
Helping consumers to get better deals in communications markets: mobile handsets

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STATEMENT AND CONSULTATION:

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1. Overview

Ofcom wants customers to be able to shop around with confidence, so they can make informed choices and get a fair deal. We have been concerned that many mobile phone customers, who pay for their mobile handset and airtime together in a bundled contract, continue to pay the same price after the end of their minimum contract period when they could save money on a SIM-only deal. This document sets out our analysis, decisions and proposals to help ensure customers are treated fairly.

What we have found

We have examined the mobile market in significant detail. We have analysed millions of tariffs to build an accurate picture of actual prices paid. We have focused on mobile customers who are ‘out-of-contract’ (i.e. beyond their minimum contract period) for deals that include a handset. This is the first time this issue has been examined in-depth in this way.

Most out-of-contract customers on these ‘bundled’ contracts are overpaying, although by less than previously estimated. Two million bundled customers are out-of-contract. Of those, around 1.4 million would save money if they switched to a cheaper SIM-only deal. Our detailed analysis shows these customers are collectively overpaying around £182m a year – less than our initial estimate of £330m.

Customers are increasingly choosing alternative deals. More customers are moving to options such as SIM-only deals or ‘split’ contracts, where there are separate contracts for the handset and airtime. This means that the £182m figure will continue to decline. Nonetheless, we expect bundled contracts will remain available, as many customers value them as an affordable way of acquiring a handset. And we remain concerned that too many customers are not getting a fair deal.

Some out-of-contract customers are getting better deals. More than a quarter (around 600k) of out-of-contract bundled customers would pay *more* if they switched to an equivalent SIM-only deal. These customers would pay an extra £39m a year if they were forced to switch. We have also found that there are significant differences between providers.

New commitments

As a result of Ofcom’s review, mobile companies have made commitments to reduce bills for out-of-contract customers. Specifically:

- **Virgin Mobile** will move its out-of-contract customers to the equivalent 30-day SIM-only deal;
- **EE, Tesco and Vodafone** will reduce the monthly price paid by out-of-contract customers. The level of discount will vary between each provider, and we expect it to take account of the level of savings available to each of their customers if they switched to a comparable SIM-only deal.
- **O2 (for its direct customers)** will reduce the monthly price of its out-of-contract customers to the equivalent 30-day airtime-only deal. O2 has not committed to provide a discount to customers it acquires through indirect channels such as Carphone Warehouse, which are the vast majority. But it has committed to enter into discussions with these indirect channels.

These discounts will come into effect by February 2020. Together, we expect they will help tackle the harm for nearly 80% of out-of-contract customers that are overpaying.

However, **Three** has decided *not* to apply any discount to its affected customers. We are disappointed that, as a result, these customers will continue to overpay and will not receive similar protections if they decide to stay on their current deal.

Our decision and next steps

New European laws provide a package of rules to protect customers, but they fall short of giving us the powers to require providers to move customers to fairer default tariffs: After we consulted last year on requiring providers to move customers onto default tariffs, a new EU framework for telecoms was passed in December 2018. It sets out a package of rules to protect people and gives us new powers – requiring people to be given information at the start and end of their contracts so they engage with the market and make informed choices, and helping them to switch providers – but they do not include powers to set default tariffs.

We are focused on protecting customers as quickly and effectively as possible within the constraints of our powers. The new EU framework has to be implemented by December 2020. Wherever possible, we are seeking to implement it early, to protect customers as quickly and effectively as we can.

The commitments from mobile operators will protect consumers. In light of the constraints on our powers, we have focussed on securing commitments from the mobile operators to address the harm we have identified. These will help to protect many customers quickly without removing incentives for people to shop around and find the best deal. They will sit alongside the direct action we are taking within our powers.

The new rules we finalised in May will also help address the cost of confusion among mobile customers. Not all customers are being treated fairly. Our analysis shows that the costs of bundled contracts are not being made clear. So we have already set new rules to help people. We recently announced that mobile phone customers must be told when their contract is coming to an end, *and* shown the best deals available, including SIM-only deals. We are bringing these requirements into force nine months early, from February next year.

We will also give people extra help to make the right choices. The EU Framework also requires customers to be told – before they sign up to a bundled mobile contract – the price they could buy the handset and airtime separately, where that’s possible. We will shortly be setting out how we plan to introduce this for UK customers, as part of a broader consultation on implementing the EU framework.

We are now proposing an additional rule to tackle the issue of some customers being tied into long split contracts. Some split contracts are linked in a way which we think could deter customers from switching – for example, customers may have a 12-month airtime contract but linked to a longer handset contract of up to 36 months. As these contracts are becoming more popular, we want to ensure they operate in customers’ best interests. Our new rule would apply a 24-month limit to linked split contracts. We consult on this rule in this document and plan to bring it into force as soon as we can before December 2020 too.

Background

- 1.1 Ensuring customers are treated fairly is a priority for Ofcom. We want customers to shop around with confidence, make informed choices, and get a fair deal.
- 1.2 In the mobile sector, customers that choose a pay-monthly contract (rather than pay-as-you-go) have a number of different options for how they buy their mobile handset with their airtime, including bundled contracts,¹ split contracts² and SIM-only options.
- 1.3 While this variety offers a lot of choice for customers, and there are lots of good deals on offer, we are concerned that not all customers are being treated fairly.
- 1.4 In particular, we are concerned that some customers on bundled contracts continue to pay the same price if they do not take action at the end of their minimum contract period. These customers may be overpaying. Part of their original price may have been designed to recover the value of the handset they were given. They might be able to pay less for the same, or better, airtime allowances on a SIM-only contract and continue using their existing handset. This raises concerns about fairness, especially where people are not able to make informed choices, or their behaviour is being exploited.
- 1.5 In addition, when customers sign up to a bundled contract, it is not clear to them how much of the price they pay is, effectively, for the different elements of the bundle. As a result, customers may not know what they are buying, may not compare it fully with alternatives, and may not assess what represents the best option for their needs.
- 1.6 We also have concerns about some split contracts. Many require that customers who want to switch airtime provider must immediately pay off any remaining charges on their handset contract, rather than paying it off over time as originally agreed, even if they are out-of-contract on their airtime. We call these 'linked split contracts' and we think their terms are liable to deter customers from switching.
- 1.7 In September 2018, we set out our concerns about bundled mobile contracts and we identified two potential solutions to address them:
 - i) achieving greater transparency in the pricing information customers are given; and
 - ii) the introduction of fairer default tariffs that would apply at the end of the minimum contract period.
- 1.8 We received a wide range of responses to our September consultation and, in general, most respondents agreed with our concerns, but had mixed views on our proposed solutions.
- 1.9 There was broad support for increased transparency, and some respondents supported default tariffs. Mobile phone providers raised concerns about the effect these could have on customer engagement and competition. In considering our next steps, we have taken

¹ A single contract where the customer receives a handset and airtime and pays one monthly price.

² Where the customer signs up to two contracts at the same time, one for the airtime and one for the mobile handset, and where the monthly cost to the customer is separated into a price for each of the handset and airtime.

account of these comments, as well as new data we have gathered and broader developments in the market.

- 1.10 We have also taken account of the new European Electronic Communications Code ('EECC'), which became part of EU law in December 2018. It reflects similar concerns to ours and contains provisions to address them, but it also includes some limits on our powers to act.

We have updated our analysis

- 1.11 We have gathered data on all out-of-contract bundle customers from mobile providers and conducted consumer research. Unlike previous work by us and others, our updated analysis is based on the actual monthly charges and airtime allowances for customers, using provider billing data for out-of-contract bundle customers.
- 1.12 The evidence we have gathered reveals a complex picture. Some customers are overpaying, albeit by less than previously estimated, while some customers are actually better off staying on their current deals.
- 1.13 Our analysis shows that around two million customers are 'out-of-contract' (beyond their minimum contract period). This represents 11% of all customers on bundled contracts, and less than 5% of all pay-monthly customers. While most of them (1.4 million customers) are overpaying, not all of them are. Also, while many customers are out-of-contract for only a few months, there are some who have been out-of-contract for much longer.
- 1.14 These 1.4 million customers are overpaying, on average, just under £11 per month more than if they switched to a comparable SIM-only deal. This amounts to a total figure of around £182m a year across all these customers.
- 1.15 But these averages hide considerable differences between customers. More than a quarter (27%) of out-of-contract customers would be financially better off staying on their current deals rather than switching to SIM-only. These customers would pay an extra £6 a month – or £39m over a year – if they were forced to switch.³ There are also big differences between providers. While Three's out-of-contract customers that are overpaying are doing so by significantly more than the average, Tesco customers are, on average, better off on their current deals.⁴
- 1.16 The mobile sector is also changing rapidly, which means that any harm is likely to decrease over time. Bundled contracts are becoming less popular, and other ways of paying for handsets are becoming more attractive to customers. Bundled contracts now account for less than half of the pay-monthly market, compared to 74% in 2014. At the same time, take-up of SIM-only contracts has more than doubled – a trend we expect to continue as customers increasingly buy their handsets separately or keep their existing handsets for

³ That is, moved onto the comparable 30-day SIM-only product with their current provider.

⁴ Based on pricing data as of 1 November 2018.

- longer. Split contracts also already make up 15% of the pay-monthly market, and we expect this to increase significantly as more mobile providers plan to introduce them.
- 1.17 Despite these trends, we expect that bundled contracts will continue to be available. They offer a more affordable way of acquiring a handset. Many customers value them because they may not want or be able to pay upfront for a handset or get a separate contract for one. They can also often represent a better deal for customers than other alternatives.
- 1.18 We have also carried out consumer research to understand the reasons why people stay out-of-contract. Three in five say they are happy with their current handset and nearly a third (31%) say they are happy with their current price. However, this may be partly driven by low awareness of SIM-only options. For example, we found that less than a fifth – only 18% – of out-of-contract bundled customers knew they could switch to a 30-day rolling SIM-only contract with their existing provider. That confusion could be costing them money.
- 1.19 Our analysis did not find that vulnerable customers are disproportionately affected. There was some evidence that older customers were more likely to be out-of-contract for longer. But the amount of overpayment for these customers was smaller than for other groups.

The new European Electronic Communications Code

- 1.20 The EECC is the EU framework from which our powers are drawn, and was passed into EU law in December 2018. It sets out a precise package of rules and powers that help us protect customers. It applies a principle of ‘full harmonisation’ in these areas which means regulators like Ofcom must apply the rules it sets out exactly, and cannot impose stricter (or lesser) ones. It stops short of giving us the power to impose default tariffs. Within these constraints, we are doing as much as we can to look after people’s interests.
- 1.21 One thing the EECC requires is that customers are given information at the start and end of their contracts to prompt them to engage with the market and to enable them to make informed choices. In May, we implemented the end-of-contract measures contained in the EECC (the ‘ECN measures’).⁵ This means that, from February 2020, providers will be required to send an end-of-contract notification which will tell customers about any changes to their price and services at the end of their contract, and about their best tariffs available (including at least one SIM-only deal for bundled mobile customers).
- 1.22 The EECC also requires that customers are told, before signing up to a bundled mobile contract, the price at which they could buy the handset and airtime elements separately from that provider (where the provider sells them separately). This means that, before they make a decision to buy a contract, people will be given information about the cost of the airtime without the handset (i.e. the closest equivalent SIM-only deal), and, where the provider sells handsets directly, the total cost of the handset.

⁵ Ofcom, 2019. [Helping consumers get better deals - end-of-contract notifications and annual best tariff information](#) (‘ECN statement’).

1.23 The importance of switching is recognised in the EECC too. It retains the 24-month limit on contracts for airtime, but also extends that limit to bundled contracts, including linked split contracts (as described above). Customers may not be tied into such contracts for longer than 24 months, so their ability to switch is protected.

Our decision and next steps

1.24 Our updated analysis shows that, even though the picture is mixed, and the extent of overpayment and consumer harm is smaller than previously estimated (and declining), a significant number of customers are overpaying.

1.25 The lack of transparency to customers buying bundled contracts about the price they pay for the different elements of the bundle, including the handset, is also an issue we believe needs to be tackled. It makes it difficult for customers to know what they are buying and whether it is the best option for them, and it adds to the cost of confusion in this market.

1.26 We recognise that split contracts offer an option to customers where these concerns do not arise. The pricing is more transparent, and at the end of their handset contract the customer's payment for their handset stops (because they have paid for it in full). However, we are concerned that, where these contracts are linked, they could deter switching, particularly where the airtime is linked to a longer handset contract. Handset contracts are often up to 36 months long.

1.27 Noting the constraints of the powers in the EECC, we have focused on doing as much as we can, as quickly and effectively as possible, to protect customers now.

1.28 EE, Vodafone, O2, Tesco Mobile and Virgin Mobile have committed to apply a discount to the monthly price paid by bundled customers that are (or will become) out-of-contract. As set out in the table below, the level of the discount varies between each provider, taking account of the level of the savings available to each of their customers if they switched to a comparable SIM-only deal. These discounts will come into effect by February 2020⁶ and will help tackle the harm we have identified for nearly 80% of those out-of-contract customers that are overpaying.

	Commitment
Virgin Mobile and O2 ⁷ (direct only)	<ul style="list-style-type: none"> Will move, or reduce the monthly price of, out-of-contract customers to an equivalent 30-day SIM-only or airtime-only deal.
Tesco Mobile	<ul style="list-style-type: none"> Will adjust the monthly charge to ensure out-of-contract customers are on the best available airtime tariff.
EE and Vodafone	<ul style="list-style-type: none"> Will apply a discount to the monthly charge of all customers out-of-contract for more than three months. They will confirm the level of this discount by December 2019.

⁶ Virgin Mobile's commitment will apply during Q1 2020, alongside the implementation of our ECN measures.

⁷ Most of O2's direct customer base take its Refresh or Custom tariffs which are split contracts rather than bundled contracts. As explained in Section 3 customers on split contracts are not at risk of overpayment when they go out-of-contract.

- 1.29 We are disappointed that Three has refused to apply any discount to its affected customers. This means these customers will continue to overpay and will not receive the same protections offered by the other providers. In addition, customers who purchase O2 tariffs through third party retailers such as Carphone Warehouse will not, for the time being, benefit from any discount to their tariffs once they are out-of-contract. O2 has committed to enter into discussions with these third-party retailers to find a solution for these customers.
- 1.30 We are also disappointed that Vodafone and EE have not been able to confirm the amount of discount they will apply to their out-of-contract customers at this stage. We will continue discussions with them to ensure that the discount takes into account the level of savings available if customers switched to a comparable SIM-only tariff.
- 1.31 If we had the powers to do so, we would have considered (and carried out an assessment of) a targeted pricing rule to ensure all out-of-contract customers were protected from overpaying. However, the voluntary discounts are a pragmatic, and quick, way to protect most customers from paying more than they need to once they are out-of-contract, while maintaining an incentive for customers to shop around and find the best deal.
- 1.32 Alongside these discounts, we will also be implementing a new measure to address our concerns about the transparency of bundled contracts. The EECC transparency provisions offer a clear route to achieve this. We plan to consult on a General Condition, and accompanying guidance, implementing these provisions.
- 1.33 These provisions will need to be applied not just to mobile services, but also across broadband, home phone and pay-TV services, as part of a broader set of information requirements. Some elements of the requirements will not be confirmed by the European Commission until next year.
- 1.34 We will therefore set out our proposed new rules to implement these transparency requirements, as part of a broader consultation we have planned on all the relevant EECC measures, later this year. We expect to make a final decision on these in spring 2020, and the measures to come into force by the EECC deadline of December 2020.
- 1.35 Alongside our ECN measures, this additional transparency at the point of sale will enable people to make well-informed choices – at the start and end of their contracts – about the way they pay for their handsets and airtime.
- 1.36 For split contracts, the EECC’s provisions on the duration of bundled contracts provide a solution that will address the majority of our concerns. They will prevent providers from linking split contracts where the handset contract is over 24 months. Customers will effectively not be tied to their airtime provider for excessive periods.
- 1.37 Because the use of split contracts is growing, and more providers are planning to offer them, we propose that these provisions should be implemented as soon as possible to protect people. We are therefore consulting in this document on an amendment to our rules to introduce the 24-month limit. Stakeholders have until **16 September 2019** to comment on this amended rule.

- 1.38 We are proposing that this rule could be implemented within three months of our final statement, which we plan to publish before the end of the year.

Ongoing review

- 1.39 We plan to monitor this market closely to see how it develops, in particular the likely increase in the use of split contracts and declining use of bundles, as well as the effect of the relevant providers' price reductions and our ECN measures.
- 1.40 If we continue to have concerns that a significant number of customers are not being treated fairly, we will step in again. That may require new legal powers.

2. Background and introduction

- 2.1 We want customers to get a fair deal for their communication services. Ensuring that communications providers treat them fairly and put customers interests' at the heart of their businesses is a priority for our work this year.⁸
- 2.2 In the mobile market, there are range of different options for how customers can buy a handset alongside their airtime. This variety offers people a lot of choice, and there are good deals on offer, but we are concerned that the market is not working well for everyone.
- 2.3 In particular, we are concerned that customers on bundled handset and airtime deals who do not take action at the end of their minimum contract period are, in many cases, at risk of staying on a deal that leaves them financially worse off than a comparable SIM-only contract to which they are free to switch. We do not think consumers are being provided with sufficient information to make informed choices about the contracts they enter into and, for some customers, providers could exploit their lack of engagement. We are also concerned that split contracts are often constructed in a way that could tie customers into longer contracts than is appropriate and deter them from switching.
- 2.4 This document sets out our plans to tackle these concerns.

We consulted on our initial concerns in September 2018

- 2.5 Our September 2018 consultation⁹ set out a concern that, in the mobile sector, many customers on bundled handset and airtime contracts continue to pay the same price at the end of their minimum contract period, even if they have already effectively paid off their handset.¹⁰ We sought views on a range of potential solutions to ensure that consumers are sold mobile airtime services and handsets in a way that is fair. These included:
- achieving greater transparency in the pricing information customers are given; and
 - the introduction of fairer default tariffs that would apply at the end of the minimum contract period.
- 2.6 We also set out that, whilst we recognised the benefits of the increased flexibility and pricing transparency of split contracts, we were concerned that they could tie customers into excessively long contracts with providers (in some cases up to 36 months). We said that could act to inhibit switching and deny these customers the benefits of competition.

⁸ Ofcom, 2019. [Ofcom's Annual Plan 2019/20](#) ('Annual Plan 2019/20'). The Annual Plan 2019/20 sets out our planned timings for these projects.

⁹ Ofcom, 2018. [Helping consumers to get better deals in communications markets - mobile handsets](#) (the 'September 2018 consultation').

¹⁰ Ofcom, 2018, [Pricing trends for communications services in the UK](#). ('2018 Pricing Trend Report'). This was an issue we had previously highlighted in our 2018 Pricing Trends Report, and which was also raised with us by the CCP in early 2017 (as highlighted in its response to our September consultation).

2.7 We received a wide range of responses to the September 2018 consultation, including from providers, consumer bodies and advocacy groups, industry bodies and individual consumers. We have considered all these responses and have summarised and addressed the points made in the relevant sections of this document. Non-confidential versions of the responses are published on the Ofcom website.¹¹

Developments since September 2018

2.8 Since last September there have been some major developments in relation to our powers. In particular, the EU framework for regulating electronic communications, which our powers are derived from,¹² is changing. The new EECC,¹³ which sets out a revised framework, passed into EU law in December. Member States have until 21 December 2020 to implement it into their national law¹⁴ and we have a duty to secure its objectives by then and, until that time, not to do anything that would undermine their achievement.

2.9 The EECC is contained in a new EU Directive that replaces the four Directives that made up the previous EU framework. It contains a package of measures – new requirements on providers and new powers for regulators – to protect customers.

2.10 This package of measures reflects similar concerns to ours in relation to bundled contracts. They corroborate the views we set out in the September 2018 consultation and confirm the case for intervention. However, they fall short of giving us the power to control or cap prices by imposing the kind of default tariffs we proposed.

2.11 In particular, and as described more fully in Annex 6 to this document, the EECC requires that providers tell customers, before they enter into bundled contracts, the price at which they could buy the handset and airtime separately (where the provider sells them separately), as well as other relevant contract information.¹⁵ To help people switch when it's in their interests, minimum contract periods, including for bundles,¹⁶ must be limited to 24 months.¹⁷ When those periods end but the contract would roll-on,¹⁸ providers must

¹¹ See [stakeholder responses](#) to the September 2018 consultation.

¹² As explained in more detail in Annex 6, the EU framework imposes obligations on EU Member States and their regulatory authorities, like Ofcom. In the UK, the framework is implemented by the Communications Act 2003 (the 'Act') and regulatory conditions made by Ofcom (using powers given to us by the Act).

¹³ [Directive \(EU\) 2018/1972 of the European Parliament and of the Council of 11 December 2018 establishing the European Electronic Communications Code](#) ('EECC'), Articles 98 – 116.

¹⁴ The UK Government has stated that it is still minded to implement the substantive provisions of the EECC into domestic law, the uncertainty around the UK's future relationship with the EU notwithstanding. The measures we are consulting on are based on the assumption that, in the absence of a significant change in Government policy, the EECC will need to be adopted into the UK's regulatory system.

¹⁵ EECC, Article 102.

¹⁶ Which includes split contracts, where the contracts are closely related or linked. EECC, Article 107.

¹⁷ EECC, Article 105.

¹⁸ For example, by becoming a rolling monthly contract.

notify customers and give them advice about their best tariffs. Providers must also give customers best tariff advice at least annually.¹⁹

- 2.12 Most of the customer protection provisions in the EECC are subject to the principle of full harmonisation. This means that, in the areas they cover, Member States and regulatory authorities, like Ofcom, must all provide the same level of protection for users. They may not go beyond (nor fall short of) that.²⁰ The EECC also contains strict controls on Member States, and their regulators, powers to control or cap prices. They do not extend to imposing default tariffs for bundled contracts.
- 2.13 Because the package of measures in the EECC reflect concerns that we share, we are not waiting until December 2020 to implement them. The measures are designed to ensure that customers, especially consumers, can engage with the market, take advantage of competition between providers and make informed choices about the best deals for them. We are doing everything we can, within the scope of the powers we are given, to achieve these things as quickly and effectively as possible.
- 2.14 Most notably, we have an ongoing Fairness for Customers programme and we have already imposed the new requirements about the information customers must be given when their contracts end (see below). This document sets out the further steps we are taking and proposing to take.

This document is part of our work to ensure fairness for customers

- 2.15 The September 2018 consultation, and the decisions and proposals set out in this document, are part of our ongoing Fairness for Customers programme. We set out our commitment to this work in our Annual Plan 2019/20.²¹
- 2.16 This programme involves a number of different pieces of work – and we recently published an update setting out the progress we have made.²² We have summarised some of the areas of work most relevant to this document below.

Ofcom's Fairness for Customers programme

- 2.17 In June 2019, we launched our Fairness for Customers commitments.²³ These commitments are designed to embed a culture of fairness within the industry. They aim to help ensure customers are always treated fairly by their provider – whether they are signing up to a new deal, trying to fix a problem or switching to a new company.
- 2.18 All of the UK's biggest providers have signed-up to the Fairness for Customers commitments, covering the vast majority of broadband, mobile and home phone

¹⁹ EECC, Article 105. The decisions set out in our ECN statement implement the Article 105 EECC requirements on end of contract notifications and best tariff advice.

²⁰ EECC, Article 101.

²¹ Annual Plan 2019/20.

²² Ofcom, 2019. [Fairness for Customers – progress update](#).

²³ See [Ofcom's Fairness for Customers commitments](#) for a complete list of the commitments.

customers. Many of these commitments are already underpinned by existing consumer law and Ofcom regulations – in these cases the focus is on proactively innovating and going beyond minimum standards. We will be monitoring companies' practices closely and will step in where we see firms falling short. We also plan to publish a progress report next year, reviewing whether and how companies are delivering what they have promised.

- 2.19 We also recently published a draft Fairness Framework.²⁴ In that, we explain the kinds of concerns that might prompt intervention and set out our initial thinking on the types of questions and factors we would consider in assessing whether customers are being treated fairly, taking account of the complexities involved. We are seeking stakeholder comments on our proposed approach by 12 August 2019 and we intend to publish a final Fairness Framework by March 2020.
- 2.20 The approach we are taking in this document is consistent with that we put forward in the draft Fairness Framework.

End-of-contract notifications and annual best tariff advice

- 2.21 One important point at which customers need to be able to make informed choices in their best interests is when their minimum contract period is coming to an end. To enable them to do so, we published a statement on end-of-contract notifications and annual best tariff advice in May 2019 (the 'ECN statement').
- 2.22 The ECN statement reflects our belief in customers getting a fair deal. We want them to be able to take advantage of the wide choice of communication services available, engaging confidently with the market and getting what is best for their needs.
- 2.23 To ensure they know when to shop around, we have imposed new requirements on communications providers to send end-of-contract notifications to their customers. These notifications will tell customers about any changes to their price and services at the end of their minimum contract periods, and about the best tariffs available from their provider, as well as discounts available to new customers (so that customers are made aware of the benefits of switching). The notification will also have to include at least one SIM-only contract for customers on bundled mobile handset and airtime contracts.
- 2.24 In addition, all customers who remain out-of-contract will be given information about their contract and their provider's best tariffs at least annually. This means they will be told about the best tariffs for the services they buy and can see if they are on the best deal.
- 2.25 We want these requirements to apply and protect people as quickly as possible, so they will come into effect from 15 February 2020, well before the EECC's implementation deadline. We plan to carry out a programme of work to monitor the impact of the notifications, including collecting information from providers and conducting consumer research.

²⁴ Ofcom, 2019. [*Making communications markets work well for customers – a framework for assessing fairness.*](#)

We have gathered new evidence and updated our analysis on mobile

- 2.26 Since our September 2018 consultation we have been carrying out a range of detailed evidence gathering in relation to mobile deals. In particular, we have:
- i) gathered and analysed data from the providers. This data included customer-level billing data to identify how many customers are out-of-contract,²⁵ how long they stay out-of-contract and how much they are paying. We also gathered data on current SIM-only tariffs, as well as historical data on the number of in-contract and out-of-contract customers on different contracts. Annex 5 sets out the details of this data, and our analysis, in more detail;
 - ii) conducted consumer research to better understand the reasons why customers stay out-of-contract ('2019 consumer research')²⁶; and
 - iii) engaged with providers to understand their ongoing plans for different mobile contract models and to identify options to address our concerns.
- 2.27 Section 3 of this document summarises the results of our updated analysis, taking account of this evidence.

We have revised our view on next steps

- 2.28 In addition to our updated analysis of our concerns, we have set out in this document our decision on the options we presented in the September 2018 consultation. We explain our revised approach to address the issues we have identified, taking account of the EECC (and, in particular, that the powers it contains do not extend to requiring providers to switch bundled contract customers to default tariffs when their minimum contract periods end).
- 2.29 In relation to bundled contracts, we set out the package of measures we are pursuing to address our concerns in the absence of the power to impose default tariffs. This includes voluntary commitments from most providers to apply discounts, or migrate customers to SIM-only tariffs, when they go beyond their minimum contract period. It also includes the transparency measures from the EECC, alongside the measures we have already confirmed in our ECN statement. We will set out our proposals to implement these additional transparency measures so that they apply to all electronic communications services, not just mobile, alongside the rest of the EECC later this year.
- 2.30 On split contracts, we are proposing to implement the relevant measures of the EECC, as quickly as possible, via modifications to the General Conditions. We set out our proposals for these in Section 5 and the notification of the modified Condition is in Annex 7.

²⁵ Throughout this document where we refer to out-of-contract customers we mean those customers who are outside their minimum contract period.

²⁶ [2019 consumer research](#). Omnibus research among mobile users covering knowledge of contract status, awareness of what happened / would happen to monthly price paid at the end of the minimum contract period, awareness of SIM-only deals and reasons for staying out of contract.

UK legal framework

- 2.31 The powers and duties we have to implement the EECC and to take the steps set out in this document are contained in the Communications Act 2003 (the 'Act'). These are also described in more detail in Annex 6.
- 2.32 Section 3(1) of the Act says our principal duty, in carrying out our functions, is:
- a) to further the interests of citizens in relation to communication matters; and
 - b) to further the interests of consumers in relevant markets, where appropriate by promoting competition.²⁷
- 2.33 Section 3 also sets out a number of further matters to which we must have regard when performing our main duty. Amongst other things, these include the interests of consumers in respect of choice, price, quality of service and value for money.
- 2.34 Section 4 of the Act requires that, when exercising certain functions,²⁸ we must act in accordance with the six EU requirements²⁹ described there. These include requirements:
- a) to promote competition in the provision of electronic communications services;
 - b) to secure that our activities contribute to the development of the European internal market; and
 - c) to promote the interests of all persons who are citizens of the EU.³⁰
- 2.35 Section 45 gives us powers we can exercise in implementing the EU framework. It says we can impose regulatory conditions on providers. These include general conditions which contain provisions authorised or required by section 51 of the Act.
- 2.36 Section 51, in turn, enables us to make conditions making such provision as we consider appropriate for the purpose of protecting the interests of end-users of public electronic communications services. Those include conditions which require providers to give customers specified information and conditions imposing limits on the duration of contracts. Under section 47(2), any condition we set (or modify) must be objectively justifiable,³¹ not unduly discriminatory, proportionate and transparent.

