

1. Telefonica UK Ltd (“Tef UK”) welcomes the opportunity to respond to Ofcom’s consultation on mobile handsets¹.
2. Tef UK provides mobile retail services to around 25 million end users under its retail brands, O2 and giffgaff. As Ofcom notes in the consultation document², O2 enters into separate airtime and handset contracts with customers through its direct distribution channels, under the Refresh brand. The “handset contract” is, in fact, an interest free loan for the cost of the handset, governed by the Consumer Credit Act 1974 (as amended). O2 also enters into single, “bundled” contracts with customers through indirect channels³. Giffgaff’s agreements with its customers (members) are “split” within the meaning of Ofcom’s consultation document.
3. Accordingly, Tef UK has a direct and significant interest in the issue subject of Ofcom’s consultation document.

Executive summary

4. Tef UK believes that the central issue subject of this consultation, that mobile consumers pay more than they need to after the end of their minimum contract period, is a matter of worthy of consideration. Indeed, in principle, Tef UK would like to see changes implemented which would ensure that consumers were not charged for devices they’ve already paid for (assuming such changes were practical and would not lead to significant adverse unintended consequences). Further, if Ofcom’s estimate about the scale of the issue is correct⁴ then this can’t be said to be a trivial matter. In addition, although not addressed in this consultation document, to the extent that vulnerable consumers might be particularly affected, then the problem is graver, still.
5. That said, in our view, this is a complex matter that merits detailed analysis to support any regulatory intervention. In addition, the impact of Ofcom’s recent proposal relating to end of minimum contract period notifications⁵ should to be assessed. Further, the possible effects of any intervention need to be considered carefully, in the interests of good regulation and of avoiding potential unintended and harmful consequences. Accordingly, the lack of any serious legal or economic analysis in this consultation document is both striking and unhelpful. Stakeholders are being invited to comment on what would amount to intrusive intervention in a competitive market, with precious little justification (ten paragraphs to be exact⁶, which barely constitute a cursory assessment of the issue). Tef

¹ Helping consumers to get better deals in communications markets: mobile handsets. Ofcom, 7 November 2018. https://www.ofcom.org.uk/data/assets/pdf_file/0019/121708/consultation-consumers-mobile-handsets.pdf

² §3.4

³ For example, customers who contract through Carphone Warehouse

⁴ £330m, at §3.10

⁵ §2.10

⁶ §3.5 – 3.14

UK assumes that the timing of this consultation, arriving, as it did, two days before the announcement of the Citizens' Advice "super complaint"⁷, is no coincidence.

6. The absence of a proper examination of the issues is regrettable, not simply in the narrow context of the issue subject of the consultation (significant though the proposed interventions are), but more broadly; Ofcom's reputation as a well-regarded sectoral regulator can be harmed if it advances policy proposals without undertaking the necessary analysis, as it appears to have done in this instance. That is detrimental to the sector as a whole, because predictable and stable regulation, grounded in thoughtful and dispassionate analysis, is best designed to reduce the cost of capital and promote the investment in mobile infrastructure that is so important to the UK economy.
7. Tef UK believes that Ofcom should now:
 1. As the sectoral regulator, take the lead and invite the Competition and Markets Authority ("CMA") to defer to it, in relation to the mobile aspect of the super complaint;
 2. Develop a detailed and robust analytical framework to assess whether intervention is merited and, if so, how best to regulate; and
 3. Consider carefully the regulatory regime that it operates under and set out clearly the relevant statutory duties and powers it proposes to rely on if it does intend to intervene
8. We should be happy to assist Ofcom in this work. As we note above, Tef UK has already addressed the concern subject of the consultation document, by developing its Refresh proposition under the O2 brand. Further, giffgaff's offerings are similarly "split". We think that Tef UK's experience can help Ofcom realise its ambitions in this area.
9. In the remainder of this response, we set out our initial views on:
 - Relevant statutory duties and Ofcom policies
 - Competition in the mobile retail market
 - Developing an analytical framework to assess the possible effects of intervention
 - Options under consideration
 - Institutional arrangements

⁷ Excessive prices for disengaged consumers. A super-complaint to the Competition and Markets Authority. Citizens Advice. [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20(1).pdf)

Relevant statutory duties and Ofcom policies

10. There are a number of relevant statutory duties and Ofcom policies that Ofcom should consider when evaluating whether and how it might intervene in this matter.

