1. Executive Summary

1.1. Since Three's launch in 2003, we have been the UK's mobile market challenger, focusing on providing market-leading propositions, including 4G at no extra cost, and allowing our customers to use their calls, texts and data in over 71 destinations worldwide through our Go Roam offer and '123' proposition. Three carries nearly a third of the UK's mobile data traffic, with our customers using more than 3.5 times the industry average, and we were voted Best Network for Data by the Mobile Choice Consumers Awards 2018.

1.2. Three has a track-record of campaigning for measures to promote fair and effective competition to benefit consumers and increase transparency at all stages of the customer journey, from advertising through to point of sale and beyond. We have engaged closely with Ofcom, government and other stakeholders, on many consumer initiatives, over many years, including:

- in the last 18 months, discussing new solutions for financing handsets and other mobile devices and highlighting regulatory barriers to innovation in this area; and
- spending over 10 years pushing for an effective switching process, being the only mobile network operator to support Ofcom in moving to gaining-provider led switching

1.3. We believe that consumers should be able to fully engage in the market to share the benefits of competition. To realise the benefit of competition, consumers need easy access to key information and encouragement to consider their options.

1.4. The mobile market enjoys high levels of engagement and satisfaction, with mobile contract overall satisfaction at 91%. Although most people are happy and engaged, there is more that can be done to encourage increased engagement. Ofcom's project to help consumers, including vulnerable consumers, engage with communications markets is therefore a positive initiative.

1.5. As part of Ofcom's consumer engagement project, their recent proposal – to require service providers to send their customers either an out of contract or an end of contract notification – is a good example of a regulatory intervention that has the potential to make a real difference through ensuring transparency and prompting consumers to act, especially when combined with Ofcom's auto-PAC switching initiative. Three supports both these initiatives and encourages Ofcom to go further, by requiring service providers to also tell their customers that they could be better off by 'shopping around'.

1.6. However, Ofcom's two mobile handset consultation proposals:

- transparency measures requiring service providers to separately show the cost of the handset; and
- fairer default tariffs at the end of the minimum contract term

are premature – given both the end / out-of-contact notifications and auto-PAC switching initiatives have yet to be implemented and therefore the potential benefits and the need for more intrusive measures are unknown – and may harm consumers as:

- mandating a default tariff may give rise to negative unintended consequences and run contrary to Ofcom's policy goals, by discouraging consumers from engaging, chilling switching and therefore competition, and creating consumer dissatisfaction; and

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- requiring the cost of handsets to be shown separately to other costs would impose consumer credit regulation on handset-inclusive agreements. This would have significant implications for both service providers and consumers, including increased costs through duplicative regulatory regimes, reduced choice through the risk of withdrawal of handset-inclusive contracts from the market, and increased inconvenience and hassle for consumers.

1.7. These implications must be fully assessed and any benefits weighed carefully against the potential harm and costs.

1.8. Ofcom also briefly discusses split-contracts, where the handset is financed and sold with a linked airtime agreement. As Ofcom notes, some stakeholders have cautioned that these agreements do not necessarily offer consumers the best value. Worse, some service providers may be taking advantage of the differing regulatory regimes, to tie customers in to airtime agreements that are (in effect) longer than 24 months, resulting in consumers potentially being harmed and delaying those consumers' ability to switch.

1.9. Having dual regulatory regimes, with two regulators covering the same service or product is likely to cause consumer confusion or harm, and increases unnecessarily the regulatory burden on both providers and consumers.

1.10. Instead, Ofcom, working in partnership with the Financial Conduct Authority and HM Government, should review how consumer credit regulation can and should work better where mobile-devices, including handsets, are financed with consumer credit and sold with a linked airtime agreement.

1.11. We believe, to avoid unnecessary consumer harm, Ofcom should regulate both the mobile-device finance agreement and the linked airtime agreement when they are sold together. In this way, Ofcom can ensure consumers are protected, that agreements are not designed a way that consumers are inappropriately held to an airtime agreement lasting longer than 24 months, that their opportunity to switch is not inappropriately delayed, choice is enabled and competition enhanced, and the regulatory burden on both service providers and consumers is proportionate. This could be achieved by carving-out mobile-device sales with a linked airtime agreement from consumer credit regulation administered by the FCA.