Impact assessments

- 2.37 Section 7 of the Act imposes requirements on us to assess the impact of our regulatory proposals. The analysis presented in Sections 3 and 5 represents an impact assessment for

²⁷ Consumer is defined in section 405(5) of the Act and includes people acting in their personal capacity or for the purposes of, or in connection with, a business.

²⁸ Including those we propose to exercise in this document.

²⁹ Referred to in that section of the Act as 'Community Requirements.'

³⁰ We have also had regard to the objectives in Article 3(2) of the EECC.

³¹ Section 47(3) states that the setting of a general condition is not subject to the test of being objectively justifiable, although we are likely to consider this in any event when assessing whether the condition is proportionate.

this purpose with respect to our proposed modification of the General Conditions.³² As we explain more fully in those parts of this document, we have assessed the impact of our proposals in a manner that we consider appropriate given that they would implement mandatory provisions of the EECC.

- 2.38 We are also required to assess the potential impact of all our functions, policies, projects and practices on the equality of individuals to whom they will apply. Equality impact assessments assist us in making sure we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identify.
- 2.39 We have therefore given careful consideration to whether or not our proposed general condition will have a particular impact in relation to the following protected characteristics: age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex and sexual orientation. We are satisfied that the proposal is not detrimental to any group defined by these protected characteristics.

This document

- 2.40 The rest of this document is set out as follows:
- Section 3 sets out an overview of developments in the mobile market and a summary of our concerns.
 - Section 4 sets out how we are addressing our concerns about bundled contracts, including details of discounts which providers have committed to for out-of-contract bundled customers and a summary of the transparency proposals which we intend to consult on later this year.
 - Section 5 sets out our proposals for amendments to the General Conditions to address our concerns in relation to 'linked' split contracts.
 - Section 6 sets out our conclusions and next steps.
- 2.41 The Annexes to the document are:
- Annexes A1 to A4: Consultation Annexes, including consultation principles, questions and response coversheet.
 - Annex A5: Data analysis.
 - Annex A6: Legal framework and EECC provisions.
 - Annex A7: Notification of proposed modifications to the General Conditions.
 - Annex A8: Glossary

³² We will assess the impact of further proposals to amend the General Conditions, to implement other provisions of the EECC, when we make them later this year.

3. Changes in the mobile market and why we are concerned

- 3.1 Since our September 2018 consultation we have gathered a range of evidence to update our understanding of the customer experience of pay-monthly mobile contracts, and in particular the extent to which customers may be overpaying. We set out our findings³³ in this Section and the concerns we have identified.
- 3.2 We also set out an overview of the pay-monthly market and recent trends, which provides relevant context for our concerns. We identify how, more recently, the way that consumers buy mobile services has been changing. Pay-monthly customers increasingly have different options – for example SIM-only contracts are becoming more popular as customers retain their handsets for longer or choose contracts which allow them to separate the cost of the handset from the airtime and pay for the handset over a longer period.
- 3.3 Our analysis shows that this is a complex issue, with the extent of overpayment and consumer harm smaller than previously estimated (and declining).³⁴ Nevertheless, we are concerned that there remain a significant number of customers (1.4m) who are overpaying (by £182m a year). We are also concerned about the lack of transparency to customers buying bundled contracts about the price they pay (or could pay) for the different elements of the bundle, including the handset. It is difficult for consumers to evaluate what they are buying and whether this is the best option for them, and this is adding to the cost of confusion in this market.
- 3.4 We also remain concerned that some split contracts are linked by terms which mean that customers cannot switch their airtime provider without paying off the balance of their handset agreement. We think this is likely to deter switching. This a growing concern given that providers are increasingly moving to offer split contracts, and more consumers are signing-up to them.

Market context

- 3.5 The mobile sector is fast-moving, with pricing and packages changing frequently in response to technological and commercial developments in the market. We need to take account of this context as part of our assessment of whether there are concerns that we need to address, and what the appropriate intervention would be. We summarise some of the key relevant developments below.

³³ Annex 5 sets out our data analysis, findings and methodology in detail.

³⁴ Paragraphs 3.43 and A5.53-55 of Annex 5 set out the basis on which we have calculated the overpayment and what we mean by the term. Broadly speaking, by 'overpayment' we mean the difference between the customer's current monthly recurring charge and a comparable SIM-only deal (for minutes, texts and data) with the same provider.

There is a range of contract options for pay-monthly mobile customers

- 3.6 Pay-monthly contracts make up 70% of the UK's 79 million mobile subscriptions.³⁵ Within this market, there are primarily three types of contract options available to customers:
- a) **'bundled contracts'** - under which the customer receives a handset and airtime and pays a single monthly price which includes both the handset and the cost of the airtime, and also can include other additional services such as content (e.g. music or TV subscriptions, insurance or anti-virus software protection services);
 - b) **'split contracts'** - under which customers purchase both an airtime tariff (plus any additional services) and a mobile handset at the same time under two contracts, and where the monthly cost to the customer is separated into prices for the airtime and the handset;³⁶
 - c) **SIM-only contracts** – under which the monthly cost to the customer includes the airtime (and any additional services) but the provider does not supply the customer with a handset under the contract (instead the customer either purchases a handset separately or uses a handset they already own).
- 3.7 Within each of these models, customers have different contract length options. Any contract which includes airtime can vary from a 30-day rolling contract up to a 24-month minimum contract period.³⁷ Handset loan agreements sold as part of the split contract model do not have a prescribed maximum length, although currently the longest offered in the market is 36 months.
- 3.8 As handsets have become increasingly expensive, minimum contract lengths have increased – 24-month contracts make up the largest portion (48%) of new pay-monthly subscriptions.³⁸ However, more recently there has been a significant growth in SIM-only contracts with a minimum contract period of 12 months.³⁹
- 3.9 If a customer decides to cancel their contract before the end of their minimum contract period they would usually be required to pay a charge (an early termination charge).⁴⁰ Beyond that point, the contract continues (usually as a 30-day rolling contract),⁴¹ and the customer continues to receive the service although they are free to switch to another deal

³⁵ Ofcom, 2019, [Communications Market Report](#) ('CMR 2019'). These are active mobile subscribers who use mobile services on mobile handsets (for example excluding data only subscriptions).

³⁶ The handset agreement is generally provided as a consumer credit loan under the Consumer Credit Act. Providers have to be registered with the Financial Conduct Authority to provide such loans.

³⁷ This is the maximum permitted length under General Condition C1.4.

³⁸ Ofcom, 2018, [Communications Market Report](#) ('CMR 2018'), p.58.

³⁹ In fact, almost all pay-monthly services with a minimum contract period of 12 months or less in Q4 2017 were SIM-only: CMR 2018, p.58. Providers only recently (this year) started offering SIM-only contracts of 24 months.

⁴⁰ Providers' early termination charges have to be based on the remaining amount of the customer's monthly charges, minus any costs they save (such as VAT). We currently have an [open enforcement programme](#) looking at early termination charges across the sectors.

⁴¹ Providers are prohibited from automatically renewing customers into another minimum contract period under General Condition C1.3.

without paying a charge. In this document, we refer to customers in these circumstances as 'out-of-contract.'⁴²

- 3.10 Under bundled contracts, providers usually advertise the handset as an inclusive, or 'free', part of the contract, in some cases alongside a partial one-off upfront payment. In practice, the provider is likely to have factored in the costs of the handset into the overall bundle price, although this may not always correspond with the minimum contract period. The handset becomes the customer's property at the point they enter into the contract, or shortly after.⁴³ Customers that cancel their airtime contract before the end of their minimum contract period can keep their handset, subject to paying the relevant early termination charge. If they remain a customer after their minimum contract period they usually continue to pay the same price, even if the provider has fully recovered the value of the handset.

Bundled contracts remain popular but take-up is decreasing as the market evolves

- 3.11 Almost 18m customers are currently on a bundled contract, which represents nearly half (46%) of all pay-monthly customers.
- 3.12 As shown in Figure 3.1 below, the take-up of bundled contracts has been decreasing as customers increasingly select other types of contracts, particularly SIM-only contracts. The latter now have an almost equivalent take-up to bundled contracts (38%, or 15m customers when considering both 30-day rolling and 12-month options).

⁴² These customers are beyond, or outside of, their minimum contract period, although they are still being provided with services.

⁴³ For example, under EE's terms of service, EE retains ownership of the handset for the first six months of the contract (Condition 10.1: [EE Pay Monthly Network Terms October 2018](#)).

Figure 3.1: Composition of pay-monthly contracts from January 2014 to January 2019⁴⁴



Source: Second s.135 data⁴⁵

3.13 This trend reflects that, as innovations in smartphones have slowed and handsets have become more expensive, consumers have started to keep their handsets longer. In 2017, the CEO of Dixons Carphone noted that customers were on average keeping their devices for 29 months (an increase of 4 to 5 months from previously).⁴⁶

3.14 Our 2019 consumer research also provides evidence of this trend, with customers on SIM-only contracts being more likely to have had their current handset for longer – 42% of customers on a 12-month SIM-only contract had their current handsets for two years or more, compared to 22% of customers on bundled contracts.⁴⁷

Split contracts are already popular, and are likely to grow

3.15 Split contracts now make up 15% of pay-monthly mobile customers (5.9 million people) up from 4% in 2014.⁴⁸ They are currently offered by O2, Virgin Mobile, Sky Mobile, Tesco Mobile and Giffgaff.

⁴⁴ Vodafone were unable to provide data for the whole period and are therefore only included from January 2017 onwards. Vodafone offers bundled contracts and no split contracts, and including Vodafone's data only from 2017 onwards explains why the share of bundled contracts does not fall from January 2016 to January 2017 (Refer to Figure A5.2).

⁴⁵ Specifically provider responses to the second mobile handsets s.135 information request. See Glossary.

⁴⁶ Reuters, 2017. [Dixons Carphone shares plunge 30 percent after handset sales falter](#).

⁴⁷ 2019 consumer research Q,1B, Table 2.

⁴⁸ See Figure 3.1.

- 3.16 O2 is the largest provider of split contracts. It has offered this model through its direct sales channels,⁴⁹ on its 'Refresh' tariff, since 2013. Until last year it offered handset agreements of up to 24 months, but from August 2018 it launched its new 'Custom' plans, which offer handset agreements of up to 36 months alongside a 30-day rolling airtime contract. Similarly, Tesco Mobile first started offering the split contract model in 2014, and has recently started offering handset agreements of up to 36 months as part of its Anytime Upgrade Flex contracts.⁵⁰
- 3.17 Sky Mobile and Virgin Mobile more recently introduced these contract models (in 2016 and 2017 respectively). Sky Mobile's 'Swap' tariff offers either a 30-month handset agreement with a 24-month airtime contract or a 12-month airtime contract with a 24-month handset agreement. Virgin Mobile's 'Freestyle' tariff offers either a 24 or 36-month handset agreement alongside a 30-day rolling airtime contract.
- 3.18 The recent move towards offering handset agreements of longer than 24 months has resulted from the increasing cost of some devices. Those commonly sold under split contracts, including the iPhone XR, the Samsung Galaxy S10 or the Google Pixel 3, typically cost between £750 and £900. Longer contracts allow customers to spread the cost and reduce the monthly amount they pay. Over a 36-month contract for a handset costing £800, a customer would typically pay just over £22 per month.
- 3.19 Other major providers are also now looking to offer split contracts to their customers. In particular, EE and Three have confirmed to us that they have plans to launch split contracts. Whilst the details of these plans are still being worked out, the confirmation from these providers of their plans means that we can expect to see a significant growth in split contracts over the next few years, and an associated decrease in the take-up of bundled contracts. For example, EE has confirmed that it intends to phase out its bundled contract model once it launches split contracts. Nevertheless, we expect that some providers will continue to offer bundled contracts, particularly given that many customers value the benefits they can offer, as discussed further at paragraph 3.39 below.
- 3.20 The split contracts currently used by O2, Sky Mobile and Tesco Mobile contain terms which require (or entitle the provider to require) that, if the consumer ends their airtime contract at any time, they must also pay off the remaining balance under their handset agreement as a lump-sum.⁵¹ We refer to these as 'linked' split contracts. Over 5 million customers are on this particular type of split contract.⁵²

⁴⁹ It continues to offer bundled contracts to customers that sign-up via an indirect channel, such as Carphone Warehouse.

⁵⁰ Tesco, 2018. [Tesco mobile launches lowest ever monthly prices with new anytime upgrade flex contracts.](#)

⁵¹ For example, page 6 of [Sky Mobile Customer contract](#) (from November 2018) states: "If you take Sky Mobile services and pay for any equipment with an equipment payment plan you must maintain an active data plan for the duration of your equipment payment plan. If you no longer have an active data plan but still owe us money under the equipment payment (for example, you end this contract, or we end it due to something you have done), we may ask you to repay the outstanding amount in full".

⁵² See Figure A5.1 in Annex 5.

- 3.21 The contracts offered by Virgin Mobile and Giffgaff, however, do not contain the same requirement. The customer is free to switch airtime provider but can carry on paying for their handset over the term of their original contract.

We have assessed the market and remain concerned about bundled contracts

We consulted on our initial concerns in September 2018

- 3.22 In September we set out our concern that, if customers on bundled contracts do not take action at the end of their minimum contract period, their contract rolls forward. By default they continue to pay a price which effectively includes the cost of the handset, which in many cases they will have already paid-off.
- 3.23 We also noted a concern about the transparency of these contracts, in particular that customers are not made aware of, and may not understand, how much they are paying for each element of the bundle (i.e. the handset and airtime). We said this makes it difficult for them to compare packages and consider whether separate contracts for the handset and airtime, or buying a handset outright and combining it with a SIM-only contract, or even retaining their current handset and taking out a SIM-only contract, might be better value or better meet their needs.
- 3.24 We referred to estimates, from our 2018 Pricing Trends report, that approximately 1.5 million people were out-of-contract on a bundled contract and therefore might be paying more than necessary. We said that, collectively, UK mobile customers could be overpaying by approximately £330m each year.⁵³
- 3.25 We also referred to evidence from our 2018 consumer research which found that a quarter of consumers on a bundled contract were unaware of the possibility of moving to a SIM-only contract at the end of their minimum contract period.⁵⁴ We noted that there might be other points during the lifetime of a contract when consumers need transparent information to make informed choices, too.

Many respondents agreed with our concerns, but providers said that there were additional complexities to consider

- 3.26 Many respondents, including Citizens Advice, Which? and Sky Mobile, agreed there was a concern about bundled customers overpaying. Citizens Advice said that these customers were being charged for a handset they had already paid off and referred to this as a “*mobile handset loyalty penalty*”. It estimated that four million people overpaid a total of £490m on their last mobile contract, and that over 65s were twice as likely to have paid a loyalty penalty for over 12 months.⁵⁵ Dixons Carphone, however, said that, rather than

⁵³ 2018 Pricing Trend Report. This figure was based on a monthly overpayment of £18.52.

⁵⁴ Ofcom, 2018. [Consumer engagement quantitative research](#), slide 29.

⁵⁵ Citizens Advice, 2018. [Reviewing bundled handsets](#).

- there being a specific overpayment concern, the key issue was of customers not engaging in the market at the end of their minimum contract period, with the result that these customers could find themselves on tariffs which were no longer fit for their needs.
- 3.27 Many of the providers said that this was a complex issue which needed more detailed analysis. BT noted that our figures on the extent of overpayment were estimates, rather than actual data from all providers, and its own data suggested the extent of overpayment was significantly lower. Three similarly noted that a number of its out-of-contract bundled customers were on plans that were at least as good value as current offers and said it was “*overly simplistic*” to assume that all out-of-contract customers could obtain better value by switching to a current deal. Vodafone submitted a report by Frontier Economics which made similar points (see Annex 5 for further details).
- 3.28 Virgin Mobile said there was a misconception about how bundled contract prices were set. It noted that Ofcom’s calculations appeared to assume there was a formula to ensure that the unit cost of each handset was recovered precisely over the minimum contract period, whereas in practice providers know that, on average, customers stay with them for longer than the minimum term. It said this meant providers might choose to risk recouping the value of the handset (and any other acquisition costs) over a period longer than the minimum term, thereby reducing the monthly charge offered to the customer over that initial term. BT also similarly emphasised that the monthly amount paid by the customer for bundled contracts reflects the overall service supplied, with the handset just one element of that.
- 3.29 The providers also emphasised that the mobile market was highly competitive and pointed to previous findings by Ofcom, the Competition and Markets Authority (‘CMA’) and the European Commission in support of this. Some of the providers, including BT, Virgin Mobile and Vodafone, noted in particular that Ofcom’s own data showed that mobile prices had reduced in recent years while data usage has increased, suggesting that most consumers were getting good value for money.
- 3.30 The providers also pointed to the variety of different contract options now available, which they believed showed the market was responding to customers’ changing needs. Vodafone for example pointed to the growing availability of split contracts as an alternative. Virgin Mobile also pointed to its recently launched bundled contract deal where, at the end of the contract term, the monthly price is automatically reduced by moving the customer to the nearest equivalent SIM-only tariff. BT said bundled contracts remained an attractive option to customers because they offered a low upfront cost for the device, as well as additional benefits, such as more generous allowances and features.
- 3.31 Some providers said there were already high levels of engagement and satisfaction in the mobile market. BT, Vodafone and Virgin Mobile said Ofcom should therefore acknowledge that some customers were aware of their options but chose not to engage. For example, Vodafone noted that these customers could be waiting for a new device to come out, or their perceived switching costs may be higher than the benefits they expect to get from a new deal. BT and Three said it was not necessarily problematic in itself that different customers pay different prices, depending on their level of engagement. Three said this

was especially true where customers have access to good quality and timely information about their services and the options available to them.

- 3.32 Both Vodafone and BT also noted that out-of-contract customers are not necessarily vulnerable and that we had not presented any analysis of this. BT highlighted that the customer profile of its out-of-contract customers had “*broadly the same demographic mix as customers within their minimum contract term.*” Vodafone pointed to our research which showed that there was a higher prevalence of bundled contracts in younger customers, customers on higher incomes, and customers in social group AB. It said that these customers were unlikely to be disengaged from the market (see Annex 5 for further details on Vodafone’s comments).
- 3.33 In terms of our concerns about transparency, Vodafone said it already informed its customers about relevant information on price, contract duration and device costs, and the availability of SIM-only alternatives made it easy for customers to compare the two. It also pointed to the strong growth in the numbers of SIM-only customers and split contracts as demonstrating that customers were aware of these options.
- 3.34 A number of other stakeholders, however, agreed with our concerns about transparency. O2 said Ofcom’s consumer research evidence showed there could be an issue with customers not being aware of the fact they were, or were coming, out-of-contract, or of the options that are available to them, which it said could be the main reason why customers were being charged for handsets after the end of their minimum term. In addition, Citizens Advice said a lack of transparency about the costs of the handset and airtime elements of a bundle make it hard for customers to compare offers and make fully informed decisions.
- 3.35 Shortly after our September 2018 consultation, Citizens Advice submitted a super-complaint to the CMA on the issue of excessive prices for disengaged consumers, which it refers to as the ‘loyalty penalty.’ It included in this its concerns about customers overpaying for mobile handsets (see paragraph 3.26 above).⁵⁶ In its response to that complaint, the CMA noted that Citizens Advice’s estimate of the overpayment appeared implausible when considered alongside Ofcom’s analysis of provider data and was therefore likely to be an over-estimate. It also noted that neither the Citizens Advice estimate, nor the estimate that Ofcom had previously made (£330m), were based on the price actually paid by customers after their minimum contract period. It noted the need for more work to understand the scale of the issue.⁵⁷

⁵⁶ Citizens Advice, 2018. [Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority](#) (‘Citizens Advice super-complaint’).

⁵⁷ CMA, 2018. [Tackling the loyalty penalty: Response to a super-complaint made by Citizens Advice](#) (‘CMA’s response to the super-complaint’), paragraphs 4.10-4.13.

We have gathered more data to better understand the concerns

- 3.36 We agreed with those respondents, and the CMA, who said we needed to gather further information. We noted in our September 2018 consultation that we intended to do so as we had some indications that the number of bundled customers who are out-of-contract was more than 1.5 million. We also recognised that not all of these customers would necessarily pay higher prices than current SIM-only prices (e.g. there may be customers that benefited from attractive legacy deals).⁵⁸
- 3.37 We have therefore carried out a significant data gathering exercise. In particular, we gathered billing data on all out-of-contract bundled customers as of November 2018 from all the major providers.⁵⁹ Using this data, along with information on each provider's current SIM-only packages, we have been able to:
- i) more accurately assess the extent to which out-of-contract customers are overpaying on their current contracts. Specifically, we have compared the inclusive minutes, texts and data allowances of the tariffs⁶⁰ these customers were actually on with a comparable SIM-only tariff offered by their current provider; and
 - ii) identify the extent of variation in overpayment and length of time out-of-contract by different customer groups.
- 3.38 This is the first time that this issue has been analysed in-depth in this way and it provides us with a much clearer, and more accurate, picture of this overpayment issue than has previously been available. Annex 5 sets out our analysis, including a description of the data and the methodology we have used, and our detailed findings. We set out a summary of our key findings below.

Bundled contracts are still valued and can be a more affordable way to buy a handset and airtime

- 3.39 In considering our findings, it is important to note that our concern relates to out-of-contract bundled customers who are overpaying, not bundled contracts in themselves. Many customers value the benefits of these contracts. They may, for example, have a preference for a new handset at the time of contracting, or may not wish to (or be able to) get a separate handset agreement. As highlighted by some respondents, bundled contracts can often represent a better deal for customers than other alternatives.⁶¹
- 3.40 Some stakeholders said that customers on bundled contracts had "paid off" their handset once they had reached the end of their minimum contract period. However, this is not always the case (see also paragraph 3.6 above about how these contracts are structured).

⁵⁸ September 2018 consultation, footnote 19.

⁵⁹ EE, O2, Three, Vodafone, Virgin Mobile and Tesco Mobile.

⁶⁰ As noted in Annex 5, there are some additional services which can also be included in bundled contracts which could be a relevant part of some out-of-contract customers services (e.g. add-ons such as content services, or roaming services). We have excluded these services from our analysis and therefore where we refer to the term 'overpayment' throughout this document, we are specifically referring to the minutes, texts and data allowances of tariffs only.

⁶¹ uSwitch, 2018. [New breed of mobile tariff could cost customers £231 million.](#)

Customers on these contracts pay a single charge and receive a bundle of services and a handset (which they own, typically at no cost or for a one-off payment, often from the start of the contract). There is usually no specific amount or charge of their monthly payment that is attributed to that handset. Providers normally take account of a number of different factors when setting a customer's monthly charge, including the cost of the handset they wish to recover and how long the customer is likely to remain with them. As highlighted by Virgin Mobile (see paragraph 3.28) in making that calculation they may assume the customer will stay beyond their minimum contract period.

- 3.41 What we can say with certainty, however, is that, at the end of their minimum contract period, the customer is free to switch to an alternative deal without paying an early termination charge and is also free to keep their handset. The focus of our concern, therefore, is where out-of-contract bundled customers are overpaying for their service, without necessarily realising, because they remain on the same deal as their original bundled contract but could switch to an equivalent SIM-only contract and make savings (in some cases, considerable ones).

Our data analysis shows the issue is complex but most out-of-contract bundled customers are overpaying

- 3.42 Of the almost 18m customers on bundled contracts (46% of all pay-monthly customers),⁶² 2m (11%) are outside their minimum contract period. This is nearly 5% of all pay-monthly mobile customers.
- 3.43 We have calculated the difference between the price these customers are currently paying on their bundled contract and that of the closest equivalent 30-day SIM-only contract with their existing provider available at the time.⁶³ These calculations indicate that, on average, these customers are paying just under £6 (£5.91) more per month by remaining on their bundled contract.
- 3.44 However, this does not mean they overpay for long periods of time (nor that all of them overpay – see further below). We have found that 29% of bundled customers are out-of-contract for three months or less, and 50% for eight months or less. After 12 months of the contract ending, however, 39% remain out-of-contract. Taking into account the length of time customers are out-of-contract, the average overpayment per out-of-contract customer is around £37 per year. This equates to an annual overpayment of around £142m across all out-of-contract bundled customers.
- 3.45 These overpayment amounts are significantly lower than previous estimates by us, and others (for example, the Citizens Advice estimate of £473m). By using customer billing data

⁶² Our data is the position at a snapshot on 1 November 2018. However, our analysis (explained in Annex 5) shows that the distribution of the length of time people spend out-of-contract does not change much over the year.

⁶³ As explained in Annex 5, we use a number of methods of matching a customer to an equivalent SIM-only package. In the figures that we quote here, we have used our 'baseline' in which a customer is matched to the closest SIM-only package of their current operator which does not reduce any of the airtime allowances (call minutes, texts or data). We used a 30-day deal to match the flexibility that a customer gets by remaining out-of-contract.

rather than making assumptions about how much customers are paying, we have been able to establish robust, accurate estimates on the scale of this issue.

3.46 Our analysis also shows that it is an over-simplification to assume that all out-of-contract customers are paying too much. This is a complex issue, with the average figures masking considerable variations in the impact on different groups of out-of-contract customers. In particular:

- a) **A material proportion of bundled customers would be better off remaining on their current deal:** our data indicates that, of the 2m bundled customers that are out-of-contract, 27% (around 600k) would not, in fact, save money by moving onto the closest equivalent SIM-only contract. This aligns with comments from providers, and our analysis shows these customers tend to be those that have been out-of-contract for longer. It would actually cost these customers an average of £6 a month extra if they switched to an equivalent SIM-only contract with their provider at the time of our analysis.
- b) **The amount of overpayment varies considerably between customers:** looking just at those who are out of contract and overpaying on their current deal, these customers could, on average, save almost £11 per month if they switched to SIM-only. However, this average again masks considerable variations:
 - i) around 22% of these customers could save less than £5 per month; but
 - ii) nearly 20% of these customers (nearly 400,000 people) could save more than £15 per month.
- c) **The extent of overpayment also varies by the length of time customers have been out-of-contract:** in general, customers who have been out-of-contract for longer are overpaying by a smaller amount per month than customers who went out-of-contract more recently. For example, the average monthly overpayment for those out-of-contract for less than one month is £8.67, compared to £2.79 for those who have been out-of-contract for between three and four years.
- d) **Older people have been out-of-contract for longer, on average, but they are overpaying less:** the provider data shows the average length of time spent out-of-contract rises consistently by age group: eight months for those aged 16-24 compared to over 18 months for those aged 65+.⁶⁴ The data also shows that the level of overpayment declines with age. While 25-34 year olds could save £9.14 a month on average by switching to an equivalent SIM-only tariff, the average monthly savings decrease to £4.90 and £2.40 for the 55-64 and 65+ age brackets, respectively.

3.47 Our data analysis also identified significant variations between providers both in terms of the number of affected customers (including whether those customers were acquired

⁶⁴ The median length of time out-of-contract for 16 to 24-year-olds is 4 months, rising to 7 and 8 months for 35 to 44 year-olds and 45 to 54 year-olds respectively. The 65-years plus group have a median of 12 months out-of-contract.

directly or through indirect channels such as Carphone Warehouse), as well as the extent of overpayment. In particular:

- a) EE had the highest number of out-of-contract bundled customers, as might be expected given its largest share of retail customers. Vodafone has the second largest number of out-of-contract bundled customers, followed by Three (which again broadly reflects their market share); O2 has fewer out-of-contract bundled customers than the other providers because it has been primarily offering split contracts through its direct sales channels since 2013.⁶⁵ It still, however, has a large number of out-of-contract bundled customers acquired through third party channels, such as Carphone Warehouse. As smaller 'virtual' providers⁶⁶, Tesco Mobile and Virgin Mobile had fewest out-of-contract bundled customers, though Tesco Mobile had more than twice as many as Virgin Mobile;
- b) Almost all of Vodafone's out-of-contract customers are overpaying ([3<]%). EE⁶⁷, O2 and Virgin Mobile are around the industry average of 70% with Three being slightly lower. Tesco Mobile, however, had just [3<]% (less than half) of its out-of-contract customers overpaying. As a result, we found that, on average, Tesco Mobile's out-of-contract customers would pay more if they switched to an equivalent SIM-only contract;
- c) The level of overpayment among those out-of-contract customers who would save money on a SIM-only tariff also varies by provider. For customers of Vodafone and Three, the overpayment is considerable, and above the average (at £13-£16 and £10-£13 per month, respectively). O2 is around the industry average of £11 (but this varies depending whether customers are acquired directly or indirectly, see below), while EE is slightly lower. Virgin Mobile customers are overpaying by around two thirds of the industry average; and Tesco Mobile customers would save less than £3 per month on a comparable SIM-only contract; and
- d) We also found that in general, customers who have purchased their bundle indirectly would make greater savings from switching to a SIM-only contract (around 30% more). This is principally driven by O2's indirect customers. As we say above, the vast majority of O2's bundled sales are through indirect channels, and these out-of-contract customers are overpaying by considerably more than its direct customers.

3.48 The picture, therefore, is a mixed and complex one. There are significant variations across out-of-contract bundled customers, with some customers actually better-off on their current deals. The extent of overpayment is smaller than previously estimated, and we

⁶⁵ O2 still provides a very small number of bundled contracts directly to some customers.

