



Protecting consumers from  
mis-selling of mobile  
telecommunications services

Statement

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## Section 1

# Summary

- 1.1 Tackling the mis-selling of communications services is an important Ofcom priority. Sales and marketing behaviour that is misleading and inappropriate can undermine consumer confidence in markets and cause individuals harm. Consumers mis-sold services can suffer anxiety, distress and inconvenience. Financial harm can also result if consumers are on inappropriate price or service packages due to mis-selling.
- 1.2 Complaints to Ofcom about the mis-selling of mobile communications services began to rise sharply in 2006, from about 50 per month in 2004/5 to 200/250 per month in 2006. Problems experienced by consumers included being given false or misleading information when purchasing services and 'slamming' where consumers find themselves with a new contract without their knowledge and/or consent.
- 1.3 One aspect of mis-selling around certain 'cashback' schemes became an increased cause for concern during 2007. With cashback, an independent retailer undertakes to pay an amount of money to the customer when they take out a contract from a mobile service provider ('MSP'). Problems arose where the consumer had been unable to obtain the cashback, typically either because the terms for claiming were too onerous or because the independent retailer had gone out of business.
- 1.4 In light of the increased number of complaints, we worked with Mobile Network Operators ('MNOs') to develop and introduce in July 2007 a voluntary 'code of practice for the sales and marketing of subscriptions to mobile networks' aimed at tackling misleading sales and marketing practices ('the Code'). On its introduction, we made clear that unless the Code resulted in a significant and rapid reduction in consumer complaints we would consider the case for formal regulatory intervention.

## Review and consultation

- 1.5 By October 2007 there had been no significant change in the level of complaints to Ofcom and we began a review to consider the case for further action. In a consultation in March 2008 ('the 2008 Consultation'), we reported the introduction of the Code appeared to have brought about some positive changes in practices by some MNOs and retailers, particularly in respect of cashback offers. However, we found that the extent of monitoring and compliance varied between MNOs and that it appeared to address cashback problems rather than general mis-selling.
- 1.6 In light of the continued high levels of complaints, the extent of consumer harm involved and the varying levels of monitoring and enforcement of the Code by the MNOs, we proposed to introduce a new General Condition ('GC') on sales and marketing practices that would apply to all MSPs. GCs are rules imposed by Ofcom on Communications Providers in accordance with the Communications Act 2003 ('the Act'). Amongst other things, the proposed condition would require MSPs:
  - not to engage in dishonest, misleading or deceptive conduct and to ensure that those selling their products and services do not mis-sell ('a general prohibition on mis-selling');
  - to make sure customers get the accurate information they need when they buy the product;

- to make sure the customer is authorised to, and intends to, enter into a contract;
- to ensure that the terms and conditions of all sales incentives offered by their retailers are not unduly restrictive; and
- to carry out due diligence and a number of checks in respect of their retailers to ensure the soundness of the company and its directors.

## Conclusions

1.7 We have considered comments received to the 2008 Consultation, continued to collect and analyse complaints data from Ofcom and other sources, carried out further market research to understand the extent and nature of the harm. We have also requested further information from MSPs and a number of independent retailers on the potential costs of, and required time for, implementing our proposals.

1.8 On the basis of this further analysis, additional evidence and consultation responses (in addition to the evidence and analysis carried out pre-consultation), we have decided to proceed with the introduction of a GC. The main provisions of such a GC are as proposed in the 2008 Consultation. In reaching this decision, we have taken account in particular of:

- **The level of complaints.** Complaints to Ofcom relating to general mis-selling have not decreased significantly from the levels just before the Code was introduced. In the six months prior to the introduction of the Code general mis-selling complaints averaged 228 per month; between August 2008 and January 2009 complaints averaged 212 per month. They have however fallen from a peak of above 300 per month reached during the 2008 Consultation.

In addition, Consumer Direct report that mobile phone service agreements are the second most complained about item in the UK (behind used car sales). Of all mobile phone related complaints in 2008 (51,400), we estimate that around 10,600 complaints may include mobile mis-selling issues (up from 9,000 in 2007).

- **The level of consumer harm.** On the basis of market research and information from independent retailers, we estimate the current ongoing value of financial harm to consumers from general mis-selling at £21million a year, from cashback mis-selling at £8million a year and from the cost of time spent dealing with mis-selling and cashback problems £3million per year.
- **The additional provisions in the GC.** The GC includes a general prohibition on mis-selling and requires specific information about the service being purchased to be provided to the customer. These or similar provisions are not explicitly included in the Code and are intended to provide additional protection for consumers and reduce the instances of mis-selling.
- **The additional enforcement powers that the GC will provide.** The range of remedies available to Ofcom to enforce compliance with a GC are different from the remedies currently available under the Enterprise Act 2002 ('EA'). These include the ability to issue a fine or require a company to remedy the consequences of contravention, for example by providing compensation. This should help address ongoing harm and act as a deterrent to mis-selling in the future. In addition, small and medium enterprises (SMEs) are covered by a GC whereas the EA covers only consumers.