1.12. As the consultation appears to be relatively preliminary and written to prompt discussion, we anticipate that Ofcom will undertake the required further significant analysis before Ofcom more formerly consults on carrying forward either of their two proposals. However, we urge Ofcom to first:

- focus on demand-side measures that promote competition by enabling consumers to better engage with markets; and

- allow the pending or proposed measures – the auto-PAC switching and out / end of contract notifications initiatives – to be given an opportunity to bed-down before Ofcom moves to consider more intrusive remedies.

2. Effective engagement and competition

Introduction

2.1 The mobile market has high-levels of consumer satisfaction with 91% of mobile contract customers satisfied with overall service provided and 84% satisfied that their service provides value for money.[1] Nonetheless Ofcom is concerned that out of contract mobile customers are paying more than they need to for their services.

2.2 Over and above general 'horizontal' consumer protection rules[2], Mobile phone consumers benefit from significant 'vertical' regulatory protections through the General Conditions of Entitlement[3] and other telecommunications and mobile specific regulations.[4]

2.3 However, some policy makers[5] and consumer advocates[6] are concerned that not all mobile consumers benefit as much as they could from competition, as potentially disengaged consumers may pay more for the same service compared to more engaged consumers. Citizens Advice have coined this concern the 'loyalty penalty'; however, viewed from the perspective of engaged consumers it could equally be described as an 'engagement reward'.

2.4 All consumers should have the opportunity to engage effectively with markets and to fairly obtain the benefits that engagement brings. To achieve this, consumers need to be able to access (and sometimes be given) the right information, at the right time (sometimes with a 'nudge'), and be able to access the right tools to enable them to assess their choices, and consumers then need to be able to easily act on their choice (including if that choice is to do nothing).[7] This increased effective engagement will then further contribute to the "virtuous competition cycle", with providers competing vigorously to win customers and active, informed customers buying the products which offer them the best value for money.

2.5 Where there are engagement concerns, Ofcom should review the market, identifying any demand-side problems that exist, and develop remedies designed to help consumers more effectively engage. Ideally these demand-side, consumer facing remedies would focus on: (i) disclosure and transparency[8]; (ii) shopping around[9]; and (iii) switching.[10] Following Ofcom's own Better Policy

[1] Ofcom, Customer Satisfaction Tracker, 2018

[2] General consumer protection measures include, Consumer Protection from Unfair Trading Regulations, Consumer Rights Act, The Consumer Contracts (Information, Cancellation and Additional Charges Regulations)

[3] The General Conditions of Entitlement are a set of rules that all communication service providers must follow. The consumer protection rules are in Part C of the General Conditions and include requirements around form and content of contracts (condition C1), to provide consumers with and publish detailed information about their products and services (condition C2), and measures to meet the needs of vulnerable consumers (condition C5). These conditions were recently reviewed, with new and amended conditions coming into force as recently as 1 October 2018

[4] For example, regulation relating to roaming while in the EU

[5] For example, Margot James, Digital Economy Minister, Hansard, Mobile Phone Contracts, 16 January 2018

[6] Reviewing Bundled Handsets, Citizens Advice, September 2018

[7] This follows the OFT's 3As Framework: Access, Assess, Act and which is discussed in more detail in Three's response of 15 October 2018 to the Competition and Markets Authority's consultation questions posed on 28 September 2018 as part of the CMA's review of Citizens Advice's Super-complaint. The 3As framework is also discussed, as part of wider reviews of how to better engage consumers in The role of Demand-Side Remedies in Driving Effective Competition, A Review for Which?, Professor Amelia Fletcher, CCP, University of East Anglia, November 2016 and Helping people get a better deal: Learning lessons about consumer facing remedies, FCA and CMA, October 2018

[8] Remedies focusing on addressing asymmetric information challenges, facilitating consumer awareness and understanding, facilitating comparison across services / products, preventing consumers from being misled, and aiding decision-making when consumers already take a service