⁶⁶ Mobile Virtual Network operators ('MVNOs') provide mobile services to customers but using another provider's network, e.g. Virgin Mobile uses the EE network and Tesco Mobile uses the O2 network.

⁶⁷ As set out in Annex 5, since the date of our analysis (November 2018) EE has undertaken its annual pricing review and the gap between the price out-of-contract handset customers and SIM-only customers are paying has reduced significantly.

expect it to decline in light of the market trends we have outlined earlier in this Section (in particular the likely increase in the use of split contracts).

3.49 Our analysis also did not find that vulnerable customers are disproportionately affected. Whilst there was some evidence (from both provider data and our 2019 consumer research)⁶⁸ that older consumers were more likely to be out-of-contract for longer, the amount of overpayment by these customers was below the average.

3.50 Nevertheless, we remain concerned that there are a significant number of customers who are overpaying, specifically the 1.4m customers that are overpaying by £182m a year.

There is also a lack of transparency and a risk that less confident customers could be exploited

3.51 We agree with the comments from some providers that there may be rational reasons why a customer may choose to remain out-of-contract. For example, if they are on a good legacy bundle deal, or if the savings they could make by switching to a new contract are relatively low compared to the perceived costs of re-engaging with the market (e.g. spending time searching for the right deal), or they may also prefer the flexibility of remaining out-of-contract for a few months in order to wait for the launch of a new handset model. Where customers are making a rational, informed decision about their contract status we may not have a concern.

3.52 However, we are concerned that the information that is currently provided to customers about bundled contracts and the SIM-only alternatives is not sufficient for them to be aware of all of the options available. Our 2019 consumer research indicates that one of the main reasons people give for remaining out-of-contract is that they are happy with their current phone *“and will wait until I need or want a new phone before looking into it”* (60%). Furthermore, a significant proportion (30%) say they are happy with the price they are currently paying.⁶⁹

3.53 Our analysis, though, shows that the majority of out-of-contract customers (70%) could save money by switching to an equivalent SIM-only contract, and so we are concerned that the reasons given by customers reflect a lack of awareness about the savings they can make whilst retaining their existing handset. The lack of transparency to customers buying bundled contracts about the price they pay (or effectively pay) for the different elements of the bundle, including the handset, is making it difficult for customers to evaluate what they are buying and whether this is the best option for them. This is also confirmed by other evidence from our 2019 consumer research.

3.54 In particular, we found that, whilst there is broad awareness of the availability of SIM-only options (88% of all bundled customers), only around one in six out-of-contract bundled customers were aware they could switch to a 30-day rolling SIM-only contract with their

⁶⁸ 2019 consumer research Q14B, Table 2.

⁶⁹ 2019 consumer research Qs 17 A/B, Tables 26-28.

existing provider.⁷⁰ Customers who could be better off switching may not be doing so because of confusion or ignorance about their options and the savings that might be available.

3.55 Our research also found that out-of-contract customers are less confident about engaging with their provider than those who are in-contract. They displayed lower levels of confidence in comparing the cost of deals (38% vs. 54%), speaking to their current provider about deals (40% vs. 58%), understanding the language and terminology used by providers (34% vs. 51%), and in using maths in everyday life (45% vs. 54%).⁷¹ Lack of confidence in these areas could lead to these customers being less likely to engage in the market, which providers may be able to exploit.

3.56 We set out plans for tackling our concerns on bundled contracts in Section 4.

We also have a concern about some split contracts

We asked for views on split contracts in September 2018

3.57 In our September 2018 consultation we said that split contracts could help achieve our aim of ensuring people know what they are paying for at the start, during, and at the end of their contract. We also noted that some stakeholders, such as Citizens Advice, had advocated the use of these contracts as fairer and more transparent. We considered, however, that mandating the use of these contracts was not appropriate. Consumer choice is an important aspect of the mobile market and we wanted to ensure that providers continue to make a wide range of competitive offers. We said that unduly restricting their ability to bundle services could lead to a reduction in innovation, less competition in the provision of mobile services and, ultimately, to poorer outcomes for customers.

3.58 We also highlighted a concern about split contracts tying people into long contracts with providers, deterring switching and denying them the benefits of competition. In particular, we noted that linked split contracts, which require customers who switch their airtime contract to pay off any remaining sums due under the handset agreement immediately, could give rise to substantial lump-sum liabilities. Those could constrain customers' abilities to switch.

Stakeholders had mixed views on split contracts; some agreed with our concern

3.59 The majority of respondents, including the providers (O2, Vodafone and Three) and some consumer groups (uSwitch and Citizens Advice), agreed with our view that mandating split contracts was not desirable as it could have the unintended consequences of reducing the number of options available to customers. The Communications Consumer Panel and ACOD ('CCP') nonetheless stated that we should not "*rule out looking again at the*

⁷⁰ 2019 consumer research Q.3/Q.4 Tables 4 and 5.

⁷¹ 2019 consumer research Qs 20 A/B/C, tables 31 - 33.

possibility of split contracts if there is evidence that the current proposals fail to achieve a reduction in consumer harm.”

- 3.60 Vodafone and Citizens Advice pointed to the benefits of split contracts in terms of increased pricing transparency, with Vodafone noting that split contracts also offer the ability for customers to spread the cost of high value handsets over a longer period of time. Vodafone also said its own research into split contracts suggested that being able to select the length of the handset agreement was a key feature in the popularity of split contracts.
- 3.61 At the same time, Three and Dixons Carphone noted that these contracts did not necessarily offer the best value deals to consumers. uSwitch made a similar point and highlighted research which had found that customers on split contracts could end up paying more for airtime.⁷²
- 3.62 Ombudsman Services and Three agreed with our concern that the increasing length of handset agreements could tie people into airtime contracts for longer than 24 months. Ombudsman Services and Citizens Advice in particular suggested that we should intervene to stop providers linking the handset and airtime contracts: Citizens Advice said that the practice could be *“a one-off barrier to switching of hundreds of pounds.”* Vodafone, however, said it did not see any issues with tying customers into longer contracts with providers as long as the contract length, and any other relevant conditions (including early termination charges), were made clear at point of sale.
- 3.63 Three was concerned that some providers were taking advantage of the *“dual regulatory regimes”* for handsets and airtime (where the Financial Conduct Authority (‘FCA’) regulates the consumer credit agreements for handset agreements alongside Ofcom’s regulation of airtime contracts) to tie customers into longer airtime contracts. Having *“two regulators covering the same service or product was likely to cause consumer confusion or harm”*. It suggested that, to address this concern, Ofcom should have sole regulatory responsibility where handsets are sold under a credit agreement alongside an airtime contract.

We continue to be concerned about the impact of ‘linked’ split contracts on switching

- 3.64 We remain of the view that split contracts should be part of a range of options in a competitive mobile market, so that customers can choose the contract type that works best for them. We agree with stakeholders that these contracts can offer benefits in terms of clearer pricing structures, as well as longer handset agreements which allow people to spread the cost of more expensive devices.
- 3.65 We do not share Three’s concern about the application of consumer credit regulation to handset (loan) agreements. Where providers sell devices on credit, it is appropriate that consumers are protected by consumer credit legislation administered by the expert sectoral regulator. There is a distinction between that specific aspect of regulation and the regulation by us of the electronic communication services provided to the customer. Such

⁷² uSwitch, 2018. [New breed of mobile tariff could cost customers £231 million.](#)

regulatory arrangements have been in place since providers began offering split contracts, including handset agreements, in 2013. We have seen no evidence of them proving problematic.

- 3.66 However, we also agree with Citizens Advice and Ombudsman Services about these deals tying people to long airtime contracts. A large proportion of customers are on split contracts that are linked. In many cases, these customers would be required to make a substantial one-off payment for their handset if they want to switch airtime provider, even where they are outside the minimum period of their airtime contract. We think this is likely to deter switching and tie them unduly to their airtime provider. That is likely to be true where the customer is a consumer or a small business customer with similar bargaining power.⁷³
- 3.67 Constraining customers' abilities to switch is likely to harm each of them individually. By affecting switching generally, it is also likely to undermine the competitive process as a whole, harming customers collectively. The extent of that harm is only likely to grow the more providers use linked split contracts.
- 3.68 Not all split contracts contain the links we are concerned about. Where they are not linked, the consumer is free to switch to a different airtime provider whilst continuing to pay off their handset agreement in instalments with the original provider. That provider obtains the benefits to which it is entitled under that contract, but the consumer can take advantage of the benefits of competition by switching to an airtime deal which best meets their needs.
- 3.69 In response to Vodafone, we agree that transparency is essential for consumers to make informed choices about the services they buy. However, transparency alone does not necessarily remove the problematic effects any contract terms can have. In this particular case, telling a consumer at the start of their contract that they may subsequently be subject to a requirement to make a lump-sum payment does not stop that requirement from affecting their incentives to switch.
- 3.70 We set out our proposals for linked split contracts, and how they will address our concerns, in Section 5.

⁷³ These kinds of customers are similarly likely to consumers to be affected by excessive minimum contract periods.

4. Addressing our concerns about bundled contracts

- 4.1 This Section sets out the measures we are taking to address our concerns about bundled contracts, namely that many out-of-contract bundled customers are overpaying and that there is a lack of transparency about the prices customers pay. Whilst we think our end-of-contract notifications will go some way to addressing this harm, we consider that further measures are needed.
- 4.2 We are taking a revised approach to the options set out in our September 2018 consultation. We do not have the power under the EECC to impose the default tariffs options we consulted on in September.
- 4.3 Because of this, we have focussed instead on what we can do to protect people as quickly as possible. Following our intervention, most mobile providers have agreed to apply discounts to their out-of-contract bundled customers' monthly price. Although Three has refused to take part, these discounts help to tackle the harm we have identified for nearly 80% of out-of-contract customers that are overpaying. We set out details of the discounts from each relevant provider in this Section.
- 4.4 Alongside these discounts, we plan to implement a new measure to address our concerns about the transparency of bundled contracts. The EECC transparency provisions offer a clear route to achieve this. We set out in this Section our initial view on how we expect these information requirements to apply when we implement them as part of a broader consultation on the EECC provisions later this year. These measures will complement the requirements we have already imposed on providers to give their customers end-of-contract notifications and best tariff advice.

Our end-of-contract notifications will address some of our concerns, but more needs to be done

- 4.5 As set out in Section 2, we recently published our ECN statement which confirmed the imposition on providers of new requirements to send end-of-contract notifications and annual best tariff advice to their customers.
- 4.6 These requirements mean that, from February 2020, mobile customers will receive a standalone notification between 10 and 40 days before the end of their minimum contract period. These notifications will tell customers about the best tariffs available from their provider which, for customers on a bundled contract, must include at least one SIM-only contract. In addition, all customers who remain out-of-contract will be given this information at least annually.
- 4.7 Our judgment is that, by specifically telling customers on bundled contracts about the availability of a SIM-only option, these notifications will markedly improve consumer

awareness of these deals. Customers will be given a prompt to take steps to avoid paying more than they need to, once they are out-of-contract.

- 4.8 As part of research we carried out for our ECN statement, participants reported that receiving these notifications would empower them with knowledge about their contract and the options available. They felt that would mean they could make more informed decisions about the right deal to choose.⁷⁴ Mobile pay-monthly participants who were not interested in getting a new handset specifically noted that the inclusion of information about the SIM-only option would be valuable.⁷⁵
- 4.9 The measures in our ECN statement will therefore significantly increase the transparency of the options available to customers at the end of their contracts. They will go a considerable way to addressing the risk of out-of-contract mobile customers continuing to overpay for their service. We do not, however, think they will remove that risk on their own.
- 4.10 In that respect we note that, in response to the September 2018 consultation, some stakeholders said that our ECN measures would be sufficient to address the concerns we had raised. Specifically, the majority of providers and uSwitch said that end-of-contract notifications would address any harm in this area and we should allow these measures to come into effect before considering further proposals. Three also pointed to the Auto Switch reforms.⁷⁶
- 4.11 Other stakeholders, however, disagreed that ECNs would be enough to prevent further harm. Both Citizens Advice and Which? said additional measures would still be required.
- 4.12 While we believe (and our research indicates) that our ECN measures will prompt a significant proportion of customers to engage in the market and make more informed choices, we expect there will remain a proportion of customers that will not respond to the notifications they receive. Some of them will continue to be at risk of overpaying.
- 4.13 We note that evidence from trials in other sectors demonstrates that not all customers respond to these types of prompts. For example, Ofgem carried out a trial of a 'Cheapest Market Offer letter' which, whilst it did result in an increase in customer switching, found that many still took no action in response to the letters.⁷⁷
- 4.14 We also note the evidence, described in Section 3, of the lack of confidence some customers have about engaging with their provider. It is reasonable to suppose some of

⁷⁴ Ofcom, 2019. [Best Tariff Advice Research 2019; Executive Summary of findings](#) ('2019 Best tariff research'), p.4.

⁷⁵ 2019 Best tariff research, p.6.

⁷⁶ On 1 July 2019, new regulations came into force which make it easier for mobile customers to switch providers. Customers can now request and automatically receive a unique code by text, or through their online account, which they can give to their new provider to switch and port their existing mobile number (if they wish to do so). The new regulations also ban notice period charges after the switching date, meaning consumers will no longer have to pay for their old and new service at the same time, and require providers to provide customers with clear information about the switching and number porting process. Ofcom, 2017. [Decision on reforming the switching of mobile communication services](#).

⁷⁷ Ofgem, 2017. [Results cheaper market offers letter trial](#).

them will not respond to the notifications they get. That lack of engagement could enable providers to charge them higher prices.

- 4.15 If we were to assume, for example, that, of the 1.4 million out-of-contract bundled customers that would be better off switching to an equivalent SIM-only contract, 25% will take action in response to their best tariff advice notification, there would still be over one million customers paying more than they need to.⁷⁸ Even if we were more generously to assume that 50% of these customers will take action, we would still see more than three quarters of a million customers paying too much.
- 4.16 Our ECN measures will also not address shortfalls in the information customers have at the start of (and during) their contracts. In particular, those entering into bundled contracts would still not necessarily be told, at that point, about the price of the different elements of that bundle, and alternative options, nor what will happen to the price and the choices they will have at the end of the minimum contract period. Some providers have said they already provide some of this information, but there is not a consistent approach across the market.
- 4.17 Taking account of all these points, and while they will be a key source of help to customers, we do not consider that our ECN measures alone are sufficient to address our concerns as some respondents to the consultation suggested. There is a need for further measures to protect customers and secure fair outcomes.

We are taking a revised approach to the options we set out in September

- 4.18 In September we consulted on two options to address the concerns we identified about bundled contracts:
- i) achieving greater transparency in the pricing information customers are given; and
 - ii) the introduction of fairer default tariffs that would apply at the end of the minimum contract period.
- 4.19 There have been a number of developments since our consultation. In particular, as set out in Section 2, the requirements of the EECC have now been confirmed. In addition, as explained in Section 3, we have undertaken new analysis which has given us a clearer insight into the extent of the problems. As we indicate in that Section, we have identified two broad areas of concern which we consider require further action:
- **out-of-contract bundled customers overpaying:** 1.4 million out-of-contract customers on bundled contracts could save money by switching to cheaper SIM-only contracts; and

⁷⁸ As an example of why 25% might be a reasonable estimate, Ofgem's [Active Choice Collective Switch trial](#) was found to increase switching by 22% overall. This trial involved an exclusive tariff being presented to customers as part of several notification letters, and therefore has some differences to our ECN measures, although it is still a relevant comparison.

- **transparency of bundled contracts and alternative options:** customers seeking to enter into a bundled contract are not presented with enough information to make an informed choice.

4.20 We set out below our revised approach on each of these areas of concern, taking into account the provisions of the EECC. As part of this, we have also set out, and (where relevant) responded to, stakeholder comments received in response to the two options we set out in our September 2018 consultation.

Protecting out-of-contract customers from overpaying

The EECC does not give us the power to implement our default tariff option

- 4.21 In response to our September 2018 consultation, a number of stakeholders were supportive of the default tariff option. They believed it would be in customers' best interests to require providers to automatically place them on a fairer, default deal after their minimum contract period ends.
- 4.22 However, a number of stakeholders also raised concerns that this option would result in worse outcomes for consumers, such as higher prices or the loss of 'extra' allowances provided as part of a bundle. Several providers also raised concerns about the negative impact on consumer engagement, innovation and competition; they suggested that automatic discounting could disincentivise customers from engaging in the market once they are out-of-contract. Others noted that pricing remedies would result in less choice for consumers. Some stakeholders also raised concerns around the practical difficulties of implementing the options.
- 4.23 In its response to Citizens Advice's super-complaint, the CMA said it supported the fairer default tariff option we had consulted on.⁷⁹ In addition, the Government also said the situation needs to change and that it will consider legislation if this is necessary to address the issue.⁸⁰
- 4.24 As explained in Section 2 and Annex 6, the EECC, which has significant implications for our legal powers in this area, came into force in December 2018. We are required to implement it. The consumer protection provisions it contains are full harmonisation measures. In the areas they cover, we cannot impose stricter or lesser requirements than those specified. The EECC also limits the circumstances in which we can control or cap providers' prices. The powers it gives us do not include the power to implement the default tariff option we consulted on in September.
- 4.25 If we had the powers to do so, we may have considered (and carried out an assessment of) some form of pricing rule to ensure all out-of-contract customers were protected from overpaying. In doing so, we would need to have taken account of the points raised by

⁷⁹ CMA's response to the super-complaint, paragraph 33 of the executive summary.

⁸⁰ DCMS, July 2019. [*Statement on strategic priorities for telecommunications and the management of radio spectrum and postal services*](#), paragraph 52.

stakeholders on the practicalities of implementation and the risks of unintended consequences. We would also need to have considered how such a rule could have been targeted only at those customers that are overpaying, and the possible effects on prices for those customers already on good deals.

- 4.26 That option is not, however, available to us. We have, therefore, focused instead on what we can do to protect customers as quickly and effectively as possible within the limits of our powers, taking account of our updated analysis of the harm they are suffering.

We have instead secured discounts that will quickly deliver benefits to most out-of-contract bundled customers

- 4.27 Since our September 2018 consultation, we have been in discussions with providers about how they are planning to respond to market developments in the mobile sector, including plans to offer split contracts and, in some cases, to stop offering bundled contracts. We have explained our concerns in detail and the steps we would expect providers to take to address them.
- 4.28 We had similar discussions with providers prior to our September 2018 consultation, but at that time they did not make any firm commitments. Since then, we have re-iterated that ensuring providers treat customers fairly is our number one priority and, in June, all the major mobile operators signed up to six Fairness for Customers commitments, including a commitment to fairer pricing.⁸¹ As part of the more recent discussions, we have also been able to share with providers our updated analysis which demonstrates the extent of the overpayments their out-of-contract customers are making (see Annex 5).
- 4.29 We have secured commitments from all of the major providers apart from Three to apply a discount to the monthly price paid by their bundled customers that are (or will become) out-of-contract. EE, Vodafone, O2, Tesco Mobile and Virgin Mobile have made these commitments. The level and approach each will take to these discounts will vary, taking account of the variations in the level of savings available to their out-of-contract customers if they switched to a similar SIM-only tariff. We set out details of the discounts in the table below.

Table 4.1: Summary of the commitments offered by each provider

Provider	Voluntary commitment
Virgin Mobile	<ul style="list-style-type: none"> Migration of all legacy bundled customers to the equivalent SIM-only tariff from the point they go out-of-contract (new customers are already migrated in this way – see paragraph 3.30 in Section 3), ensuring no customer is worse off after migration.

⁸¹ Ofcom, 2019. [Britain's biggest broadband and phone firms to put fairness first.](#)

O2	<ul style="list-style-type: none"> • Migration of its bundled out-of-contract customers (acquired directly) to the equivalent airtime-only tariff available at the time they took the initial contract,⁸² ensuring that no customer is worse-off after the migration. • Also committed to initiate discussions with its indirect sales channels to find a solution for the customers acquired through these channels.
Tesco Mobile	<ul style="list-style-type: none"> • Will reduce the monthly payments of its bundled out-of-contract customers to ensure they are on the best available airtime tariffs.
EE	<ul style="list-style-type: none"> • A discount to the monthly charge of all customers on its bundled contracts after they have been out-of-contract for three months. • It will confirm the discount amount by December 2019.
Vodafone	<ul style="list-style-type: none"> • A discount to the monthly charge of its all customers on its bundled contracts after they have been out-of-contract for three months • It will confirm the discount amount by December 2019.
Three	<ul style="list-style-type: none"> • None

4.30 As indicated in the table above, EE and Vodafone’s discounts will apply three months after the customer has gone out-of-contract. We know that customers may go out-of-contract for rational reasons (see paragraph 3.51 in Section 3 where we discuss this), such as waiting for a new handset model – and our evidence shows that a third of customers switch or re-contract within three months. We therefore consider this three-month period is a suitable amount of time to allow customers to act on their ECNs and best tariff advice and engage in the market.⁸³

4.31 O2, Tesco Mobile and Virgin Mobile have agreed to move, or reduce the monthly price of, out-of-contract customers to equivalent airtime/SIM-only prices, or the best available tariff. We welcome this as it ensures that their customers are protected from any overpayment.

4.32 Vodafone and EE will confirm the exact level of discount later this year. We are disappointed that they have not been able to confirm the discount amount at this stage. We will continue discussions with them, and we expect these discounts to take into account the level of savings available to their individual customer bases (as set out in Section 3 and Annex 5 there are significant variations between providers).

4.33 The varying discounts offered by each provider will become part of the range of competitive offerings customers will be able to choose between. While they do not necessarily remove all the risk of overpayment, they will address a large part of it,

⁸² For a small number of customers this may not be possible, in which case the equivalent tariff would be as at the date they go out-of-contract.

⁸³ As set out in Annex 5, our analysis also indicated that when we assess the monthly average overpayment there is limited variation when we exclude those customers who have been out-of-contract for less than three months.

especially in combination with our ECN measures and the transparency requirements we plan to implement shortly (see further below).

- 4.34 We are disappointed that Three has decided not to apply any discount to its affected customers, particularly as it is the only provider to have taken this position and despite being a signatory to the Fairness for Customers commitments. It means these Three customers will continue to overpay, and suffer harm, and will not have the protection other providers are giving their customers. As set out in Annex 5, Three has between 150k and 200k out-of-contract bundled customers who would save money on a SIM-only tariff; these customers are overpaying by an average of £10 to £13 per month.
- 4.35 In addition, whilst we welcome O2's commitment that it will discuss options with its indirect sales partners (including Carphone Warehouse) we note that this means that, unless an agreement can be reached quickly, there is a risk that O2's indirect customers will continue to overpay. These customers make up a substantial amount of O2's bundled contract customer base⁸⁴ (over 70%), and its customers that are overpaying are doing so by £10 to £12 per month. We will therefore be continuing to discuss with O2, and Carphone Warehouse, to seek a clearer commitment to implement a solution for these customers. Carphone Warehouse has told us that the ongoing customer billing relationship and monthly tariff charges are managed by providers and not Carphone Warehouse, therefore any decision to offer voluntary discounts ultimately rests with the providers.
- 4.36 Taking all these points into account, we consider that the discounts we have secured so far are a pragmatic and quick way, within the limits of our powers, to help protect most customers from paying more than they need to. They will give most customers this protection without removing their incentives to engage with the market and for providers to compete with good deals. Our ECN measures mean customers will be given prompts and information that helps them engage with the market and search for the best deals. Those who do not (or cannot) take action in response to those ECNs, and remain on out-of-contract bundled deal, will have some protection against overpaying. The risk of their lack of engagement being exploited is reduced.
- 4.37 As set out in Section 6, these discounts will come into effect by February 2020⁸⁵ or earlier, and we also set out in that Section how we intend to monitor the effectiveness of the different provider discounts, alongside broader developments in the market.

⁸⁴ The majority of O2's direct customer base are on O2's Refresh tariffs, which are split contracts. As explained in Section 3 customers on split contracts are not at risk of overpayment when they go out-of-contract.

⁸⁵ Virgin Mobile's discounts will come into effect during Q1 2020, alongside our ECN measures. O2 will bring the migration of bundled customers into effect by the end of the year, although it has indicated that this is subject to system changes and it will keep us informed if there are any delays in this timetable.

Increased transparency of bundled contracts

We proposed a transparency measure in our September 2018 consultation

- 4.38 As part of our September 2018 consultation, we proposed to increase the transparency of the pricing of bundled contracts. We noted that the (then draft) EECC placed particular importance on the information provided to customers about the individual elements of bundled contracts and made clear that this information should be provided before a consumer was bound by a contract.
- 4.39 We said that, under our proposal, providers would inform customers when they purchased services of the different cost elements of the bundle they were buying, particularly where it included a handset, airtime and any other services. We also referred to the importance of customers having information that helps them make good choices at other times as well.

Stakeholders had mixed views on the proposed transparency measure

- 4.40 A number of respondents supported our proposal. The CCP noted that any information provided should be accessible and consistent with existing arrangements between providers and their customer.
- 4.41 Some respondents who supported our proposal also said it needed to be implemented alongside other measures. Both Which? and Citizens Advice said that, to be effective, transparency measures should be combined with automatic price reductions at the end of the minimum contract period. uSwitch suggested that information provided at the end of the minimum contract period, with an explicit call to action, would drive consumer engagement more than information provided before or during the contract.
- 4.42 Others, particularly individual respondents, agreed with the harm we identified and favoured remedies which would give customers clear information before, during and at the end of the contract. In particular, Citizens Advice and Which? stated that customers should receive the breakdown of costs for the different elements of a bundle on a monthly basis rather than just at the beginning of their contract.
- 4.43 A number of respondents had concerns about requiring providers to stipulate the monthly cost of a handset to customers. In particular, O2 and BT raised concerns about the practicality of calculating such a cost without clear guidance. O2 and Virgin Mobile suggested that our proposals did not fully reflect how bundled contracts were formulated, and Dixons Carphone questioned whether the provision of such information would be meaningful to customers.
- 4.44 More specifically, O2 raised concerns that our proposals could force providers to disclose details of confidential agreements with manufacturers, which could raise competition law concerns. Three was concerned that requiring handset costs to be shown separately would

likely result in providers having additionally to comply with consumer credit regulation. That, it said, would force it to offer only split contracts.⁸⁶

- 4.45 Others were concerned that our proposals would require providers to give customers too much information. Virgin Mobile and Three suggested that more information would overwhelm and confuse customers. Virgin Mobile also noted that the information provided had to assist customers in making informed decisions and could not be an end in itself, whilst Three added that, for increased transparency to enable engagement, the information must also be useful. Vodafone said customers were already given sufficient information – it noted that it already displayed the handset value in its bundled contracts.
- 4.46 Some respondents said more research was required before additional transparency requirements were imposed. Vodafone and Citizens Advice said we needed first to understand why customers were out-of-contract. uSwitch said we should incorporate the proposed additional information into any testing we undertook of our end-of-contract notification requirements.

We have considered stakeholder responses and the new requirements of the EECC

- 4.47 We have considered the stakeholder responses carefully. We have also taken into account the evidence from our 2019 consumer research which suggests that consumers do not have the information they need to make clear and informed choices (see for example paragraphs 3.51 – 3.56 in Section 3), in addition to the (now confirmed) requirements of the EECC.
- 4.48 We agree with respondents that pre-contract transparency requirements alone are not sufficient to address the concerns, and the resulting consumer harm, we have identified. That is why we have secured the commitments from most providers to offer additional protection to the majority of out-of-contract customers against overpaying.
- 4.49 We also agree that transparency of information about the prices offered and options available to customers for their mobile contract should not only be provided at the point of sale.⁸⁷ It should also be available at different points of their contract, so they are able to understand and assess their position. Our ECN measures, when implemented in February 2020, will ensure customers get appropriate information at the end of their contract, so they can weigh up whether to stay on their contract or whether they would be better off switching deals or providers.
- 4.50 Even so, transparent pre-contract information about prices is important in helping customers make informed choices and the evidence suggests such information is lacking.

⁸⁶ In a confidential submission, another stakeholder also noted that mandating transparency measures would cause additional regulation.

⁸⁷ See our Fairness for Customers commitment three: *“Customers are supported to make well-informed decisions with clear information about their options before, during, and at the end of their contract”*. Also see paragraphs 3.33 and 3.34 of our draft Fairness Framework.

As a result, we are minded to impose additional, pre-contract, transparency requirements on providers.