11. Firstly, s 3(1)(b) of the Communications Act 2003 (“CA 2003”), states that:

“it shall be the principal duty of OFCOM, in carrying out their functions ... to further the interests of consumers in relevant markets, where appropriate by promoting competition”

12. As we demonstrate in the next section, the UK mobile retail market has been found time and again to be competitive.

13. Section 3(3)(a) of the CA 2003 requires that:

*“In performing their duties under subsection (1), OFCOM must have regard, in all cases, to—
(a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed”*

14. Tef UK does not see how the requirements of s 3(3)(a) can be fulfilled unless the effects of any proposed regulatory intervention have been analysed sufficiently. We set out below the issues that we think Ofcom should consider in developing a robust analytical framework which is necessary to assess whether intervention is justified and, if is, how best to regulate.

15. Section 3(4)(i) of the CA 2003 requires that:

“OFCOM must also have regard, in performing those duties, to such of the following as appear to them to be relevant in the circumstances:

...

the needs of persons with disabilities, of the elderly and of those on low incomes”

16. Ofcom does not appear to have considered whether such customers are affected disproportionately by the issue subject of this consultation, and it may be that data about this are difficult to obtain. Nevertheless, Tef UK believes that this statutory duty could be relevant and merits consideration.

17. Section 7 of the CA 2003 requires Ofcom, broadly, to carry out and publish an assessment of the likely impact of a proposal before implementing it. Ofcom has also published its policy on impact assessments⁸. The introductory paragraphs are instructive:

*1.1 The decisions which Ofcom makes can impose significant costs on our stakeholders and it is important for us to think very carefully before adding to the burden of regulation. **One of our key regulatory principles is that we have a bias against intervention.** This means that a high hurdle must be overcome before we regulate. **If intervention is justified, we aim to choose the least intrusive means of achieving our objectives, recognising the potential for regulation to reduce competition.** These guidelines explain how Impact Assessments will be used to help us apply these principles in a transparent and justifiable way.*

1.2 Impact Assessments form a key part of best practice policy making, which is reflected in our statutory duty to carry them out. They provide a way of considering different options for regulation and then selecting the best option. In selecting and analysing options, the need to further the interests of citizens and consumers is of paramount importance.

1.3 Impact Assessments are also useful tools for reviewing existing regulation. They provide a framework for weighing up the costs and benefits of removing regulation, as well as analysing other options.

1.4 In identifying options, we will aim to consider a wide range of options, including not regulating. Where appropriate, we will explore more risk-based, targeted approaches to regulation and will consider whether there are alternatives to formal regulation, such as co-regulation.

1.5 In developing policy proposals, our aim will be to think widely about the possible impacts, taking account of the whole value chain and knock-on effects across the communications sector. By doing so, we will seek to minimise any unintended consequences.

1.6 To be effective, the process of doing an Impact Assessment should begin right at the start of a project, with the Impact Assessment being developed from then onwards. An Impact Assessment should therefore be a core part of the policymaking process, not a bureaucratic add-on.” (emphasis added)

18. Ofcom needs to comply with the requirements of s7 of the CA 2003 and its own policy on impact assessments, in relation to this matter.

⁸ Better Policy Making. Ofcom’s approach to Impact Assessment. Ofcom 21 July 2005. See: https://www.ofcom.org.uk/data/assets/pdf_file/0026/57194/better_policy_making.pdf

Competition in the mobile retail market

19. The consistent finding by Ofcom, the CMA and European Commission is that the UK mobile retail market is effectively competitive.
20. For example, Annex 1 to Ofcom's statement regarding the award of the 2.3 GHz and 3.4 GHz spectrum bands⁹ contains its conclusions on the "Current state of the UK mobile market". These conclusions were arrived at following the receipt of extensive factual, economic, statistical and econometric analysis of such matters as subscriber pricing, market shares and pricing trends. The analysis covered: recent changes to the structure of the market; development in the retail and wholesale mobile markets; the evolution of UK mobile pricing; mobile revenues; the effects of spectrum shares on competition; international comparisons of network quality.
21. The Annex summarised Ofcom's conclusion, as set out in the November 2016 consultation on the same issue:

"A1.8 Based on that evidence we argued that the UK mobile market was currently working well for consumers and businesses, with strong competition between the different MNOs. We considered that the UK enjoyed relatively low prices when compared to other countries, whilst seeing significant levels of investment in new products and services.