[9] Remedies nudging or triggering consumers to shop around, as well as removing of specific inhibiting factors; they focus on remedies instigating or enhancing collation of information to facilitate search and comparison, that impose access to personal information to facilitate comparison, trigger or nudge consumers, or otherwise de-risk or facilitate shopping around

[10] Remedies making switching – from the perspective of the consumer – less costly, quicker, more reliable, and easier, or which remove inhibiting factors, including removing or changing contractual restrictions and which improve the process and consumer experience

Making principles,[11] only if these engagement remedies are tried, tested and fail, should Ofcom then move to consider more intrusive regulation.

2.6 Ofcom's continuing work to ensure consumers can exercise choice includes a project to consider how regulation can help consumers better engage. The first phase of this consumer engagement project proposed requiring service providers to send notifications to their customers, telling them when they were approaching or had reached the end of their minimum contract period, and reminding them about important information about their service.[12]

2.7 Further, when the benefits of out-of-contract and end-of-contract notifications are combined with the benefits that will flow from the new auto-PAC switching regime[13], handset-inclusive[14] customers will be nudged to engage at the right time, will be given the key information they need about their current service to help inform their decision making, and will then be able to easily, quickly and safely, without risk, switch if they want.

2.8 These two initiatives, especially if the end-of-contract notification includes Three's proposal to tell consumers that they may be better off if they shop around[15], have real potential to encourage and help consumers effectively engage and to create a step change in engagement levels. These two pending and proposed measures should be given the opportunity to bed-down before Ofcom considers further and more intrusive remedies.[16]

2.9 The next phase of Ofcom's consumer engagement project will: (1) consider whether some consumers have difficulty understanding their own needs and usage requirements; (2) consider whether some consumers also struggle to understand or navigate the market; and (3) review the price differences between 'in-contract' and 'out-of-contract' prices referred to as the 'loyalty penalty'.[17]

2.10 We look forward to working with Ofcom on this second phase of their work, which Ofcom say they will report on in the first half of next year.[18]

Harm and the 'loyalty Penalty'

2.11 Essentially, the harm that Ofcom identifies is that disengaged consumers pay more for their services than engaged consumers. This type of differential pricing is a common feature of competitive markets where undertakings offer lower or discounted prices to win (or retain) customers. However, it is not necessarily problematic that different consumers pay different prices, depending on their level of engagement. This is especially true where consumers have access to good quality information about their current tariff and the options available to them.

2.12 Understood in purely economic terms, Price discrimination[19], as a pricing strategy for handset-inclusive mobile services, allows mobile providers to serve more consumers than in a world of uniform-pricing. If providers were required to offer the same prices to all consumers (or move consumers to the cheapest tariff for them), then the most competitive offers in the market may

[11] "*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*", para 1,1, Ofcom, Better Policy Making – Ofcom's approach to Impact Assessment, 21 July 2005

[12] Ofcom's consultation on end-of-contract and out-of-contract notifications, 31 July 2018

[13] And will apply from July 2019

[14] Although we use the term handset-inclusive, these agreements can apply to other mobile devices, including tablets (e.g. Samsung's Galaxy Tab A), wearables (e.g. Apple's Watch), and dongles

[15] Three's response to Ofcom's consultation on end-of-contract and out-of-contract notifications, 10 October 2018

[16] For example, time is needed to inform consumers about the change, and for consumers to then learn to trust the new process

[17] Mobile Hand set Consultation, paragraphs 2.17 & 2.18

[18] Mobile Handset Consultation, paragraph 2.20

[19] An economic term for the factual situation where the ratio of price to marginal cost differs for similar products

disappear. This may result in engaged consumers, with affordability constraints, being priced-out of the market for services they would otherwise have been able to afford to buy.