- 4.51 In particular, we propose to require that, before customers enter into bundled mobile contracts, providers must give them information about: (i) the prices for which they could buy the handset and airtime from the provider separately; and (ii) the price of their bundle and their alternative options at the end of the minimum contract period (i.e. that customers will be able to switch to a SIM-only deal). It should be provided in a durable form that enables the customer to make ongoing reference to it during the lifetime of their contract. We also plan to issue guidance on the way providers should comply with these requirements.
- 4.52 These additional information requirements will implement Article 102 of the EECC. They will complement our ECN measures, and form part of a coherent package of remedies to ensure that customers have the information they need, at the time they need it, to make informed choices and select deals that are in their best interests.
- 4.53 We do not agree that giving customers this information at the point of sale would confuse or overwhelm them. They need information, presented clearly, to help them weigh up the competing offers from providers. Having it in the required form will make their choices easier. Where they do not have it, and cannot make informed choices, that is unfair. As we set out in our draft Fairness Framework (see Section 2 for more details), we are likely to regard certain practices as unfair where there is a lack of transparency or where consumers' behavioural biases are exploited.⁸⁸
- 4.54 The EECC recognises this need for information and Article 102⁸⁹ is a mandatory requirement we are required to implement. The recitals to the EECC set out the objectives of the information requirements.⁹⁰
- 4.55 In particular, Article 102(1) aims to ensure that, when they take out a contract, customers are able easily to compare the prices of various services offered in the market.⁹¹ They must be given the appropriate information in a suitable manner before they enter into a contract so they can make a well-informed choice.⁹²
- 4.56 The Article also reflects that contracts are an important tool for end-users to ensure transparency of information and legal certainty.⁹³ They need to be given information in a form that enables them to refer to it, and understand and evaluate their position, throughout the duration of their contract.
- 4.57 We do not expect the proposals to impose impractical requirements on providers to calculate the prices of handsets. Nor would they require providers to disclose details of

⁸⁸ Ofcom, *Making communications markets work well for customers*, paragraph 3.13.

⁸⁹ Set out in Annex 6.

⁹⁰ EECC, Recitals 3 and 257, and Article 3(2)(d).

⁹¹ EECC, Recitals 261 and 265.

⁹² EECC, Recital 261.

⁹³ EECC, Recital 258.

confidential agreements with manufacturers or give customers information that is not meaningful.

- 4.58 Providers who sell bundled contracts and who also sell the airtime and/or handsets separately would have to tell customers the prices at which they could buy those elements separately from that provider:⁹⁴
- If they sell SIM-only contracts separately, but not handsets, they would have to tell their customers about their comparable SIM-only tariffs.
 - If they sell both handsets and airtime separately, they would need to set out the price of both.
- 4.59 In other words, customers would be given information about the real prices at which they could enter into alternative, comparable transactions with the provider for the handset and/or airtime, not notional or confidential values attributed artificially to the parts of a bundle. Since all providers sell SIM-only contracts, even if they do not sell handsets separately, all customers considering buying a bundled contract would at least be told about the price of a comparable SIM-only tariff. Customers would be able to use what they are told to make an informed choice between the deals offered by a provider and decide which is best.
- 4.60 We also do not agree that the requirement to state the prices at which the elements of a mobile handset and airtime bundle may be bought separately would necessarily turn the purchase of the bundle into a consumer credit arrangement. Any particular case would depend on the facts, and be a matter ultimately for the courts. Nonetheless, if the bundle transaction would not, by itself, involve a consumer credit agreement, we do not see how stating the prices of alternative transactions would necessarily transform the bundled contract into a credit arrangement (see Section 4 for our assessment of bundled contracts).
- 4.61 In terms of any potential testing of the requirements, in our ECN statement we set out our plans to monitor and evaluate whether the approach providers take to implementing end-of-contract notifications and best tariff advice is effective in achieving the consumer outcomes we are seeking. We said we would keep under review the need for further testing depending on the results of that monitoring work. We will also be proposing to include, as part of this monitoring work, a review of how the relevant transparency measures are implemented, and consumers' responses to them, to ensure they are effective in addressing our concerns.

⁹⁴ In accordance with Article 102(1) and Annex VIII, Part B, paragraph 2(V), providers would have to state the prices of the individual elements of the bundle *to the extent they are also marketed separately*. Where providers do not sell precisely the same airtime element separately (perhaps because inclusive bundled allowances differ from those sold on a SIM-only basis), they would have to state the price of the closest equivalent airtime (e.g. SIM-only) element. Where providers sell the airtime separately (for example, on a SIM-only basis) but not the handset, they would have to state its price. We intend to publish proposed guidance alongside our draft general condition in our consultation later this year.

We will consult on a transparency general condition as soon as possible

- 4.62 We intend to consult on a general condition imposing the relevant transparency requirements later this year, when we consult on implementing the rest of the EECC's consumer protection provisions. This is because the transparency requirements will need to be applied not just to mobile services, but across broadband, home phone and pay-TV services as well, as part of a broader set of information requirements. In addition, some elements of the requirements will not be confirmed by the European Commission and the UK Government until sometime next year.
- 4.63 In this document, therefore, we provide an indication of how we expect the requirements will apply to mobile contracts when we consult later this year. At that point, we will propose to modify the General Conditions so that, before consumers enter into a bundled mobile contract, providers must tell them, in a clear and comprehensible way, on a durable medium:⁹⁵
- a) the price of the individual elements of the bundle - the handset and the airtime - to the extent they are also marketed separately by the provider; and
 - b) where a contract would be automatically prolonged after the expiry of the minimum contract period,⁹⁶ the price that would apply at that time and a summary of their options when they reach that point.
- 4.64 To assist providers and customers alike, we will also set out proposed draft guidance to accompany the modified General Conditions. The draft guidance would set out the minimum steps we consider necessary for providers to take to comply with their obligations under the conditions in line with the requirements and objectives of Article 102 of the EECC.
- 4.65 The guidance is likely to cover areas such as:
- a) the point in the customer sales journey - whether online, over the phone or in-store - at which the information should be provided;
 - b) compliance with the requirement for the information to be 'clear and comprehensible;' and
 - c) factors the provider should take into account in identifying the relevant price to present to the customer for the individual elements of the bundle (for example, what might be an 'equivalent' SIM-only price for the airtime element).
- 4.66 We expect to consult in detail on this proposed guidance later this year too.

⁹⁵ Where provision of the information on a durable medium is not feasible, it must be provided in an easily downloadable document made available by the provider. Where it makes the information available in easily downloadable document, the provider must expressly draw the customer's attention to its availability and the importance of downloading it for the purposes of documentation, future reference and unchanged reproduction.

⁹⁶ Referred to in the General Conditions as the 'Fixed Commitment Period.'

5. Proposals for ‘linked’ split contracts

- 5.1 The ability of customers to switch providers is key for effective competition, benefiting consumers and efficient providers alike. Where that ability is limited, we may need to act.
- 5.2 As we described in Section 3, the market is increasingly moving towards widespread availability of split contracts with a growing number of customers buying their handset and airtime under this type of arrangement. Whilst this is a welcome move, many of the split contracts currently available contain terms that, in our provisional view, are likely to deter customers from switching. That is liable to harm them, as well as the competitive process and the providers who participate in it.
- 5.3 The EECR reflects the importance of switching and our concerns about contractual terms which inhibit it. Amongst other things, it requires Member States to limit the duration of certain contracts to 24-months. That includes split contracts for airtime and handsets where the terms require that, if the customer terminates the airtime contract, they must pay off any sums due for the handset.
- 5.4 We propose to amend the General Conditions to give effect to the EECR requirement. This section sets out why and how we are proposing to do that.

We are concerned that linked split contracts could deter customer switching

- 5.5 As set out in Section 3, our concern relates principally to those contracts we refer to as ‘linked’ split contracts, which contain terms requiring that, if the customer ends their airtime contract, they must also pay off the remaining balance under their handset agreement. We think these terms are likely to deter customer switching. We would have a similar concern about split contracts that are linked or interdependent in other ways, too.
- 5.6 There are several factors behind our concern. In particular:
 - a) the importance of switching;
 - b) the increasing numbers of providers using split contracts and of customers signing up to them;
 - c) the length of handset agreements and the lump sums customers are required to pay when they terminate their airtime contracts; and
 - d) the likely effects of the terms on switching.
- 5.7 Being able to switch providers is an important aspect of a well-functioning competitive market. It enables customers to engage with the market and helps them get a good deal. It gives an incentive for providers to offer a range of high-quality, good-value services. Customers and providers benefit from this.
- 5.8 Conversely, harm arises where there are barriers to switching, including contractual terms and charges relating to contract termination. Where switching is difficult, or customers

perceive it to be so, they are less likely to engage with the market or change providers. This dampens competition, to the detriment of the customers and providers who would benefit from it.

- 5.9 These points are reflected in existing regulatory provisions. General Condition C1.4 limits the duration of contracts for the provision of electronic communication services to consumers – like mobile airtime – to 24-months. Condition C1.3 requires providers to ensure that their conditions and procedures for contract termination do not act as disincentives to end-users switching provider. These conditions give effect to provisions of the Universal Service Directive.⁹⁷
- 5.10 It is important, therefore, that the contract terms providers use do not undermine or inhibit switching. We are concerned, however, that this is the effect of split contracts which are linked in the way we have outlined.
- 5.11 As set out in Section 3, split contracts are gaining in popularity and providers who have so far not introduced these contracts are developing plans to do so over the next year or so, and in some cases earlier. O2, Sky Mobile, and Tesco Mobile already have split contracts which include the linked terms we are concerned about.⁹⁸ We estimate over 5 million customers are on these types of contracts, with at least a million customers, and potentially significantly more, on handset agreements with a minimum contract period of more than 24 months.
- 5.12 A key driver behind the growing popularity of split contracts is the increasing cost of handsets. As described in Section 3, some of the devices commonly sold under split contracts can cost between £750 and £900. Selling these over an extended period enables more customers to buy them by spreading out, and reducing, the monthly cost they have to pay (even if in some cases the overall price is higher than buying the same handset through a bundle deal or outright).
- 5.13 The increased accessibility of mobile handsets is in itself a development that can benefit customers. However, a requirement for a customer to pay off their remaining handset balance if they terminate their airtime contract before the end of the fixed term of the handset agreement can mean they would have to pay a substantial lump-sum.
- 5.14 For example, a customer terminating their airtime agreement with Sky Mobile after twelve months would likely be required to pay off around £444 in respect of its 30-month linked handset agreement for an iPhone XR. Even where that customer stayed with Sky Mobile for a 24-month period (the maximum permitted for airtime contracts) they would be required to pay-off around £156 of their handset loan.⁹⁹

⁹⁷ See Directive 2002/22/EC, Articles 30(5) and 30(6) and recital 47 of Directive 2009/136/EC.

⁹⁸ Specifically these are set out in Clause 17 of O2's [Pay-monthly Terms and conditions](#), p.6 of [Sky Mobile's Equipment terms and conditions](#), and the small print of [Tesco Mobile's terms and conditions](#).

⁹⁹ Sky website, [mobile package for iPhone XR](#).

- 5.15 Similarly, a customer terminating an airtime agreement with O2 after 24 months would likely be required to pay off around £256 for a 36-month linked handset agreement on an iPhone XR.
- 5.16 It seems to us self-evident that a requirement to pay such a substantial sum is likely to deter switching and, effectively, tie the customer to the provider as an airtime customer. The customer should, of course, pay for their handset in full. However, they need not remain an airtime customer of their provider in order to be able to do that over the fixed term of their handset agreement. They could switch airtime provider, potentially to a deal that better suits their needs, whilst continuing to pay off their handset with their existing provider. The customer would still be meeting their obligations under the contract and the provider would be no worse off.¹⁰⁰
- 5.17 Moreover, where the fixed handset agreement is longer than 24 months, a consumer is effectively tied to the provider as an airtime customer for longer than the period permitted by General Condition C1.4. This would circumvent that regulatory provision and undermine the purpose – facilitating switching – for which it exists.
- 5.18 Accordingly, linked split contracts are liable to harm customers. The longer the handset agreement and/or the higher the handset value, the greater the harm because it increases the lump-sum the customer has to pay-off in order to switch, adding to the deterrent effect. The more providers use these contracts and the more customers sign up to them, the more the total extent of this harm will increase.
- 5.19 This concern is strongest where the customer is an individual consumer. It also applies, however, in relation to other groups of customers who, in our view, are likely to have similar bargaining positions and be in a similar position, such as some small business customers. These customers do not have the stronger bargaining positions that some larger businesses can have when negotiating their contract terms. We think these other customers should have similar protection to consumers as far as minimum contract periods are concerned (both generally and in relation to linked split contracts specifically).
- 5.20 Similar sorts of points would also apply where split contracts are linked by other terms or they have other sorts of close relationship.¹⁰¹ For example, where the termination of the airtime contract would have a financial or other impact on the handset agreement, such as the loss of a discount or an effect on the price of the device, changes to the terms and conditions, or changes to the way the device may be used.¹⁰²

¹⁰⁰ The consumer would have to pay any fair early termination charge to switch as they are entitled to do at any time while within their minimum contract period for the airtime (see footnote 40 in Section 3). They would also have to pay for their handset over the remainder of the relevant contract term. The provider would be in the same position as they would have been, had the contract been performed.

¹⁰¹ So as to bring them within the EECC's definition of a 'bundle,' as set out in its recital 283.

¹⁰² This paragraph does not, however, seek to define linked or closely related contracts in an exhaustive way. There may also, for example, be other kinds of close relationships between services that mean they fall within the EECC's definition of a 'bundle' (in recital 283) and should be treated in a similar way.

- 5.21 Split contracts linked in the ways described in the paragraph above can be seen as ‘financially linked or interdependent contracts.’ Where termination of an airtime contract has an adverse effect on a financially linked or interdependent handset agreement, that could otherwise continue unaffected, that is also liable to inhibit switching.
- 5.22 For these reasons, it appears to us that there are grounds to take action to address the harm linked split contracts are liable to cause. Likewise, those split contracts which are otherwise financially linked or interdependent or which otherwise fall within the EECC’s definition of a ‘bundle’.^{103 104}
- 5.23 In making that assessment, we also note that some stakeholders share our concern about linked split contracts. Both Ombudsman Services and Citizens Advice said in their responses to our September 2018 consultation that we should intervene to end the practice of providers linking these contracts.
- 5.24 We similarly note Vodafone’s alternative view that, provided the contract length and any other relevant terms are made clear at the point of sale, long handset agreements are not problematic. We agree transparency is essential for customers to make informed choices about what they buy. However, transparency alone does not necessarily remove the problematic effects these terms can have. In this particular case, telling a customer at the start of their contract that they may subsequently be subject to a liability that inhibits their ability to switch does not stop that liability having that effect.

The EECC provides a route to address our concern for contracts longer than 24 months

- 5.25 The end-user provisions of the EECC confirm the case for intervention. It includes measures which aim to encourage consumers to engage with communications markets and take advantage of the competitive environment by switching services when it is in their best interest to do so.¹⁰⁵ To that end, the EECC notes that it is essential consumers are able to switch, “... *without being hindered by legal, technical or practical obstacles, including contractual conditions, procedures and charges.*” That aim “.... *does not preclude providers from setting reasonable minimum contractual periods of up to 24 months in consumer contracts*”,¹⁰⁶ but they may be no longer than that.
- 5.26 The same objectives apply to bundled services, including those made up of electronic communications services and terminal equipment, like handsets. These: “... *should be considered to exist in situations where the elements of the bundle are provided or sold by the same provider under the same or a closely related or linked contract.*”¹⁰⁷

¹⁰³ In recital 283.

¹⁰⁴ Together, we refer to these as, ‘other split contracts falling within the EECC’s definition of a bundle.’

¹⁰⁵ EECC, recitals 273 and 277.

¹⁰⁶ EECC, recital 273.

¹⁰⁷ EECC, recital 283.

- 5.27 There is a specific recognition that, whilst bundling often benefits consumers, it can make switching more difficult or costly and raise the risk of inappropriately locking the consumer into a contract. In particular: *“Where different services and terminal equipment within a bundle are subject to divergent rules on contract termination and switching or on contractual commitments regarding the acquisition of terminal equipment, consumers are effectively hampered in their rights under this Directive to switch to competitive offers for the entire bundle or parts of it”*. Certain essential provisions of the EECC, including those on contract duration, *“... should, therefore, apply to all elements of a bundle, including terminal equipment...”*.¹⁰⁸
- 5.28 In pursuit of these objectives, Article 105(1) of the EECC requires that:
“Member States shall ensure that conditions and procedures for contract termination do not act as a disincentive to changing service provider and that contracts concluded between consumers and providers of publicly available electronic communications services¹⁰⁹ do not mandate a commitment period longer than 24 months.”
- 5.29 Article 107 adds that:
“If a bundle of services or a bundle of services and terminal equipment offered to a consumer comprises at least an internet access service or a publicly available number-based interpersonal communications service, Article 105 ...shall apply to all elements of the bundle including, mutatis mutandis, those not otherwise covered by those provisions.”
- 5.30 In other words, so that consumers are free to switch when it is in their best interests, all contracts that make up relevant bundles must be subject to the 24-month limit on their minimum contract period. That includes the airtime and handset agreements that comprise linked split contracts. The terms that require the handset agreement to be paid-off simultaneously with the airtime contract means these are contracts, *“... provided or sold by the same provider under the same or a closely related or linked contract”* [Emphasis added]. The same applies where the contracts contain other terms that make them financially linked or interdependent or otherwise bring them within the EECC’s definition of a bundle.
- 5.31 The EECC also expressly recognises that microenterprises, small businesses and not for profit organisations are in a similar bargaining position to consumers as far as contract durations, switching and bundles are concerned and need similar protection in those regards. Amongst others, it applies the provisions in Article 105(1) to contracts for electronic communications services and bundles that providers enter into with these groups of customers.¹¹⁰

¹⁰⁸ EECC, recital 283.

¹⁰⁹ Other than number-independent interpersonal communications services and other than transmission services used for the provision of machine-to-machine services.

¹¹⁰ See EECC, Recital 259 and Article 102(2) which says the requirements on contract duration apply to these customers unless they expressly agree to waive them.

We are proposing to implement the relevant EECC provisions now

- 5.32 Given our concerns and the EECC's objectives, in particular the provisions it contains to secure those objectives and meet that concern, we propose to implement the relevant provisions of Articles 105 and 107 by amending General Condition C1.4 on contract duration.
- 5.33 We propose to amend the relevant condition as set out below (see Annex 6 for the formal notification of the proposed amendments):
- "C1.4 Regulated Providers shall not include a term in any contract with a Consumer for the provision of Electronic Communications Services that stipulates a Fixed Commitment Period of more than 24 months in duration. The same prohibition shall apply to any contract for the provision of such services between the Regulated Provider and a Microenterprise, Small Enterprise Customer or Not For Profit Customer, unless such Microenterprise, Small Enterprise Customer or Not For Profit Customer has expressly agreed otherwise.*
- C1.4A Condition C1.4 shall also apply to contracts for the provision of Bundles in so far as the Subscriber concerned is:*
- (a) a Consumer; or*
 - (b) a Microenterprise, Small Enterprise Customer or Not For Profit Customer, unless such Microenterprise, Small Enterprise Customer or Not For Profit Customer has expressly agreed otherwise."*
- 5.34 We would also amend the definitions section of the General Conditions to include these definitions:
- "'Bundle' means where Mobile Communication Services and Terminal Equipment are sold by the Regulated Provider under the same or closely related or linked contracts;"¹¹¹*
- "'Microenterprise' means a Small Enterprise Customer who carries on an undertaking for which fewer than 10 individuals work (whether as employees or volunteers or otherwise) and whose annual turnover and/or annual balance sheet total does not exceed 2 million Euros;"*
- "'Not For Profit Customer', in relation to a Communications Provider which provides services to the public, means a Customer which, otherwise than as a Communications Provider, is a Customer of that provider and which by virtue of its constitution or any enactment:*
- (a) is required (after payment of outgoings) to apply the whole of its income, and any capital which it expends, for charitable or public purposes; and*

¹¹¹ We are limiting this definition to mobile services for the purposes of this consultation. The relevant provisions of the EECC, however, apply to all electronic communications services and we will be consulting on their broader implementation, beyond mobile services (and all other relevant provisions of the EECC) later this year.

(b) is prohibited from directly or indirectly distributing among its members any part of its assets (otherwise than for charitable or public purposes);”

“‘Small Enterprise Customer’, in relation to a Communications Provider which provides services to the public, means a Customer of that provider who carries on an undertaking for which fewer than 50 individuals work (whether as employees or volunteers or otherwise) and whose annual turnover and/or annual balance sheet total does not exceed 10 million Euros, but who is not himself a Communications Provider;”

“‘Terminal Equipment’ means equipment directly or indirectly connected to the interface of a public telecommunications network to send, process or receive information. In either case (of direct or indirect connection), the connection may be made by wire, optical fibre or electromagnetically. A connection is indirect if equipment is placed between the terminal and the interface of the network;”

- 5.35 The effect of our proposed amendments to General Condition C1.4 would be that a relevant customer may not be bound by obligations in respect of their airtime or their handset for a minimum contract period of more than 24-months. Where the airtime and handset are provided under separate contracts linked by a term requiring the customer to pay off the remaining handset agreement if the airtime contract is terminated, each contract may not be longer than 24-months. The same would apply to other split contracts falling within the EECC’s definition of a bundle.
- 5.36 These amendments would address a significant element of the harm we are concerned about. A consumer (and other relevant customers) could not be bound to a provider by linked split contracts, or other split contracts falling within the EECC’s definition of a bundle, for an excessive period. Their position would be aligned with the existing limitation on airtime minimum contract periods under General Condition C1.4 (which reflects the harm consumers suffer where they are tied to a provider for longer). They would be in a similar position to consumers with bundled (airtime and handset) contracts. Their ability to switch when that is in their best interests, in accordance with the objectives of the EECC, would be protected in a similar way.
- 5.37 Another effect of our proposals would be that microenterprises, small businesses and not for profit organisations could not be bound by contracts for electronic communications services with minimum contracts periods of more than 24-months. Again, this would reflect that they are, broadly, in a similar position to consumers and should have protection against excessive contract durations. Our provisional view is that, in the interests of pragmatic and consistent regulation, we should apply this requirement of the EECC now too, and not just where these groups of customers sign up to linked split contracts. They are, as the EECC reflects, as likely to be harmed by excessively long contracts as consumers, whether for single services or bundles. The requirement would, in any event, apply to contracts for electronic communications services from December 2020 at the latest.
- 5.38 Our proposal does mean providers could continue to use split contracts involving handset agreements longer than 24-months where they fall outside the definition of a ‘Bundle.’ For

example, where the terms of the airtime and handset agreements are wholly independent of one another.¹¹² That could be the case where the terms of one contract are not affected by the other and each could continue on the same terms without the other (and without the consumer losing any benefit or entitlement or suffering any detriment). This means providers could continue to sell handsets under separate agreements for longer than 24 months but, if the customer wants to switch airtime provider, they could not be subject to a requirement to pay-off the remainder of their handset liability in one go.

- 5.39 We also recognise that our proposed amended condition would mean providers could continue to link their split contracts for up to 24-months. We remain concerned that the linked terms in these contracts could deter switching, particularly where the contract end dates are not aligned (for example, where the minimum contract period for the airtime is 12 months, and the handset agreement is 24 months long – we refer to these as ‘non-coterminous contracts’).
- 5.40 Providers will, nonetheless, continue to be subject to General Condition C1.3 which requires them to ensure that their conditions and procedures for contract termination do not act as disincentives for end-users against changing provider. We will therefore continue to monitor the operation of the kinds of the contracts in the preceding two paragraphs and may take enforcement action where appropriate.

We are proposing to give providers three months to implement these requirements

- 5.41 We are minded to make the proposed changes to the General Conditions as soon as possible. We are required to give effect to the EECC and secure its objectives by 21 December 2020 (and, until then, not to do anything that would undermine their achievement). Given the harm we have identified, we see no reason to deprive UK consumers (and other relevant customers) of the protections afforded by those provisions until then, especially as the extent of the harm is liable to increase the more prevalent linked split contracts become. We think it is important to stop the spread of that harm, as well as giving providers currently developing their split contract a clear signal about how they should be structuring these contracts before they launch them.
- 5.42 It is also important in this context that our proposal would align the position with the existing requirements in General Condition C1.4 for airtime and bundled (airtime and handset) contracts. We do not think the protection provided by this condition should remain open to circumvention in respect of consumers and others on relevant split contracts until the end of 2020.
- 5.43 We recognise that providers that currently offer these linked split contract terms will need to make changes to their terms and conditions. They will also need to amend their websites and any printed material which refers to their contractual terms, as well as

¹¹² And not otherwise closely related or linked.

training staff on the new terms. We consider, however, that these are changes which can be made relatively quickly and without a need for a significant lead time.

- 5.44 We are therefore proposing to set an implementation deadline of three months from the date of our final statement (which we expect to publish before the end of this year). We think this period is an appropriate balance between ensuring that the relevant customers benefit from the removal of switching barriers sooner, whilst giving providers time to make the changes they need without incurring any unnecessary additional costs (for example, in some cases it may allow providers to make changes to their terms and conditions as part of already planned regular updates to those terms).

We have assessed the impact of our proposals

- 5.45 Our assessment of the likely impact of our proposal to modify General Condition C1.4 is set out below. We have considered the likely impacts on consumers (and other relevant customers) and providers, including that of implementing the relevant provision of the EECC before the transposition deadline.
- 5.46 In summary, we assess that:
- a) our proposed measure will benefit consumers and other relevant customers by removing a barrier to switching, which in turn will increase competition, and bring benefits more generally;
 - b) there will be minimal implementation costs for providers to comply (they will need to remove the relevant linking clauses from their contracts);
 - c) there may be some price re-balancing effects, although we expect these to be limited;
 - d) the effect of imposing these requirements ahead of the EECC deadline is that it brings forward the realisation of these costs and benefits; and
 - e) given our view that the benefits are important, our provisional judgment, considering those benefits and the costs in the round, is that the outcomes would be fairer, and positive overall, for consumers and other relevant customers if we implement the EECC requirements earlier than the deadline for doing so.

Our proposals should have a positive impact on consumers and other relevant customers

- 5.47 We have explained above, and in Section 3, why we consider that the link between split contracts is liable to reduce switching. Deterring customers from switching could prevent them from being on the deal that is best suited to their needs. It could also reduce competition between providers, with the effect of increasing prices. Measures to limit the duration of linked split contracts, which have the effect of limiting the costs to consumers and other relevant customers if they terminate them, will therefore benefit all these groups by removing a barrier to switching and supporting greater competition in the

market. The sooner we make the proposed changes, the sooner those benefits can be realised.

- 5.48 The proposed measure may have other, unintended, consequences. At present, providers may anticipate that some customers will stay with them longer than 24-months, until the end of their handset agreement, because of the deterrent of having to pay off the handset liability in one go. This could be leading providers to compete more aggressively to obtain the customer in the first place, for example by lowering prices for handsets or airtime. If the provider expected more customers to switch after 24 months, or earlier, as a result of our proposal, prices could rise for one or both elements of the linked split contract as the provider sought to retain the same overall revenue.
- 5.49 A provider might also currently, to some extent, subsidise the handset element of the split contract, based on an expectation of keeping the associated airtime contract in place for longer. If the provider knew there was an increased likelihood that a customer might switch away from the airtime contract earlier than the end of the handset deal, this might affect their incentives. Providers might decide to stop offering handset agreements of over 24 months, which benefit customers in being able to spread the cost of more expensive handsets over longer periods. Alternatively, they might offer handset agreements longer than 24 months but with higher prices.
- 5.50 However, we do not think these concerns are likely to be material in practice because:
- a) If airtime or handset prices go up, this type of linked split contract will become less attractive to consumers and other relevant customers compared to other options such as buying the handset outright and combining it with a SIM only deal, or indeed a bundled contract. If providers increase prices elsewhere to compensate for the (potential) revenue loss, they risk losing customers to other providers who offer a better deal.
 - b) If there is a rebalancing and any handset subsidies (if present) are removed, the relative prices for the handset and airtime elements may change. This, in itself, is not a problem and may make the true cost of the handset more transparent for customers.
 - c) Consumers and other relevant customers have a wide range of preferences in this market, such that providers have a strong incentive to maintain a wide portfolio of products and pricing options. Therefore it is not clear that providers would necessarily limit the options they make available as a result of no longer being able to link split contracts of more than 24 months.
 - d) In particular, there is clear demand for longer handset agreements because they enable consumers and other relevant customers to spread the monthly cost of more expensive handsets. This was highlighted in providers' consultation responses (for example Vodafone, which pointed to its own consumer research in support of this). If a provider decided to remove this option, a customer could look to other providers that were willing to offer it (and there are already non-linked split contracts available with handset agreements of over 24 months, e.g. those provided by Virgin Mobile and Giffgaff).

- e) In any case, the above potential effects should be balanced against the benefits our proposal will bring by removing a barrier to switching. By making it more likely that consumers and others may switch contract or provider, our proposal increases the competitive pressure in the market, which will bring general benefits in terms of lower prices and/or higher quality. Providers need to compete by offering appealing products at the right price, not by introducing barriers to switching that may be unforeseen by the customer. Taking these points into account, our judgment is that, overall, our proposal to amend General Condition C1.4 would likely benefit consumers and other relevant customers.

