Lawyers to the travel and leisure industry

travellers' checks

Spring 2004

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Welcome to the Spring edition.

In this issue, we report on the guidelines recently issued by the OFT on the fairness of terms commonly found in booking conditions in holiday brochures. It is pleasing to note that many points made by us on behalf of clients during the OFT's enquiry have been taken into account.

Our guest writer is Malcolm Balderstone, a VAT consultant, who brings us up to date on the Tour Operators Margin Scheme.

We wish all our readers a safe and successful summer season.

OFT guidance on unfair contract terms

On the 5th March 2004, the Office of Fair Trading published new guidance aimed at tour operators, explaining how the Unfair Terms in Consumer Contracts Regulations (UTCCRs) apply to package holiday contracts. The guidance deals primarily with the potential unfairness of standard contract terms used in booking conditions for package holidays and explains the basis on which the OFT is likely to take enforcement action.

The UTCCRs came into force in 1999 and apply to standard contract terms used with consumers in contracts made after 1 July 1995. A term is unfair if it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer. Although standard terms may be drafted to protect commercial needs, they must also take into account the interests and rights of consumers by going no further than is necessary to protect those legitimate commercial interests. The test does not apply to core terms that set the price or describe the main subject matter of the contract provided that they are in plain and intelligible language.

We highlight overleaf a selection of those terms considered by the OFT to be common unfair terms in package holiday contracts.

Before departure

Brochures

The OFT recognises that because brochures are published months in advance, there may have to be changes during the "life" of the brochure. However, in such circumstances the OFT provides that consumers should be informed of changes at the time of booking, and before entering into a contract. Terms that exclude or limit a operator's liability for changes made to the brochure's description of the holiday are likely to be considered unfair under the UTCCRs. Similarly, a term should not limit or exclude liability for a failure to supply the holiday as described in the brochure. Likewise, terms that seek to exclude or limit liability for errors on invoices, for example, by placing all the responsibility for checking their accuracy on the consumer, or imposing short deadlines for notification of errors, are likely to be unfair.

Consumers right to transfer the holiday if prevented from travelling

Regulation 10 of the Package Travel Regulations (the "PTRs") gives consumers the right, where they are prevented from proceeding with a package holiday, and where they give reasonable notice, to transfer the holiday booked to a substitute who satisfies any conditions that apply to the package. The OFT considers that the kind of event that would qualify the consumer as "prevented from proceeding" would include illness, death of a close relative, or jury service. The model term suggested by the OFT also provides that "reasonable notice" is considered to be "*at least fourteen days prior to the outward departure date*". Therefore, terms requiring the consumer to give an unduly long period of notice of the transfer are highly likely to be considered unfair.

Price revision clauses

The OFT is firmly of the view that terms providing for price revisions are void under the PTRs unless they provide for both upward and downward revision. In addition, Regulation 11(3) of the PTRs states that no increase may be made within thirty days of departure. In addition, terms that provide for surcharges beyond those allowed by the PTRs are highly unlikely to be considered fair.

Consumers' rights on pre departure change or cancellation by the operator

When operators have to cancel a holiday or make significant changes to essential aspects of it before departure, consumers are given a number of specific rights under the PTRs. The OFT would generally regard a reduction in the stay in resort of more than twelve hours; accommodation of a lower standard; change to a different resort; change of UK airport (other than in London) change of flight time by more than twelve hours; or a change of a day flight to a night flight as amounting to a significant change. In the event that the operator has to cancel or make a significant change to essential aspects of a holiday, the options available to the consumer under Regulation 13 of the PTRs are:

- take a substitute package of equivalent or superior quality if available;
- take a substitute package of lower quality and to be refunded the difference in price; or
- a full refund of all moneys paid under the contract.

Terms that conflict with this Regulation are very likely to be unfair. In the OFT's view, where a package of superior quality is taken under option 1, the PTRs do not allow the operator to require an additional payment from the consumer. However, the operator is not expected to offer a holiday which is so far superior as not to be a genuine substitute.

Compensation

The OFT acknowledges that many package holiday contracts limit compensation for cancellation and changes before departure to a set sliding scale. However, the OFT considers that such compensation terms are more likely to be fair if they do not prevent the consumer from seeking more compensation where appropriate. Such terms should allow for payments that reflect the actual loss of the consumer resulting from cancellation or change made by the operator, and acknowledge that in particular cases the consumer may be entitled to claim more (through arbitration or the courts for example).