- **The costs of implementing the GC relative to the benefits.** Our analysis suggests that the introduction of the proposed GC is likely to result in net benefits. We estimate the potential net present value of the benefit could be £45million over five years.

1.9 The GC (General Condition 23) will come into force six months from the date of the publication of this statement.

## Section 2

# Introduction

- 2.1 Ofcom's principal duty is to further the interests of citizens and consumers through a regulatory regime which, where appropriate, encourages competition. Effective competition delivers choice and lower prices to consumers as well as opportunities for new services and new entrants. However, competition alone may not always deliver appropriate results and consumers may need protection from inappropriate and unacceptable behaviour by certain market players that may undermine confidence in the market as well as cause individual detriment.
- 2.2 The term 'mis-selling' covers a range of sales and marketing activities that can work against the interests of consumers and undermine confidence in the industry which can have a detrimental impact on competition.
- 2.3 We split mis-selling into two categories. The first category is general mis-selling and may include activities such as:
- the omission of relevant or the provision of false and/or misleading information (for example, about tariffs, potential savings or network coverage);
  - applying unacceptable pressure to switch providers, such as using threatening or intimidating behaviour or – in the case of sales at the premises of the customer – refusing to leave until the customer signs a new contract; and
  - slamming, an extreme form of mis-selling, where customers find themselves with a service from a new company without their knowledge and/or consent. Forms of slamming can include, passing off (i.e. where representatives claim to represent a different company), customers being told they are merely signing up for information rather than entering into a new contract, or the forging of customers' signatures on contracts.
- 2.4 The second category is a specific form of mis-selling related to cashback schemes. Mobile cashback schemes are a form of promotion offered to consumers, where a consumer signs up to a mobile phone network, and is promised the payment of a certain amount of money in return. A mobile service deal with cashback attached usually consists of two formally independent pricing components – a tariff for the service paid by the consumer to the MSP and cashback received by the consumer as an incentive to contract from the retailer. However, consumers may view the two offsetting components together and thus consider the 'net' price to be the tariff minus any cashback received<sup>1</sup>.
- 2.5 We have observed three different types of problems involving cashback schemes:
- i) Independent retailers refusing to pay out on cashback offers on the basis that the consumer has failed to comply with the terms of the offer. In a number of cases it appeared that the terms and conditions attached to the cashback offer were unduly onerous and the consumer was misled about the difficulty in claiming. Onerous terms and conditions are imposed to reduce the redemption rate i.e. making it more difficult for consumers to claim the cash that they are due. As

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<sup>1</sup> Indeed, in 2007 many independent retailers advertised mobile services quoting the line rental tariffs net of cashback payments which encouraged consumers to view the deals in this way.

some consumers fail or are unable to claim, the independent retailer can offer very attractive deals which, if fully redeemed, would not be financially viable.

- ii) During pre-consultation, we carried out an analysis of cashback complaints into the Ofcom Advisory Team ('OAT') and noticed that according to consumers, retailers refused to pay cashback even when they did comply with the terms and conditions. Where the consumer complaint is justified, this might suggest that some retailers are dishonest and actually had no intention of honouring all the cashback offered. In some cases the terms and conditions attached to the cashback deal gave the retailer the 'sole discretion to refuse an application'.
- iii) The third type of problem involves independent retailers going out of business and therefore being unable to honour the cashback offers. A number of independent retailers reported financial problems when cashback claims were larger than expected (which might arise if the independent retailer is operating a bad cashback scheme and the actual redemption rate is greater than that expected or assumed). However, this problem is not exclusive to independent retailers offering bad cashback deals and businesses may cease trading for a large number of reasons<sup>2</sup>.

### The consumer interest

2.6 Consumers' interests can be harmed as a result of irresponsible sales and marketing activities in a number of ways. For example, customers could suffer financial harm, inconvenience and/or distress if:

- Certain aspects of their mobile deal are different from the pre-sale advice they received, for instance:
  - The monthly rental amount is more expensive than advised;
  - Charges not included in the 'bundle' of services included in monthly charge are more expensive than advised (or certain charges which were advised to be included in the bundle turn out to be outside the bundle);
  - The coverage is insufficient in certain areas; or
  - The functionalities of their mobile device are not as promised; or
  - The contract or mobile device does not allow the phone to be used in certain countries.
- They have been 'slammed' i.e. a new contract has been taken out without their knowledge and/or consent. The customer may suffer financial harm if they are transferred onto a more expensive price plan or end up with multiple contracts.
- They are unable to obtain sales incentives promised and, in the case of cashback, are still bound to pay the full monthly line rental to the MSP for the duration of the minimum term of the contract.