The early implementation of the EECC provisions will create some minor additional costs for providers

- 5.51 For providers that already offer linked split contracts, there will be some costs to implement our proposals. In particular, costs for updating their terms and conditions and any other relevant material (for example, their webpages advertising split contracts), as well as training staff.
- 5.52 These costs are likely to be minor. Providers usually need to make changes to terms and conditions from time to time anyway, and they may be able to make the changes required to implement our proposals as part of any existing planned updates with little, if any, incremental costs involved. Our proposed three-month implementation period would also help ensure providers have time to absorb these changes as part of any regular planned updates.
- 5.53 Any such costs, in any case, result from the provisions of the EECC, which must be implemented by December 2020, not an Ofcom decision to impose regulatory requirements. Any costs arising from our decision would be limited to those providers will incur as a result of having to implement changes approximately nine months earlier than they otherwise might.
- 5.54 Providers may also need to make further changes to their contract terms as a result of the implementation of the other provisions of the EECC in December 2020. The earlier implementation of our proposal for linked split contracts may mean that providers incur two sets costs (i.e. one for our proposal and another for changes necessary to implement the rest of the EECC).
- 5.55 Our assessment is that any costs in the categories described in the preceding two paragraphs would likely be limited (and, the former case, minimal), and, again, providers are likely to be able to absorb them within their usual processes for changing their contracts from time to time anyway. Such costs as there may be would, we think, be justified by the benefits we expect our proposed measure will bring.
- 5.56 Providers could be affected by our proposal in that they may lose revenue from customers who switch because a barrier to doing so is removed. Since that revenue would be derived from such a barrier, we would not consider it a legitimate cost of our proposal.

- 5.57 We also note that, whilst our proposal removes a cost for customers who wish to switch, it does not force them to switch away if they are happy with their current deal. There remains an opportunity for providers to retain customers by providing quality service and value. There would also be the chance to win additional customers who will find it easier to switch from their existing providers.
- 5.58 We expect the impact on legitimate revenue that providers currently derive from split contracts should be neutral. They would still recover the full cost of the handset over the term of the handset agreement and all the net profit to which they are entitled under the 24-month airtime contract.¹¹³ Or, they can decide to use longer, unlinked handset agreements and recover the cost of the handset over that term and receive their airtime revenue over two years.

Legal powers and tests

- 5.59 We propose to amend the General Conditions using our existing powers under the Act. Under section 51(1)(a), we can make or modify conditions, ‘... *Making such provision as OFCOM consider appropriate for protecting the interests of the end-users of public electronic communications services*’. Under section 51(2)(g), that power includes the ability to ‘... *impose a limit on the duration of a contract between an end-user and a communications provider*’. Our proposed amendments fall within these provisions.
- 5.60 Before we can modify the General Conditions as proposed, we must be satisfied that the tests set out in section 47(2) of the Act are met (see Annex 6). We are minded to consider that they are for the following reasons.
- 5.61 In our provisional view, the proposed modifications of the Conditions are objectively justified. As set out in detail in Section 3 and above, we have identified that consumers and other customers are harmed by the terms we are concerned about in linked split contracts (and those in other split contracts falling within the EECC’s definition of a bundle). The measures we propose would address that harm. Likewise, the harm liable to be caused to certain non-consumer customers by excessively long contracts for electronic communications services.
- 5.62 We also do not think the measures would be unduly discriminatory. They would apply only to providers of mobile communications services because that is where we have identified harm to relevant customers. Similar requirements will apply to providers of other services in due course, when we implement the rest of the EECC. The temporary distinction our proposed measures make between providers is, accordingly, justified.
- 5.63 The modifications, in our view, would also be proportionate to what they are intended to achieve. For the reasons set out above, our provisional assessment is that the measures we propose are necessary to address the harm we have identified and to give effect to the

¹¹³ A similar analysis applies to those contracts for electronic communications services with microenterprises, small businesses and not for profit organisations which would be limited to 24-months’ duration.

relevant provisions of Articles 105(1), 105(2) and 107 of the EECC and meet their objectives. They would do no more than is required to secure those outcomes.

- 5.64 We also think our proposed measures are transparent in relation to what they are intended to achieve. The requirements are set out in full in the notification in Annex 6. They are also explained in this document.

Ofcom's general duties

- 5.65 We also provisionally conclude that the proposed modifications of the General Conditions would fulfil our duty to further the interests of citizens and consumers. In particular, they would protect consumers' and others' abilities to switch providers where doing so is in their best interests.
- 5.66 In generating our proposals, we have had regard to other considerations set out in section 3 of the Act. Those include, in particular, the interests of consumers in respect of choice, price, quality of service and value for money (section 3(5)) which we consider would be served in the ways we explain above.
- 5.67 We have also had regard, as set out in this document, to the desirability of promoting competition in relevant markets (section 3(4)(b)), the desirability of encouraging investment and innovation in relevant markets (section 3(4)(d)), and the needs of persons with disabilities, of the elderly and of those on low incomes (section 3(4)(i)).
- 5.68 Additionally, we are minded to consider that the proposed modifications of the General Conditions would be in line with our obligation to ensure our regulatory activities are proportionate and targeted only at cases in which action is needed (section 3(3) of the Act). Our basis for that view is explained above.

Duties for the purpose of fulfilling EU obligations

- 5.69 Our further provisional assessment is that, by modifying the General Condition as proposed, we would be acting in accordance with the six European Community requirements in section 4 of the Act. These include the duties:
- a) to promote competition in the provision of electronic communications services;
 - b) to secure that our activities contribute to the development of the European internal market; and
 - c) to promote the interests of all persons who are citizens of the European Union.¹¹⁴
- 5.70 In implementing the relevant parts of the EECC, we are contributing to the development of the European internal market. By modifying the General Conditions as proposed we would be encouraging consumers and other relevant customers to engage in the market and

¹¹⁴ Read in light of Article 8 of the Framework Directive. We have also had regard to the objectives in Article 3(2) of the EECC.

enabling them to switch providers in order to take advantage of competition between providers.

Consultation questions

5.71 We welcome stakeholder comments on the following:

Question 1: Do you agree that our implementation proposal for bringing the requirements of the EECC into effect is sufficient to address our concern that linked split contracts (and other split contracts falling within the definition of a bundle) are liable to deter switching?

Question 2: Do you agree that the draft General Condition (in Annex 6) would achieve our aim of limiting the minimum contract periods of the contracts we are concerned about to 24-months?

Question 3: Do you agree with our implementation proposal that providers should have three months to make the necessary changes to their contracts and other relevant materials?

Question 4: Do you have any comments on our impact assessment of our proposal to prohibit linked split contracts (and other split contracts falling within the definition of a bundle) of over 24 months?

Please provide evidence in support of your views on each question.

6. Conclusions and next steps

- 6.1 In this document we have set out our updated analysis of the consumer experience of pay-monthly mobile contracts, our assessment of consumer harm and the measures we are taking, or are proposing to take, to address that harm.
- 6.2 In particular, we have set out the following package of measures:
- a) **discounts by most mobile operators for their out-of-contract bundled customers;**
 - b) **point of sale transparency measures**, which we propose would require providers to set out the price at which the handset and airtime elements of bundled contracts can be bought separately; and
 - c) a proposed prohibition on **linked split contracts over 24-months long** (and associated amendments to the General Conditions).
- 6.3 We consider that this package of remedies, combined with the measures imposed in our ECN statement, is a pragmatic way to address most of our concerns within the scope of our powers.
- 6.4 Below we summarise the next steps for each of these measures, and our plans to keep this issue under review alongside our ongoing work to secure fairer outcomes for consumers.

Most out-of-contract bundled customers' prices will be discounted from February 2020

- 6.5 EE, Tesco Mobile, Vodafone and Virgin Mobile¹¹⁵ have confirmed their discounts will apply from February 2020 to coincide with the introduction of our ECN measures.¹¹⁶ Vodafone and EE will confirm the level of discount they will apply by December 2019.
- 6.6 O2 intends for the discounts for its directly acquired customers to come into effect by the end of this year, although it has indicated that this is subject to changes to its systems and it will keep us informed if there are any delays to this timetable.
- 6.7 In addition, as set out in Section 4, we will be continuing to discuss with O2, and with Carphone Warehouse (O2's largest indirect sales partner), a clearer commitment to apply a discount to the prices of its indirectly acquired customers.
- 6.8 Whilst we are disappointed that the discounts will not extend to all affected customers, they will ensure that most out-of-contract bundled customers (nearly 80%) have some protection as quickly as possible. When these discounts come into effect, alongside our ECN measures, customers who do not (or cannot) take action in response to the ECNs, and

¹¹⁵ Virgin Mobile's discounts will come into effect during Q1 2020, alongside our ECN measures.

¹¹⁶ BT Mobile is also considering a discount for its out-of-contract bundled customers (of which we understand there are relatively few).

remain on out-of-contract bundled contract, will still have some protection against overpaying.

- 6.9 As set out below, we intend to keep these discounts under review, in particular the effectiveness of the different range of discounts being offered.

We will be consulting on a new transparency measure for bundled contracts later this year

- 6.10 As set out in Section 4, the provisions of the EECC offer a clear route to achieve the increased transparency we think is required at the point of sale for bundled contracts.
- 6.11 We will consult later this year on these transparency measures. We will make proposals to amend our General Conditions, and to issue associated guidance, as part of our consultation on the broader implementation of all the relevant EECC measures.
- 6.12 Following that consultation process, and subject to considering the responses we get to our proposals, we expect to confirm the amendments to our General Conditions, and the final guidance, in Spring 2020. They will then need to come into effect by the EECC deadline of 21 December 2020.

We expect our linked split contract proposals to come into effect from early 2020

- 6.13 Our proposed modification of the General Conditions to implement the 24-month limit on linked split contracts (and other associated amendments) is in Annex 6 to this document. Stakeholders have until **16 September 2019** to comment on our proposals, in accordance with the process set out in Annexes 1 to 4 of this document.
- 6.14 Subject to considering stakeholders' responses, we plan to issue a statement setting out our final decision, and the amendments to the General Conditions, before the end of the year. We have proposed in Section 5 that providers will have three months from the date of our final statement to implement the changes. Subject to this consultation process, we therefore expect the changes to come into effect from around February/March 2020.

We plan to monitor closely, alongside our ongoing work to ensure fairness for customers

- 6.15 In our ECN statement, we explained our plans to monitor the impact of the notifications providers send their customers. That will include collecting information from providers and conducting consumer research on engagement with, and the effectiveness of, providers' notifications.
- 6.16 In light of the measures set out in this document, we also plan to monitor the mobile market closely to see how it develops. In particular, we will look at the likely increase in the

use of split contracts and declining use of bundles, as well as the effect of the relevant providers' price reductions, alongside our planned monitoring of our ECN measures.

- 6.17 We also expect this monitoring to sit closely alongside our ongoing work on the Fairness for Customers commitments, which all of the major providers recently signed-up to (see Section 2). We will be monitoring companies' practices closely against these commitments, and we plan to publish a progress report next year summarising the progress we observe against the commitments.
- 6.18 If the market does not produce fair outcomes for mobile handset customers, we will take further action. That may require new legal powers.

A1. Responding to this consultation

How to respond

- A1.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on **16 September 2019**.
- A1.2 You can download a response form from <https://www.ofcom.org.uk/consultations-and-statements/category-2/consumers-communications-markets-mobile-handsets>. You can return this by email or post to the address provided in the response form.
- A1.3 If your response is a large file, or has supporting charts, tables or other data, please email it to mobile.handsets@ofcom.org.uk, as an attachment in Microsoft Word format, together with the cover sheet (<https://www.ofcom.org.uk/consultations-and-statements/consultation-response-coversheet>). This email address is for this consultation only, and will not be valid after 30 September 2019. Responses may alternatively be posted to the address below, marked with the title of the consultation:
- Lorna Horton
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- A1.4 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:
- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
 - Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.
- A1.5 We will publish a transcript of any audio or video responses we receive (unless your response is confidential)
- A1.6 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.
- A1.7 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.
- A1.8 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 4. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.

- A1.9 If you want to discuss the issues and questions raised in this consultation, please contact Lorna Horton on 020 7783 4157, or by email to Lorna.Horton@ofcom.org.uk.

Confidentiality

- A1.10 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that everyone who is interested in an issue can see other respondents' views, we usually publish all responses on our website, www.ofcom.org.uk, as soon as we receive them.
- A1.11 If you think your response should be kept confidential, please specify which part(s) this applies to, and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A1.12 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.13 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further at <https://www.ofcom.org.uk/about-ofcom/website/terms-of-use>.

Next steps

- A1.14 Following this consultation period, Ofcom plans to publish a statement before the end of 2019.
- A1.15 If you wish, you can register to receive mail updates alerting you to new Ofcom publications; for more details please see <https://www.ofcom.org.uk/about-ofcom/latest/email-updates>

Ofcom's consultation processes

- A1.16 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex 2.
- A1.17 If you have any comments or suggestions on how we manage our consultations, please email us at consult@ofcom.org.uk. We particularly welcome ideas on how Ofcom could more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.18 If you would like to discuss these issues, or Ofcom's consultation processes more generally, please contact the corporation secretary:

Corporation Secretary
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA
Email: corporationsecretary@ofcom.org.uk

A2. Ofcom's consultation principles

Ofcom has seven principles that it follows for every public written consultation:

Before the consultation

- A2.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. If we do not have enough time to do this, we will hold an open meeting to explain our proposals, shortly after announcing the consultation.

During the consultation

- A2.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A2.3 We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A2.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A2.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A2.6 If we are not able to follow any of these seven principles, we will explain why.

After the consultation

- A2.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

A3. Consultation coversheet

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts? _____

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

A4. Consultation questions

A4.1 This Annex lists the questions we are consulting on.

Question 1: Do you agree that our implementation proposal for bringing the requirements of the EECC into effect is sufficient to address our concern that linked split contracts (and other split contracts falling within the definition of a bundle) are liable to deter switching?

Question 2: Do you agree that the draft General Condition (in Annex 6) would achieve our aim of limiting the minimum contract periods of the contracts we are concerned about to 24-months?

Question 3: Do you agree with our implementation proposal that providers should have three months to make the necessary changes to their contracts and other relevant materials?

Question 4: Do you have any comments on our impact assessment of our proposal to prohibit linked split contracts (and other split contracts falling within the definition of a bundle) of over 24 months?

Please provide evidence in support of your views on each question.

A5. Data analysis

A5.1 In this Annex, we describe the data analysis we have conducted and present our findings.

A5.2 In summary, we find that:

- a) Across all four mobile network providers and two of the largest MVNOs who have customers on bundled contracts,¹¹⁷ just over two million customers are beyond their minimum contract period on bundled contracts.¹¹⁸ This represents 11% of all customers on bundled contracts, and 4.6% of all pay-monthly customers.
- b) The proportion of customers on bundled contracts has been declining with the increasing popularity of SIM-only and split tariffs.¹¹⁹ Bundled contracts have fallen as a proportion of pay-monthly contracts from 74% in January 2014 to just 46% in January 2019. This is due to a rise in split contracts (from 4% to 15%) and in 12-month SIM-only contracts (from 15% to 34%).¹²⁰
- c) There is considerable variation in the length of time customers spend beyond their minimum contract period before they re-contract (if at all).¹²¹ Whilst a material proportion (29%) are 'out-of-contract' for three months or less and the majority of customers (61%) recontract within a year, there is also a long tail of customers who have been out-of-contract for much longer.
- d) On average, customers beyond their minimum contract period on bundled contracts could save around £6 p.m. by switching to a comparable SIM-only contract. Taking into account the length of time customers remain out-of-contract, this translates into an average overpayment of £37 per out-of-contract customer over a year and an annual aggregate overpayment figure of around £142 million p.a. across all out-of-contract bundled customers.¹²²

¹¹⁷ EE, Vodafone, O2, Three, Virgin Mobile and Tesco Mobile.

¹¹⁸ These are contracts in which the customer receives a handset and airtime and pays a single monthly price which includes both any cost for the handset and the cost of the airtime.

¹¹⁹ SIM-only contracts are those under which the monthly cost to the customer includes the airtime but the provider does not supply the customer with a handset under the contract (instead the customer either purchases a handset separately, or uses an existing handset they already own). Split contracts are those in which customers purchase both an airtime tariff and mobile handset at the same time under two contracts, and where the monthly cost to the customer is separated into prices for the airtime and the handset.

¹²⁰ 30-day SIM-only contracts have remained relatively stable over this period, reducing from 6% to 4%. 24-month SIM-only contracts were a very recent development in the market at the time of this analysis.

¹²¹ For convenience, we describe this as being 'out-of-contract'.

¹²² We explain in detail later on how we calculate these average overpayments, at paragraph A5.58 and how to reconcile these two numbers.

- e) These average overpayments mask differences between customers. A material proportion of out-of-contract customers (27%) would be financially better off staying on their current terms rather than switching to a SIM-only package. When we consider just the group who are paying more than the comparable SIM-only tariff, these customers could save £11 p.m. on average, or £74 p.a. over a year.¹²³
- f) In general, the monthly overpayment is lower for those who have been out-of-contract for longer. They may have purchased cheaper handsets or be on advantageous legacy deals.
- g) There are considerable differences between providers. For example:
 - i) Vodafone's customers are overpaying by considerably more than the industry average of £6 p.m.
 - ii) Three's customers, on average, are not overpaying by much; however, when we consider only those who would save money by switching, we find that these customers are overpaying by £10 to £13 per month.
 - iii) Tesco Mobile's customers are, on average, better off on their current terms than switching to a SIM-only contract; for the group that would save by switching, the price difference is relatively small (less than [\pounds]).
- h) There is some difference depending on whether the customer purchased the bundle direct from the provider or indirectly i.e. through a third-party channel such as Carphone Warehouse. In particular, we find that O2 has a large number of indirect customers (more than 70% of their out-of-contract bundled customers), and that these customers, on average, are overpaying by significantly more per month than O2's direct customers.
- i) We found that older customers tend to stay out-of-contract for longer than younger customers. However, the average monthly overpayment for customers aged 65+ was lower than for other age groups. Considering the annual overpayments (weighted by the number of months spent out-of-contract), older customers are not disproportionately worse off than other age groups.

A5.3 The rest of this Annex is structured as follows:

- a) we outline the issues we sought to investigate further in this as part of our data-gathering exercise;
- b) we describe why the billing data we obtained from providers was able to give us a more detailed understanding of these issues compared to previous analysis in this area;
- c) we provide a description of the data we obtained to conduct our analysis;
- d) we describe how we used the available data to investigate the issues of interest; and

¹²³ This calculation takes into account how long customers typically remain out of contract, and is therefore a weighted annual figure. We explain how we calculated this figure in paragraph A5.67 below.

e) we set out our findings.

Focus of our analysis and previous assessments of the problem

- A5.4 As part of our review of this issue, we wanted to explore in more detail the extent to which many bundled customers appeared to overpay for their mobile services after the end of their minimum contract period.
- A5.5 We have been monitoring this issue in our Pricing Trends for Communications Services report since 2017 in the broader context of pricing trends and consumer engagement in mobile services. In our 2018 Pricing Trends report, we found that approximately 1.5 million people on bundled tariffs might be paying more than necessary; and that, collectively, UK mobile consumers could be overpaying by approximately £330m each year (an assumption being that all of the £18.52 p.m. difference in average spend for pay-monthly bundled and pay-monthly SIM-only customers related to the device).¹²⁴ These estimates were based on survey data as well as data collected from providers.
- A5.6 We used the estimates from our Pricing Trends reports to inform our early thinking in this area, which we set out in our September 2018 consultation. We considered this initial analysis suggested that there were a significant number of customers on bundled contracts who did not take action at the end of their minimum contract period and continued to pay the same price, whereas they could save by moving to a SIM-only contract. We noted that we intended to collect further information to derive a more precise estimate of the current extent of overpayment, and the number of customers who were affected.¹²⁵
- A5.7 Shortly after our September 2018 consultation, Citizens Advice submitted a super-complaint to the CMA which included its own estimates of the extent of overpayment by customers on bundled tariffs beyond their minimum contract period.¹²⁶ Citizens Advice estimated that 3.97 million bundled customers were currently beyond their minimum contract period (based on survey evidence). Citizens Advice also estimated that the average monthly overpayment by these out-of-contract customers was £22 (based on differences in price between currently available bundled tariffs and SIM-only tariffs), and that the average annual overpayment by an out-of-contract customer was £264. They then used survey data on the numbers of customers out-of-contract and their estimate of the monthly overpayment to calculate an aggregate annual overpayment figure across all out-of-contract customers of £473m.¹²⁷

¹²⁴ 2018 Pricing Trends Report, p. 22. £18.52 was the difference between the out-of-contract ARPU for all bundled customers and those on SIM-only. This was combined with Ofcom that showed that the percentage of customers who did nothing at the end of their contract was stable year-on-year at 6%, giving approximately 1.5 million customers. $1.5 \text{ million} * 12 * £18.52 = £333\text{m}$.

¹²⁵ September 2018 consultation, footnote 19.

¹²⁶ Citizens Advice, 2018. [*Excessive prices for disengaged consumers.*](#)

¹²⁷ This was the summation of: monthly overpayment (£22) x no. of months OOC x no. of customers OOC for that no. of months. E.g. There were 937k customers (out of the 3.97m) OOC for 12 months, so $12 * £22 * 937\text{k} = £247\text{m}$. This was done for each month.

- A5.8 Responses to our September 2018 consultation said we should explore this issue in more detail to inform our view on the most appropriate approach. In particular, some stakeholder responses gave reason to suggest the customer experience may vary widely across out-of-contract customers, even to the extent of whether customers are overpaying or may be financially better off remaining out-of-contract. These responses also suggested that estimates of the overpayment based on currently available tariffs may not be representative of the typical experience for out-of-contract customers.
- A5.9 For example, EE explained why customers may choose to remain out-of-contract for rational reasons, including the fact some customers were on legacy tariffs which represented a better deal than they would be able to obtain by switching to a currently available SIM-only tariff. Three similarly commented that, of their customers who had been out-of-contract for more than 24 months, a significant number were on plans that offered at least as good a deal as current SIM-only tariffs. Vodafone submitted a report by Frontier Economics, which noted that customers may be out-of-contract for a number of reasons (including rational reasons) and observed that Ofcom's data did not allow for the identification of how many customers belonged in each of these categories. The Frontier Economics report also presented evidence (based on Ofcom data) suggesting that the price differential between a bundled tariff and SIM-only tariff could be significantly lower for certain customers (especially those who had been out-of-contract for longer) than a comparison of the average price difference between a bundled tariff and a SIM-only tariff might suggest.
- A5.10 There was also some suggestion that the average length of time out-of-contract may not be representative of the typical customer experience. For example, EE's response (based on analysis of its own data) suggested that the distribution of length of time out-of-contract could be skewed by a small number of individuals who had been out-of-contract for a very long period of time.
- A5.11 Finally, some stakeholder responses suggested that the incidence of any overpayment (and consequently the impact of any intervention) may vary by vulnerability status. For example, the Frontier Economics report submitted by Vodafone in its response suggested that out-of-contract customers on bundled tariffs may disproportionately be from higher income groups (based on data from Ofcom's Technology Tracker survey). Citizens Advice found that over 65s were twice as likely to be out of contract for more than 24 months than younger people (based on their own survey data). Citizens Advice also presented evidence (again from its own survey) suggesting that consumer inertia may be a greater issue for the over-65s and those in DE socio-economic group.
- A5.12 In order to get a better understanding of these issues, we requested billing data on all out-of-contract customers at a given point in time (November 2018) from the main providers who offer bundled contracts.¹²⁸ This data represented the entire population of customers who were out-of-contract with these providers at that point in time, and so allowed for a far richer analysis than would have been possible if we had requested a sample of data

¹²⁸ See paragraph A5.15 to A5.16 for details of the data we collected.

only. Obtaining this billing data allowed us to estimate the extent to which out-of-contract customers could save money by switching to a SIM-only tariff with a greater degree of accuracy than we could with previously available evidence, as it enabled us to compare the tariffs these customers were actually on with similar, currently available, SIM-only tariffs. The use of billing data rather than survey data also allowed us to explore in more detail some of the issues raised in the September 2018 consultation responses, including the extent of variation in overpayment and length of time out-of-contract by different customer groups. In addition to billing data, we requested some more aggregated data to investigate trends over time.

- A5.13 The CMA shared our view that we needed to explore this issue in more detail in its response to the Citizens Advice loyalty penalty super-complaint. The CMA cited both the Pricing Trends reports and Citizens Advice figures in its report, and commented that the significant difference in estimates of the number of customers affected highlighted the potential limitations of using survey evidence and the sensitivity of the results to survey design. It considered that the Citizens Advice numbers appeared implausibly high in light of subsequent Ofcom figures based on data from providers, and noted this discrepancy highlighted the need for more consistent estimates in this market.¹²⁹
- A5.14 In relation to the estimates of average monthly overpayment, the CMA noted that, whilst the Ofcom and Citizens Advice figures were similar, neither method identified the price actually paid by customers who were beyond their initial contract term or a comparator price which took into account the actual specification of the services purchased by these customers. It considered this might affect the accuracy of both estimates, as customers taking out more recent contracts may have taken out more expensive packages with higher data allowances and/or more expensive handsets. The CMA concluded the resulting uncertainty of the size of the price differential and lack of clarity on what proportion of contracts were likely to result in the customer still paying for the handset after the initial contract period highlighted the need for more work in this area.¹³⁰

We obtained detailed billing data from all the main providers

Which data did we gather?

- A5.15 Our quantitative analysis is based on data requested from the four UK mobile network operators (EE, O2, Three and Vodafone)¹³¹ and four of the largest ‘mobile virtual network operators’ (MVNOs)¹³² (Giffgaff, Sky Mobile, Tesco Mobile and Virgin Mobile). The information we obtained, through a formal notice under section 135 of the Act, included:

¹²⁹ CMA’s response to super-complaint, para 4.10 – 4.11.

¹³⁰ CMA’s response to super-complaint, para 4.12 - 4.13.

¹³¹ We did not request data from BT Mobile who have about a [X]% share of the market as the end of Q1 2019.

¹³² Although we requested data from Giffgaff and Sky Mobile, they do not offer, and have never offered, bundled handset and airtime contracts. They were not able, therefore, to supply any billing data for out-of-contract bundled customers and do not contribute to the estimation of the overpayment.

- a) The total number of in-contract and out-of-contract customers, with some additional demographic breakdown, on the specific dates of 1 February 2018, 1 May 2018, 1 August 2018 and 1 November 2018. The information request covered the following services:
 - i) bundled contracts;
 - ii) split contracts; and
 - iii) 30-day and 12-month SIM-only contracts.¹³³
- b) Individual billing information for all out-of-contract customers on bundled contracts for the specific date of 1 November 2018 on an anonymised basis. The requested information included the composition of each customer's current tariff (including minutes, data and text allowances), the recurring monthly charge, the end date of the minimum contract period, the handset model, and personal characteristics (including postcode and age). The requested tariff information covered in-bundle charges only, excluding the price of any add-ons or out-of-bundle charges.
- c) Detailed information on all SIM-only tariffs available to consumers on 1 November 2018, including the recurring monthly charge, the minimum contract period and the minutes, data and text allowances (plus any extras) included in each tariff.¹³⁴

A5.16 We subsequently asked for historical data on the total number of in-contract and out-of-contract customers on bundled, split and SIM-only contracts, as well as data on how long customers had spent out of contract at various dates.¹³⁵ This information enabled us to look in more detail at trends within the mobile sector, specifically the changing composition of bundled, split and SIM-only contracts over time. It also allowed us to look at whether the distribution of the length of time customers remain out of contract has changed over time.¹³⁶ We requested these data on monthly basis from January 2014 to March 2019.

The data were of high quality and the very small number of missing/incomplete observations are unlikely to have reduced the reliability of results

- A5.17 In general, the data we received was of high quality. However, for some of the variables we received a very small amount of missing or potentially incorrect data:
- a) *Monthly charge* – Out of two million customers, only four customers did not have a monthly charge provided. These are not included in the matching process, and therefore do not contribute to the estimate of overpayment.

¹³³ See the Glossary in Annex 8 and Section 3 for definitions of these contracts.

¹³⁴ We collected information on 30-day SIM-only tariffs where possible. Some providers also provided 12-month SIM-only tariffs in addition to, or instead of, 30-day SIM-only tariffs if they do not sell/market them.

¹³⁵ See definition of second information request in the Glossary in Annex 8.

¹³⁶ We present and discuss this distribution in paragraphs A5.31 to A5.34.

- b) Negative monthly charges – Some providers provided us with data that suggested that a very small minority (0.8%) of out-of-contract bundled customers are charged a negative recurring charge (i.e. the customer in effect would receive a payment or credit from the provider each month). We confirmed with the relevant providers that this was correct, and these customers are therefore included in our analysis.
- c) Bundle components – Around 20,000 (1%) customers did not have a complete set of data for the components of their current bundle of minutes, texts and data. Providers were unable to provide this data and these customers are therefore not included in the matching process or our estimates of overpayment.
- d) Age and minimum contract period end date – A very small proportion of customers did not have data for age (0.3%) or the end date of their minimum contract period (0.05%). These customers were included¹³⁷ in the matching process and our estimates of overpayment, but are excluded from the figures provided later in this annex which provide breakdowns by age and the length of time they have been out-of-contract.¹³⁸

A5.18 Given the very small proportion of the total dataset these observations represent, we do not consider they are likely to have reduced the reliability of our results.

The data we obtained cover the vast majority of the pay-monthly consumer bundled market

A5.19 We collected data from all four mobile network providers and four MVNOs. However, Sky Mobile and Giffgaff do not, and never have, offered bundled contracts, so they did not supply any relevant data and are not included in our analysis. Our analysis covers EE, Vodafone, O2 and Three (the MNOs) as well as Tesco Mobile and Virgin Mobile (MVNOs).

