

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

Citizens Advice response

September 2019



## Introduction

Citizens Advice gives people the knowledge and confidence they need to find their way forward - whoever they are, and whatever their problem. Our network of independent charities offers confidential advice online, over the phone, and in person, for free. Last year we helped 2.6 million people in person, by phone, email or webchat. Our advice website had over 25 million visits, with 34 million pages viewed.

Ofcom's analysis of customer-level billing data provides a definitive picture of the loyalty penalty faced by consumers on bundled mobile phone contracts, revealing that loyal consumers are overpaying by £182 million each year. We therefore welcome the voluntary commitments from most mobile providers to introduce fairer prices for consumers who are out of contract. It is disappointing that Three have decided not to act.

We are also concerned that the voluntary nature of the commitments could undermine Ofcom's objectives. For instance, Three have refused to make a voluntary commitment. **Some customers will continue to pay a loyalty penalty of between £1.5 million and £2.7 million each month. This is unacceptable.** EE and Vodafone will also need to be clear that their discounts will cover the cost of the handset.

### **Ofcom should be clear about the options available should these voluntary commitments fall short, setting out:**

- If there are other interventions - aside from price controls - that could protect loyal consumers.
- What regulatory powers government should introduce, if Ofcom does not have the appropriate powers to protect loyal customers.

We were pleased to see the development of Ofcom's draft fairness framework. This will be a useful tool for testing whether the voluntary commitments are delivering their intended aims. **Ofcom should commit to testing the outcomes of the voluntary agreements against the framework by the end of March 2021.** If the voluntary agreements fall short, Ofcom must take stronger action.

## **Our remaining recommendations are:**

- Three should immediately commit to reducing monthly bills for out-of-contract bundled customers
- EE and Vodafone customers should not have to pay 3 months of loyalty penalty before benefiting from the discount
- Consumers who enter into a bundled contract via a third-party must also benefit from fairer default tariffs.

## **The rest of our response is structured as follows:**

1. Context - our previous work on the loyalty penalty
2. The loyalty penalty paid by bundled contract customers
3. Ofcom's powers and the use of voluntary commitments
4. Improving the transparency of bundled contract costs
5. Ending the practice of linking split contracts for more than 24 months

## 1. Context - our previous work on the loyalty penalty

Deep, structural price discrimination against disengaged and loyal consumers has been a persistent feature of essential markets for many years.

In the energy market this is well-established. Years of investigation by Ofgem, the Competition and Markets Authority (CMA) and government have led to a range of protections for consumers. In 2018 this culminated in a cap on the cost of energy for all customers on default tariffs in the market, expected to save consumers £75 a year on average.

Excessive prices for disengaged consumers can be just as high - if not more so - in other essential markets like mortgages and mobile phones. In 2017 and 2018 we published a series of policy reports presenting evidence on the penalty paid by loyal consumers.

In September 2018, when it was clear that providers and regulators were not taking action quickly enough, we submitted a super-complaint to the CMA.<sup>1</sup> We outlined the scale of harm across 5 markets. In December 2018 the CMA agreed with our findings and recommended regulators take robust action.

## 2. The loyalty penalty paid by bundled contract customers

Ofcom's analysis reveals that a significant minority of out-of-contract consumers are better off staying on their current tariff. But there are more than twice as many who are paying a loyalty penalty - costing them £182m each year.

Despite their declining popularity, around 18 million consumers are on a bundled mobile phone contract.<sup>2</sup> When they reach the end of the minimum contract period, the monthly price remains the same. This is despite the fact that they have, in effect, 'paid off' the handset. Consumers who remain on the contract are therefore penalised for their loyalty.

In September 2018 we published a report investigating the impact of this practice and called for providers to stop charging consumers for handsets they have already paid for. If providers were not willing, we called upon Ofcom and

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<sup>1</sup> Citizens Advice, [Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority](#), September 2018

<sup>2</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, 46% of all pay-monthly contracts were bundled, down from 78% in 2014.

government to intervene to protect consumers.<sup>3</sup> Following this, we were pleased to see Ofcom's September 2018 consultation outlining 2 proposed solutions to the handset loyalty penalty: increased transparency and fairer default tariffs. In the latter, the cost of the handset would be deducted at the end of the minimum term.<sup>4</sup> In our response, we argued that increased transparency alone would not be enough to prevent overpayment - only fairer default tariffs could adequately address the handset loyalty penalty. Our position remains unchanged.