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<sup>2</sup>It is possible that there is a link between retailers offering very high cashback amounts and an increased probability of going out of business. The redemption rate cannot be predicted with certainty before purchase - if the redemption rate is higher than expected it is more likely that a business model paying high cashback will prove unsustainable.

- They may suffer a detrimental impact on credit rating because they cannot afford to pay bills and go into arrears because charges are higher than advised (which might have financial implications e.g. if the consumer is charged a higher rate on loans because their credit profile is adversely affected).

2.7 In addition there is the risk that adverse publicity relating to irresponsible sales and marketing activity could result in consumers losing confidence in the mobile retail market or a set of suppliers within that market. This might mean consumers are discouraged from participating in the market and choosing to switch. This might make competition less effective to the detriment of consumers.

### **The need to take action**

2.8 Following a rising trend in complaints about selling practices in the mobile market, Ofcom worked with the mobile industry in developing a self-regulatory initiative in the form of a code of practice for the sales and marketing of subscriptions to mobile networks ('the Code')<sup>3</sup>, aimed at stamping out misleading sales and marketing practices. This Code was adopted by the 5 MNOs on 31 July 2007.

2.9 The Code lays out best practice principles for selling and promoting mobile phone subscriptions and pay-as-you-go deals through both direct and indirect sales channels. It also sets standards on sales incentives and due diligence.

2.10 We made clear at the time that we expected the Code to have a quick and significant impact in reducing complaint numbers and that we would move swiftly to assess more formal regulatory options to protect consumers should the Code not have the desired impact.

2.11 As set out in the Ofcom consultation which was published on 18 March 2008<sup>4</sup> ('the 2008 Consultation'), given the evidence that mis-selling of mobile services continued to be a significant problem, Ofcom began a review in autumn 2007 to consider whether to impose regulatory rules requiring providers to adhere to certain standards of conduct.

### **Ofcom's policy objectives**

#### **Communications Act 2003**

2.12 Under section 3 of the Communications Act 2003 it is the principal duty of Ofcom:

- To further the interests of citizens in relation to communication matters; and
- To further the interests of consumers in relevant markets, where appropriate by promoting competition.

2.13 Section 51 and 52 of the Act further set out that Ofcom has the duty to set such General Conditions ('GC') as we consider appropriate for securing that providers establish and maintain procedures, standards and policies necessary to secure the effective protection of domestic and small business customers of such providers.

2.14 We consider that addressing mis-selling and cashback issues falls within the scope of sections 3, 51 and 52 of the Act, in particular as it will further the interests of

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<sup>3</sup> The Code can be found in Annex 8 of the 2008 Consultation.

<sup>4</sup> This consultation can be found at <http://www.ofcom.org.uk/consult/condocs/mobmisselling/>.

consumers by reducing the harm arising due to general mis-selling in the mobile sector and onerous or misleading cashback offers, and secure the effective protection of customers.

### **European Community requirements for regulation**

- 2.15 Section 4 of the Act requires Ofcom to act in accordance with the six European Community requirements for regulation which includes (amongst others) a requirement to promote competition on the provision of electronic communication networks and services, associated facilities and the supply of directories.
- 2.16 In doing so, we have to read these requirements in accordance with the requirements of Article 8 of the Framework Directive<sup>5</sup> which include the obligations to:
- Ensure a high level of protection for consumers in their dealings with suppliers; and
  - Promote the provision of clear information, in particular requiring transparency of tariffs and conditions for using publicly available electronic communications services.
- 2.17 Based on these requirements and our statutory duties, we have formulated the following policy objectives in respect of mobile mis-selling and cashback issues (as set out in Section 2 of the 2008 Consultation):
- To support, and promote, competition in retail mobile communications to the benefit of customers including, preserving, to the maximum extent possible, the commercial freedom of MSPs and independent retailers to compete in creating varied offers that may appeal to different groups of consumers.
  - To ensure that consumer confidence in the market is not undermined.
  - To ensure that consumers have adequate protection from irresponsible and inappropriate sales and marketing activities.
  - To ensure that terms and conditions around sales incentive offers are fair and consumers are able to redeem offers.
  - To ensure any proposed solution is targeted at those undertaking mis-selling activity, and is a proportionate response in line with our regulatory principles.