A5.20 There are also a number of small MVNOs which are not included in our analysis, but it is our understanding that, not only do they have a very small proportion of customers, but many of them do not offer any bundled contracts. Therefore, although our data does not cover the market in its entirety, we nevertheless, we believe that our results are robust for the following reasons:

- a) our data covers the vast majority of the pay-monthly consumer market.¹³⁹
- b) Some of the MVNOs not covered by our information request tend to focus on SIM-only tariffs and thus are likely to have relatively few customers on bundled contracts.
- c) In addition, some of the MVNOs not covered by the information request have been operating for a shorter time. Hence, these MVNOs are unlikely to have a significant number of long-term out-of-contract customers.

The data suggests that the proportion of out-of-contract bundled customers is stable over time

¹³⁷ Not including customers of BT Mobile.

¹³⁸ Customers with missing data for their minimum contract period end date are assumed to have been out-of-contract for over 12 months when estimating the annual cost.

¹³⁹ Over 90% of the post-pay consumer market at the end of Q1 2019.

- A5.21 Our analysis of some key areas of interest, including the extent of overpayment and distribution of length of time out-of-contract, is based on data on customers who were out-of-contract on 1 November 2018 as well as on SIM-only tariffs available on the same date.
- A5.22 We recognise that each month individual customers will change their status, with some previously in-contract customers coming to the end of their minimum contract period and failing to re-contract, some out-of-contract customers remaining out-of-contract for an additional month, and other out-of-contract customers re-contracting and thus losing their out-of-contract status. Consequently, the identity of customers who are out-of-contract for a given amount of time will be different on any date other than 1 November 2018. We assume, however, that any customer who changes their status is replaced by a customer with the same out-of-contract status.
- A5.23 We consider this approach reasonable, given our analysis of historical data suggests that the distribution of length of time customers remain out-of-contract is broadly stable over time.¹⁴⁰ Furthermore, our 2019 consumer research indicates that the proportion of consumers on bundled contracts who are now out-of-contract and still paying the same price has remained stable over recent years at around 6% (which, allowing for margin of error, accounts for around between 1.1 to 1.8 million people in the UK).

Methodology and findings

- A5.24 In this section we describe:
- a) The number of bundled customers who are out-of-contract;
 - b) The distribution of the length of time these customers spend out-of-contract;
 - c) The methodology for calculating whether customers would save money by switching to a SIM-only contract or remaining out-of-contract;
 - d) The average amount that customers would save by switching;
 - e) The ways in which these overpayments differ according to the length of time that a customer has been out-of-contract;

¹⁴⁰ To explore this assumption, we plotted the distribution of length of time out-of-contract in different years and also calculated various summary statistics across the period as a whole and for individual years within this period. We find that length of time out-of-contract has been increasing somewhat over time, but that the mean, median and standard deviation of length of time out-of-contract are nonetheless all relatively stable over the period covered by the historic data (January 2014 – March 2019). For example, whilst the mean duration out-of-contract increased from 11.3 months in 2014 to 13.9 months in 2019, it did not increase consistently throughout the period (e.g. mean duration out-of-contract fell from 13.4 months in 2016 to 12.7 months in 2017) and varied around an overall figure across the whole period of 12.8 months. Similarly, whilst the median duration out-of-contract increased from 6 months in 2014 to 9.6 months in 2019, this was again not a consistent increase (e.g. median duration out-of-contract fell from 8.4 months in 2016 to 7.5 months in 2017) and varied around an overall figure of 7.3 months. The standard deviation for length of time out-of-contract ranged from 12.4 in 2014 to 13.0 in 2019 around an overall figure of 12.5. We note these figures were calculated on a different basis from the calculations based on the November 2018 billing data, as we asked for the historic data on a more aggregated basis than the main billing data request. In particular, the historic data only provides the number of customers that were out-of-contract for <=1 month, <=2 months, etc. and not the actual length of time out-of-contract for each customer (as in the billing data). We consider this reasonable for the purposes of conducting a robustness check.

- f) Differences between providers (including the effect of whether the customer initially contracted directly with the provider or through a third party); and
- g) Whether older customers are particularly worse off.

Number of bundled customers who are out-of-contract

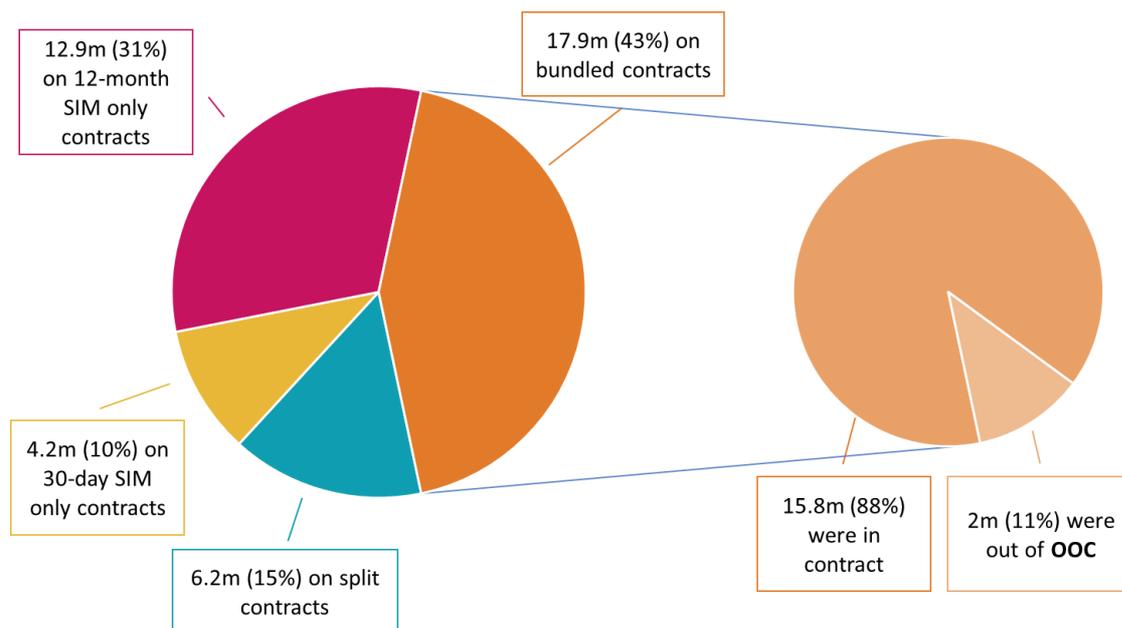
A5.25 We first used aggregate data to look at the proportion of customers on bundled tariffs and, within this cohort, to identify the number of these customers who were out-of-contract on 1 November 2018.

A small but material proportion of pay-monthly mobile customers are out of contract

A5.26 We find that a small proportion (4.9%) of all pay-monthly mobile customers are beyond their minimum contract period on bundled contracts (out-of-contract). Given the size of the mobile market, this is still a material number.

A5.27 On 1 November 2018 there were 17.9 million customers on bundled contracts and, of these, 2 million (11%) were out-of-contract (Figure A5.1).

Figure A5.1: Composition of pay-monthly customers on 1 November 2018¹⁴¹



Source: First s.135 data.

A5.28 This estimate is comparable with our previous estimate set out in the 2018 Pricing Trends report (which found approximately 1.5m out-of-contract mobile customers may be paying

¹⁴¹ See definition of first information request in the Glossary in Annex 8. The data in Figure A5.1 were collected from the four MNOs (EE, O2, Three, Vodafone) and four MVNOs (Giffgaff, Sky Mobile, Tesco Mobile and Virgin Mobile). The figures relate to consumer contracts only and exclude dedicated mobile broadband contracts. As discussed earlier in paragraph A5.20, we accept that the data does not cover the entire market, but we consider the market coverage to be wide enough to provide accurate and meaningful insights.

more than necessary by continuing to pay a monthly fee that includes the cost of a mobile handset)¹⁴² but significantly lower than the Citizens Advice estimate of 3.97m. We note that Citizens Advice made the assumption that anyone who said they took out their current contract for their bundled mobile phone service two or more years ago was paying a ‘loyalty penalty’. Their survey did not ask respondents whether they had subsequently re-contracted or conducted any negotiation with their provider over their contract price, neither did it ask whether respondents were now paying the same, more, or less than when they took out their current contract. This is likely to have distorted their estimate.

The proportion of customers on bundled tariffs has fallen over time

A5.29 We then used the historical data to look at how the proportion of customers on bundled tariffs had evolved over time.

Figure A5.2: Composition of pay-monthly contracts from January 2014 to January 2019^{143,144}



Source: Second s.135 data.

¹⁴² Taking account of the error margin in this research (+/-2%), we estimate that the number of consumers affected is somewhere between just over 1 million to just over 2 million. Our 2019 consumer research reported a broadly consistent estimate i.e. between 1.7 and 1.8 million people. In addition, using our market research data, we estimate that around 750,000 mobile consumers are on a combined contract and unaware of their contract status. It is likely that many of these are out-of-contract and paying a similar amount or more than when in-contract.

¹⁴³ Vodafone were unable to provide data for the whole period and are therefore only included from January 2017 onwards. Vodafone offers bundled contracts and no split contracts, and including Vodafone’s data only from 2017 onwards explains why the share of bundled contracts does not fall from January 2016 to January 2017.

¹⁴⁴ Due to differing data sources, the figures in January 2019 do not precisely align with those as of 1 November 2018 in Figure A5.1.

A5.30 Figure A5.2 shows that bundled contracts have fallen as a proportion of pay-monthly contracts from 74% in January 2014 to just 46% in January 2019. This is due to a rise in split contracts and 12-month SIM-only contracts, from 4% to 15% and 15% to 34%, respectively. On average, the volume of bundled contracts fell by 7% per year since 2014.¹⁴⁵

Distribution of length of time spent out-of-contract

A5.31 We used the individual billing data to analyse the length of time that customers who go out-of-contract spend in this state before re-contracting. To do this, we used the end date of each customer's minimum contract period (included in the billing data) to calculate the number of months that each customer who was out-of-contract on 1 November 2018 had spent in this state.

The majority of out-of-contract bundled customers re-contract within a year

A5.32 The billing data indicates that there is considerable variation across customers in the length of time they have been out-of-contract.

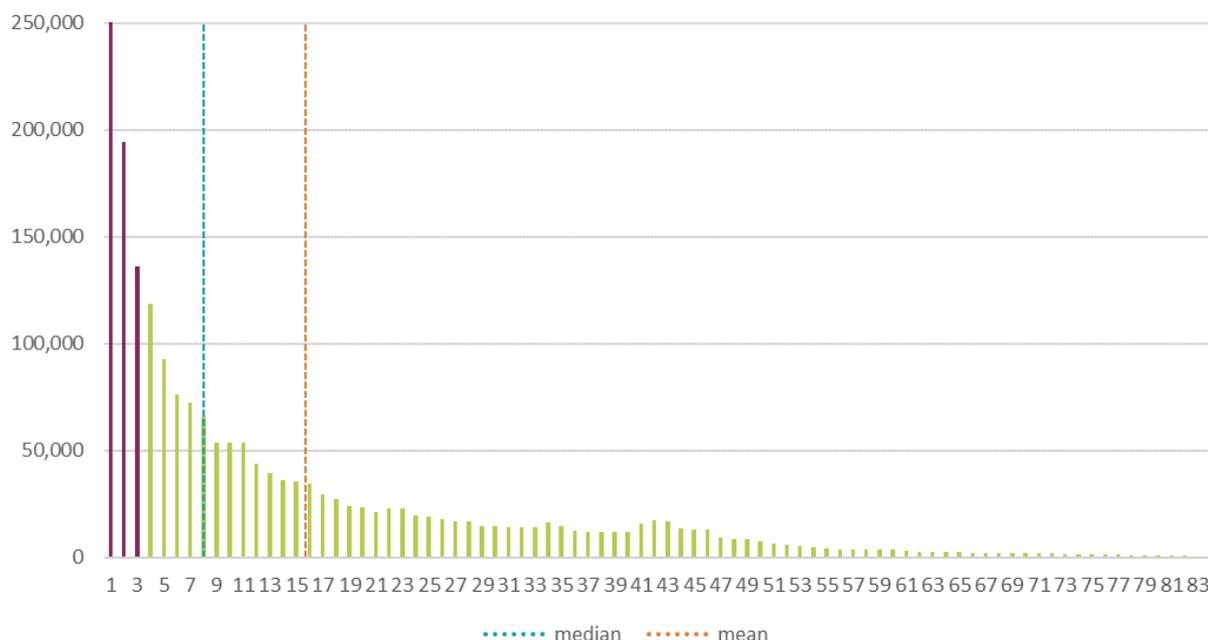
A5.33 We have found that 29% of customers have been out-of-contract for fewer than 3 months; and 62% for a year or less, as shown in Figure A5.3 below. We observe that the length of time out of contract is relatively stable (see A5.23), indicating that in general these proportions of customers re-contract within three months and a year.

A5.34 However, there is also a long tail of customers who have been out-of-contract much longer. Thus, while the median time spent out of contract is eight months, the mean length of time spent out of contract is significantly longer, at 15.7 months. Furthermore, around 16,000 (0.81%) and 5,000 customers (0.25%) have remained out of contract for more than seven and ten years respectively.¹⁴⁶

¹⁴⁵ From January 2014 to January 2016 the total volume of bundled contracts decreased, but this excluded Vodafone. From January 2017 to January 2019 the total volume of bundled contracts also decreased, this time including Vodafone. However, due to differing data sources these volume figures do not match to the aggregated figures in Figure A5.1.

¹⁴⁶ These customers are not displayed in Figure A5.3.

Figure A5.3: Distribution of time spent out-of-contract, graph cropped at 84 months (7 years)¹⁴⁷



Source: First s.135 data.

We matched all out-of-contract bundled customers in our data set to a comparable SIM-only product

A5.35 To estimate the savings that customers beyond their minimum contract period on bundled contracts could potentially make by switching (while keeping their current handset and comparable airtime package), we matched all bundled customers in our data set to a comparable SIM-only product.

A5.36 Specifically, we matched each out-of-contract bundled customer to a 30-day SIM-only tariff with their current provider. Our reasoning was:

- a) Customers were matched to tariffs with their current provider because factors other than price may determine which provider a customer prefers. Therefore, we have assumed that customers have selected the best provider in line with their preferences and we respect that choice.
- b) We used 30-day SIM-only tariffs as the comparator because, although they tend to be more expensive than 12-month SIM-only tariffs, they match the flexibility of being out-of-contract (i.e. a 30-day notice period).¹⁴⁸

¹⁴⁷ In this figure the median is indicated by the blue dotted line and the mean is indicated by the orange dotted line.

¹⁴⁸ On 1 July 2019, new regulations came into force which will make it easier for mobile customers to switch providers. Customers will be able to request and automatically receive a unique code by text, or through their online account, which they can give to their new provider to switch and port their existing mobile number (if they wish to do so). The new regulations will also ban notice period charges after the switching date, meaning consumers will no longer have to pay for their old and new service at the same time, and require providers to provide customers with clear information about the

- A5.37 We then calculated the difference between the price the customer was currently paying on their bundled tariff and the price they would pay on a comparable SIM-only tariff to estimate the potential savings for each out-of-contract customer.
- A5.38 We used several methods to match customers to comparable SIM-only tariffs, based on the three main components of an airtime plan: inclusive minutes, texts and data. There three matching methods were:
- a) **Baseline** methodology, which matches the customer to a SIM-only contract with the same or greater allowances of data, minutes and texts;
 - b) **'Data-only'** method, matching to a SIM-only tariff which maintains only the current data allowance as a minimum; and
 - c) **'Closest data match'**, matching to a SIM-only tariff with the closest data allowance, in absolute terms.
- A5.39 Add-ons, such as Netflix or Spotify, could also be relevant for some out-of-contract bundled customers.¹⁴⁹ However, since it is difficult to attach a monetary value to some of these add-ons, we have excluded them from the matching analysis. Furthermore, in many cases these add-ons do not continue beyond the minimum contract period and are therefore not relevant for the comparison between a customer's tariff beyond this point and a SIM-only tariff. While omission of add-ons simplifies the analysis, the exclusion of these extras, and others such as free international roaming which may carry on beyond the minimum contract period, may mean we have over-estimated the extent of overpayment for some customers.¹⁵⁰

Baseline matching methodology

- A5.40 Our baseline matching method requires that each out-of-contract customer maintains all three components of their current airtime bundle as a minimum. We therefore match them to a plan which has at least as many minutes, texts and data as included in their current plan. This methodology results in a conservative estimate of the overpayment because customers can only be upgraded to bundles with equivalent or more generous allowances and therefore the matched SIM-only tariff is more likely to have a higher monthly charge than in the other matching methods. We make this method our baseline, because it evaluates monetary savings that customers could make without reducing any element of their current package.

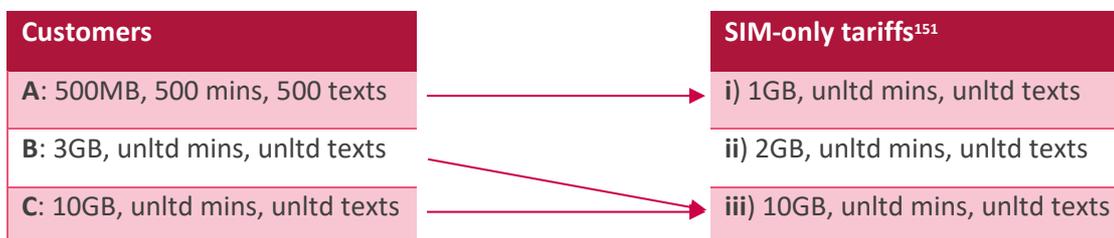
switching and number porting process. Ofcom, 2017. [Decision on reforming the switching of mobile communication services](#).

¹⁴⁹ Around 6% of out-of-contract customers were identified as having an add-on with a majority of these applying within the first few months customers beyond the end of the minimum contract period (69% and 81% within 3 and 6 months, respectively). Extras tend to be either 1) free subscription to content services (e.g. Spotify) or 2) zero-rated data for certain services (i.e. Facebook).

¹⁵⁰ In most cases, to maintain equivalence of bundles, the add-ons would need to be purchased separately in the event that a customer moved to a SIM-only tariff. The cost of these add-ons could offset the overpayment estimate.

A5.41 The example below illustrates the working of this matching method. In the example, customers maintain all components of their current bundle as a minimum but can be upgraded on some, or all, elements of their bundle, as is the case for customer A.

Figure A5.4: Baseline matching methodology



A5.42 Using this matching method, we were unable to find a comparable SIM-only tariff for around 3% of out-of-contract customers. In 2% of cases, the customer’s current provider does not offer a SIM-only that satisfies the matching requirements.¹⁵² The remaining failures to match occurred due to missing values in the data provided by the providers. This can be seen in Figure A5.8.

A5.43 The results we refer to in this document are calculated using this baseline method. We discuss the impact on our estimates from using the following two methods in paragraph A5.51. We found that the other methods produced slightly higher estimates of overpayment but there was not a large difference.

‘Data only’ method

A5.44 The second matching method, which we will refer to as the ‘data only’ method, requires only the data component to be maintained as a minimum. The other components of the airtime bundle are not considered and therefore it is possible for a customer to be matched to a SIM-only tariff where the inclusive minutes and/or texts are lower than in their current contract.

A5.45 In the example below, all consumers either maintain or see an increase in their current data allowance. Customer B, however, sees a reduction in the texts and minutes components of their current airtime bundle.

¹⁵¹ It is assumed that tariff i) has the lowest monthly charge, and iii) has the highest.

¹⁵² This largely arises when the provider does not offer unlimited data SIM-only tariffs and so out-of-contract bundled customers with very high, or unlimited, data allowances are not matched to a SIM-only tariff.

Figure A5.5: ‘Data only’ matching methodology



A5.46 We have chosen to prioritise the data component in this instance for two reasons:

- a) Just under half of the SIM-only tariffs provided to us include unlimited texts and minutes, and over 80% include at least unlimited minutes or texts. The proliferation of these allowances indicates that texts and minutes may be less relevant when determining the SIM-only tariff that matches most closely the current airtime bundle of a customer; and
- b) Evidence suggests that data allowance is by far the most important factor in determining the pay-monthly price of an airtime bundle.¹⁵³

A5.47 In some cases, a customer may be matched to a package with a lower allowance under this method compared to our baseline method (because, even though the data element is matched in the same way through both methods, in this method it is possible for them to be matched with a plan with fewer minutes or texts). Since bundles with lower call and text allowances are likely to be cheaper, this matching method is likely to result in a slightly higher overpayment estimate compared to our baseline method estimates.

‘Closest data match’ method

A5.48 The third matching method, which we refer to as the ‘closest data match’ method, also prioritises the data component but, instead of maintaining the current data allowance, we match each out-of-contract customer to a SIM-only tariff with the data allowance that is closest, in absolute terms, to the current data allowance.¹⁵⁴ The other components are not considered in this matching process.¹⁵⁵

A5.49 In the example below, customers A and B are upgraded on at least one component of their airtime bundle, while customer C’s tariff is matched to a SIM-only tariff with a lower data allowance.¹⁵⁶

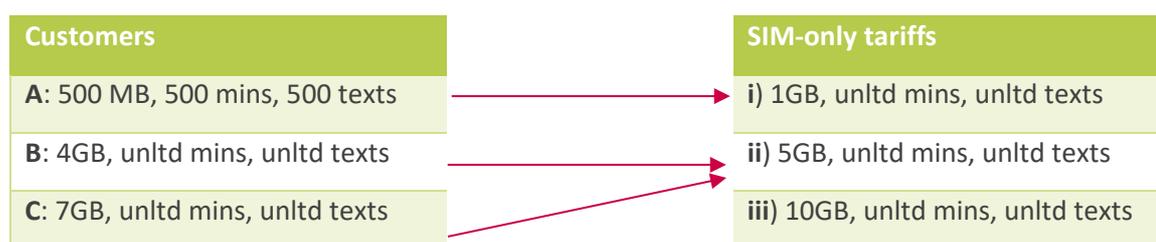
¹⁵³ 2018 Pricing Trend Report, p. 14-15.

¹⁵⁴ This means that no customer will ever be matched to a tariff with an unlimited data allowance, with the exception of those with unlimited data in their current bundle. Where customers’ current data allowance is equidistant to data allowances in several SIM-only tariffs, the customer is matched to the cheapest of those SIM-only tariffs.

¹⁵⁵ Inclusive minutes and texts were not considered to avoid any conflicts in component priorities.

¹⁵⁶ In theory, it is possible for customers to be downgraded on all three components of their bundle.

Figure A5.6: ‘Closest data match’ methodology



A5.50 This matching method may, in some cases match customers to SIM-only tariffs with lower minutes, texts or data allowances than their current bundle, or in other cases it will match them with more higher allowances. In the first two methods (the baseline method and the ‘data-matching’ method), the data allowance was never reduced, however in this method it may be. Therefore, because bundles with lower minutes, texts or data allowances are likely to be cheaper, this matching method is likely to result in a higher estimate of overpayment compared to the estimates based on our first two matching methods.

Our robustness checks support our broad conclusions

A5.51 Estimates of monthly overpayment could potentially be sensitive to the method used to match out-of-contract customers to comparable SIM-only tariffs. To check the robustness of the baseline estimates, we undertook the analysis under our two alternative matching methods. As expected, alternative matching methods result in higher overpayment estimates. The broad conclusions, however, remain unchanged, as shown in Figure A5.7.

Figure A5.7: How estimates of overpayment vary by matching method

Matching method	Average monthly overpayment per out-of-contract customer	Average monthly overpayment per out-of-contract customers who would save money on a SIM-only contract	Average annual overpayment per out-of-contract customer
Baseline	£5.91	£10.83	£37.08
‘Data only’	£6.27	£11.10	£39.61
‘Closest data match’	£7.51	£11.26	£47.61

Source: First s.135 data.

A5.52 As noted above, the detailed analysis which we present in this annex is calculated using our baseline matching method because this method takes account of the savings customers could make without reducing any of the current allowances in their package. We explain how we have calculated the average monthly and annual overpayment in the following sections.

The monthly overpayment varies considerably across out-of-contract customers

Just over two-thirds of customers would save money on a SIM-only contract; just over a quarter would pay more if they re-contracted

- A5.53 After matching each customer to a comparable SIM-only tariff using one of the methods above, we then calculated the difference between their current monthly charge and the comparable SIM-only cost to estimate the extent of overpayment by customers.
- A5.54 We looked at the distribution of overpayment across all out-of-contract customers, where we were interested in exploring how the extent of overpayment varied across customers: particularly in relation to observable characteristics including length of time out of contract, and provider. We considered examining vulnerability indicators, but providers were not able to supply that data,¹⁵⁷ with the exception of customer age, which we have analysed in paragraphs A5.100 to A5.101 below.
- A5.55 We found there was considerable variation in the extent of overpayment across customers. According to our baseline matching method, while the majority of out-of-contract customers (70%) would save money on a comparable SIM-only tariff, a material proportion (27%) would be financially better off remaining out-of-contract on their current tariff.¹⁵⁸
- A5.56 Around 31% of those who would save from switching would achieve savings of less than £5 a month.¹⁵⁹ At the same time, nearly 28% of those who would save from switching would achieve savings of more than £15 a month. Figure A5.8 shows the number of customers who would save different amounts by switching to comparable SIM-only tariffs.

¹⁵⁷ A new General Condition was introduced in October 2018 requiring providers to have policies and procedures relating to the gathering of data on potential vulnerabilities. This is discussed further in paragraph A5.100.

¹⁵⁸ As noted in paragraph A5.42 we were unable to match 3% of the customers in our dataset.

¹⁵⁹ That is, 22% of the 70% who would save money on a SIM-only tariff.

Figure A5.8: Savings available to the out-of-contract customers under the baseline matching method¹⁶⁰



Source: First s.135 data.

A5.57 Because of this significant variation in the potential savings available to out-of-contract customers (and, as we will show below, the different picture depending how long a customer has remained out of contract or which provider they are with), we do not consider it is meaningful to look at the average level of overpayment in isolation.

A5.58 Nonetheless, as it provides an indication of the scale of the issue, we calculated the average monthly overpayment across all out-of-contract customers by:

- a) summing the price difference for each out-of-contract customer across all out-of-contract customers, and
- b) dividing by the total number of out-of-contract customers.

A5.59 We then separately calculated the average overpayment for just those out-of-contract customers who would be better off on a SIM-only tariff, as well as the average savings made by those out-of-contract customers who are better off remaining out-of-contract than switching to SIM-only.

A5.60 As Table A5.1 shows, the average monthly overpayment is c.£11 for those who could save by moving to a SIM-only contract, compared to c.£6 when all customers are considered. Those who financially benefit from remaining on their current deal are around £6 p.m. better off compared to the equivalent SIM-only contract.

¹⁶⁰ When considering only those out-of-contract customers that do match (i.e. excluding the 3% that have no monthly charge, no bundle information, or do not match a SIM-only tariff in this matching method), 28% would save less than £0 and 20% would save £15 or more. Other savings buckets remain unchanged (due to rounding).

Table A5.1: Average monthly overpayment for different customers

	Number of customers (000s)	Average monthly overpayment
All out-of-contract customers	2,004	£5.91
Out-of-contract customers who would save money on a SIM-only contract	1,398	£10.83
Out-of-contract customers who would pay more on a SIM-only contract	545	-£6.03

Source: First s.135 data.

A5.61 To put this in context, we have looked at the average monthly charges in our sample, as shown in Table A5.2 below. The average actual monthly bundle charge for out-of-contract customers on 1 November 2018 was c. £25. This table shows that those customers who are financially better off on their current terms are, on average, paying a relatively low monthly charge of £12.21. This suggests that some customers are on good value deals that may no longer be offered.

Table A5.2: Average actual and comparable SIM-only monthly charges

	Average actual monthly charge	Average comparable SIM-only monthly charge
All out-of-contract customers	£25.32	£19.08
Out-of-contract customers who would save money on a SIM-only contract	£30.24	£19.41
Out-of-contract customers who would pay more on a SIM-only contract	£12.21	£18.24

Source: First s.135 data.

The extent of overpayment varies by length of time out-of-contract

A5.62 We find that monthly savings available to out-of-contract customers vary considerably with the time spent out-of-contract:

- a) The average monthly savings are relatively high (£7.33) for customers who reached the end of their minimum contract period within the last 24 months.¹⁶¹ And for those who have been out-of-contract for less than one year, the average monthly saving is £7.62.¹⁶² High savings for these customers is likely to reflect a shift towards more expensive handsets.

