communications data

Transposition of the Directive into national law is not, however, the end of the story. On 27 April the Government finally unveiled plans for even more far-reaching reforms, aimed at ensuring that the UK's communications data capabilities keep pace with advances in technology. The proposals are set out in the Home Office consultation document "Protecting the public in a changing communications environment". The initial consultation runs until 20 July.

Readers may remember that a Communications Data Bill was outlined in the Government's draft legislative programme in May 2008 (see our July 2008 Update). That bill (which never materialised) seemed to be intended as a marriage of convenience, combining measures to transpose the Directive, along with the more far-reaching reforms needed to "future proof" the communications data regime. It is those more fundamental changes which are outlined in the new consultation paper.

The Government's rationale is that the scope of the data retention regime established by the Directive is already limited in its effectiveness and will continue to be eroded by new advances in technology. In particular the following loopholes are cited: diversification of modes of communication, especially the move to IP protocol; the diminishing need for service providers to retain data for business purposes; the increasing anonymisation of services; the greater fragmentation of data across different communications networks; and the move to service providers based outside the jurisdiction. The Government therefore concludes that new legislation will therefore be required.

The Government has rejected the rumoured option of a centralised, government maintained database of all communications data, which fuelled a great deal of media hype last year. Instead it proposes to build on the current decentralised system whereby service providers retain data for a 12 month period (extendable in certain specific circumstances) and disclose only specific data on a case by case basis to the authorities on request, subject to the existing safeguards. Even so, the proposed new regime goes far beyond the existing Directive. Service providers would need to retain all data that the authorities might need – this would include data relating to third party services crossing their network as well as data relating to their own services, and data which would not otherwise be retained for the service provider's operational needs. To address the problem of fragmentation of data relating to a single communication, it is proposed that service providers should not only collect and store the data but also organise it and match it with any third party data relating to the same communication.

The proposals and questions in the consultation document are very high level ones, and the devil of any ensuing legislation will be in the (considerable) detail. The Government is keen to mitigate the practical and cost impact on the industry. Its initial cost estimate is of up to £2 billion over ten years. Press reports so far suggest that certain ISPs have given the proposals a cautious welcome, provided that (like the current regime) they are "cost neutral" to the industry. Watch this space!

Claire Walker

EU telecom reform

In the October 2008 and January 2009 updates we looked in some detail at how the reform of the EU regulatory framework for electronic communications was progressing. Since then, firmly divergent positions of the Council of the European Union, the European Commission and the European Parliament on a range of issues have resulted in tripartite negotiations ("trialogue"). These negotiations aim to ensure the adoption of a final text before the European elections of early June 2009.

To date, the negotiations have led to compromises on almost all the issues of reform. The following points have already been confirmed:

European telecom body - BEREC

There will be a Body of European Regulators for Electronic Communications ("BEREC"), composed of the national regulators and a European Commission representative. It will replace ERG and will advise the Commission, the European Parliament and the Council. It will not be an agency nor have a legal personality and it will act by two-thirds majority of all its members. An autonomous Community body with a legal personality (the "Office") will provide professional and administrative support. The Office will be funded by the Community budget and voluntary national contributions.

No veto power of the Commission over remedies

The Commission will have no veto power over remedies drafted by national regulators. However, national regulators should still take "utmost account" of the opinion of the Commission and, if any, of that of BEREC. If the Commission has "serious doubts" and BEREC shares these "serious doubts", the three should cooperate closely, with the objective of identifying the "most appropriate and effective measure". In short, the Commission will have no veto power over remedies but will have delaying and discussion power.

Functional separation remedy

After much debate the remedy of functional separation (c.f. the creation of Openreach in the UK) will form part of the package, although as an exceptional remedy of last resort.

Infrastructure sharing and risk sharing of next generation networks

National regulators can oblige dominant players to share facilities such as buildings, entries to buildings, building wiring, masts, antennae, towers and other supporting constructions, ducts etc. On the other hand, national regulators should also promote investment and innovation in new infrastructure. Specifically, any related access obligation should take "appropriate account" of the risk incurred by the investing undertakings and should allow "cooperative arrangements" between investors and access seeking parties to "diversify the risk".

Anti-piracy rules

The last significant hurdle before the reform is adopted concerns an anti-piracy provision. It provides that no restriction to end-users' freedoms (i.e. internet access) may be imposed without a prior ruling of a judicial authority. This provision was added into the reform by the European Parliament in reaction to a French bill ("loi Hadopi"). This bill allocates the task of suspending internet access of users presumed to be

downloading illegal content, to a non judicial authority. This politically very sensitive issue is currently blocking the reform and could cause it to be postponed until autumn (for a formal conciliation procedure), if the Council of the European Union does not align its position with that of the European Parliament.

Next steps

The next formal step is the Telecommunications Council of the European Union, forecasted for 12 June 2009.