2.13 The 'harm' that Ofcom identifies is the higher-price paid as a result of disengaged customers not benefiting from better value pricing available in the market had they engaged and taken an alternative service, for example a SIM only contract and is classified as a form of 'loyalty penalty' by Citizens Advice and others.[20]

Proposed measures

2.14 Ofcom's research suggests that some consumers have difficulty in finding relevant information, including when their minimum contract term is coming to an end[21], and some consumers have trouble in switching services.[22] These, and other similar factors, may discourage some consumers from engaging in the market. Therefore, as the 'harm' that Ofcom identifies flows from consumers not engaging and therefore potentially paying more than they need to, Ofcom should focus on:

- identifying those things which discourage or prevent consumers from effectively engaging; and
- introducing proportionate demand-side measures that encourage and enable consumers to more easily engage.

2.15 Ofcom's work on introducing an auto-PAC switching mechanism[23] and their proposed out / end-of-contract notifications[24] are just the type of remedies that will help address the identified harm by increasing consumer engagement. These remedies should, once introduced, be given an opportunity to bed-down and to work before additional and more intrusive remedies are considered.

2.16 Rather than address the 'loyalty penalty' concern as part of Ofcom's wider phase 2 work, Ofcom's mobile handset consultation separately considers the 'loyalty penalty' in the context of handset-inclusive contracts and proposes two options: (1) mandating further transparency measures and / or (2) fairer default tariffs. Ofcom also considers mandating split-contracts, but does not propose this as an option.

Option 1: mandating further transparency

2.17 For handset-inclusive contracts, as we have previously explained to Ofcom, requiring the handset cost to be shown separately would very likely result in the service provider having to additionally comply with consumer credit regulation. So, while positioned as an information remedy, the option would very likely have the effect of mandating split-contracts.[25] This would incur increased cost for both service providers and customers and potentially result in unintended consequences, including reduced consumer choice[26] and alternative forms of consumer harm.

2.18 Against these unintended consequences, it is unclear what, if any, benefit the transparency Ofcom proposes would bring to consumers. Consumers should choose the best value contract (or combination of contracts) based on the total charge they will incur, over the minimum contract

[20] See footnote 6

[21] Para 1.5, Consultation on end-of-contract and out-of-contract notifications, July 2018

[22] Ofcom has previously explained that a quarter of consumers that switched their mobile provider experienced significant process difficulties – of consumers that had actively considered switching but did not, 37% said these difficulties were a major factor in their decision (Para 3.2, Ofcom, Consumer switching Decision on reforming the switching of mobile communication services, December 2017).

[23] Ofcom Statement, Decision on reforming the switching of mobile communications services, 19 December 2017

[24] Ofcom Consultation, End-of-contract and out-of-contract notifications, 31 July 2018

[25] Ofcom highlights that some service providers offer separate contracts for handset loan and airtime elements. Ofcom calls these 'split-contracts'; however, generally these contracts are not truly split (i.e. separate) as the airtime contract may need to be maintained until the handset loan is repaid.

[26] This therefore runs contrary to Ofcom's stated preference to maintain consumer choice, Mobile handset consultation, para 4.27

period for the services they want to buy, and weighing in other factors such as network coverage and quality and the type of handset they want.

2.19 Increased transparency does not, in and of itself, enable engagement – to increase engagement, the information must also be useful. Assessing best-value requires information about the upfront charge (if any), the monthly charge, and the minimum contract length. Over the length of the minimum contract period or other appropriate time frame, knowing the cost of the handset for a handset-inclusive contract will not help a consumer assess whether that handset-inclusive service is better value versus a split-contract arrangement or purchasing the handset and a SIM only contract completely separately.

2.20 It is also important to avoid information overload: if consumers are provided with unhelpful information they may become confused or feel overwhelmed and may be discouraged from engaging.

2.21 The transparency that Ofcom proposes may come with other unintended consequences. In 2016, the Advertising Standards Agency introduced 'advice' that requires fixed broadband providers to show the combined (bundle) price for the line rental and broadband.[27] This requirement was imposed due to consumer confusion around the true cost of the service advertised, with providers inflating the fixed line charge and minimising that charge's visibility within an advert versus the promotional 'free' or very cheap broadband charge. The individual elements of the dual-play bundle, i.e. line rental and broadband, were not relevant to consumers being able to easily assess the value of the bundle, what was and is important is the combined bundle charge.