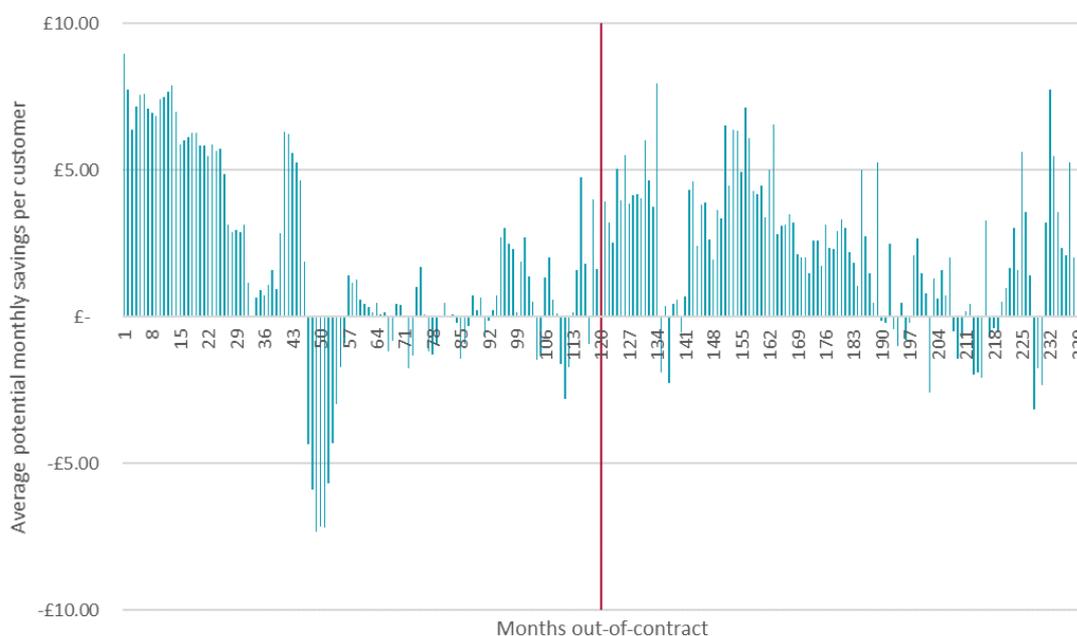
¹⁶¹ 78% of out-of-contract customers have been out-of-contract for less than two years.

¹⁶² 61% of out-of-contract customers have been out-of-contract for less than one year.

- b) The monthly saving is more frequently negative for customers who have been out-of-contract between 47 and 112 months (i.e. almost four years to over nine years); these customers on average are financially better off remaining out-of-contract on their current terms instead of taking out a comparable SIM-only tariff.
- c) A small minority (around 4,000 customers) of all out-of-contract bundled customers have been out-of-contract for over ten years; these customers could make some savings (on average c. £2.67 p.m.) by switching to a comparable SIM-only tariff. The overpayment has been material, given that these customers have been on this particular bundled contract for more than ten years.
- d) When looking at savings that could be made by only those who would save money by switching (rather than the average across all customers), we find that, in general, savings would be greater for those who have gone out-of-contract more recently, reflecting market trends towards more expensive bundled contracts largely due to the rise in handset price and additional services which are included in the bundle price.

A5.63 Figure A5.9 below sets out the average monthly savings by length of time out-of-contract. It is important to note that 95% of customers are out-of-contract for less than four years, and furthermore, 99.79% are out-of-contract for less than ten years. Therefore, the portion of the graph to the right of the red vertical line (which marks 120 months) shows savings available to only 0.21% of out-of-contract bundled customers, or around 4,000 customers.

Figure A5.9: Savings available by time spent out-of-contract under the baseline matching method¹⁶³

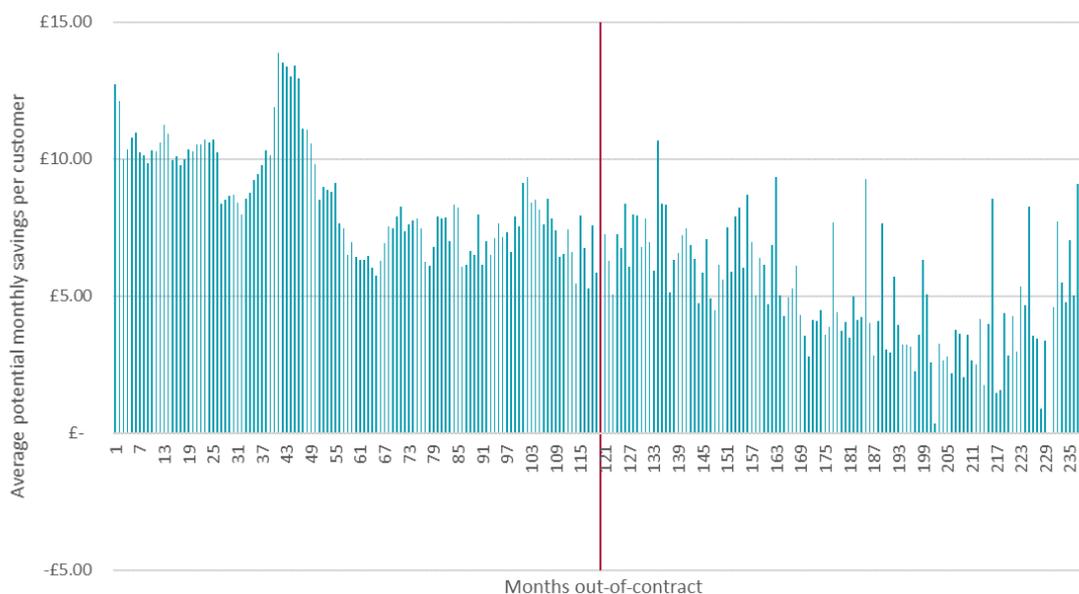


Source: First s.135 data.

¹⁶³ From around four to eight years out-of-contract, cheaper than typical bundled contracts from a couple of providers are driving the lower and/or negative average monthly savings.

A5.64 Figure A5.10 below shows the potential savings just for those customers who would save money on a SIM-only contract. In general, the savings are greater for those who have gone out-of-contract more recently. This perhaps reflects the fact that handsets have become more expensive over time, which is likely to drive a higher price for bundled contracts relative to SIM-only.

Figure A5.10: Savings available by time spent out-of-contract for those out-of-contract customers who would save by switching to a SIM-only tariff



Source: First s.135 data.

We also considered the average annual overpayment by an out-of-contract customer

A5.65 The average **monthly** overpayment by an out-of-contract customer provides one indication of the materiality of the issue. However, the length of time that customers typically remain out-of-contract is another important dimension to consider. Customers who remain out-of-contract for longer will typically be overpaying for longer than those who re-contract within a shorter period.

A5.66 One approach to summarising these two dimensions could be to calculate a simple average overpayment, by multiplying the average monthly overpayment by the average length of time out-of-contract. However, this approach would lose a considerable amount of the richness of information available to us from the billing dataset we obtained on the distribution of both variables: we were able to relate the overpayment of each customer to the length of time they spend out of contract in a given year, rather than take the average of each variable. Moreover, it would be likely to give a misleading picture, given that the distribution of the length of time out-of-contract, in particular, is highly skewed (see figures A5.4 and A5.5 above) and that the monthly overpayment itself varies considerably with length of time out-of-contract.

- A5.67 To combine the two dimensions – monthly overpayment and length of time out-of-contract – in a way which better exploits the data available to us, we:
- a) Created an annual overpayment figure for each out-of-contract customer by multiplying their monthly over/underpayment by the length of time they had been out-of-contract. For customers out-of-contract for longer than 12 months, the monthly price difference was multiplied by 12 (as this is the maximum number of monthly payments in a year).
 - b) This annual overpayment was then summed across all out-of-contract customers, and
 - c) Divided by the number of out-of-contract customers to give an estimate of the annual average overpayment by an out-of-contract customer.
- A5.68 Based on this method the resulting amount of overpayment, which we refer to as the average annual overpayment, for a customer on a bundle beyond the minimum contract period is £37. If we only consider the overpayment for those customers who would save money by switching, the average annual overpayment is £74.
- A5.69 To put this average overpayment in context, the average annual monthly charge for all customers in our dataset (i.e. all out-of-contract bundled customers) is £25.32, or £303.81 per year.

Comparison with previous estimates of overpayment

- A5.70 Our estimates are lower than previous estimates of the average monthly overpayment. Citizens' Advice estimated a potential monthly saving of £22 for an average out-of-contract customer, based on desk research of 721 bundled and SIM-only tariffs available at the time from the main providers. Our 2018 Pricing Trends report estimated an average monthly handset charge (and therefore potential monthly saving) of £18.52, based on the difference between the weighted average monthly spend of pay-monthly with handset customers and the weighted average monthly spend of pay-monthly SIM-only customers. The bespoke analysis we have undertaken as part of our current analysis, based on individual customer billing data for two million out-of-contract customers, indicates an average monthly overpayment of c.£6.
- A5.71 The difference between our estimate and that from Citizens Advice reflects the fact that theirs was based on currently available bundled tariffs, whereas many out-of-contract customers are on tariffs which no longer exist. Using billing data to estimate the price difference tends to find smaller price differentials for two main reasons. Firstly, handsets were typically significantly cheaper in the past than they are today, so the handset element of a bundled tariff for a customer who has been out-of-contract for a relatively long time will tend to be smaller than the handset element of a current bundled tariff. Secondly, a number of providers offered cheaper deals for a given airtime allowance in the past (e.g. to promote 4G uptake and data usage), with the result that looking at currently available bundled tariffs will tend to over-state the amount that customers on these legacy tariffs pay.

- A5.72 The Citizens Advice annual aggregated overpayment figure was calculated by first using survey data to estimate the number of customers out-of-contract for different lengths of time (i.e. 1-2 months, 3-4 months, 5-6 months etc). They then calculated the annual aggregate overpayment by multiplying their estimate of the average monthly overpayment (i.e. £22) by the number of months each cohort of customers was estimated to be out-of-contract for (i.e. £22 * 1 month * number of customers out-of-contract for 1-2 months + £22*3 months*number of customers out-of-contract for 3-4 months+....+ £22*12 months*number of customers out-of-contract for 12 months or more).¹⁶⁴
- A5.73 Our 2018 Pricing Trends report figure, meanwhile, was obtained by multiplying the monthly difference between the average pay-monthly with handset spend and the average pay-monthly SIM-only spend (£18.52, which it was assumed related to the cost of the handset) by the estimate of the number of customers out-of-contract on combined tariffs (1.5 million, derived from Ofcom consumer research) by 12. This approach assumed that the number of customers out-of-contract was broadly stable over time (as was suggested by Ofcom consumer research), meaning that while in any given month of the year there was approximately 1.5 million out-of-contract pay-monthly bundled customers, they were not necessarily the same individuals through the year: as some customers reach the end of their minimum contractual term, others re-contract or switch provider.¹⁶⁵
- A5.74 We note that Citizens Advice also previously estimated the annual overpayment per out-of-contract customer to be significantly higher than our £37 estimate, at £264 per out-of-contract customer per year. This reflects the fact that their estimate of the average monthly price difference was significantly higher than ours (£22 per month compared with our estimate of c.£6) and also that they assumed customers remained out-of-contract for a full year after the end of their minimum contract period.¹⁶⁶ While it is true that the average length of time out-of-contract is more than a year, this average overstates the typical experience of an out-of-contract customer because of the highly skewed nature of the distribution (as shown in Figure A5.3 above).
- A5.75 In contrast, our estimates incorporate information on the population distribution of length of time customers spend out-of-contract (rather than a summary measure of this distribution such as the average or median) because we had access to individual level billing data. Where data are skewed in this way, using the population distribution rather than a summary measure will typically result in more accurate estimates.
- A5.76 In our view, our method for calculating the extent of overpayment is a robust way of analysing the characteristics of bundled contracts in the mobile sector and provides an accurate assessment for the extent of that overpayment.

¹⁶⁴ Citizens Advice super-complaint, p.53.

¹⁶⁵ 2018 Pricing Trend Report, p.22.

¹⁶⁶ For the purposes of their annual overpayment per out-of-contract customer calculation. Their estimate of total aggregate overpayment harm (described below) used survey data on length of time out-of-contract to capture the fact that not all customers remain out-of-contract for a full 12 months.

Total annual aggregate overpayment is small in the context of the overall mobile market, but not insignificant

- A5.77 To give an indication of the scale of the issue across the industry as a whole, we also used the billing data to estimate the annual aggregate overpayment across all out-of-contract customers. To calculate this figure, we:
- a) summed the monthly overpayment for each individual out-of-contract customer in our dataset over all out-of-contract customers to give an estimate of the total aggregate monthly overpayment;
 - b) multiplied this figure by 12 to provide an estimate of the total aggregate annual overpayment.
- A5.78 We multiplied the monthly overpayments by 12 in this (aggregate) case, instead of weighting by months out-of-contract, as we did to calculate a representative annual per customer payment. This is because we want to reflect the extent to which the providers are benefitting, or not, from these price differentials over a year, which is the net monthly overpayment multiplied by 12. Since the distribution of length of time out-of-contract is roughly stable, as explained in paragraph A5.21 to A5.23, we can assume that someone who re-contracts after one month will be replaced by someone else who will remain out-of-contract for one month, and so on. We found the aggregate (industry-wide) annual overpayment was £142m.
- A5.79 We also calculated this figure separately for those out-of-contract customers who would be better off switching to a SIM-only tariff (i.e. excluding those who benefit financially from remaining out-of-contract).
- A5.80 The aggregate annual overpayment just for the group who would save money by switching to a SIM-only tariff is £182m.
- A5.81 The total overpayment is small when viewed in the context of the overall mobile market. In 2017, retail mobile voice and data revenues in the UK were valued at £15.6bn and so the overpayment constitutes 0.5% of annual revenues in the sector.¹⁶⁷ Nonetheless, it is not an insignificant amount.
- A5.82 Our estimates of total annual overpayment are also somewhat lower than previous estimates, for the reasons discussed above:
- a) Citizens Advice estimated that the total annual level of what it called the ‘loyalty penalty’ was £473m;¹⁶⁸ and
 - b) Ofcom’s 2018 Pricing Trends Report estimated that the total annual overpayment was approximately £330m.¹⁶⁹
- A5.83 A key source of difference between the estimates presented in this document and both of these previous estimates is the significant difference in our most recent estimate of the

¹⁶⁷ CMR 2018, p. 51.

¹⁶⁸ Citizens Advice super-complaint, p. 10, 12.

¹⁶⁹ September 2018 consultation, paragraph 1.7 and 2018 Pricing Trend Report.

extent of monthly overpayment. As noted from paragraph A5.77 above, this difference arises from the fact we were able to use data on the actual monthly charges paid by out-of-contract customers, rather than looking only at currently available tariffs (as was the case for the Citizens Advice estimate). Another key source of difference between the estimates we present here and the Citizens' Advice figure is the difference in our estimates of the number of bundled customers who are out-of-contract. As noted at paragraph A5.81(a) above, its estimates of this figure was considerably higher than ours.

The overpayment varies by provider

A5.84 We examined data from six mobile operators: EE, Vodafone, O2, Three, Virgin Mobile and Tesco Mobile as these are the largest providers offering bundled handsets either directly, indirectly through third parties such as Carphone Warehouse or both. The extent to which bundled customers may be overpaying when out-of-contract varies by provider, due to their different portfolios of current and legacy bundled and SIM-only contracts.

EE and Vodafone have the most out-of-contract bundled customers

A5.85 The number of bundled customers beyond their minimum contract period for each provider varies considerably, as shown in Table A5.3 below. EE had the highest number of out-of-contract bundled customers, followed by Vodafone and then Three. Despite its relatively high share of the overall retail market (22%)¹⁷⁰, O2 sells relatively few bundle contracts as, since 2013, it has focused on selling split contracts directly under its Refresh (and now Custom) plans. Nevertheless, it still sells bundled contracts through third party sellers such as Carphone Warehouse, and a considerable number of those customers are out-of-contract. As would be expected, given their overall market share,¹⁷¹ MVNOs Tesco Mobile and Virgin Mobile had the fewest customers on bundles beyond their minimum contract period out of the providers included in our analysis.

¹⁷⁰ Source: Enders Analysis. This refers to market share of subscribers at December 2018. This share does not include Tesco Mobile (a joint venture with O2) and Giffgaff (owned by the same parent company as O2, Telefonica).

¹⁷¹ According to Enders Analysis, Tesco Mobile's market share as of December 2018 was 6% of retail mobile subscribers, and Virgin Mobile's was 4%.

Table A5.3: Bundled customers no longer in the minimum contract period, by provider

Provider	All out-of-contract bundled customers		Customers who have been out-of-contract for more than 3 months	
	Number (000s)	% of industry	Number (000s)	% of industry
All industry	2,004		1,421	
EE	[X]	41 to 45	[X]	36 to 40
Vodafone	[X]	21 to 25	[X]	21 to 25
Three	[X]	16 to 20	[X]	16 to 20
O2	[X]	6 to 10	[X]	6 to 10
Tesco Mobile	[X]	6 to 10	[X]	6 to 10
Virgin Mobile	[X]	0 to 5	[X]	0 to 5

Source: First s.135 data.

Vodafone’s out-of-contract bundled customers are paying considerably more than their equivalent SIM-only price; Tesco Mobile customers are not

A5.86 As noted above, the average monthly overpayment across the industry is £5.91, or £10.83 for those customers who would gain financially from moving to a SIM-only contract. This, however, conceals considerable differences between providers.¹⁷² We note that providers for whom the extent of overpayment appears lower are not necessarily offering a better deal to their customers (though this may be the case in some instances). A lower potential saving could in fact reflect more expensive SIM-only tariffs.

A5.87 If we consider the average monthly overpayment:

- a) Vodafone’s out-of-contract customers were overpaying by the largest amount: [X], (between £10 and £13 per month)¹⁷³ a figure considerably more than the industry average;
- b) The average monthly overpayments for O2 customers were just above the industry average¹⁷⁴ of £5.91 and EE and Virgin Mobile were slightly lower;
- c) The average monthly overpayment for Three was less than half of the industry average; and

¹⁷³ This range does not indicate that the overpayment per customer lies in the range of £10 to £13 per month – some customers will be overpaying by more and some would not be better off switching to a SIM-only product. It indicates that the actual average is within this range.

¹⁷⁴ There is a considerable difference in potential savings between O2’s customers who purchased their bundle through direct and indirect channels, as discussed from paragraph 3.47(d).

- d) The out-of-contract customers with Tesco Mobile would save very little by switching to a SIM-only tariff, and on average they are financially better off staying on their current terms. Nonetheless, there are some Tesco Mobile customers who are overpaying: these customers would save, on average, less than £3 per month.

A5.88 We also considered the average monthly overpayment for just those customers who would save money on a comparable SIM-only contract, as shown in Figure A5.11 below. That is, excluding the roughly one third of customers who pay more on a SIM-only contract.

Figure A5.11: Average monthly overpayment per out-of-contract customer and per out-of-contract customer who would save by switching to a SIM-only tariff, by provider

[✂]

Source: First s.135 data.

- A5.89 On this basis, Vodafone and Three's customers are overpaying by more than the industry average of just under £11; O2 is around the industry average; EE is slightly lower, and Virgin Mobile is somewhat lower again. Tesco Mobile customers that would be financially better off switching are currently overpaying by less than £3 per month on average.
- A5.90 In addition, we considered the picture for each provider, considering only those customers who had been out of contract from longer than three months, as shown in Table A5.4 below. We looked at this because some providers (in particular Vodafone and EE) will be applying their discounts to customers who have been out-of-contract for longer than three months (see Section 4 where we discuss these commitments). We find that it does not make much difference to the monthly average overpayment whether we include those customers who have been out-of-contract for less than three months.
- A5.91 Looking at those customers who are overpaying and have been out of contract for more than three months, Vodafone's customers are overpaying by the largest amount, with a figure above the industry average. Three and O2 are around the industry average of £10.34; EE and Virgin Mobile are below, and Tesco Mobile customers are overpaying by less than £3.

Table A5.4: Monthly overpayments of different groups of customers, by provider

Provider	All out-of-contract customers		Out-of-contract customers who are overpaying (would save by switching)		Out-of-contract customers who are overpaying and have been out of contract for more than 3 months	
	% of all industry in this category	Amount	% of all industry in this category	Amount	% of all industry in this category	Amount
Industry in aggregate		£5.91		£10.83		£10.34
Vodafone	21-25%	£10-£13	31-35%	£13-£16	31-35%	£13-£16
O2	6-10%	£6-£10	6-10%	£10-£13	6-10%	£10-£13
EE	41-45%	£3-£6	36-40%	£6-£10	36-40%	£6-£10
Three	16-20%	£0-£3	11-15%	£10-£13	11-15%	£10-£13
Virgin Mobile	0-5%	£3-£6	0-5%	£6-£10	0-5%	£6-£10
Tesco Mobile	6-10%	Better off by less than £1	0-5%	£0-£3	0-5%	£0-£3

Source: First s.135 data.

A5.92 We make the following observations on the provider-level monthly data:

- a) It does not make a large difference if we include or exclude those who have been out-of-contract for less than three months.
- b) Vodafone’s customers could save the most by moving to a SIM-only contract, whichever category we assess, with overpayments considerably above the industry average. Almost all of Vodafone’s out-of-contract customers on bundles would save money on a SIM-only tariff.
- c) For the group of Three’s customers who would save by switching to SIM-only, the average overpayment is considerable, and more than the industry average ([>]: £10 to £13).
- d) Tesco Mobile’s out-of-contract customers appear to be paying little more, if any, than they would on a comparable SIM-only tariff (less than £3 per month for those who would save by switching). All the other providers’ customers – excluding Tesco Mobile – are overpaying by at least £6 per month when we only consider those who would be better off on a SIM-only tariff, and in some cases more than £10 p.m.

A5.93 As part of our analysis, we have also examined providers' prices: both the actual monthly charge for out-of-contract customers and the comparable SIM-only tariffs. This information provides some context for the overpayment ranges presented above, and how those ranges compare to each provider’s pricing approach. Table A5.5 sets these out below: the actual charge is the monthly payment that the out-of-contract customers in the dataset are currently paying for their bundle; in most cases this will not correspond to currently available bundled tariffs. We found that:

- a) Vodafone overpayments are high because Vodafone customers in our dataset had relatively high monthly bundled charges compared to the industry average.
- b) Three has relatively high SIM-only tariffs which is why the average monthly overpayment is lower than the industry average.
- c) O2 has higher than average monthly bundle charges, and high SIM-only tariffs.
- d) EE’s pricing reflects the industry average.
- e) Tesco Mobile has very low relative monthly bundle charges and SIM-only tariffs.
- f) Virgin Mobile has relatively low bundle prices and low SIM-only tariffs.

Table A5.5: Average monthly bundled and SIM-only charges for out-of-contract bundled customers, by provider

Provider	Average monthly charges	
	Actual charge	Comparable SIM-only tariff
Industry in aggregate	£25.32	£19.08
Vodafone	£30-£32	£18-£20
O2	£28-£30	£20-£22
EE	£24-£26	£18-£20
Three	£24-£26	£20-£22
Virgin Mobile	£16-£18	£8-£10
Tesco Mobile	£8-£10	£10-£12

Source: First s.135 data.

Average annual overpayment: the picture changes slightly when we weight by length of time out of contract

A5.94 We can also consider the weighted average overpayment that a customer would pay over the course of a year (for convenience we call this an average annual overpayment).¹⁷⁵ This takes into account differences in how long the bundled customers of each provider typically spend out of contract, by provider. As we noted above, the annual overpayment across the industry was £37, and £74 when we considered just the 70% of customers who could save on a SIM-only contract.

A5.95 Broadly speaking, the annual picture is similar to monthly overpayment, with a few differences:

¹⁷⁵ We explained how this was calculated in paragraph A5.67 above.

- a) Vodafone customers continue to overpay by the largest amount, c. £[X] p.a. The annual overpayment is slightly worse than when we consider the monthly picture; perhaps because Vodafone customers stay out-of-contract slightly longer than the industry average (see Table A5.6 below).
- b) The picture for Three changes when we consider annual overpayments. On average, its customers would be financially better off staying on their current tariff, by £[X] p.a. However, over half of Three's customers would be better off on a SIM-only tariff, and they would save £[X] p.a. on average. Three's customers tend to stay out-of-contract for longer than the industry average, but it tends to be customers who have been out-of-contract for less than 12 months that overpay by the largest amount with customers out-of-contract for between two to ten years better off staying on their current contract on average.¹⁷⁶
- c) Virgin Mobile customers are overpaying by £[X] p.a. on average. Although its monthly overpayments were below the industry average, the annual ones are well above. Virgin Mobile customers stay out-of-contract for considerably longer than those of other providers.
- d) O2 customers overpay by £[X] p.a. on average, slightly above the industry average, as was the case with the previous (monthly) analysis.
- e) EE customers overpay by £[X] p.a. on average, a little less than the industry average, as was the case with the previous (monthly) analysis.
- f) The picture for Tesco Mobile customers is very similar whether we consider annual overpayments or monthly figures. Tesco Mobile customers, on average, would pay more on a SIM-only contract, by £[X] p.a. For the group that would save money on a SIM-only tariff, the average annual savings are £[X].

¹⁷⁶ The average annual overpayment is calculated by multiplying each customer's monthly overpayment by the number of months they have been out-of-contract, up to a maximum of 12 months (for those that have been out-of-contract for a year or more). These annual overpayments are summed and divided by the number of customers to get an average. Therefore, customers that have been out-of-contract for less than 12 months will be weighted less in the average annual overpayment than in the monthly one.

Table A5.6: Average length of time out of contract, by provider

	Mean number of months out of contract	Median number of months out of contract
Industry as a whole	15.7	8
Virgin Mobile	31-33	28-30
Three	19-21	10-12
Vodafone	16-18	10-12
O2	13-15	7-9
EE	13-15	7-9
Tesco Mobile	13-15	10-12

Source: First s.135 data.

Differences between customers who purchase contracts through direct and indirect channels

A5.96 We have also looked at how the average overpayment changes based on whether the customer bought their package directly from the provider, or indirectly through a third party (such as Carphone Warehouse). We find that, in general, customers who have purchased their bundle indirectly would make greater savings from switching to a SIM-only contract (around 30% more).

Table A5.7: Monthly average overpayment, by channel of purchase

	Monthly average overpayment per out-of-contract customer
All out-of-contract customers	£5.91
Direct channels	£5.38
Indirect channels	£7.06

Source: First s.135 data.

A5.97 We have also looked at the difference in overpayment between direct and indirect channels depending on whether the customer would save by switching and only those who have been out-of-contract for more than three months (as above). In each case, the pattern is similar in that those who have purchased through indirect channels would save more by moving to a SIM-only contract.

A5.98 Around one third of out-of-contract bundled customers have purchased through indirect channels. However, it is more meaningful to consider the picture on a provider-by-provider basis. Tesco Mobile, for example, has no indirect bundled customers, and Three and Virgin have relatively few. O2, by contrast, has the vast majority of its bundled sales through

indirect channels¹⁷⁷ and, therefore, a large proportion (over 70%) of O2’s out-of-contract bundled customers are indirect customers. EE and Vodafone have more indirect out-of-contract bundled customers in absolute terms than O2, but indirect customers represent a lower share of their out-of-contract bundled customers.

Table A5.8: Numbers of direct and indirect customers, by provider¹⁷⁸

[X]

Source: First s.135 data.

A5.99 As shown in Table A5.9 below, O2’s indirect customers are paying significantly more: £8 to £10 on average, but £10 to £12 when only those customers overpaying are included. It is these indirect customers which account for O2’s relatively high average monthly overpayment, shown in Figure A5.11 above. When only its direct bundled customers are considered, O2’s average overpayment is less than £2 p.m. In contrast, Three’s direct customers (the majority) are worse off than their indirect customers. There is not a great deal of difference between direct and indirect customers for Virgin Mobile, EE and Vodafone and, as noted above, Tesco Mobile has no indirect customers.

Table A5.9: Average monthly overpayment for direct/indirect out-of-contract customers, by provider

	Direct	Indirect	Average
All industry	£5.38	£7.06	£5.91
O2	£0 to £2	£8 to £10	£6 to £10
Three	£2 to £4	Less than £0	£0 to £3
Vodafone	£12 to £14	£10 to £12	£10 to £13
EE	£4 to £6	£4 to £6	£3 to £6
Virgin Mobile	£4 to £6	4 to £6	£3 to £6
Tesco Mobile	Less than £0	N/A	Less than £0

Source: First s.135 data.

¹⁷⁷ See paragraph 3.47(d) above.

¹⁷⁸ Some providers were not able to identify whether an out-of-contract customer was a direct or indirect customer. This applied to [X]% of O2’s out-of-contract customers, [X]% of EE’s and [X]% of Virgin Mobile’s (2% of out-of-contract customers overall). We contacted O2 about these unknown direct/indirect customers who said the information is not held as these customers started their contracts before [X] which pre-dates their data source for this information. These customers were excluded from the proportions shown in this table but are included in our other analysis.

Older customers are not particularly disadvantaged

A5.100 Apart from data on age, providers were largely unable to provide information on the socio-economic status or vulnerability of their out-of-contract customers.¹⁷⁹ Prior to October 2018, there was no formal requirement on providers to maintain in their records if a customer was deemed to be vulnerable. In October 2018, a new General Condition came into force (Condition C5) which requires providers to have policies and procedures for the fair and appropriate treatment of consumers whose circumstances may make them vulnerable, including how they record that information. However, because this Condition had only been in place for a month at the time of our information request, providers had collected very limited information on vulnerability characteristics and the collected information does not reliably reflect the customer population.