Cancellation by the consumer

Similarly, terms providing for cancellation by the consumer will often set a scale of cancellation charges that rises with the approach of the departure date. Although the OFT does not object in principle to the use of such sliding scales, the OFT guidance provides that they should represent a genuine pre-estimate of the operator's loss from cancellations. In addition, the law does not allow operators whose customers cancel their contracts to reclaim losses that they could have avoided had they taken reasonable steps to do so. In setting a cancellation charge scale, operators should take into account the likelihood that they will be able to limit their losses. The OFT considers, that an operator would not, for example, be able to recoup the loss of the expectation of profit from optional excursions. Whatever method is chosen for arriving at the charges, it must accord with generally accepted accounting principles.

During the holiday

Exclusions of liability for occurrences between departure and return

Contract terms cannot be used to exclude or restrict a operator's liability for death or personal injury caused by its negligence. They are void under the Unfair Contract Terms Act 1977, except where their use is authorised by law. The UTCCRs are even wider in terms of exclusion and limitation clauses and apply not only to terms which would apply where the operator was negligent, but to exclusions of liability for death or personal injury caused by the operator's act or failure to act. The OFT do not consider, therefore, that terms which exclude or limit liability for death or injury can be made safe from challenge by accepting liability for loss or damage caused by negligence alone.

Unreasonable compensation limits

The PTRs allow an operator to limit the compensation it will pay for failure to supply services it has contracted to supply (except for personal injury) provided that the limitation is "not unreasonable". Although "not unreasonable" is not defined, the OFT considers that terms that could leave the consumer with less compensation than common law and statute would provide would not meet this standard.

ABTA recommends to its members that compensation should not be limited to less than three times the cost of the holiday and the OFT states that it has not generally challenged terms that use this yardstick.

After return

Reporting of complaints by consumers

The PTRs stipulate that package contracts should oblige the consumer to communicate any complaint at the earliest opportunity. However, the OFT is of the opinion that this does not mean that an operator is entitled to exclude all liability if the consumer does not in fact do so. A term that excludes liability for complaints not made in resort or within a specified period after return (often 28 days) is likely to be found unfair.

Miscellaneous

Jurisdiction

The OFT states that consumers should not be prevented from starting legal proceedings in their local courts, for example by a term restricting proceedings to the courts of England and Wales when the contract may be made in another part of the UK having its own laws and courts (ie. Scotland or Northern Ireland).

Headings

The OFT asserts that headings should be straightforward such as "Booking Conditions" or "Our Agreement" to avoid giving the misleading impression that the contracts have the approval of some independent body.

Enforcement

The enforcement procedure is based on the Stop Now Orders Regulations 2001 which came into force under the provisions of the Enterprise Act 2002. Enforcement action can be taken against infringements of both "domestic" and "community" law. "Community" includes infringements of the UTCCRs and the PTRs. The OFT and trading standards departments have powers to act against all types of infringement. Ultimately, however, only a court can decide whether a term is unfair.

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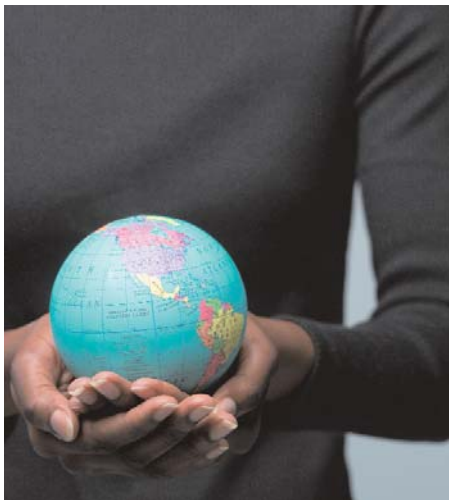
Home or Away - Can overseas employees sue their UK employer for Unfair Dismissal?



The recent Court of Appeal decision in the case of Lawson v Serco Limited [2004] is welcome news for UK employers in the travel and leisure industry, many of whom employ people to work overseas. The Court of Appeal held that an employment tribunal did not have jurisdiction to hear an unfair dismissal claim brought by a UK citizen working abroad for a UK company.

Good news for UK employers?

The law

Section 196 of the Employment Rights Act (ERA) 1996 used to exclude employees "ordinarily" working outside Great Britain from claiming unfair dismissal and other rights under the ERA. It was relatively straightforward therefore to determine whether an employee would qualify for UK statutory employment rights or not. Employers knew where they stood.