### **The consultation document and stakeholders' responses**

- 2.18 In the 2008 Consultation we outlined our analysis of mis-selling and cashback issues, a number of options to tackle these issues and set out our preferred option.
- 2.19 Our preferred option was to introduce a new GC on sales and marketing practices that would apply to all MSPs. Amongst other things, the GC would require MSPs:
- not to engage in dishonest, misleading or deceptive conduct and to ensure that those selling their products and services do not mis-sell;
  - to make sure the customer is authorised to, and intends to contract;

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<sup>5</sup> [http://eur-lex.europa.eu/pri/en/oj/dat/2002/l\\_108/l\\_10820020424en00330050.pdf](http://eur-lex.europa.eu/pri/en/oj/dat/2002/l_108/l_10820020424en00330050.pdf)

- to make sure customers get the accurate information they need when they buy the product;
- to ensure that the terms and conditions of all sales incentives offered by their retailers are not unduly restrictive; and
- to carry out due diligence and a number of checks in respect of their retailers to ensure the soundness of the company and its directors.

2.20 We received 21 non-confidential and 2 confidential responses to the consultation. The non-confidential responses are published on our website<sup>6</sup>.

2.21 In this statement we are setting out our conclusions to the review, taking account of the responses to the consultation and of additional data that we have received and analysed.

### **What has happened since the 2008 Consultation was published?**

2.22 Since publication of the 2008 Consultation we have done the following:

- Discussed the proposed GC with a number of MSPs, retailers and distributors;
- Slightly modified the proposed GC based on responses to the consultation;
- Commissioned market research in order to:
  - update our cashback analysis carried out in November 2007; and
  - estimate the number of consumers who have been subject to other types of mis-selling, including the amount of money lost by those consumers.
- Continued to monitor the level and types of complaints regarding mis-selling and cashback into our call centre, the OAT;
- Collected and analysed complaints information from Consumer Direct and Citizen Advice Bureaux;
- Sent a statutory request for information to MSPs and a number of retailers in order to obtain information regarding:
  - The current market situation for mobile retail telephony services;
  - The manner in which the Code has been implemented by MNOs (where applicable);
  - Estimated costs and time required to implement an updated version of the proposed GC; and
  - Number of cashback offers sold, amounts of those offers and redemption rates (retailers only).
- Carried out further work to refine our Impact Assessment.

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<sup>6</sup> <http://www.ofcom.org.uk/consult/condocs/mobmisselling/responses/>

## Structure of this statement

2.23 The remainder of this document is structured as follows:

- In section 3 we provide background information regarding the market for mobile telephony services, including a background on mis-selling and existing legislation, the structure of the market and the implementation of the Code.
- In section 4 we examine the development of complaints numbers over time, and the quantification of consumer harm based on market research and further analysis.
- In sections 5, 6 and 7 we summarise the options we identified to tackle mis-selling, cashback issues and retailer insolvency respectively, including a qualitative assessment per option and our preferred option. These sections also contain stakeholders' responses and our comments on their responses.
- Section 8 and Annex 6 contain our decision.
- A detailed cost-benefit analysis of our preferred option can be found in Annex 2.

## Section 3

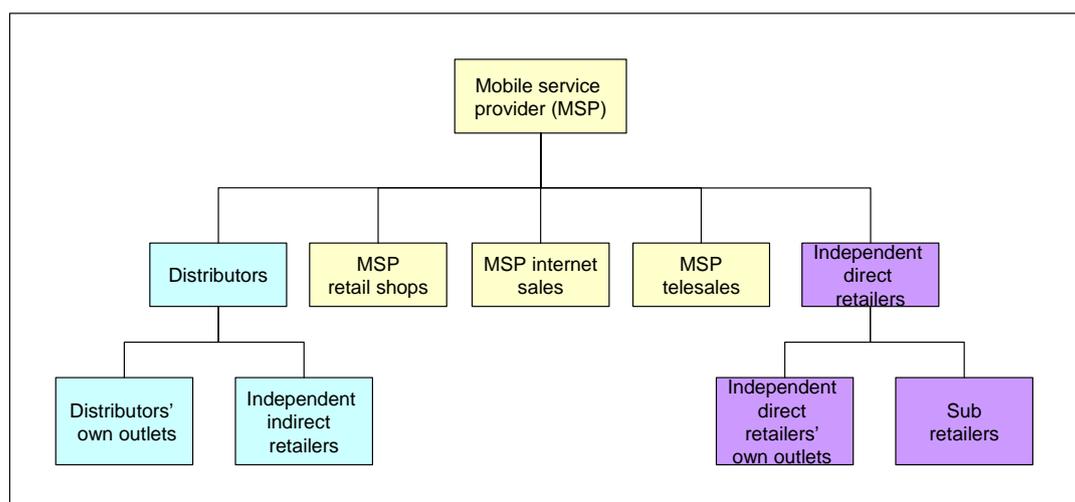
# Mis-selling and cashback: background information