2.22 If consumers are encouraged by regulation to make choices on a basis that does not reflect their true preferences (i.e. they overly focus on the cost of the handset, as opposed to the monthly charge), then providers may compete to win customers on this 'wrong' basis. For example, if a consumer chooses a supplier solely based on an 'emphasised' handset cost, due to the monthly charge having been 'deemphasised'.[28] The current pricing, i.e. with no cost breakdown, avoids this potential negative behavioural impact.

Option 2: default tariffs

2.23 Led by their finding that some customers do not engage at the end of the minimum contract period for handset-inclusive contracts, Ofcom is concerned that these customers are likely to be paying for handsets costs that have already been paid off and that this does not seem to them to be in consumers' best interest. To address this concern, Ofcom suggests that service providers should move customers to different, fairer, default tariffs at the end of the minimum contract period.

2.24 Many consumers are happy with the service that they are paying for and may choose to take no action, particularly if the consumer feels that there is not an equivalent, better value, service that meets their needs. Moving consumers to a default tariff, on an opt-out basis, may drive consumer dissatisfaction and complaints.

2.25 For example, of Three's customers who have been out of contract for more than 24 months a significant number are on plans which have features which provide at least as good value as current plans (including SIM-only offers). These plans provide a rationale reason not to switch or change service. It is therefore overly simplistic to assume that customers can obtain a better value through purchasing an alternative service.

[27] From October 2016, the ASA enforced an approach requiring broadband price statements to: "• […] present all compulsory elements of the total financial commitment (up-front costs, ongoing costs and contract length) together, avoiding undue emphasis on any one element. • […] one inclusive price for compulsory up-front costs and an inclusive price for a consumer's ongoing monthly cost (combining the line rental and broadband costs where the line rental is offered by the provider). • […]", ASA, Compulsory Charges: Telecommunications, Advice online, 7 July 2016

[28] Present bias, myopia and hyperbolic discounting: these behaviours effectively involve consumers giving disproportionate weight to the present and insufficient weight to the future." CCP report, The role of Demand-Side Remedies in Driving Effective Competition, A review for Which?, November 2016, page 17, para 1.25

2.26 Imposing default tariffs on consumers (and other forms of price control) may also come with unintended consequences and risks:

- consumers (including those who are currently engaged) may come to believe that the regulator will ensure that they will always be put on the best value deal for their needs, with the effect that engagement and switching stalls, competition is chilled, and innovation is reduced; and

- harming long-term competition, through entrenching the market shares of large and / or incumbent companies.

Further options considered: mandated split-contracts

2.27 Mandated split-contracts are considered but discounted by Ofcom as their preference is to ensure a wide range of competitive offers to consumers.[29] While this approach is sensible and should be encouraged, Ofcom should not lose an opportunity to ensure that regulation of these services is both proportionate and effective: i.e. that consumers are appropriately protected and regulation does not inappropriately discriminate between different services that involve the provision of a handset.

2.28 Split-contracts may represent poor value for some customers. For example, some handsets sold on credit are linked to specific airtime contracts. However, the price of the airtime component can be inflated compared to the service provider's equivalent SIM only tariff, and the 'retail price' of the handset can be significantly more than an equivalent handset purchased from an alternative provider.

2.29 Some providers take advantage of the differing regulatory regimes to avoid particular consumer protection rules. For example, some providers require the customer to maintain an airtime agreement with the provider for the duration of the loan. Some finance agreements can last 36 months or more and therefore circumvent the General Condition consumer protection requirement that contracts last no longer than 24 months.[30]

2.30 Other providers may also use the differing regulatory regimes to avoid providing full service information to potential customers. For example, one provider advertised a mobile handset with finance, over 30 months, but with no reference to minimum terms as would be required for a handset-inclusive service. The provider also reserved the right to increase the airtime price during the loan period, yet the airtime agreement must be maintained during the duration of the loan. This potentially circumvents rules that allow consumers to exit their contract without being penalised where there is 'material detriment' such as a price rise.