S196, however, was repealed by the Employment Relations Act 1999 and the law has been in a state of confusion ever since. Employers have, as a result, found themselves facing claims for unfair dismissal from employees who do not even work in the UK, but work wholly or mainly overseas. Employees have sought to exploit this confusion because the employment rights available in the UK were far more attractive than those, if any, in the country where they predominantly worked. There have been a number of conflicting EAT decisions as to whether tribunals have jurisdiction to hear those claims.

The facts

In the present case L was employed by S Ltd a UK registered company as a security guard at an RAF base on Ascension Island. He was a UK citizen and was domiciled in the UK. He had been recruited in the UK, but had never worked for S Ltd in the UK. He was on the UK payroll and was paid in pounds sterling into his UK bank account, but paid no UK taxes because he worked abroad. His contract stated that it was subject to English law. L brought a complaint before an employment tribunal for unfair constructive dismissal. L claimed that S Ltd had committed a fundamental breach of his contract forcing him to resign. He claimed that he been forced to work excessively long hours in breach of both his contract and the Working Time Regulations 1998. S Ltd argued that the claim should be

dismissed since L was not employed in the UK. The EAT, however, allowed his claim to proceed.

Court of Appeal overrules EAT

The Court stated that the issue to be determined was:

"On what employees does the law of England and Wales confer the right not to be unfairly dismissed?"

In coming to its decision the Court rejected a number of wider tests put forward by the EAT in this and other cases. For example the "place of business test" applied by the EAT in this case which meant that employees could bring a claim of unfair dismissal regardless of where they worked if the employer carried on business in Great Britain. It also rejected the 'substantial connection' test which required tribunals to consider all the factors surrounding the employment, including the place of employment and the residence of the employer and the employee, but not the law governing the contract. Finally, the Court rejected the 'base' test, i.e. the country in which the employee was based being determinative even though the employment was ordinarily outside that country. The Court also confirmed that the law of the contract is immaterial in determining whether or not the individual has the right to claim unfair dismissal.

"The right to bring an Unfair Dismissal claim applies only to employment in Britain."

The Court held that the right to bring an unfair dismissal claim applies only to "employment in Britain". The Court's view was that it was very unlikely that Parliament had intended to give the right to claim unfair dismissal to all employees wherever they worked.

What does "employment in Britain" mean?

The Court stated that it would not normally be difficult to decide whether the employment is in Britain or not. In the present case L was clearly not employed in Britain, he was employed on Ascension Island.

What about borderline cases?

Where does this decision leave employers in the travel and leisure industry who find themselves in situations where the facts are not so straightforward? What about air crew, travel representatives, hotel managers and staff who spend periods both working abroad and in the UK? What about directors and sales managers with dual responsibility for the UK and another country who spend equal periods of time in each?

The Court stated that in borderline cases there would have to be an assessment of all the relevant facts of the case. It specifically referred to the residence of the employer and employee as being relevant to where the employment is. The Court has not, however, provided definitive guidance on what other factors will be relevant.

What about short periods overseas?

The Court held that employees who work for a short period at a time overseas would not normally be prevented from bringing an unfair dismissal claim. Accordingly, an employee dismissed during "a single, short absence overseas" would normally be protected.

Summary

The Court seems to be advocating a common sense approach in assessing whether or not someone's employment is in the UK. Therefore the following factors should be relevant:

- where is the employee based?
- where is the employee paid, in which currency and where does he receive benefits?
- the employee's nationality and place of domicile?
- the country where recruited?
- whether the employee worked in the UK prior to working overseas?
- the period(s) of time spent abroad?
- the line management structure?

The Court of Appeal decision is good news for UK employers as it makes it more difficult for employees working overseas to bring claims for unfair dismissal in the UK, but there will still be cases which, ultimately, will only be resolved by a determination by a tribunal on the facts of the case. Employers should also be aware that different principles apply when considering whether an employee can pursue a contractual or discrimination claim in the UK.

Jackie Cuneen is an assistant in the employment department.

Congratulations to Paul Callegari on his well deserved promotion to Partner in the employment department.

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Watch out for TOMS!

In this article, Malcolm Balderstone, a VAT consultant with accountants MacIntyre Hudson, discusses some important developments in the TOMS rules.

What is TOMS?

The Tour Operators' Margin Scheme ("TOMS") is a special VAT accounting scheme which essentially applies throughout the EU to businesses which buy in and resell designated travel services without material alteration for the direct benefit of a traveller. Accommodation and passenger transport are both treated as margin scheme supplies so that a bucket shop selling flights on its own behalf falls within the TOMS, whereas a travel agent selling tickets for an airline can receive commission which is free from VAT.