A1.9 ...market concentration indices had continued to decrease since the merger between 2010 Orange and T-Mobile. [sic]

A1.10 We also showed that prices of most SIM-only baskets decreased over the 2013-2016 period. One notable exception was the highest usage SIM-only basket, which reflected H3G's price increases for its plans with unlimited data allowance. For plans with handsets the evidence was mixed with some baskets experiencing price increases followed by price decreases. We argued that these variations could be due to increased prices for some handsets as well as additional costs for 4G packages.

A1.11 We also argued that both our own international pricing benchmarks as well as those of the EC show that prices in the UK are lower than other comparable countries."

⁹ Award of the 2.3 and 3.4 GHz spectrum bands. Annexes to the statement. Ofcom, 11 July 2017. See: https://www.ofcom.org.uk/data/assets/pdf_file/0013/104305/Statement-annexes-Award-of-the-2.3-and-3.4-GHz-spectrum-bands.pdf

22. Ofcom subsequently updated the data it had used to form its earlier conclusion and also expanded upon the previous analysis of the evolution of the wholesale market and included a section on international comparisons of network quality. Upon the basis of this updated and expanded analysis Ofcom re-affirmed that competition was “generally working well”¹⁰.

23. Ofcom concluded that:

“... mobile prices in the UK are relatively low compared to international benchmarks based on our own analysis as well as the international comparison carried out by the EC”¹¹

24. Similarly, the CMA, in considering BT’s acquisition of EE, found that:

“Based on the evidence set out above, our view is that the retail mobile market is currently competitive.”¹²

25. In addition, the European Commission has noted that:

“the retail mobile telecommunications market in the United Kingdom is well functioning and very competitive at present.”¹³

26. Tef UK is not aware of any subsequent evidence that might question any of these findings.

27. The fact that the UK mobile retail market is competitive is pertinent, not least because Ofcom’s relevant principal statutory duty under the CA 2003, to further the interests of consumers in relevant markets, where appropriate by promoting competition. Any proposed intervention in a competitive market needs to be justified by a clear demonstration as to why welfare would be enhanced (or else why proposed measures would benefit vulnerable consumers, in particular).

¹⁰ §A1.245

¹¹ §A1.233

¹² §10.81 of “BT Group plc and EE Limited A report on the anticipated acquisition by BT Group plc of EE Limited” Competition and Markets Authority, 15 January 2015:

https://assets.publishing.service.gov.uk/media/56992242ed915d4747000026/BT_EE_final_report.pdf

¹³ CASE M.7612 - HUTCHISON 3G UK /TELEFONICA UK, 11 May 2016, §1175, p.258.

Developing an analytical framework to assess the possible effects of intervention

28. Tef UK believes that Ofcom should develop a robust analytical framework which can be used to assess the effects of proposed intervention. This is not just a matter of sound regulation (although that is self-evidently the case). As noted above, Ofcom has a statutory duty to do this, and its own policy on impact assessments says that:

“In developing policy proposals, our aim will be to think widely about the possible impacts, taking account of the whole value chain and knock-on effects across the communications sector. By doing so, we will seek to minimise any unintended consequences.”

29. Ofcom is used to undertaking such exercises and is best placed to consider and evaluate all the likely possible impacts of its proposals, given its expertise and statutory information gathering powers. Tef UK considers that the following set of issues should be considered, but we do not suggest that it is necessarily a comprehensive list.

Ofcom’s existing proposals to inform customers

30. Ofcom has found that people often don’t understand what coming to the end of their minimum term means, or what their options are¹⁴. This has inspired proposals to require communication providers to send a notification to customers when they are approaching the end of their minimum contract period, informing them that a SIM only deal would be available¹⁵.

31. Tef UK believes that the evidence provided by Ofcom’s consumer research is that there could be an information asymmetry problem, here, in the sense that a significant number of consumers are not sufficiently aware of the fact that they are ending their minimum term, or of the options that are available to them, and this could be the principal reason why consumers are being charged for handsets after the end of their minimum term. Ofcom’s policy response, to provide consumers with relevant information, seems to Tef UK to be targeted, proportionate and objectively justifiable, in the circumstances. If Ofcom proceeds to give effect to these proposals, it may take the view that it should wait and see how effective they are in resolving the problem subject of the current consultation, before deciding whether to adopt more intrusive measures.