A5.101 The only customer characteristic that we found had been reliably recorded was age.¹⁸⁰ Our analysis of the data found that the amount of time spent out-of-contract and the available monthly savings vary with age:

- a) There were far more (i.e. 65+) older out-of-contract bundled customers than younger customers (i.e. 16-24). However, the age group with the highest number of out-of-contract customers was the 45-54 age bracket (Figure A5.12).¹⁸¹
- b) Older customers are more likely to be out-of-contract for longer. The average time spent out-of-contract by those aged 16-24 was eight months, whereas those aged 65+ had, on average, spent 18 months out-of-contract (Figure A5.13).¹⁸²
- c) Average net monthly savings from switching to SIM-only with their current provider decrease with age. While 25-34 year olds could save £9.30 a month on average by switching to an equivalent SIM-only tariff, the average monthly savings were £6.18 for 45-54-year olds and further decrease to £5.05 and £2.53 for the 55-64 and 65+ age brackets, respectively (Figure A5.14).

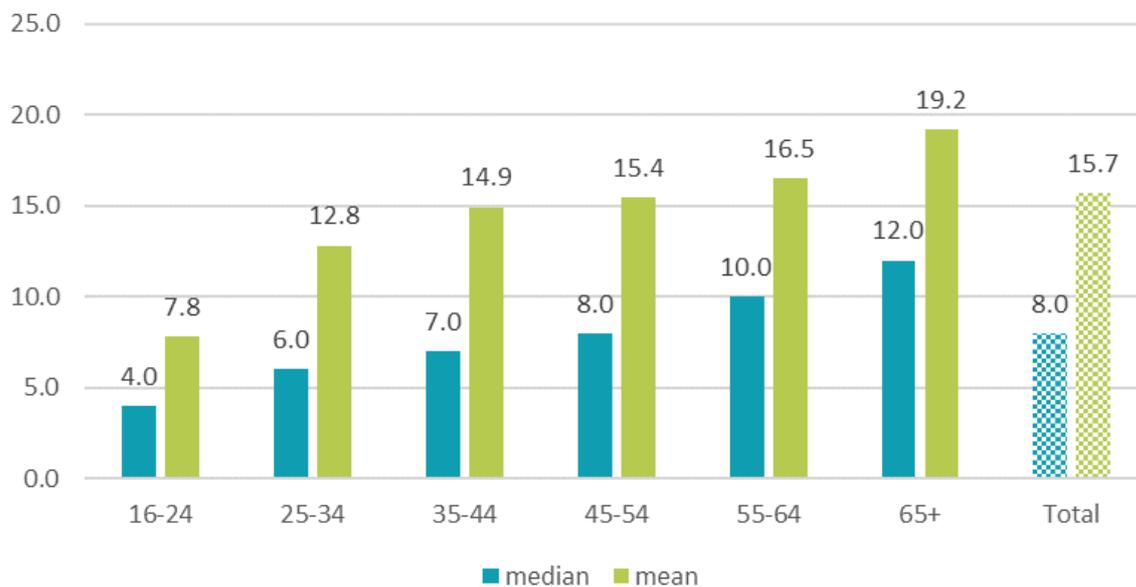
¹⁷⁹ General Condition C5 defines vulnerable consumers broadly as consumers who the provider has been informed or should otherwise reasonably be aware may be vulnerable due to circumstances such as age, physical or learning disability, physical or mental illness, low literacy, communications difficulties or changes in circumstances, such as bereavement.

¹⁸⁰ Only 0.3% of customers did not have age data.

¹⁸¹ There are less than 50,000 out-of-contract customers aged 16-24, but around 300,000 aged 65+. There are over 500,000 aged 45-54.

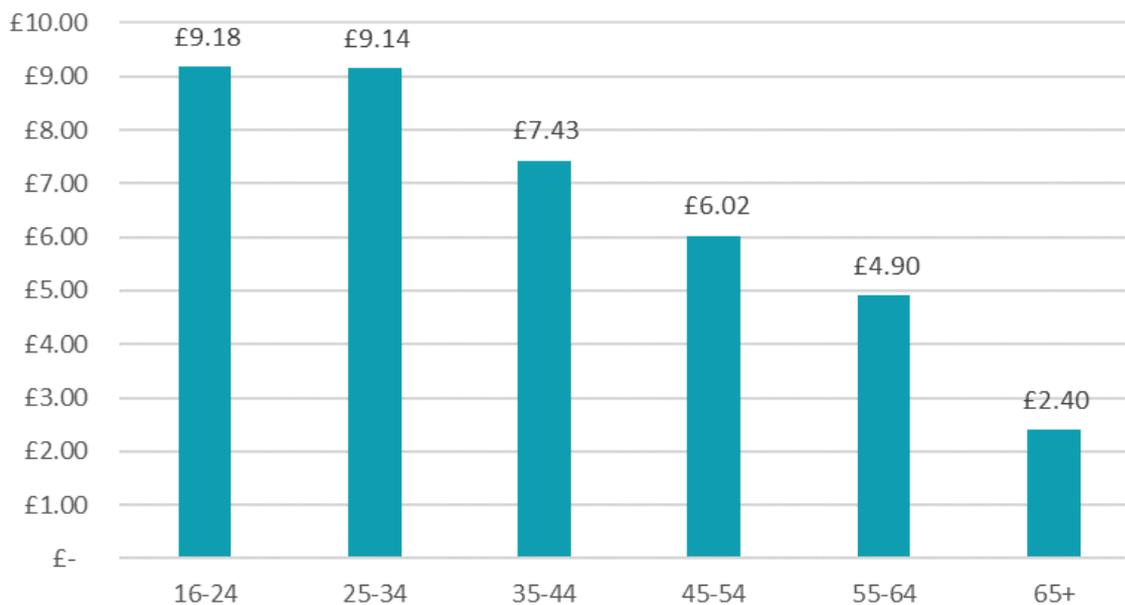
¹⁸² Average figures may be skewed by extreme values. The median time spent out-of-contract by those aged 16-24 is four months, and 11 months for those aged 65+.

Figure A5.12: Average and median time spent beyond the minimum fixed term, by age group



Source: First s.135 data.

Figure A5.13: Average monthly overpayment, by age group



Source: First s.135 data.

A5.102 For the purposes of calculating an annual net overpayment, longer time spent out-of-contract and lower monthly savings of older customers pull in opposite directions. Lower savings dominate, and annual net overpayment tends to decrease with age, as shown in Figure A5.14 below.

Figure A5.14: Average annual overpayment by age



Source: First s.135 data.

A6. Legal framework and EECC provisions

A6.1 This Annex outlines the legislative framework and associated powers and duties that are relevant to this document. In Section 5 we set out how our proposals for split contracts accord with those powers and duties.

The European framework for electronic communications

A6.2 The regulatory framework for electronic communications is derived from EU law. At EU level, the framework was made up of four Directives imposing requirements that Member States and their National Regulatory Authorities must meet (by transposing them into their national regulatory regimes).¹⁸³ These Directives have been updated and replaced by the EECC. The EECC is a new EU Directive imposing requirements on Member States and NRAs.¹⁸⁴

A6.3 The EECC passed into EU law on 20 December 2018 and the deadline for transposing its requirements into national law is 21 December 2020. We have a duty to secure the objectives of the EECC by that date and, until then, not to do anything that would undermine their achievement.

A6.4 The EECC's transposition deadline falls after the newly agreed date of 31 October 2019 by which the UK plans to leave the EU. Notwithstanding the uncertainty surrounding the UK's future relationship with the EU, the UK Government has stated that it is still minded to implement substantive provisions of the EECC into domestic law¹⁸⁵ and it is currently consulting on related matters.¹⁸⁶ Where we are consulting on proposed modifications to General Conditions in this document, therefore, we are doing so on the assumption that, in the absence of a significant change in Government policy, the EECC will need to be adopted into the UK's regulatory system.

A6.5 Title III of Part III of the EECC contains rights for end-users, building on those currently contained in the Universal Service Directive.¹⁸⁷ In particular, Articles 102, 105, and 107 contain a range of protections for end-users, including in relation to:

- a) information requirements for contracts;
- b) contract duration and termination; and
- c) bundled offers.

A6.6 Article 102(1) of the EECC contains provisions that, in due course, will help to address the concerns set out in this document. Specifically, it includes a requirement to provide

¹⁸³ Framework Directive (2002/21/EC), Authorisation Directive (2002/20/EC), Access Directive (2002/19/EC) and Universal Service Directive (2002/22/EC), all as amended, which are repealed by the EECC with effect from 21 December 2020.

¹⁸⁴ See footnote 13.

¹⁸⁵ DCMS, 2018. [What telecoms businesses should do if there's no Brexit deal.](#)

¹⁸⁶ DCMS, July 2018. [Implementing the European Electronic Communications Code.](#)

¹⁸⁷ EECC, Articles 98 – 116.

consumers with specified information before they enter into a bundled contract. That information includes the price of the individual elements of the bundle, to the extent the provider also markets them separately, as well as the total price of the goods or services and the monthly costs.¹⁸⁸ The same information must be given to end-users that are micro-enterprises, small enterprises and not-for-profit enterprises.¹⁸⁹

- A6.7 The required information must be provided “*in a clear and comprehensible manner on a durable medium,*” such as a print-out or an email, so that it can be addressed to the recipient personally; can be stored for as long as it is needed; and is protected from any alteration.¹⁹⁰ Alternatively, where it is not feasible to distribute information in this manner, it can be produced “*in an easily downloadable document,*” so long as the availability and the importance of storing an unchanged copy for future reference are expressly drawn to the recipient’s attention.
- A6.8 Article 105 includes protections for consumers and certain other end-users¹⁹¹ in respect of the duration of, and the termination process for, contracts. Some of these also address our present concerns to a substantial extent, and we have already taken steps to implement some of them.¹⁹²
- A6.9 Amongst other things, Article 105 provides that:
- a) the minimum contract period for contracts must not be longer than 24 months;¹⁹³
 - b) where a contract has a minimum contract period and, at the end of that period, it would continue automatically,¹⁹⁴ providers must inform end-users of the end of the contract period and how they can terminate the contract and, at the same time, provide best tariff advice relating to the relevant services;¹⁹⁵ and
 - c) providers must give end-users best tariff advice at least annually.¹⁹⁶
- A6.10 Article 107, meanwhile, says that some of the EECC’s end-user provisions apply to bundles of services and of services and terminal equipment. Such bundles, ‘... *should be considered to exist in situations where the elements of the bundle are provided or sold by the same provider under the same or a closely related or linked contract.*’¹⁹⁷ The provisions which apply to these bundles include parts of Article 102 and Article 105.
- A6.11 What is particularly relevant to the matters on which we are consulting in this document is that under, Article 107, where a bundle comprises mobile communication services

¹⁸⁸ EECC, Article 102(1) and B.I.(2) of Annex VIII.

¹⁸⁹ Unless they expressly agree to waive all or part of the requirements. EECC, Article 102(2).

¹⁹⁰ Directive 2011/83/EU, Point (10), Article 2.

¹⁹¹ Micro-enterprises, small enterprises and not-for-profit enterprises, unless they expressly opt-out. EECC, Article 105(2).

¹⁹² In our ECN statement we set out the decision we have made to implement the end of contract notification and best tariff advice requirements.

¹⁹³ EECC, Article 105(1).

¹⁹⁴ For example, by rolling over into a monthly contract.

¹⁹⁵ EECC, Article 105(3).

¹⁹⁶ EECC, Article 105(3).

¹⁹⁷ EECC, Recital 283.

(airtime) and terminal equipment (a handset) – e.g. it is a bundled contract or a linked split contract – the limits on the duration of contracts (in Article 105) apply. The contract or contracts relating to the airtime and the handset may not have a minimum contract period longer than 24 months. These limits apply to providers' contracts both with consumers and with micro-enterprises, small enterprises and not-for-profit enterprises (unless, in the latter cases, they expressly agree otherwise).¹⁹⁸

- A6.12 Except where they specifically say otherwise, the end-user provisions in the EECC are subject to the principle of full harmonisation. This means that, in the areas they cover, Member States must implement the provisions as specified and may not maintain or introduce end-user protections in national law that diverge from them. They may not include in their national regulatory regimes more or less stringent provisions which would provide a different level of protection for end-users.¹⁹⁹

Recitals of the EECC

- 6.19 The end-user provisions of the EECC set up a scheme for end-user, especially consumer, protection. Their objectives and intended scope can be identified in the accompanying recitals. The objectives include ensuring effective protection of consumers and other end-users who have similar bargaining positions,²⁰⁰ and the applicability of fully harmonised end-user provisions to ensure a high common level of protection across the EU.²⁰¹ As part of this high-level of protection, Articles 102, 105 and 107, specifically, are part of a coherent set of measures designed to enable end-users to engage with the market and make and give effect to informed choices about the services they buy, in their best interests.
- A6.13 Article 102(1) aims to ensure that, when they take out a contract, consumers and other relevant customers are able easily to compare the prices of various services offered on the market.²⁰² They must be given the appropriate information in a suitable manner before they enter into a contract so that they can make a well-informed choice.²⁰³ The Article also reflects that contracts are an important tool for end-users to ensure transparency of information and legal certainty.²⁰⁴ The requirement that information be provided in a durable medium pursues those objectives.

¹⁹⁸ EECC, Article 107(4).

¹⁹⁹ Article 101, EECC. Recital 257 elaborates on the requirement for full harmonisation. It notes that divergent implementation of the rules on end-user protection has created significant internal market barriers affecting both providers and end-users. Those barriers should be reduced by the applicability of the same rules ensuring a high common level of protection across the EU. A calibrated full harmonisation of the end-user rights covered by the EECC should considerably increase legal certainty for both end-users and providers, and should significantly lower entry barriers and unnecessary compliance burden stemming from the fragmentation of the rules.

²⁰⁰ Micro-enterprises, small enterprises and not-for-profit enterprises – see EECC, Recital 259.

²⁰¹ EECC, Recitals 3 and 257, and Article 3(2)(d).

²⁰² EECC, Recital 265.

²⁰³ EECC, Recital 261.

²⁰⁴ EECC, Recital 258.

- A6.14 Article 105 seeks to attain similar objectives to Article 102. It also recognises that the possibility of switching between providers is crucial for effective competition.
- A6.15 To be able to make choices about changing provider when it is in their best interests later on in their contractual relationship,²⁰⁵ the relevant end-users²⁰⁶ need transparent, up-to-date and comparable information on the offers and services available. That is a key element of competitive markets where several providers offer services, and end-users need to be given the information at appropriate points in time to help them engage in the market.²⁰⁷ End-users also need to be able to give effect to the choices they make without being hindered by legal, technical, or practical obstacles including contractual conditions, procedures, and charges.²⁰⁸
- A6.16 Article 107 also pursues the same sorts of aims. It takes into account that, while bundles often bring about benefits for consumers, they can make switching more difficult or costly and raise risks of contractual ‘lock-in.’ Where different services and terminal equipment in a bundle are subject to divergent rules on contract termination and switching, or on contractual commitments in respect of the acquisition of terminal equipment, consumers are effectively hampered in their rights to switch to competitive offers elsewhere. Essential provisions of the EECC, including on contract duration (and termination and switching) should, therefore, apply to all elements of a bundle, including terminal equipment like handsets.²⁰⁹
- A6.17 The EECC expressly recognises that micro-enterprises, small enterprises and not-for-profit enterprises need similar protection to consumers in certain regards because of the similarity of their bargaining positions. It specifies that, for that reason, the provisions on pre-contract information (in Article 102(1)), contract duration (in Article 105(1)) and bundles (in Article 107(1)) should also apply to these groups of customers unless they explicitly waive them.²¹⁰

Other provisions of the EECC

- A6.18 The end-user provisions should also be considered in the context of the whole EECC. It is a wide and coherent sectoral framework which covers a range of matters designed to harmonise (to varying degrees) the regulation of electronic communications networks and services across the EU.
- A6.19 The framework set up by the EECC seeks to promote effective competition between providers on the basis that this will lead to lower prices and other benefits for citizens and consumers. To do that, the EECC includes, amongst other things, provisions dealing

²⁰⁵ Or not.

²⁰⁶ Consumers and micro-enterprises, small enterprises and not-for-profit enterprises.

²⁰⁷ Such as when any fixed minimum commitment period ends and they are free to switch without paying early termination charges.

²⁰⁸ EECC, Recitals 265, 273 and 277.

²⁰⁹ EECC, Recital 283.

²¹⁰ EECC, Recital 259 and Articles 102(2), 105(2) and 107(4).

specifically with such competition and the circumstances in which regulatory authorities may control wholesale and retail prices. It provides for specific consumer (and other end-user) protection measures, and protection for vulnerable people, alongside the provisions designed to promote competition.

- A6.20 As part of this scheme to promote competition between providers and protect end-users, the EECC strictly limits the circumstances in which regulatory authorities may impose price controls.²¹¹ For instance, it says that such controls may be imposed on dominant providers who, because of their significant market power (SMP), would be able to charge excessive prices.²¹² It also says that regulators can only impose price controls on providers who are not dominant in very limited, specific cases.²¹³ Such cases do not include where the prices they charge are higher than they might be if customers engaged more with the market and shopped around.
- A6.21 Read together, the effect of all its provisions on Ofcom is that the EECC does not give us the power to impose controls on the retail prices of mobile bundled contracts. That means we may not impose automatic price reductions (or default tariffs) on those bundles at the end of their minimum contract periods.

UK Legal Framework

- A6.22 In UK law, Ofcom's duties and powers to regulate electronic communications in line with the EU framework are set out in the Communications Act 2003 (the Act).

Our general duties

- A6.23 The Act places on us a number of duties we must fulfil when exercising the regulatory powers and functions we are given. Section 3(1) provides that our principal duty, in carrying out our functions, is:
- a) to further the interests of citizens in relation to communication matters; and
 - b) to further the interests of consumers in relevant markets, where appropriate by promoting competition.²¹⁴
- A6.24 In performing our duties under section 3(1) of the Act, we are required to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed, as well as any other principles appearing to us to represent best regulatory practice (section 3(3) of the Act).

²¹¹ EECC, Articles 68 – 74.

²¹² EECC, Articles 68 and 74. In those cases, wholesale price controls must be considered first and regulators may only impose retail price controls on dominant providers as a last resort, if wholesale controls would not work – see Article 83.

²¹³ EECC, Articles 68 – 74.

²¹⁴ Consumer is defined in section 405(5) of the Act and includes people acting in their personal capacity or for the purposes of, or in connection with, a business.

- A6.25 Section 3(4), provides that we must have regard, in performing our duties, to a number of matters (as they appear to us to be relevant), including the desirability of promoting competition in relevant markets; the desirability of encouraging investment and innovation in relevant markets; the needs of persons with disabilities, of the elderly and of those on low incomes; the opinions of consumers in relevant markets and of members of the public generally; and the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in section 3(1) is reasonably practicable.
- A6.26 In addition, section 3(5) of the Act requires that, when performing our duty to further the interests of consumers, we must have regard, in particular, to the interests of those consumers in respect of choice, price, quality of service and value for money.

Duties for the purpose of fulfilling EU obligations

- A6.27 As set out in section 4(2) of the Act, when exercising certain functions,²¹⁵ we must act in accordance with the six European Community requirements described there. These include requirements:
- a) to promote competition in the provision of electronic communications services;
 - b) to secure that our activities contribute to the development of the European internal market; and
 - c) to promote the interests of all persons who are citizens of the European Union.²¹⁶

Powers and duties in relation to general conditions

- A6.28 The Act also gives us powers we can exercise in implementing requirements of the EU framework. In particular, powers to set (and modify) regulatory conditions imposing obligations on communications providers in order to give effect to the relevant end-user provisions.
- A6.29 Section 45 of the Act says that we may set (and modify) general conditions which contain provisions authorised or required by one or more of sections 51, 52, 57, 58 or 64. Under section 51(1)(a), we may set (and modify) general conditions making such provisions as we consider appropriate for the purpose of protecting the interests of end-users of public electronic communications services.
- A6.30 Section 51(2) sets out a non-exhaustive list of the specific types of general conditions that we may set (and modify) in pursuance of this purpose. Section 51(2)(d), for example, provides that we can, by general condition, “*require the provision, free of charge, of specified information, or information of a specified kind, to end-users*”. Section 51(2)(g) says we can set (and modify) general conditions that impose a limit on the duration of a contract between an end-user and a communications provider.

²¹⁵ Including those we propose to exercise in this document.

²¹⁶ We have also had regard to the objectives in Article 3(2) of the EECC.

A6.31 Section 47(2) governs the circumstances in which we can set or modify a general condition. It states that a condition can be set or modified where it is objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates,²¹⁷ not such as to discriminate unduly against particular persons or against a particular description of persons, proportionate to what the condition or modification is intended to achieve, and transparent in relation to what it is intended to achieve.

²¹⁷ Section 47(3) states that the setting of a general condition is not subject to the test of being objectively justifiable, although we are likely to consider this in any event when assessing whether the condition is proportionate.

A7. Notification of proposed modifications to the General Conditions under section 48A(3) of the Act

Proposal to modify the General Conditions

Background

1. Ofcom proposes:
 - (a) to modify the General Conditions, and
 - (b) to add new definitions to those set out in the Definitions section of the General Conditions.
2. The draft modifications to Condition C1 of the General Conditions are set out in Schedule 1 to this Notification. The new definitions to be added to those set out in the Definitions section of the General Conditions are set out in Schedule 2 to this Notification.
3. Ofcom's reasons for making these proposals, and the effect of the proposals, are set out in the accompanying consultation document.
4. Ofcom considers that the proposals comply with the requirements of sections 45 to 49C of the Act, insofar as they are applicable.
5. Ofcom considers that the proposals are not of EU significance pursuant to section 150A(2) of the Act.
6. In making these proposals, Ofcom has considered and acted in accordance with its general duties under section 3 of the Act and the six Community requirements set out in section 4 of the Act.
7. Representations may be made to Ofcom about the proposals until 5pm on 16 September 2019.
8. If implemented, the proposed modifications and the new definitions shall enter into force on a date to be specified in Ofcom's final statement in relation to these proposals.²¹⁸
9. A copy of this Notification is being sent to the Secretary of State in accordance with section 48C(1) of the Act.
10. In this Notification:
 - (a) "**Act**" means the Communications Act 2003;

²¹⁸ Proposed to be 3 months after publication of Ofcom's final statement.

(b) “**General Conditions of Entitlement**” and “**General Conditions**” means the general conditions set under section 45 of the Act, effective from 1 October 2018, as amended or replaced from time to time, and

(c) “**Ofcom**” means the Office of Communications.

11. Words or expressions shall have the meaning assigned to them in this Notification, and otherwise any word or expression shall have the same meaning as it has in the Act.

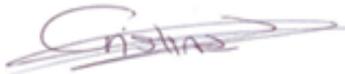
12. For the purposes of interpreting this Notification:

(a) headings and titles shall be disregarded, and

(b) the Interpretation Act 1978 shall apply as if this Notification were an Act of Parliament.

13. The Schedules to this Notification shall form part of this Notification.

Signed by

A handwritten signature in purple ink, appearing to read 'Cristina', with a horizontal line drawn through it.

Cristina Luna-Esteban
Director of Consumer Policy

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

22 July 2019

SCHEDULE 1

Ofcom proposes that the following modifications shall be made to General Condition C1 in Part C ('Consumer protection conditions') of the General Conditions.

1. In Condition C1, the following modifications marked in bold and highlighted in yellow shall be made:

"C1.4 **Regulated Providers** shall not include a term in any contract with a **Consumer** for the provision of **Electronic Communications Services** that stipulates a **Fixed Commitment Period** of more than 24 months in duration. **The same prohibition shall apply to any contract for the provision of such services between the Regulated Provider and a Microenterprise, Small Enterprise Customer or Not For Profit Customer, unless such Microenterprise, Small Enterprise Customer or Not For Profit Customer has expressly agreed otherwise.**

C1.4A Condition C1.4 shall also apply to contracts for the provision of Bundles in so far as the Subscriber concerned is:

(a) a Consumer; or

(b) a Microenterprise, Small Enterprise Customer or Not For Profit Customer, unless such Microenterprise, Small Enterprise Customer or Not For Profit Customer has expressly agreed otherwise."

SCHEDULE 2

1. In the 'Definitions' section of the General Conditions, the following new definitions shall be inserted in the appropriate alphabetical place:

“**Bundle**’ means where **Mobile Communication Services** and **Terminal Equipment** are sold by the **Regulated Provider** under the same or closely related or linked contracts;”

“**Microenterprise**’ means a **Small Enterprise Customer** who carries on an undertaking for which fewer than 10 individuals work (whether as employees or volunteers or otherwise) and whose annual turnover and/or annual balance sheet total does not exceed 2 million Euros;”

“**Not For Profit Customer**’, in relation to a **Communications Provider** which provides services to the public, means a **Customer** which, otherwise than as a **Communications Provider**, is a **Customer** of that provider and which by virtue of its constitution or any enactment:

(a) is required (after payment of outgoings) to apply the whole of its income, and any capital which it expends, for charitable or public purposes; and

(b) is prohibited from directly or indirectly distributing among its members any part of its assets (otherwise than for charitable or public purposes);”

“**Small Enterprise Customer**’, in relation to a **Communications Provider** which provides services to the public, means a **Customer** of that provider who carries on an undertaking for which fewer than 50 individuals work (whether as employees or volunteers or otherwise) and whose annual turnover and/or annual balance sheet total does not exceed 10 million Euros, but who is not himself a **Communications Provider**;”

“**Terminal Equipment**’ means equipment directly or indirectly connected to the interface of a public telecommunications network to send, process or receive information. In either case (of direct or indirect connection), the connection may be made by wire, optical fibre or electromagnetically. A connection is indirect if equipment is placed between the terminal and the interface of the network;”

A8. Glossary

2019 consumer research: Research conducted amongst mobile users, from January to March 2019, covering knowledge of contract status, awareness of what happened / would happen to the monthly price paid at the end of the minimum contract period, awareness of SIM-only deals and reasons for staying out-of-contract.

Act: The Communications Act 2003.

Bundled contracts: A contract under which the customer receives a handset and airtime and pays a single monthly price which includes both the handset and the cost of the airtime, and also can include other additional services such as content (music or TV subscriptions), insurance or anti-virus software protection services.

Communications Market Report ('CMR'): Ofcom's annual statistical survey of key market developments in the UK communications sector. The report contains data and analysis on broadcast television and radio, fixed and mobile telephony, and post:

<https://www.ofcom.org.uk/research-and-data/multi-sector-research/cmri>

Early termination charge: A charge that may be payable by a consumer for the termination of a contract before the end of the minimum contract period.

End-of-contract notification ('ECN'): From 15 February 2020, customers will receive an end-of-contract notification from their provider informing them of any changes to their price and services at the end of their minimum contract periods, and about the best tariffs available from their provider. See the ECN statement.

ECN statement: Our May 2019 statement on ECN's and annual best tariff advice. It set out requirements on providers to send an end-of-contract notification to customers when their minimum contract period is coming to an end, as well as annual best tariff advice to customers that remain out-of-contract. The notifications will include any changes to the price of their service and the best tariffs available from their provider, including at least one SIM-only deal for bundled customers: <https://www.ofcom.org.uk/consultations-and-statements/category-2/helping-consumers-get-better-deals>

End-user: Someone who is a customer of a Provider or a user of a Provider's services, and who is not themselves a Provider.

European Electronic Communications Code ('EECC'): A new Directive which updates and replaces the four Directives that currently make up the EU regulatory framework for electronic communications.

First information request ('first s.135 data'): Data received from EE, Giffgaff, O2, Sky Mobile, Tesco Mobile, Three, Virgin Mobile and Vodafone in response to an information notice sent on 14 December 2018 and 21 December 2018, pursuant to our information gathering powers under section 135 of the Act. The request concerned the total numbers of in- and out-of-contract customers, billing information for out-of-contract handset and airtime customers, monthly SIM-only tariffs, handset costs and corresponding standard tariffs.

Full harmonisation: The End-User protection provisions in the EECC are subject to the principle of full harmonisation, which means that (unless otherwise stated) Member States must provide the same level of protection to all relevant users and may not go above, or fall short of, that.

General Condition ('GC'): Regulatory conditions imposed on providers by Ofcom under section 45(2)(a) of the Act.

Handset agreement: A contract for the purchase of the handset only.

In-contract: Refers to customers who are within the minimum contract period for any service provided by the provider.

Minimum contract period: The fixed period of time over which the provider and a customer have entered into an agreement for communications services and for which an early termination charge may be payable by the customer if they cancel their contract during this period.

MNO (mobile network operator): An organisation that is allocated spectrum or owns its own wireless network and provides mobile telephony services to its customers.

MVNO (mobile virtual network operator): An organisation which provides mobile telephony services to its customers, but does not have allocation of spectrum or its own wireless network.

Out-of-contract: When customers are outside of their minimum contract period but are still paying for a service (e.g. broadband, mobile, landline) provided by the provider (e.g. via a rolling monthly contract).

Provider: A person who provides an electronic communications network or provides an electronic communications service, as defined in the Act.

Second information request ('second s.135 data'): Data received from EE, O2, Tesco Mobile, Three, Virgin Mobile and Vodafone in response to an information notice sent on 10 April 2019 pursuant to our information gathering powers under section 135 of the Act. The request concerned the total number of in- and out-of-contract customers from January 2014 to March 2019, on a monthly basis.

Split contracts: A contract under which customers purchase both an airtime tariff (plus any additional services) and a mobile handset at the same time under two contracts, and where the monthly cost to the customer is separated into prices for the airtime and the handset.

SIM-only contract: A contract under which the monthly cost to the customer includes the airtime (and any additional services) but the provider does not supply the customer with a handset under the contract.