3.1 In this section we set out the structure of the mobile retail market and consider what factors might cause mis-selling. We then examine the appropriateness of other options to address mis-selling – the use of existing legislation and the continued reliance on the Code and provide an overview of how the Code has been implemented. We also assess the Code against criteria set out in our statement on principles for analysing co- and self-regulation<sup>7</sup>.

### The structure of the mobile retail market

3.2 We set out in our 2008 Consultation that MSPs may use a number of different channels to market, to promote and sell their products to end-users. Figure 3.1 below provides an example of the different channels used.

**Figure 3.1: Typical channels to market used by the MSPs**



3.3 Each MSP can have a number of retail shops, selling solely the MSP’s own products and services. From information we obtained from MNOs, the number of retail shops per MNO varies between 270 and 470, according to information provided to us during the pre-consultation phase. In addition to this, most MSPs offer mobile phone subscriptions, accessories, handsets and SIM-cards that can be purchased online (through their own websites) and via their own telesales.

3.4 MSPs may also use so called ‘independent direct retailers’, to promote and sell their services. These are independent third parties with whom a MSP contracts directly to acquire customers. There are two types of independent direct retailers:

- The ‘multiples’, large independent retailers with multiple stores such as Carphone Warehouse, Phones4U, the Link, Argos and some of the large supermarkets. The multiples can have their own retail outlets (including own telesales and

<sup>7</sup> <http://www.ofcom.org.uk/consult/condocs/coregulation/statement/>

internet sales) and can also use what we call ‘sub-retailers’ to promote their services.

- Smaller independent direct retailers, who typically do not use sub-retailers to sell their services.
- 3.5 A third channel to market used by MSPs is the ‘distributor’ channel. Distributors mainly fulfil an intermediary role between MSPs and independent indirect retailers, although distributors may also sell directly to end-users. Through distributors, MSPs can extend their reach while not having to enter directly into individual contracts and relationships with every independent retailer. Distributors can use a large number of independent retailers. We understood during the pre-consultation phase that the number of independent retailers per distributor can be anything between 200 and 1000. Distributors typically supply handsets, and extend credit lines to their independent retailers. They receive commission from the MSPs, which they pass on to independent retailers (minus their margin). They may be subject to commission clawbacks from the MSPs. Clawbacks may apply if a customer defaults on their payments or changes their tariff plan.
- 3.6 The independent retailers have been an important channel for customer acquisition across all MNOs. Based on information provided to us by the MNOs, approximately 50% of the current customer base across all MNOs was acquired through independent retailers.
- 3.7 Because of the complex retail structure that can apply between MSPs and retailers, as set out in Figure 3.1, the MSPs may not always have full visibility of the way their services are sold, or what kind of separate offers are made by the independent retailers. For instance an MSP will typically not know which indirectly acquired customers had a cashback offer as part of the deal. However the contractual relationships that exist between MSPs, retailers and other parties involved in the retail channels can be used by MSPs to require their services to be sold and market in certain ways.
- 3.8 In this document where we use the term ‘retailer’, unless stated otherwise, this refers to any sales channel through which mobile services are sold directly to end-users.

### Why does mis-selling arise?

- 3.9 Mobile phone products/services are experience goods where quality can only be ascertained after purchase. Imperfect information about quality before purchase can create incentives for opportunistic behaviour by sellers.
- 3.10 The MSP wants to achieve as many sales as possible and provides incentives for independent retailers to maximise sales in the form of a commission<sup>8</sup>. However, the desire to increase sales (and thus earn high commissions) may encourage retailers to mis-sell (e.g. by offering mis-leading advice).
- 3.11 Our complaints evidence suggests that both MSP retail outlets and independent retailers mis-sell. However, cashback mis-selling is a particular feature of the independent retailer market (MSPs tend not to offer cashback deals).
- 3.12 One might expect that MSPs are against mis-selling because it may result in consumers on inappropriate tariffs and an increased probability of such customers

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<sup>8</sup> Some independent retailers are incentivised via revenue sharing agreements.

defaulting on contract payments. Moreover, wide-spread consumer dissatisfaction with 'bad' purchase experiences may damage brand reputation. When consumers who had experienced general mis-selling were asked in an Ofcom consumer survey which company gave the incorrect advice 85% reported an MSP and 10% reported an independent retailer. It could be that 85% of mis-selling genuinely arises from MSPs but it is also possible the consumers associate mis-selling with the MSP even when it is actually undertaken by an independent retailer (perhaps because the consumer is billed by the MSP for the mobile service or because they perceive that this mis-selling is somehow sanctioned by the MSP). To an extent the interests of consumers and the MSP may be aligned, and it may be in the MSP's interest to take action to prevent mis-selling.