¹⁴ §2.9

¹⁵ §2.10

Waterbed effect

32. The “waterbed effect” is the idea that if the return to a communication provider from a particular service is reduced, it may compensate for that by increasing other charges to consumers.
33. Ofcom is very familiar with the concept because it has considered it on many occasions in the past (for example, in relation to wholesale mobile call termination charges and disputes about interconnect charges for non-geographic calls).
34. In the context of the current issue, the concern would be that a reduction in subscription charge revenues from customers who are outside the minimum contract term (following intervention to require providers to move customers to another deal), might result in higher charges for other customers (for example: higher subscription charges, generally; less attractive SIM-only deals; higher out of bundle charges; etc).
35. Ofcom should examine the extent of the waterbed effect and consider the impact of an increase in other charges that might arise should it require mobile communication providers to move customers to other deals at the expiry of their minimum contract terms.

Third degree price discrimination

36. Tef UK understands that Ofcom’s consumer research suggests that some consumers do not switch tariffs due, in part at least, to information asymmetry, as we note in paragraphs 30 and 31, above. Ofcom has sought to address this through its proposals to require providers to send a notification to customers when they are approaching the end of their minimum contract period, informing them that a SIM only deal would be available.
37. However, to the extent that consumers’ behaviour simply reflects different price elasticities of demand (i.e. consumers who switch are more price sensitive than those who do not), the issue subject of this consultation document may be considered to be an example of third degree price discrimination. Economic literature suggests that third degree price discrimination can be welfare enhancing if it increases output (relative to uniform pricing).
38. Tef UK believes that Ofcom should examine whether moving customers to another deal might result in a reduction in output and, therefore, lower welfare.

Vulnerable consumers

39. As noted above, under s 3(4)(i) of the CA 2003, Ofcom must have regard, in performing its duties, to the needs of persons with disabilities, of the elderly and of those on low incomes, if relevant. Ofcom does not appear to have considered whether any particular class of potentially vulnerable customer might be disproportionately affected by the issues subject of this consultation. Tef UK believes that it has a clear statutory duty to do so.

Impact on competition

40. Intervention to require mobile communication providers to move customers to another deal at the end of the minimum contract term could dampen competition between mobile communication providers, in attracting new customers. This is because the average life time value of customers (to communication providers) would be reduced, making them less attractive to acquire in the first place. Clearly, if this were the case, intervention would seem to be inconsistent with Ofcom's principal statutory duty, to further the interests of consumers in relevant markets, where appropriate by promoting competition.

41. As part of a broader framework to assess the impact of these proposals, Ofcom should consider the impact on competition between mobile communication providers.

Options under consideration

42. Section 4 of the consultation summarises two options which Ofcom is considering:

- Mandating further transparency measures and/or
- “Fairer” default tariffs

43. The first point to make, here, is that, as noted above, Ofcom has already consulted on proposals to require communication providers to send a notification to their customers when they approach the end of their minimum contract period¹⁶. The intention was to provide customers with information to put them in a better position to make purchasing decisions and it is clear that Ofcom had in mind mobile consumers:

“Also, certain mobile consumers continue to pay the same price after the end of their minimum contract period, which for some consumers could be significantly higher than if they switched to a SIM-only deal.”¹⁷

44. Ofcom is currently considering responses to this consultation. If it proceeds to implement its proposals, then it presumably would do so with the intention of meeting its regulatory objectives, including in relation to mobile customers. Accordingly, further intervention, such as those proposed in this current consultation, may be otiose

45. More generally, as set out above, Tef UK does not think that the case has yet been made to justify regulatory intervention. Accordingly, we think it premature to analyse to a great extent the policy options that Ofcom has set out and, on that basis, Tef UK reserves its position until Ofcom has made the case for intervention, properly. Nonetheless, there are some practical issues that Ofcom may wish to bear in mind when developing its proposals.

Mandating further transparency measures

46. Ofcom says that, under this option, providers would inform customers when they purchase services, and in a clear transparent manner, of the different cost elements of the mobile package, particularly where this includes handset, airtime and any other services.