We are pleased that Ofcom has now conducted a far more detailed analysis - using actual recorded data instead of a model - that gives a definitive account of the penalty paid by loyal mobile consumers. This new analysis finds over 1.4 million consumers are out of contract and are overpaying by £182m each year. Approximately 600,000 more would be better off staying on their current tariff.<sup>5</sup>

**This represents a significant level of harm.** The practice has to end.

### **3. Ofcom's powers and the use of voluntary commitments**

Citizens Advice is pleased that Ofcom has secured commitments from most major mobile providers to introduce fairer prices for consumers who reach the end of the minimum contract period. However, it is extremely disappointing that Three have chosen not to make a voluntary commitment. **This decision will cost their loyal customers between £1.5 million and £2.7 million each month.**

Providers have opted to apply these discounts in differing ways. Tesco will move its customers onto the best available airtime tariff, while Virgin Mobile and O2 will - for contracts sold through direct channels - move their customers onto an equivalent 30-day SIM-only or airtime-only deal. EE and Vodafone will apply a discount to the monthly charge of all out of contract customers after 3 months, and will confirm the level of this discount in December 2019.<sup>6</sup>

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<sup>3</sup> Citizens Advice, [Reviewing Bundled Handsets](#), September 2018

<sup>4</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), September 2017

<sup>5</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraphs 1.13, 3.46A

<sup>6</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 6.5

**Table 1: Commitments made by the major mobile networks**

Provider	Commitment	Applied
Virgin Mobile	Move, or reduce monthly price of, out of contract customers to an equivalent 30-day SIM-only or air-time only deal	When minimum term ends
O2		
Tesco Mobile	Adjust the monthly charge to ensure out-of-contract customers are on the best available airtime tariff	When minimum term ends
EE	Apply a discount to the monthly charge of all customers out-of-contract for more than 3 months	3 months after minimum term ends
Vodafone		
Three	None	N/A

**Ofcom should use its fairness framework to assess whether providers are pricing their services fairly, and be prepared to take stronger action if required.**

We understand that Ofcom’s ability to control prices is limited by the European Electronic Communications Code (**EECC**), so Ofcom have instead secured voluntary commitments from providers.<sup>7</sup> However, there is a risk that these commitments fall short of the necessary level of protection and consumers continue to be harmed. Ofcom may not have the power to control prices, but it should set out which, if any, alternatives interventions are compatible with its powers and duties. **Therefore, we are recommending Ofcom is clear about the options available, setting out:**

- Any other interventions - aside from price controls - that could be used to protect loyal consumers.
- What regulatory powers government should introduce, if Ofcom does not have the appropriate powers to protect loyal customers.

We are concerned that Ofcom seems not to have the necessary power to compel providers to act. If this is the case then Ofcom should set out clearly if there are

<sup>7</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 1.20

any actions that Government could take - either directly, or to provide Ofcom with stronger powers. Ofcom should do this by February 2020 when the commitments come into force.

Ofcom states that the approach taken in their statement and consultation document is consistent with the approach set out in their fairness framework.<sup>8</sup> However, this preempts the details of the commitments themselves. The extent to which they address the loyalty penalty (and are therefore fair) will depend on details such as the level of discounts introduced. We won't know these details until Ofcom publishes the progress report next year.

**Ofcom should commit to testing the outcomes of the voluntary agreements against the fairness framework by the end of March 2021.** If there are issues with non-compliance or if the discounts offered are judged by Ofcom to be at a level that is unfair, then stronger enforcement action will be necessary.

In the case of **EE and Vodafone**, we do not know how much discount will be offered and if this will adequately reflect the cost of the handset. If the discount is too low then consumers will continue to be ripped off. For instance, it would not seem fair if the monthly discount equated to around £2 or £3 per month as this would not be equivalent to the monthly cost of the handset. Similarly, we don't know how **Tesco** will define the 'best available airtime tariff'. We can envisage a situation where providers are offering discounts, but consumers still pay a loyalty penalty and are therefore subject to unfair practice.

**EE and Vodafone customers should not have to pay 3 months of loyalty penalty before benefiting from the discount**

EE and Vodafone's discounts will only apply once a customer has been out of contract for longer than 3 months. Many of their customers will therefore continue to be penalised for their loyalty. In our view this is incompatible with the aims of the voluntary commitments and the fairness framework.

Ofcom state that the 3 month delay is justified because:

- Customers may go out-of-contract for rational reasons such as waiting for a new handset model

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<sup>8</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 2.20

- One third of customers switch or re-contract within three months
- The average monthly overpayment does not change significantly when excluding consumers who have been out-of-contract for 3 months or less.

Ofcom concludes that the three-month period is a suitable amount of time to allow customers to act on their end of contract notifications and best tariff advice and engage in the market.<sup>9</sup> However, we do not agree that this is justified.

Consumers may go out-of-contract for rational reasons, but that does not mean they should continue to be charged for a handset they've already paid off. If a consumer wanted to wait 3 months to get a new handset, to avoid paying a loyalty penalty they would have to switch to a 30-day rolling SIM-only contract for 3 months, and then switch to their new contract. Consumers should not be required to repeatedly engage in the market just to avoid being ripped off. Fundamentally, whether consumers go out of contract for rational reasons or not, they should not be overpaying.

Whilst the average monthly overpayment doesn't vary based on excluding or including consumers who have been out-of-contract for 3 months or less, consumers will still experience material harm in this time. They will face an average monthly overpayment of between £6 and £10. Therefore, it is entirely plausible that, on average, an EE or Vodafone customer could pay a £30 loyalty penalty before the discount kicks in.

Our position has always been that consumers should not continue to pay for a handset they already own, and this £30 overpayment is incompatible with that. These consumers are still going to face material harm, even if the extent of this harm is limited by the fairer default tariff that applies after the third month.