### **If consumer and MSP interests are aligned why would mis-selling occur?**

- 3.13 MSPs might face a conflict of interest because, as noted above, they can profit from mis-selling via higher prices or enticing consumers to take higher tariffs. Adopting a less stringent approach to mis-selling than other MSPs may improve sales and profits (e.g. if they gain sales at the expense of other MSPs). They may be concerned that clamping down on mis-selling would result in the loss of sales to other brands (e.g. if other MSPs take a more 'relaxed' view on mis-selling). In the case of sales via independent retailers they may assume that they are sufficiently removed from the sale so 'blame' falls on the retailer rather than the MSP, or that blame is attributed to the entire industry rather than their brand.
- 3.14 It may be the case that some large retailers form a significant proportion of smaller MSPs' sales and these MSPs find it difficult to impose rules and take action against bad practices.

### **Impact of imperfect information and experience in other markets**

- 3.15 Mis-selling is more likely to be a problem in markets characterised by 'information asymmetry' i.e. when at least one party to a transaction has relevant information when the other(s) do not<sup>9</sup>.
- 3.16 Mobile mis-selling does not lead to market collapse but can result in 'suboptimal trades' (i.e. on the basis of information gained after purchase, the consumer would have been better off with a different mobile tariff – further detail is provided in Annex 2). The heart of the problem of information asymmetry is the inability of the party with more information to signal their type e.g. whether they are offering an 'acceptable' or 'bad' cashback deal. There are a number of mechanisms to address this problem. For example, in the used car market a seller might offer a warranty to signal that a car is good quality. In the case of cashback a seller could signal they are offering an acceptable deal by paying the cashback upfront at the point of sale (some retailers do offer cashback on this basis). However, the seller would then be open to exploitation by the consumer who could profit by taking the cashback and then

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<sup>9</sup> In the most extreme cases information asymmetry can ultimately lead to market collapse – as is the case in the theoretical 'lemons' example which illustrates the problem of quality uncertainty in the market for used cars. In this example there are good used cars and defective used cars ('lemons'), but because of asymmetric information about the car (the seller knows much more about the problems of the car than the buyer), the buyer of a car does not know beforehand whether it is a good car or a lemon. So the buyer's best guess is that the car is of average quality; accordingly, they will be willing to pay the price of a car of known average quality. This means that the owner of a good used car will be unable to get a high enough price to make selling that car worthwhile. Therefore, owners of good cars will not place their cars on the used car market and only lemons will be traded.

defaulting on the contract with the MSP – meaning that the retailer would not earn commission and thus end up out of pocket.

- 3.17 Another signalling mechanism is brand image e.g. where a seller who is able to build a reputation for honouring cashback agreements. However, it is possible that consumers may incorrectly estimate the value of seller reputation. In addition, it might not be easy for a consumer to access information on brand reputation unless the company is well known. In the absence of negative information on reputation it might seem reasonable to transact with a seller before the sale but it turns out not to be the case after purchase.
- 3.18 Where market solutions to market failure are not adequate, regulatory intervention may be justified to improve consumer outcomes and efficiency. A number of other markets are subject to regulations to prevent or deal with the consequences of mis-selling. In this case the threat of a penalty is used to deter mis-selling and the potential for recourse helps to give consumers confidence in the market. For example:
- The Financial Service Authority ('FSA') sets out binding Principles for Business. Principle 6 requires a firm to 'pay due regard to the interests of its customers and treat them fairly' and Principle 7 requires a firm to 'pay due regard to the information needs of its customers and communicate information to them in a way which is clear, fair and not misleading'<sup>10</sup>. Contraventions of those Principles could lead to enforcement action by the FSA. In addition, the FSA also has targeted rules for specific areas, for example, payment protection insurance, mortgage protection insurance and self invested personal pensions<sup>11</sup>.
  - Ofgem includes a marketing condition in suppliers' licences which includes rules for sales and marketing of gas and electricity.<sup>12</sup>
  - Ofcom has GC 14.5 which covers sales and marketing for fixed line telecoms<sup>13</sup>.
- 3.19 We have actively used GC 14.5 to tackle mis-selling in fixed line telecoms since the rules took effect in May 2005 through an industry-wide enforcement and monitoring programme. We have been monitoring allegations of mis-selling from consumers in order to identify companies who are engaged in mis-selling, so that we can take action to protect the interests of consumers. Since the enforcement programme commenced Ofcom has conducted investigations into 12 providers on fixed-line voice mis-selling issues.