Under the TOMS the margin between the buying and selling price is subject to standard rate VAT when the margin scheme supply is enjoyed in the EU and zero-rated when it is enjoyed outside the EU. The TOMS does not apply to in-house supplies or those which are made from a suppliers own resources, from purchases which have been materially altered or further processed, e.g. accommodation in a hotel which the supplier owns. The TOMS applies not only to tour operators but also to any business which trades in margin scheme supplies, including membership organisations which sell packages to an all-inclusive conference. The location of the event then determines whether VAT is due on any margin or profit made.

The travel industry has worked with the intricacies of the TOMS since it was originally introduced in 1988 although various changes in VAT accounting under the TOMS have been implemented since then, for example, that part of the margin relating to passenger transport for tours enjoyed in the EU was zero-rated before 1 January 1996 and has been standard rated ever since. In the UK certain schemes to mitigate the VAT due on passenger transport are available although these have recently come under threat from the European Commission.

The airline charter option, the agency option and the trader to trader (wholesale) option are all available to reduce VAT due on passenger transport where tours are enjoyed in the EU, although last year the European Commission tried to introduce changes to eliminate these arrangements which otherwise reduce the amount of VAT due on margin scheme supplies enjoyed in the EU.

Proposed changes

Changes were originally due to be implemented on 1 January 2005 although these have since been withdrawn due to a lack of agreement between the Member States. In certain circumstances opting out of the TOMS altogether in the UK can be agreed with Customs where supplies are made to business customers for their own consumption which can then allow for such customers to recover VAT incurred as input tax. Alternatively, supplies to business customers which are for subsequent resale do not fall under the TOMS although these can be agreed with Customs to be treated as margin scheme supplies. Any exclusions from using the TOMS are still potentially under threat by future action in Brussels.

On 1 May 2004 the EU Accession will be increasing from 15 to 25 member states in which case tours to Poland, Czech Republic, Slovakia, Estonia, Latvia, Lithuania, Hungary, Slovenia, Cyprus and Malta will, from that date, be subject to VAT on the margin, whereas until then the margin is zero-rated and therefore free of any VAT liability. Tour operators to these destinations should have already considered any VAT costing implications when pricing their holidays for later this year, whether this may be reflected in an increased brochure price or not. There will not, however, be any increase in recoverable input tax for businesses which supply tours under the TOMS as one of the consequences of accounting for any VAT due under these arrangements is that there is no ability to recover any UK or EU VAT as input tax on margin scheme supplies, other than on indirect costs such as overheads and in-house supplies.

Commission

Commission paid to travel agents is an example of an indirect cost upon which any VAT incurred can be recovered as input tax, although it cannot then be included as a direct cost of making and therefore reducing the margin made on any TOMS supplies with a standard rated liability.

Self-billing is frequently used within the travel industry by tour operators to pay commission and VAT due thereon to travel agents, although it is necessary to comply with certain requirements when adopting and applying VAT on self-billing arrangements.

Last year I worked with a tour operator and recovered a very significant amount of VAT which had not previously been reclaimed as input tax on commission paid to travel agents using an unapproved self-billing arrangement. Customs were involved and they proved most cooperative in resolving the situation.

I am also advising a tour operator on options to mitigate VAT due on passenger transport when their liability changes from zero to standard rated when its principal holiday destination joins the EU later this year. Without any action being taken the company's VAT liability will suddenly increase by hundreds of thousands of pounds. In a market where there is over supply and securing holiday bookings is price sensitive, it is not always a realistic option to simply increase brochure prices, but instead use can be made of any legitimate means available to reduce VAT due.

So, watch out for any unexpected encounters of the TOMS kind, as it may otherwise catch you out and find you unprepared.

We are grateful to Malcolm Balderstone, of MacIntyre Hudson for contributing this article.

State Aid and Low Cost Airlines - the impact of the Commission's decision in the Ryanair/Charleroi case

Following a complaint originally made in January 2002, the Commission recently issued its high profile decision that the package of benefits granted to Ryanair by Charleroi Airport contained elements of unlawful state aid and that some of these benefits would have to be repaid. This article comments on the implications of the Commission's decision.

Under EC law any aid granted by or through state resources which affects competition in the common market is unlawful (subject to various exceptions). In determining whether a state aid is unlawful, the Commission applies a "market investor" test by asking whether a private investor would have granted the same aid in similar circumstances. Where the aid cannot be economically justified it will normally be unlawful and will need to be repaid by the recipient.