Quentin Coppieters 't Wallant (Brussels)

Text costs cut in extension to Roaming Regulation

On 22 April, the European Parliament voted by an overwhelming majority to extend the duration and ambit of the 2007 Roaming Regulation. The amended Regulation will cover text messages and data services and will have a significant impact on mobile operators' roaming revenues.

Following a review of the 2007 Roaming Regulation, in September 2008 the European Commission announced proposals to extend the Regulation to cover text and data services. Click here for our previous coverage on the Commission's proposals.

The European Parliament has now voted to adopt a compromise position, which was reached in March between the Parliament and the Czech Council Presidency.

Under the amended Regulation, from 1 July 2009:

- Maximum prices of voice roaming calls will be 43 cents per minute for outgoing calls and 19 cents per minute for incoming calls (excluding VAT). These limits will decrease to 39 cents from 1 July 2010 and 35 cents from 1 July 2011 for outgoing calls and to 15 cents from 1 July 2010 and 11 cents from 1 July 2011 for incoming calls;
- Voice calls are to be billed on a per-second basis, however a 30 second minimum charging period will apply;
- The maximum charge for roamed text messages will be 11 cents; and
- Data roaming services (such as email and web-browsing) will be subject to a wholesale price cap of €1 per megabyte and will be chargeable on a per-kilobyte basis. The cap will be reduced to 80 cents from 1 July 2010 and to 50 cents from 1 July 2011.

To address the issue of perceived "bill shock", from 1 March 2010, customers will have the opportunity to set a maximum limit for their roaming bill. Customers who have not made an alternative choice by July 2010 will have a limit of €50 applied automatically. Providers will be obliged to notify their customers once they reach 80% of their agreed limit. Once the limit is reached, providers will issue a further notice setting out the procedure to be followed if the customer wishes to continue roaming. The service must automatically cease if the customer does not respond.

The Regulation, including the price caps, will expire by 30 June 2012, a year earlier than originally proposed by the Commission. By mid-2011, the Commission will have to review the consumer benefit resulting from these changes and assess methods of regulation for the roaming market other than price control.

The Council of EU Telecoms Ministers has already signalled its agreement with the new rules, which will become directly applicable law across the EU on 1 July 2009.

Mobile operators, many of whom opposed the extension of the Regulation, will now need to turn their attention to updating their billing systems in time to deal with the new limits.

Louisa Brogden

Ofcom commences narrowband market review

Ofcom has recently published its proposals on the identification of markets, determination of market power and remedies in fixed narrowband services in wholesale and in retail markets. It is also consulting on proposals in relation to the wholesale charges that BT can impose for narrowband products.

On 19 March 2009, Ofcom commenced its second review of the narrowband market by publishing for consultation its proposals on the identification of markets, determination of market power and remedies in the fixed narrowband services wholesale markets and on the identification of markets and determination of market power in the fixed narrowband retail services markets. Ofcom is also consulting on proposals in relation to the wholesale charges that BT can impose for narrowband products. To view Ofcom's proposals click here and here.

Retail regulation on BT to be relaxed?

Ofcom's consultations suggests that the retail markets in relation to:

(i) retail fixed narrowband telephone lines for business and residential consumers; and

(ii) retail fixed narrowband calls for business and residential consumers,

are now competitive and therefore proposes removing the remaining SMP conditions currently imposed on BT. Ofcom envisages, as a result of this removal, increased competition in the provision of retail telephony services from BT, since BT will be able to bundle these telephony services with other services such as broadband.

However, Ofcom continues to consider that BT has SMP in relation to ISDN2 and ISDN30 lines. However, Ofcom believes that the current retail remedies in this area are no longer effective and are potentially counterproductive in the development of enhanced competition. Ofcom therefore proposes to rely solely on the proposed wholesale remedies for these markets.

In relation to the retail markets in Hull, Ofcom has found no significant change in KCOM's position so concludes that KCOM has retained SMP in all retail narrowband markets.

Continued regulation in wholesale narrowband access markets

Ofcom's consultation suggest that there has been little change since the 2003 review of the wholesale narrowband markets. Ofcom therefore proposes to update the SMP conditions imposed on the wholesale markets rather than to relax them. The amendments to the SMP conditions include:

(i) the removal of the requirement for BT to provide certain WLR services and call origination services (Carrier Pre-Selection) in accordance with Ofcom directed functional specifications as Ofcom considers that these products are now mature and the functional specifications dictated by Ofcom are no longer proportionate and could, potentially, hinder future development of these services;

(ii) the imposition of additional obligations in relation to ISDN30 lines given the high returns BT has reported for this service;

(iii) to consult on whether it is appropriate to reduce notification periods for price changes; and

(iv) the updating of BT's reporting obligations.

Relaxation of middle mile conveyance rules

Ofcom also considers that BT no longer has SMP in local-tandem conveyance and transit and wholesale transit services markets.