2.31 Ofcom should ensure that consumers are adequately protected and that regulation is applied in a consistent way. This could be achieved through a 'carve-out' of the sale of handsets on credit[31] with a linked or associated airtime agreement from consumer credit regulation[32] and Ofcom then taking consumer protection responsibility for these split-contract arrangements, as it does for handset-inclusive sales.

[29] Mobile Handset Consultation, paragraph 4.27

[30] General Condition C1.4

[31] And where the requirement to maintain the airtime agreement with the credit agreement for the mobile-device is for no longer than 12 months and the credit agreement is at an APR of 0%, although Three would wish to explore the potential to alter applicable EU legislation to extend this 12-month period (see footnote 30) *Amend reference to 34?*

[32] A carve-out already exists for the insurance industry for insurance contracts of 12 months with an APR of 0%, is a model that works well in other jurisdictions (for example, Australia) without causing consumer detriment, and would provide a faster and more effective way of enabling a greater consumer choice

Conclusion

2.32 To ensure the best outcomes for consumers Ofcom should focus on implementing only pro-competition, demand-side consumer-focused engagement enhancing measures, and should not introduce any increased transparency measures that do not demonstrably help consumers. Only if engagement enhancing measures fail, should Ofcom then turn to consider more intrusive measures.

2.33 Ofcom should therefore not, at this time, carry forward their proposed option to increase transparency for handset-inclusive contracts by requiring the provision of cost information, and nor should Ofcom carry forward any proposal to impose supply-side regulation, such as default charges or other retail price controls.

2.34 Ofcom should however work with HM government and with the Financial Conduct Authority to address the current regulatory inconsistencies and consumer harm arising from split-contract services.[33]

[33] This is an important sectoral consumer protection and competition issue and not a matter which, as Ofcom suggests at footnote 24 of the Mobile Handset Consultation, “for providers to clarify with the FCA”.

3. Answers to Ofcom's Questions

Question 1 – Do you agree with the concerns we have identified in relation to bundled mobile airtime and handset contracts?

3.1. No. It is not necessarily problematic that different consumers pay different prices, depending on their level of engagement. This is especially true where consumers have access to good quality and timely information about their services and the options available to them. Price discrimination is a common feature of competitive markets in which service providers compete on price, coverage and quality of service to win new customers and to retain existing customers who are a flight-risk. Price discrimination is a natural pricing strategy, allowing mobile providers to compete, innovate and serve more consumers than in a world with limited pricing differentiation or uniform pricing.

3.2. However, we agree that there is more that can and should be done to help consumers more effectively engage with mobile markets and Ofcom should focus on identifying and resolving the causes of disengagement.

3.3. It is also necessary to ensure those people who, by reason of true vulnerability or disability are prevented from engaging, are appropriately safeguarded. We note that Ofcom intends to address the impact of price differentials on vulnerable consumers as part of the second phase of their consumer engagement project, and we look forward to engaging positively with Ofcom on this important aspect of their work.

Question 2 – Do you agree with the options we have outlined as potential remedies for concerns identified?

3.4. No. Ofcom's Option 1 – increased transparency through the provision of additional handset and other cost information – would radically change the make-up of the proposition to one which would require reference to the FCA which would have significant knock-on implications.

3.5. Ofcom's Option 2 – mandated default rates – risks long-term damage to competition, harming consumers and unintended consequences, and these risks should be fully assessed.

3.6. Ofcom should first focus on implementing pro-competitive, demand-side, engagement enhancing measures. Only if engagement enhancing measures are tried, tested and fail, should Ofcom then turn to consider more intrusive remedies, including supply-side default tariffs or other price controls.

Question 3 – Do you have views on additional solutions we should consider, including on split contracts.

3.7. Yes. Ofcom should work with HM government and the Financial Conduct Authority to address the current regulatory inconsistencies and consumer harm arising from split-contract services.

3.8. Ofcom – with HMG and the FCA – should consider a 'carve-out' of the sale of handsets on credit with a linked or associated airtime agreement from consumer credit regulation, with Ofcom then taking consumer protection responsibility for these split-contract arrangements, as it does for handset-inclusive sales.