### How to address mis-selling?

- 3.20 This section considers how mis-selling could be addressed, including whether there is any action the consumer could take to reduce the probability of suffering from mis-selling.

<sup>10</sup> <http://www.fsa.gov.uk/Pages/Doing/Regulated/consumer/fsma/index.shtml>

<sup>11</sup> Details can be found at [http://www.opsi.gov.uk/ACTS/acts2000/ukpga\\_20000008\\_en\\_1](http://www.opsi.gov.uk/ACTS/acts2000/ukpga_20000008_en_1), <https://www.britishinsurance.com/press-pages/FSA-rules-will-end-insurance-mis-selling.html> and <http://www.vantisplc.com/Vantis/News/A-Dayoneyearon-SIPPSmis-sellingormisbuying.htm>.

<sup>12</sup>

<http://www.ofgem.gov.uk/MARKETS/RETMKTS/COMPL/DIRECTMKTNG/Documents1/Decision%20Document%20-%20Regulation%20of%20Marketing%20to%20Domestic%20Customers.pdf>

<sup>13</sup> A consultation on the review of the GC has been published today.

(<http://www.ofcom.org.uk/consult/>)

## General mis-selling

- 3.21 A consumer subject to general mis-selling may purchase a mobile service based on misleading or inaccurate information provided by the retailer. One way to mitigate this problem would be to encourage the consumer to undertake a thorough information search prior to purchase e.g. reading the terms and conditions of the contract which the retailer is required to provide at the point of sale. The difficulty here is the terms and conditions can be dense and hard to understand or digest. As noted above, sometimes the terms and conditions are deliberately drafted to be misleading so even if time is taken to read them the consumer might not actually be able to make a better purchase decision. This might suggest that the requirement for retailers to provide some form of 'key facts' in a clear manner would be helpful (some retailers already provide this information in shops and online). However, this would be futile unless the consumer takes time to read the information provided (which might require additional education). Furthermore, the range of general mis-selling scenarios is wide which makes it difficult to identify specific information disclosures which would tackle the issue globally.
- 3.22 For some types of general mis-selling, e.g. slamming, it is difficult for a consumer to take action to protect themselves e.g. the consumer does not realise they have been slammed until it has actually happened.
- 3.23 Perhaps the most effective way to deal with most types of general mis-selling is to deter retailers from undertaking such activities (which are often underhand) e.g. by penalising those found to regularly mis-sell. However, in most cases it is probably quite difficult for an individual consumer to take action against a retailer because of the time, effort and costs involved. Many types of mis-selling involve verbal disclosures which mean it is difficult to prove (the exception to this is telesales where a call recording may exist and, if so, could be retrieved).
- 3.24 MSPs might have a better range of tools to discourage mis-selling because they have a commercial relationship with retailers and can impose sanctions. Amongst other things MSPs could discourage mis-selling by including provisions in their contracts with retailers to prohibit bad practices. The MNOs who signed the Code have taken some steps to make sure that retailers follow the provisions e.g. by sending around sales bulletins drawing attention to the Code. However, this is only fully effective if the MSP monitors compliance e.g. through complaints analysis and spot checks/mystery shopping and takes action where mis-selling is evident (e.g. via warnings, commission clawbacks or ultimately terminating the relationship with the retailer).
- 3.25 In addition MSPs could provide training to ensure retailers understand the products/services and what constitutes acceptable sales practices. This might help to reduce the incidence of 'accidental' mis-selling.

## Cashback mis-selling

- 3.26 The cashback mis-selling types described in section 2.5 – 2.7 are considered separately:

**1) Refusal to pay (failure to meet conditions)** – In this case the retailer may mis-sell by suggesting that claiming the cashback is easy or not referring to the full list of terms and conditions. Furthermore, the contract may have been designed so the terms and conditions are misleading and difficult to fulfil. The consumer would benefit from an appreciation of the difficulty of claiming at the point of sale so they

could make a fair judgement on the probability of successfully claiming. One could argue that reading the terms and conditions would provide the consumer with this information. However, as noted above the terms and conditions can be difficult to understand and consumers will not always take the time to go through a long list of terms and conditions. In this case greater transparency in the terms and conditions and restrictions on imposing onerous requirements might be beneficial. Such provisions were included in the Code e.g. stating particular terms which were deemed to be unreasonable and requiring terms to be clearly stated in writing and not to be unduly restrictive. This has probably contributed to a reduction in the number of cashback complaints over 2008.