Charge controls to be reviewed in parallel

The current network charge controls ("NCC") will expire on 30 September 2009. Ofcom is undertaking a review of NCCs to establish new controls as of 1 October 2009. The NCC review is being managed in close conjunction with the wholesale narrowband market review which will define the scope of the new NCCs.

The consultation closing date has been extended until 4 June 2009.

Anouska Spiers

Digital Rights Agency: consultation commences

As we await the final Digital Britain report, expected in June, we review one contentious aspect: the proposals for a digital rights agency.

Introduction

Regular readers of the Telecoms Update will have been following our coverage over the past few months of the steps BERR and DCMS have been considering taking to address the issue of unlawful filesharing (click here to view previous article). Their ongoing challenge has been how to balance the opposing concerns of ISPs, who generally feel they should not be held responsible for the unlawful acts of infringers simply because they are carried out via their networks, and rights holders, whose businesses are suffering from unlawful sharing of their material. In January 2009 BERR and DCMS set out in the Interim Digital Britain Report their joint proposals for the potential for a Rights Agency to bring industry together to agree how to provide incentives for legal use of copyright material; work together to prevent unlawful use by consumers…and enable technical copyright-support solutions". In March they expanded further on their proposals in a separate paper (the DRA paper).

Digital Rights Agency

The DRA paper sets out the government's proposals in the form of a "straw man" inviting comment from industry. Whilst much of the DRA straw man will be fleshed out in the final Digital Britain report, the DRA paper is clear on key aspects of the legislation that will be introduced. The DRA will establish a code of practice, which may be enforced by Ofcom. Upon receipt from a rights-holder of evidence that an individual is infringing (standards of such evidence to be set by the DRA code), ISPs will be required to notify the individual, setting out details of the alleged infringement and providing various supporting information (on how to secure your wireless network, where to access legitimate content and why copyright is important). ISPs will be required to maintain data relating to the notifications sent (but without any obligation to monitor customer activity) and to alert the rights-holder where an infringement notification is received in respect of a serious or repeated infringer. The rights-holder may then use the anonymous data in relation to that infringer to secure a court order for the release of the infringer's personal details in order to take legal action.

Funding of the DRA is a controversial, unresolved issue. The paper states that it "will be funded by industry contributions" but invites comment on how the cost should be divided between the participants. The paper estimates the costs of the DRA at as little as £500k p/a where it takes the form of a light-touch industry body similar to the Advertising Standards Authority, or at least £2.5m where it takes the form of a substantial self-regulatory body. The paper also highlights the significant time and expense involved in rights clearance. Should facilitation of clearance be a key role of the DRA, its costs are likely to be increased.

Recent events suggest the government faces a significant challenge in bringing ISPs and rights-holders together to establish the new regime. A few months prior to the DRA paper, Virgin Media's proposed unlimited, legal music sharing subscription service (heralded as the first attempt to monetise peer-to-peer file-sharing) was aborted due to failure to agree with some of the major record labels on anti-piracy issues. More recently, disputes between the PRS collecting society, which represents owners of musical compositions, and Google service over the royalties due for the use of music on YouTube resulted in the removal by Google of all official music content from the UK version of the service. Both ISPs and rights-

holders will look forward to the final Digital Britain report for the governments more detailed proposals on all of the above issues.

Nick Eziefula

Ofcom's proposals to stamp out mis-selling in the fixed line telecoms market

In March 2009, OFCOM issued a consultation on options to protect customers from mis-selling of fixed-line telecommunications services. This follows the 2005 introduction of sales and marketing codes of practice as a proactive Ofcom enforcement programme.

Introduction

Ofcom is proposing to update and tighten existing mis-selling rules to address perceived ongoing failures. In particular, Ofcom proposes to:

- clarify the existing regulations to aid understanding;
- simplify the regulations by moving away from a Code of Practice model and instead implement a prohibition on inappropriate sales and marketing activity;
- require communications providers ("CPs") to provide better and fuller information for customers on the potential consequences of switching at the point of sale and through letters;
- extend the Cancel Other rules contained in Ofcom's July 2005 Direction (click here to view this Direction) from BT to cover all CPs providing fixed-line telecommunications services; and
- clarify existing record-keeping requirements and include a new requirement on CPS to maintain voice recordings of all relevant telephone contact with a customer.

Ofcom has identified a number of factors which have contributed to ongoing mis-selling. First, it has received complaints from CPs that they are confused as to what is expected of them, and that this confusion is compounded by Ofcom's approach of requiring CPs to implement their own codes and guidelines to ensure compliance with the rules. Secondly, Ofcom has received complaints from customers who have not realised that upon switching they may continue to have existing liabilities with their existing CP. Finally, there is growing evidence of the abuse of the "Cancel Other" process where it has been used to prevent customers from switching. Cancel Other is the industry term for a functionality that allows the CP losing a customer to cancel orders during the switchover period placed by an alternative CP where it is alleged by the customer that slamming has occurred.