Ryanair's response to the Commission's decision has been that the decision will severely prejudice all budget airlines, who have sought to do deals with smaller airports as a means of reducing costs and facilitating lower fares. Indirectly these deals arguably also promote economic progress in terms of employment and infrastructure investments, by bringing passengers to lesser known airports and regions of the destination country.

Significantly, the Commission's decision goes further than merely addressing the specific arrangements made between Charleroi and Ryanair by noting in what circumstances such aid may or may not be acceptable. This guidance is highly relevant to all airlines seeking to make use of smaller European airports, as well as to the airport operators themselves:

- As a fundamental point, state aid issues only arise in the context of publicly owned airports. Private airports are therefore free to enter into loss leading deals if they so wish (so long as they do not enjoy a dominant market position).
- Aid may be acceptable where it is granted in order to facilitate the opening of new routes. In such circumstances the aid must be proportional to achieving that objective, it should be transparent and be available to all airlines, and it should be accompanied by a penalty mechanism to apply if the carrier fails to comply with its commitments.
- Aid packages should be limited in time - (five years in the case of European point to point routes) and correspond to a maximum of 50% of the net start up costs incurred. Aid should not be granted for new routes which simply replace pre-existing routes.
- Reduced airport charges are only acceptable if they are granted without discrimination to all carriers and they are limited time. (In the case of Charleroi they were granted exclusively to Ryanair for a period of 15 years).

- Reduced ground handling fees are only acceptable if an airport can show that losses on the service concerned are not offset by revenue from airport authority tasks or airport services (for which separation of accounts would be required).
- One-shot incentive payments for the opening of new routes are unacceptable unless they reflect the actual costs of setting up the new route. Flat rate payments are also unlikely to be acceptable.

In its decision, the Commission applauded the growth of the budget airline sector and the increase in competition that it has created in Europe. That said, EC competition law is intended to create a level playing field in which airports seeking to attract investment and growth must do so in a non-discriminatory and transparent fashion. The decision may result in Ryanair's similar deals elsewhere in Europe being challenged - along with those of its rivals.

Since the responsibility for complying with state aid rules sits with the national and regional governments, any airline entering into a deal with a publicly owned airport is now likely to wish to review carefully in the light of EC law the terms it is being offered, and, if appropriate to ask the government authorities concerned to obtain specific approval from the European Commission.

Ryanair is expected to appeal the Commission's decision and in the meantime is understood to be putting pressure on Charleroi to absorb the extra costs Ryanair is being asked to accept. Not surprisingly, the response to date has been to reject such pressure. Charleroi expects to have to increase the landing charges from c. EUR 5 to EUR 9 in order to respect the principles of the Commission's decision. If the airport charges are increased and/or Ryanair loses or withdraws its appeal, then it is likely that Ryanair will choose to cease to operate the Stansted - Charleroi service. This would follow its decision last year to cease flights to Strasbourg and instead to use Baden-Baden airport (in that case the tariffs offered to Ryanair at Strasbourg airport were found to be contrary to French public law).

If it remains unchallenged, the Commission's decision is unlikely to have any widespread impact on other low cost airlines or on air fares. Generally, however, it may mean that the growth in the number of low cost destinations will slow down as small public airports feel unable to offer the "no cost" or "nearly no cost" packages that have incentivised the budget airlines to open up new routes.

There may well be a particular impact on routes to the ten accession countries joining the EU on 1 May - these countries will be very keen to attract airlines to their under-used airports and may well have been tempted to offer subsidised deals - which will now be prohibited under the EC state aid laws. Finally, certain routes, such as Easyjet's services to Berlin Schonefeld, Toulouse and Marseille and Deutsche Lufthansa's operations in Leipzig and Munich are amongst those routes understood to be open to challenge on state aid grounds, and so fares on these routes could ultimately rise. (Any airline can make a legitimate complaint to the European Commission if it considers that a competitor is benefiting from state aid.)

An appeal by Ryanair to the European Court of Justice is likely to take at least a year to proceed to judgment and until then the Commission's decision stands as the authoritative statement of EC law on this issue. Although Stansted-Charleroi is only one out of Ryanair's total 146 routes, the notable immediate impact of this case was a dramatic fall in Ryanair's share price. Other airlines subject to similar decisions could suffer similar financial consequences. We will be reporting on any developments in this case. If you have any queries please contact neil.baylis@ngj.co.uk

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