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RECOMMENDATION

1. Dispute identification

Complaint No.	**:**	**201602-0005932**
Nature of dispute	**:**	**Cancellation fee: gym contract**
Adjudicator	**:**	**N Melville**
Date	**:**	**7 March 2016**

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2. Summary of the complaint

The complainant took out a one year gym contract with the supplier on 18 November 2015 and cancelled it two months after commencement. She believes she gave more than a reasonable notice of cancellation but the supplier refused to accept her offer. Instead it responded that an 80% penalty (based on the fee for the remainder of the contract) would be charged.

3. Details of steps taken to resolve the complaint

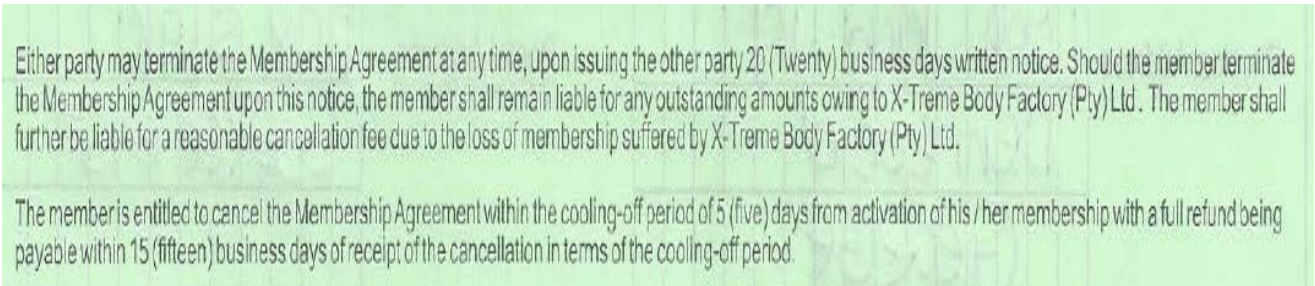
Communicated per email.

4. Outcome proposed

The complainant would like a fair and sound outcome.

5. The response of the supplier

Drawing from the various email correspondences submitted, the supplier's contract provides:



Either party may terminate the Membership Agreement at any time, upon issuing the other party 20 (Twenty) business days written notice. Should the member terminate the Membership Agreement upon this notice, the member shall remain liable for any outstanding amounts owing to X-Treme Body Factory (Pty) Ltd. The member shall further be liable for a reasonable cancellation fee due to the loss of membership suffered by X-Treme Body Factory (Pty) Ltd.

The member is entitled to cancel the Membership Agreement within the cooling-off period of 5 (five) days from activation of his / her membership with a full refund being payable within 15 (fifteen) business days of receipt of the cancellation in terms of the cooling-off period.

It communicated by email with the complainant, informing her that the cancellation fee was calculated based on the number of months outstanding on the contract, which in this instance was nine months. This meant the cancellation fee was R1 728.

It believes that the CPA is broad with regard to what a reasonable cancellation fee is and mentioned that most gymnasiums required 80% of outstanding fees. This was fair seeing that it would lose income and there was commission that had to be paid to staff on the cancelled contract.

At some point that is not clear from the correspondence, the supplier indicated it was prepared to settle on 30 % of the outstanding fees, which would come to R 648.

6. The complainant's reply

The complainant argued that if she had taken out a month-to-month gym contract, the fee would have been R 330 per month. Accordingly, the supplier's loss was R 90 per month. She offered to pay R 510 in full and final settlement. This amount included R 90 for December, R 90 for January and R 330 for her notice month.

The complainant feels the cancellation fee ought to have been revealed to her before she signed the contract.

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

5 (2) This Act does not apply to any transaction—

…

(d) that constitutes a credit agreement under the National Credit Act, but the goods or services that are the subject of the credit agreement are not excluded from the ambit of this Act;

Consumer's right to cooling-off period after direct marketing

16(3) A consumer may rescind a transaction resulting from any direct marketing without reason or penalty, by notice to the supplier in writing, or another recorded manner and form, within five business days after the later of the date on which—

(a) the transaction or agreement was concluded; or

(b) the goods that were the subject of the transaction were delivered to the consumer.

(4) A supplier must—

(a) return any payment received from the consumer in terms of the transaction within 15 business days after—

(i) receiving notice of the rescission, if no goods had been delivered to the

consumer in terms of the transaction; or

(ii) receiving from the consumer any goods supplied in terms of the transaction; and

(b) not attempt to collect any payment in terms of a rescinded transaction, except as permitted in terms of section 20(6).

National Credit Act (NCA)

Marketing and sales of credit at home or work

75(1) A credit provider must not harass a person in attempting to persuade that person to apply for credit or to enter into a credit agreement or related transaction.

(2) A credit provider must not enter into a credit agreement at a private dwelling except-

(a) during a visit pre-arranged by the consumer for that purpose;

(b) if a credit provider visited the private dwelling for the purpose of offering goods or services for sale, and incidentally offered to provide or arrange credit

(c) if the credit agreement is of a prescribed category that is permitted to be entered into during a visit to a private dwelling.

Consumer's right to rescind credit agreement

121. (1) This section applies only in respect of a lease or an instalment agreement 15 entered into at any location other than the registered business premises of the credit provider.

(2) A consumer may terminate a credit agreement within five business days after the date on which the agreement was signed by the consumer, by-

(a) delivering a notice in the prescribed manner to the credit provider; and

(b) tendering the return of any money or goods, or paying in full for any services, received by the consumer in respect of the agreement.

(3) When a credit agreement is terminated in terms of this section, the credit
(a) must refund any money the consumer has paid under the agreement within 25 seven business days after the delivery of the notice to terminate;

Case law

Standard Bank of South Africa Ltd v Dlamini 2013 (1) SA 219 (KZD)

[41] Non-disclosure of s 121(3)(a) [of the National Credit Act, reproduced above] violates the right of consumers to education and information in terms of s 3. The Bank's selection of what parts of s 121 of the NCA it should record in the agreement and what it should exclude is deliberate and deceptive. The heading of s 121 highlights its purpose as the 'Consumer's right to rescind credit agreement'. Instead of informing the consumer of this right, the Bank pitches it as an onerous bundle of obligations on the consumer to pay the Bank the costs of renting and recovering the vehicle. Projecting the consumer's obligations whilst understating his rights discourages rescission which is the consumer's statutory right.

[Naudé and Eiselen (eds): *Commentary on the Consumer Protection Act* 14-8 footnote 1 suggest the same principle applies to the CPA.]

***Nayyara Distribution Enterprise CC v Earlyworks 266 (Pty) Ltd t/a Gloria Jeans Coffees SA* NCT/4450//2012/114)(1)(P)CPA**

Referring to the CPA, the Tribunal stated at para 31(c):

c. In addition the Applicant alleged that it had tried to cancel their contracts shortly after entering into them but was informed that they could not do so without forfeiting their extensive deposit. So they allegedly decided to go ahead with the deal. Section 7 of the CPA came into operation on 24 April 2010 - so if the applicant was not informed of the cooling off period then there might have been prohibited conduct on the part of the Respondent.

9. Consideration of the law and facts

It is not evident from the information available whether or not the transaction in question is a credit transaction in terms of the NCA, although this is suggested by the supplier. In any event, the marketing provisions of both Acts apply concurrently to credit transactions. Naudé and Eiselen (cited above) at 5-35 para 96 and Melville and Palmer "The applicability of the Consumer Protection Act 2008 to credit agreements" (2010) *SA Merc LJ* 272

10. Recommended resolution

It is recommended that the parties agree that the consumer pays R 699 to settle the matter.

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.