Background

Mis-selling covers a range of activities including the provision of false or misleading information to customers (for example, references to savings to be made or promises of free gifts that do not materialise), applying undue pressure to customers to switch CPs (for example, refusing to leave a door-to-door call until the customer has signed up) and in its most extreme form, slamming. Slamming describes the practice of switching a customer from one provider to another without their consent or knowledge. This can include salesmen claiming to represent a different company from the company they are working for, customers being asked to sign a document which they are not told has given their consent to a swap or the forging of customer signatures.

Evidence of Mis-selling

Ofcom's objective in this area is to promote switching and competition whilst still protecting customers. However, it has continued to collect evidence that this objective has not been achieved. This evidence comes from two main sources; one from its own mis-selling complaints data and the other from industry Cancel Other data. The consultation provides some figures on the amount and extent of the mis-selling. In the months following Ofcom's initial consultation, complaints showed a positive downward trend; however in the 14 months to January 2009, figures rose again, totalling 940 complaints. Similarly, whilst Cancel Other cases fell significantly following the implementation of the initial rules they again subsequently increased, with data from January 2009 revealing 8,406 instances of Cancel Others applied for slamming reasons.

Increased clarity?

The current regulatory approach to tackle mis-selling is to require all CPs to establish and comply with codes and guidelines consistent with Ofcom's rules. First, as discussed above, there is evidence of "genuine confusion" on the part of CPs as to the expectations on them in order to comply. From a CP perspective, this requirement has lead to an increased administrative burden in first drafting and then implementing and enforcing company-specific codes. Secondly, from Ofcom's perspective, this leads to difficulty in ensuring compliance with the rules as to ensure that a CP is complying with rules as the CP must first have established its own set of guidelines. In the absence of a CP specific code, Ofcom's only enforcement option is to ensure that the CP in question creates a code and complies going forward. This is a seemingly ineffective way of ensuring consistency of approach across the industry and equipping Ofcom with the tools necessary to ensure compliance. It also makes it harder for Ofcom to target the worst offenders, who often lack codes.

Ofcom therefore proposes two real options (the third being to do nothing):

(1) either re-draft the current regulations with a hope to achieve greater clarity; or

(2) both re-draft the current regulations and also move to an absolute prohibition of mis-selling (Ofcom's preferred option).

In Ofcom's view, this latter option would lead to swifter and more efficient enforcement action and also provide less-prescriptive regulation.

Fuller information on switching

At present, CPs whose customers switch to another CP ("losing CP") and the new CP ("gaining CP") are currently required to use a "letter facilitation" process. These letters must be drafted in accordance with certain requirements, including that they be restricted to neutral information and do not contain any "save" material (being marketing material designed to persuade a customer not to switch). The effectiveness of this process is however limited due to CPs sometimes giving insufficient information and customers not receiving the letters or not always reading or understanding the implication of the letter. Ofcom's complaints data reveals that of those complaining, 48% were not aware of a minimum contract length or penalties for leaving early; this compares unfavourably with the mobile and broadband sector (27% and 21% respectively).

Ofcom has proposed three main options:

(1) require both the losing and gaining CPs to include specific reference in their letters to potential existing contractual liabilities;

(2) require the gaining CP to inform a consumer at the point of sale of potential contractual liabilities with their existing CPs; or

(3) (Ofcom's preferred approach) require the CPs to implement both options (1) and (2).

As Ofcom has identified, this option is likely to incur costs for CPs in changing their sales scripts and it is arguably questionable whether this will actually serve the customer well to be informed on a call of such information.

Extending Cancel Other rules to cover all CPs

Currently, the Cancel Other obligations (in Ofcom's July 2005 Direction) only apply to BT. No other CP is under a strict legal obligation to apply Cancel Other in accordance with the rules nor to keep records for cancellations. However, BT is no longer the majority user of Cancel Other, and Cancel Other usage is now widespread across the industry. The consultation identifies a number of instances of consumer harm, including losing CPs making invalid cancellations of cases to frustrate the transfer process. Ofcom's proposed options are fourfold:

(1) do nothing;

(2) withdraw the regulations concerning BT's use of Cancel Other;

(3) withdraw the aforementioned regulations and incorporate reduced requirements as part of a General Condition; and

(4) withdraw the regulations and incorporate identical requirements as part of a General Condition. The third option is Ofcom's preferred approach as re-casting the requirements as a General Condition will ensure that the new rules apply to all CPs of fixed-line telecommunication services.

Under the new and reduced regulations, CPs would be permitted to apply Cancel Other in cases where there has been a failure to cancel by the gaining CP. Losing CPs would be required to confirm the cancellation wherever it uses Cancel Other. This may arguably lead to a further administrative burden on the part of the CP. Further, and more contentiously from an ease of process point of view, where the customer has placed a legitimate order but wants to change their mind, the process will require losing CPs to direct the consumer back to the gaining CP to cancel the order. Finally, Ofcom proposes applying the reason codes that are assigned to a Cancel Other across the industry to ensure consistency of approach and transparency going forward.