**Three** have also refused to offer any fairer default tariffs whatsoever, and as a result their customers are overpaying between £1.5 million and £2.7 million each month (see Appendix 1 for full method). This is completely incompatible with the fairness commitments, to which they are a signatory.<sup>10</sup> **Three should immediately commit to reducing monthly bills for out-of-contract bundled customers.**

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<sup>9</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 4.30

<sup>10</sup> The [first fairness commitment](#) states that: *“Customers get a fair deal, which is right for their needs. Providers offer customers packages that fit their needs and have a fair approach to pricing. Prices are clear and easy to understand.”*



## **Consumers who enter into a bundled contract via a third-party must also benefit from fairer default tariffs**

It is not possible to enter into a split contract via a third-party retailer, such as Dixons Carphone Warehouse. Consumers who enter into a mobile contract which includes a handset via a third-party will be on a bundled contract that does not reduce in price at the end of the minimum term. These customers are at risk of paying a loyalty penalty.

While there is no publicly available data on exactly how many bundled contracts are sold through third-parties, Ofcom report that over 70% of all bundled O2 contracts are sold through third-parties.<sup>11</sup> These customers should not be disadvantaged because they choose to purchase their contract through a third-party retailer.

As part of the voluntary commitments secured from providers, O2 has not committed to provide a discount to customers it acquires through third-party retailers. These customers will not, therefore, benefit from fairer default tariffs.

O2 have committed to enter into discussions with third-party retailers, but we share Ofcom's concern that unless an agreement can be reached quickly, there is a risk that O2's indirect customers will continue to overpay. The average monthly overpayment of O2 customers is £10-13 per month.<sup>12</sup> In addition, we note that, according to Carphone Warehouse, any decision to offer voluntary discounts rests with the provider who holds responsibility for the ongoing customer billing relationships and monthly tariff charges.<sup>13</sup> Therefore, it is up to O2 to resolve this issue quickly and to ensure that customers who use third-party retailers also benefit from fairer default tariffs.

## **4. Improving the transparency of bundled contract costs**

Previous Citizens Advice research found that a high number of consumers were unable to correctly identify that buying a handset and a SIM-only contract separately is cheaper than a bundled contract most of the time. We found that in three quarters (73%) of cases it is cheaper to buy a handset and data separately.

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<sup>11</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 4.35

<sup>12</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, Table A5.4

<sup>13</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, paragraph 4.35

But most (55%) consumers who have bought their phone as part of a bundled contract believe that their route is usually cheaper.<sup>14</sup>

Ofcom, in its September 2018 consultation, proposed improved transparency measures as one means of reducing the loyalty penalty. In our response we supported this proposal, but argued that transparency alone would not be enough: it had to be coupled with fairer default tariffs.

Consumers should be able to see the price of the handset and the airtime components of their contract, in order to help them make a straightforward comparison with other means of paying for their mobile phone service.

We note that Ofcom will be publishing a further consultation later in the year setting out their plans to implement the transparency provisions of the EECC. Based on the information provided in Ofcom's statement, we support the proposal to give consumers information about the price of the handset and the airtime at the beginning, throughout, and at the end of their minimum contract period, along with information on how the monthly price will change.

## **5. Ending the practice of linking split contracts for more than 24 months**

Consumers who enter into a split contract - with two separate contracts for handset and airtime - are protected from paying a loyalty penalty. The monthly price reduces once the handset has been paid off, and the price of the constituent elements (handset and airtime) is clear throughout the duration of the contract.<sup>15</sup>

However, we have previously raised some concerns with split contracts, one of which is the way that linking the handset and the airtime components could discourage consumers from switching. While there is a 24 month limit on airtime contracts, consumers could enter into a split contract with a 36 month handset agreement and not be permitted to switch provider without paying off the remainder of the handset agreement. This functions as a kind of 'exit fee' which prevents consumers from switching after the 24 month limit.

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<sup>14</sup> Citizens Advice, [Reviewing Bundled Handsets](#), September 2018

<sup>15</sup> Citizens Advice, [Reviewing Bundled Handsets](#), September 2018

In our response to Ofcom's September 2018 consultation we recommended that Ofcom end the practice whereby consumers can be locked into a split contract for longer than 24 months.<sup>16</sup>

The EECC (articles 1.05(A) and 107) stipulates that all contracts that make up relevant bundles must be subject to the 24-month limit on the minimum contract period.

**We support Ofcom's proposal to implement the provisions of the EECC and end the practice of linking split contracts for longer than 24 months.** This is particularly important as split contracts are growing in popularity (from 4% of pay-monthly contracts in 2014 to 15% in 2019<sup>17</sup>). This should happen as quickly as possible - 3 months is long enough for providers to make the necessary changes.

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<sup>16</sup> Citizens Advice, [Helping consumers to get better deals in communications markets: mobile handsets: Citizens Advice response](#), November 2018

<sup>17</sup> Ofcom, [Helping consumers to get better deals in communications markets: mobile handsets](#), July 2019, Figure 3.1