47. There is no guidance on how these cost elements are to be determined. This is not a trivial matter; in principle, there are many ways in which the handset cost element (for example)

¹⁶ Helping consumers to engage in communications markets. Consultation on end-of-contract and out-of-contract notifications. Ofcom, 31 July 2018. See:

https://www.ofcom.org.uk/data/assets/pdf_file/0019/117163/Consultation-end-of-contract-notifications.pdf

¹⁷ §1.8

might be determined: would the cost element reflect the wholesale cost a communication provider is charged by a handset supplier? Would costs be historic or current, with or without any discount that could be the subject of commercial and confidential agreements between suppliers and providers? Would there be a mark-up and if so what would that be? Different approaches to exchange rates and inflation might be applied.

48. It seems to Tef UK that if the intention behind the policy is to highlight the handset element of the overall charge, there may be an incentive on communication providers to arrive at low estimates for the handset cost element, and Ofcom should be mindful of this.
49. Further, there could be commercial confidentiality and competition issues that need to be considered. As noted above, agreements between communication providers and handset suppliers are confidential. Ofcom needs to consider whether an obligation on the former to disclose handset cost information to consumers would amount to a disclosure of commercial confidential information and the consequences of this. In addition, ordinarily, the publication by a communication provider of confidential handset cost information might constitute a breach of both the Chapter I prohibition set out in the Competition Act 1998 and/or Article 101 of the Treaty on the Functioning of the European Union. Ofcom should examine its proposals through the lens of competition law.

Fairer default tariffs

50. Ofcom sets out two approaches, here: automatic migration to a SIM-only deal; or a reduction in the subscription charge to reflect the handset payment.
51. On the automatic migration proposal, Ofcom already notes some practical problems¹⁸, but dismisses these on the basis that “*providers could clearly mitigate or eliminate some of these effects if they chose to do so*”. However, absent the suggestion of inviting customers to opt out of an automatic migration (and accepting that this might not be effective)¹⁹, Ofcom does not explain how adverse consequences could be mitigated or eliminated. Clearly, more work is necessary, here, to assess the type and scale of adverse consequences and what might be done to address them.
52. Separately, Tef UK would observe that SIM-only deals are formulated in the context of the current commercial and regulatory environment. Automatic migration would likely affect the way in which mobile communications providers make their commercial decisions, by creating incentives to make SIM-only deals *less* attractive. Ofcom does not appear to have

¹⁸ §4.16

¹⁹ §4.17

considered this. Tef UK believes that Ofcom should assess how strong these incentives might be in practice, and the extent to which they might impact terms, including prices.

53. In relation to the subscription reduction idea, we would refer Ofcom to our comments on the handset cost element, set out in paragraphs 47 to 49, above. There would clearly be an incentive on mobile communication providers to minimise the handset cost element under this proposal, and Ofcom would need to address this. In any event, there are confidentiality and competition issues that would need to be considered.

Split contracts

54. Ofcom says that it is minded not to require mobile communication providers to introduce split contracts on the grounds of unintended consequences and that there are less intrusive means of achieving its policy objectives. Tef UK agrees with this. In addition, as we note above, under split contract model, the handset agreement is, in fact, a loan agreement, governed by the Consumer Credit Act 1974, as amended. Providers need to be licenced by the financial regulatory authorities in order to be able to offer such a facility. Tef UK believes that requirement to offer split contracts would be tantamount to requiring communication providers to be licensed to offer communication services and this would seem to breach of the requirements of the CA 2003, insofar as it implements the provisions of the European Authorisation Directive, which directed Member States to remove any general requirement for individual licences in favour of general authorisation schemes.

Institutional arrangements

55. As we note above, Ofcom's consultation document was quickly followed by the Citizens Advice super complaint to the CMA²⁰. The CMA has opened an investigation²¹.

56. Mobile was one of five sectors identified by Citizens Advice as areas of concern. Tef UK believes that Ofcom, as the expert sectoral regulator, should investigate the issues as they relate to mobile and that the CMA should defer to Ofcom, in respect of mobile. It would seem that Citizens Advice also envisages that Ofcom will take the lead; note, for example:

*"We therefore welcome Ofcom's consultation on how it can end this practice by introducing fairer default tariffs"*²²

57. Tef UK would welcome clarity on how Ofcom and the CMA intend to collaborate on this issue.

²⁰ Excessive prices for disengaged consumers. A super-complaint to the Competition and Markets Authority. Citizens Advice, 28 September 2018. See:

[https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20(1).pdf)

²¹ <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

²² Page 4 of the Citizens Advice super-complaint