Record-keeping requirements

Current obligations on record keeping provide that sales and marketing campaign records must be maintained for 6 months. In order to gather evidence on how CPs held such records, Ofcom sent two statutory information requests requesting information from CPs about their current approach to record keeping. It identified that CPs have different approaches to record keeping, both in terms of what they keep and the length of time they retain records. Ofcom states that this has proven to be a impediment to its

enforcement activities and has found it difficult to enforce against CPs where bad practices have been alleged but the records provided have been poor due to lack of adequate evidence provided.

Ofcom's proposed options are to:

(1) clarify existing obligations relating to record keeping obligations for sales;

(2) introduce obligations requiring CPs to keep, and retain, call recordings; or

(3i) clarify the existing obligations and introduce further obligations requiring CPs to keep, and retain, call recordings, where appropriate.

In relation to call recordings, Ofcom also proposes 3 levels of attainment – either 75% with no assumed tolerance levels, 100% based on reasonable endeavours (and never less than 90%) or 100% with no assumed tolerance levels. Ofcom's preferred option is option 3, with a call recording target of 100% based on reasonable endeavours. The obligations would include provisions requiring CPs to keep a comprehensive audit trail of the sales process including by retaining case notes recorded by the sales representative and documents, contracts and/or correspondence in support of the sale correspondence with customers.

Lydia Fairfax

Court of Appeal holds use of GSM gateways unlawful

The Court of Appeal has confirmed that in the absence of a licence or exemption granted or made under the Wireless Telegraphy Act 2006, the use of GSM gateways for the purpose of providing a telecommunications service by way of business to another person is unlawful. In doing so it criticised the Competition Appeal Tribunal in making unnecessary legal rulings and rejected the application of the principle of consistent interpretation of EC law in relation to such licences.

Ofcom has won its appeal from a Competition Appeal Tribunal ruling (*Office of Communications, and (2) T-Mobile UK Limited v Floe Telecom Limited (in liquidation) [2009] EWCA Civ 47)*. Firstly, the Court of Appeal held that, purely as a matter of domestic law, that the mobile operators' GSM licences did not cover the use of GSM gateways and that GSM gateways were not licence exempt. As such Floe's use of GSM gateways was illegal.

Secondly, the Court of Appeal held that Vodafone's licence should not have been interpreted to ensure compatibility with EC law (i.e. in order to ensure that it authorises the use of GSM gateways compliant with the RTTE Directive). Such a licence is neither domestic law made to implement an EC directive, nor is it any other kind of "law". Rather, it is the legal mechanism for authorising something which is required by the general law to be officially authorised. In *White v White and the Motor Insurers' Bureau [2001] UKHL* 9, the Court of Appeal held that the fact that the process of grant is prescribed by law does not make the product of the process (the licence) part of that body of law. On this basis the Court held that Vodafone's licence was not any kind of "law" and therefore could not be subject to the established principle that national courts should interpret the provisions of national law to be compatible with EC law. Having reached this decision the Court did not consider the CAT's conclusions in relation to EC incompatibility.

The Court of Appeal did accept that whilst the principle of consistent interpretation did not apply, the provisions of EC law are relevant aids with which the Licence should be interpreted. This may be necessary where there are, for example, undefined technical terms, however, in this case the Licence defined its own terms and they controlled the meaning of the Licence.

The judgment has wider significance for the telecoms sector, making it clear that licences and conditions, including general conditions and SMP conditions, are to be interpreted as a pure matter of domestic law, without reference to European jurisprudence.

Francisca Mendia-Lara and Tamsin Blow

A recent case serves as a warning of the risks run by inactive directors

The recent Court of Appeal case of *Lexi Holdings (in administration) v Luqman and others* serves as a timely reminder that non-executive directors may not escape their responsibilities by simply doing nothing and pleading ignorance.

In the *Lexi Holdings* case, an executive director was alleged to have misappropriated in excess of £59 million from the company and caused further substantial loss by loans to, and transactions with, parties connected with its directors. The company, by then in administration, brought an action to recover the misappropriated funds against both that director and two of the company's non-executive directors.

Significantly in this case, the non-executive director defendants were sisters of the executive director, and knew of his past criminal convictions for fraud. The court considered the extent of the duties of the non-executive directors in light of this knowledge and confirmed that this knowledge should be taken into account when assessing their conduct. The two non-executive directors were therefore under an 'enhanced' duty to be vigilant as to the activity of their brother. The court rejected the suggestion that even if the sisters had questioned certain of the dubious activities, their brother would have been able to persuade them that they were legitimate. Given their knowledge of his past, the court concluded that had they fulfilled their duties as directors properly and asked the searching questions they should have done, they could not have been persuaded of the legitimacy of the transactions in question. Referring to the earlier case of **Re Westmid Packing Services Limited** the court confirmed that it is a breach of duty for directors to allow themselves to be dominated or bamboozled by one of their number.

The law relating to directors' duties has recently been codified in the Companies Act 2006 and although this case was determined under the previous law, that case law remains relevant in interpreting the new codified duties. Given the current economic climate and recent financial scandals, the performance of directors is likely to come under heightened scrutiny. This judgment provides an important reminder that all directors, non-executives included, have a positive obligation to involve themselves in the affairs of the company - inaction on the part of a director can constitute a breach of duty. In addition, where a director has particular knowledge or skill then this will increase the level of competence and vigilance expected of him in that area. Although delegation to a reasonable extent is permitted, complete abrogation of responsibility is not and directors must therefore ensure that they are proactive, vigilant and diligent in performing their duties, particularly when faced with a 'dominant' member or members of the board.

For our previous updates on the changes to the law on directors' duties under the new Companies Act 2006 click here and here.

Simon Armitage and Diane Chadwick

Court of Appeal case considers validity of credit notes and VAT liability

A recent Court of Appeal decision concerning VAT demonstrates that it is essential that the terms of agreement between a supplier and its customers contain a proper mechanism for the issue of credit notes in specified circumstances. If not there could be adverse VAT consequences.

The decision in *Brunel Motor Company LT v Revenue & Customs & Anor [2009] EWCA Civ 118 (26 February 2009)* concerns VAT and is particularly relevant to any businesses which supply goods to customers, but retain title, for example pending onward sale by the customer. In the current economic climate, it is likely that there will be situations where a supplier will repossess goods, for instance in the event of the customer's insolvency. It could, however, also be relevant to businesses supplying services, including telecoms services.

In the case, one company, Ford Motor Company (Ford), supplied cars to a customer, Quartic Motor Group Limited (Quartic). Ford invoiced Quartic for the full price of the cars, but payment was not due from Quartic until it had sold the cars. Ford retained title to the vehicles until payment was made. Ford's invoice created a tax point for VAT so Ford accounted to HMRC for output VAT on the amount due from Quartic, and Quartic reclaimed the VAT element as input tax. To illustrate this here is a simple example:

> *Ford invoices Quartic for £1 million + VAT (£150,000). Ford pays to HMRC output tax of £150,000. Quartic has made taxable supplies to third parties and has sent them invoices, totalling £2 million + VAT (£300,000). Quartic pays to HMRC £150,000 being the difference between VAT charged (output tax: £300,000) and VAT incurred (input tax: £150,000).*

Quartic went into administrative receivership. Ford became entitled to immediate payment and repossession of the cars. Ford issued credit notes to reflect the repossession then resold the cars to Quartic's receivers. The issue of the credit notes meant that, using the simple example above, Quartic was not entitled to deduct the input tax of £150,000 and now owed this amount to HMRC.

Quartic challenged the validity of the credit notes. The Court of Appeal said that for the credit notes to be valid, the agreement between the parties should specifically have provided for repossession and the issue of credit notes. If issuing the credit notes was a unilateral act by Ford, the credit notes were invalid. The case has now been remitted to the VAT and Duties Tribunal to establish the facts, namely whether or not there was an agreement between Ford and Quartic covering the issue of credit notes.

While the outcome of the case will materially affect Quartic's VAT liability, there are also implications for Ford. If the credit notes are invalid (on the basis that the Tribunal finds the agreement did not provide for their issue), Ford will not be able to treat the original supply to Quartic as cancelled (as had been the intended effect) so that Ford would still be liable for the output VAT on that transaction.

It is likely that repossession of goods will become a more current occurrence in the current economic climate. Any contracts providing for the supply of goods or services should immediately be reviewed to ensure that they provide for the issue of credit notes by the supplier in specified circumstances.

Jill Hallpike and Lucy Hollis

Express right versus common law right to terminate; Which one wins? The Court of Appeal decides

In *Stocznia Gdynia SA v Gearbulk Holdings Limited [200] EWCA Civ 75*, the Court of Appeal was recently required to consider the proposition that the existence of an express right to terminate a contract was in substitution for the common law right to terminate for repudiatory breach.

Stocznia Gdynia (the "Yard") and Gearbulk Holdings Limited ("Gearbulk") entered into contracts for the construction by the Yard of six ships for delivery on various dates between 2001 and the end of March 2004. A separate contract was signed in relation to each ship, but in all material respects the contracts were in the same form. The proceedings related to the contracts for three of the ships. The Yard failed to deliver those three ships and Gearbulk sent letters terminating the contracts relating to the ships and seeking recovery of the first instalments of the price paid under the contracts. Following termination, a dispute arose between Gearbulk and the Yard. Gearbulk asserted that it was entitled in each case to recover damages for the loss of its bargain, i.e. for the profit which it stood to make in the form of the value of the ships as delivered in comparison to the contractual price.

The Yard said that because Gearbulk had exercised an express right to terminate given by art. 10 of the contracts, Gearbulk's remedy in each case was limited to the recovery of the instalments of the price paid in accordance with art. 10 and nothing more**.** Art. 10 consisted partly of provisions for the payment of liquidated damages (e.g. in the event of delay by the Yard) and partly of a right for Gearbulk to terminate in specified circumstances, including delay of more than 150 days in delivery of a ship and the ship not being delivered, for any reason, by a specified drop-dead date of 15 August 2003. The Yard relied in particular on the following words:

"*The Purchaser shall not be entitled to claim any other compensation and the Seller shall not be liable for any other compensation for damages sustained by reason of events set out in this Article and/or direct consequences of such events other than liquidated damages specified in this Article*".

The argument the Yard relied upon is sometimes described as the proposition that the express contractual right provides a "complete code" under which termination can occur. The proposition is often unsuccessful, as it was again here, because of the principle that the separate common law right remains preserved unless clear words are used to exclude it**.**

In considering the argument put forward by the Yard, the Court of Appeal restated the principle that it was open to the parties to agree that breach of a particular term, however slight, was to be treated as entitling the innocent party to treat the contract as repudiated; this was in contrast to repudiatory breach at common law, where a breach would have to be sufficiently serious as to go to the root of the contract. Accordingly, the parties might set the threshold for discharge by breach below that of going to the root of the contract (or that of a breach which deprived the innocent party of substantially the whole benefit of the contract).

The structure of art. 10 was to provide for a right to liquidated damages for delay or deficiency, but "*there [came] a point at which the delay or deficiency [was] so serious that it should entitle [Gearbulk] to terminate the contract*". In this case, not only did the right to terminate under the contracts co-exist with the common law right, but in fact they were, in the words of Moore-Bick LJ "*one and the same*". Note, however, that Moore-Bick LJ was considering only the effect of art. 10 in the sense of what the termination right did in substance, i.e. to provide a right, the exercise of which would discharge both parties from all future

obligations. The conclusion on this issue did not of itself mean that the rights to damages arising from termination under art. 10 were identical to those for termination at common law.

The words used in this case were not sufficient to have the effect of excluding the right at common law to damages for loss of bargain; in particular:

- the liquidated damages provided for in art. 10 were to be paid in the form of a reduction of the instalment of the contract price payable on delivery. This could not be interpreted as referring to termination of the contract, because in that scenario the delivery instalment would not be payable. The words "*events set out in this Article*" were therefore referring only to the payment of liquidated damages; and

- the sub-clause providing a right of termination expressly stated that liquidated damages would not be payable in the event of such termination, the implication being that Gearbulk was instead entitled to recover its losses in the usual way.

Art. 10.7 also provided that on exercise of the art. 10 termination right, Gearbulk was entitled to recover all instalments which had been paid. the Yard argued that this, together with the right to claim under a refund guarantee which had been issued by a bank to secure such recovery, gave rise to an election for Gearbulk. On the Yard's argument, Gearbulk had to make a choice between either exercising the art. 10 right and claiming the refund of instalments or terminating at common law and claiming loss of bargain damages.

Moore-Bick LJ considered that the effect of this argument would be to take away "*by the back door*" rights of potentially considerable value. Having accepted that art. 10 did not operate to exclude the right to claim damages for loss of bargain, there was no good reason to construe art. 10.7 as providing an exclusive remedy. Instead, the effect of art. 10.7 was to provide a remedy additional to those that would ordinarily be available to Gearbulk on termination of the contract, namely a contractual right to recover the instalments which had been paid, in addition to the rights to recover them in restitution and to claim damages for loss of bargain at common law.

As the remedies under art. 10 included the common law rights, it therefore became strictly unnecessary to determine whether Gearbulk's having terminated under art. 10 precluded it from claiming it had terminated at common law. However, the CA nevertheless expressed the view that Gearbulk was not so precluded: as the contractual right to terminate and the common law right to do so had the same consequences in this case, it was unnecessary to put Gearbulk to any election and it was sufficient for Gearbulk to have made it clear that it was treating the contract as discharged.

It is clear from the judgment that the court's conclusions were determined by construction of the provisions in question. The case nevertheless amply demonstrates again the difficulty of complete code arguments. Parties consciously wishing to excluded the right to damages for loss of bargain need to be meticulously clear in the words they use an may in reality need to say in terms that this is what they are intending to do. Equally the innocent party wishing to terminate should continue to consider the possibility of terminating at common law where an express contractual right appears not to give sufficient remedies: the courts will not find the common law right to be excluded unless the words clearly say so.

Jeremy Mash and Sarah Speller

Court of Appeal decision on Letters of Intent

The Court of Appeal's decision in *RTS Flexible Systems Ltd v Molkerie Alois Muller GMbH & Co KG (2009 EWCA Civ 26)* highlights the dangers of commencing work on a project without having completed negotiations of the final terms of the related contract.

The claimant, ("C") specialised in the supply of automated machines for packaging and product handling in the food industry. The defendant, ("D") was a leading supplier of dairy products. C was awarded a contract to design, manufacture, assemble, test, deliver, install and commission an automated system of packaging yoghurt pots for D.

In order to meet the project timescales, C agreed to commence work on the basis of a Letter of Intent pending signature of a negotiated contract. The Letter of Intent provided that full contractual terms would be based on D's amended form of MF/1 conditions (modified to meet the specific requirements of the project) and the full terms and relevant technical specifications would be finalised, agreed and signed within four weeks. The expiry of the Letter of Intent was twice postponed by agreement but it ultimately expired before a full contract was signed by the parties.

Negotiations in relation to the formal contract (which was to include extensive schedules) continued. C insisted on incorporating in the amended MF/1 conditions a provision limiting its liability and, save for one definition, an agreement was reached in respect of the MF/1 conditions prior to the expiry of the Letter of Intent. The parties then focused their attention on negotiating the schedules to the contract and, whilst most of these were agreed, the formal contract was never executed and exchanged as contemplated. Throughout this period, C continued to build and deliver the equipment and received partial payment from D. A dispute later arose between the parties regarding the delivery of certain equipment and C brought proceedings against D.

The judge held as a preliminary issue that the parties had concluded a contract which incorporated the obligations under the schedules to the draft contract (in so far as they had been agreed), but did not incorporate the MF/1 conditions. C appealed arguing as its primary case that there was no contract at all after the expiry of the Letter of Intent, such that it was entitled to payment on a quantum meruit basis and, at worst, its only liability could be to repay amounts received from D. C argued in the alternative that, if there was a contract, the MF/1 conditions applied so as to impose a cap on liability equivalent to the price. In support of its arguments, C relied on clause 48 of the MF/1 conditions, which stipulated that a contract would "*not become effective until each party has executed a counterpart and exchanged it with the other*".

The Court of Appeal found in favour of C on its primary case and held that no contract had come into existence post termination of the Letter of Intent. In reaching that conclusion, the court relied on two reasons.

Firstly, clause 48 of the MF/1 conditions was found to be a continuing stipulation that a contract would only come into existence if a written agreement was entered into. The clause did not simply operate to prevent a contract being made on the MF/1 conditions but operated to prevent any contract being entered at all.. The definition of "contract" in the MF/1 conditions demonstrated that the anticipated contract was to include both the MF/1 conditions and the schedules. This was supported by the manner in which the parties had approached the negotiations. The fact that the MF/1 conditions were dealt with first, before the schedules were even considered, demonstrated that condition 48 had clearly been agreed between the parties as the basis on which they were negotiating.

Secondly, and of more importance to the law at large, the court applied the approach of Robert Goff J in *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd*:

"*In theses circumstances, if the buyer asks the seller to commence work "pending" the parties entering into a formal contract, it is difficult to infer from the [seller] acting on that request that he is assuming any responsibility for his performance, except such responsibility as will rest on him under the terms of the contract which both parties confidently anticipate they will shortly enter into. It would be an extraordinary result if, by acting on such a request in such circumstance, the [seller] were to assume an unlimited liability for his contractual performance, when he would never assume such liability under any contract which he entered into".*

The court found that the first instance judge (who had not been taken to Robert Goff J's comments) had achieved just such an "*extraordinary result*" by concluding that a simple contract had been made which consisted of R being required to carry out the agreed price but which did not include the MF/1 conditions and therefore did not include the limitation of liability clause.

While the Court of Appeal's conclusion opens the way to disputes about what form of contract parties might be expected to enter (which was not a problem in the instant case, as it was clear from the MF/1 conditions), it recognises the injustice of finding a contract where a relatively common form of limitation clause is not incorporated. The scope for dispute on the issue nevertheless highlights the danger of the not infrequent practice of projects taking place while detailed negotiation of a contract continues.

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About Olswang

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Founded in 1981, the Firm has grown to a team of over 600, including 96 partners, across four European offices. In addition, Olswang has a formal alliance with a major US firm Greenberg Traurig LLP and a long-established best friends network of leading independent law firms throughout the world.

Our Firm continues to be acknowledged as a leading practice in many of our core areas: Olswang was voted TMT Team of the Year 2009 for the second year running at the annual Legal Business Awards; Olswang's Corporate Group won M&A Law Firm of the Year at the M&A Awards 2008 in conjunction with M&A Magazine, and was named Corporate Team of the Year – Mid markets at The Lawyer Awards 2008.

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We recruit personalities with a genuine fascination and notable reputation in the sectors they focus on, which is reflected in the quality of our advice. We also understand the importance of achieving our clients' goals and ensure that our advice is, above all else, practical.

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At Olswang the passion of our lawyers, the confidence of our approach and the commercial edge to our advice provide a unique and compelling service.

The information contained in this update is intended as a general review of the subjects featured and detailed specialist advice should always be taken before taking or refraining from taking any action.

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