**2) Refusal to pay (even when consumer seemingly meets conditions) -** Some retailers apparently do not honour cashback obligations even if the terms are met. Consumers cannot predict which retailers are genuine before purchase – the retailer possesses hidden information about its own type i.e. whether it is honest or dishonest.

In this case the retailer has broken the agreed contract so this mis-selling could be tackled by legal action against the retailer and the retailer should be deterred by the threat of legal action. However, as noted above it is often difficult/impractical for an individual to pursue a retailer, particularly considering the effort involved for what could be a relatively small cashback claim. Action by us or Trading Standards Services ('TSS') might be more effective and act as a better deterrent, but again this is subject to the limitations mentioned above.

**3) Retailer out of business (due to unsustainable cashback offers) –** The information asymmetry here arises because consumers cannot accurately estimate the probability that the independent retailer ceases to trade over the life of the contract. Independent retailers have a better idea of their business risks and probability of insolvency than consumers. In general, consumers will be unable to distinguish independent retailers with viable businesses from those without. It might be possible to infer that retailers offering very high cashback amounts have a greater probability of failure, but it would be difficult to make an accurate prediction in all cases and some retailers offering lower cashback amounts may also fail (for reasons relating to cashback or otherwise). This information asymmetry is particularly significant in the case of cashback purchases because there are two contracts. If the retailer goes out of business, the contract for the mobile service with MSP, with ongoing rental payments and early termination fees, will usually continue.

- 3.27 It is difficult to address this type of problem without making detailed stipulations about the types of business models retailers are allowed to operate and the risks they are allowed to take. The most direct way to tackle insolvency arising due to unsustainable cashback would be to ban 'bad' cashback schemes (i.e. those based on artificially low redemption rates) and require cashback to be fully funded out of commission. However, this type of regulation would be impractical to monitor because of the high number of independent retailers offering a variety of cashback deals and would also be very intrusive. It would involve monitoring all cashback deals being offered in the market, and require retailers to provide information for each of those deals regarding the commissions received and compare those amounts against the amounts of cashback. Taking into account the nature of the mobile telephony retail market, this type of offer tends to change very quickly over time and would require continuous updating, making this type of regulation very costly.

- 3.28 It might be possible for MSPs to make due diligence checks before doing business with an independent retailer which might help to weed out some 'rogue' traders. Such due diligence requirements were included in the Code e.g. conducting a credit reference search and checking the history of the directors of the company.

### Existing legislation

- 3.29 Ofcom is a 'designated enforcer' under Part 8 of the Enterprise Act 2002 ('the EA'), meaning that we are empowered to take enforcement action to stop infringements of certain consumer protection legislation, including, for example, the Unfair Terms in Consumer Contracts Regulations 1999, the Consumer Protection (Distance Selling) Regulations 2000 and the Consumer Protection from Unfair Trading Regulations 2008.
- 3.30 We have powers under the EA to request undertakings from a trader in respect of future conduct and, where such undertakings are not given (or are given and subsequently broken), to seek an order from the court. Any breaches of orders made by the court may lead to financial penalties or even imprisonment for contempt of court.
- 3.31 We will consider complaints suggesting a breach of one or more pieces of the relevant legislation, and if we believe that the evidence demonstrates a business practice that does not comply with the legislation and is harming the collective interests of consumers, we have taken<sup>14</sup> - and will continue to take - appropriate and proportionate action where necessary.
- 3.32 In addition, in certain circumstances a consumer might be able to rely on general contract law, governing the relationship, in this case, between MSPs and consumer. This view is shared, as set out in stakeholders' responses in section 5.107, by a number of TSS which stated that MSPs might already be held liable for the actions of their retailers because of a contractual agency relationship between MSPs and retailers.

### Limits of the existing legislation

- 3.33 Information received from MSPs suggests an MSP might use up to 13,000 retailer outlets to sell their mobile services. The Ofcom Advisory Team ('OAT') has received complaints relating to mobile mis-selling for over 500 retailers (ranging from just 1 complaint to 700 complaints per retailer). It would be difficult to predict how many of these retailers we would need to investigate under the EA to i) substantially reduce current mis-selling and ii) provide a credible threat which discourages mis-selling on an ongoing basis.
- 3.34 The complaints received by us reflect only a small proportion of the total complaints – in most cases an unhappy customer will go to the retailer who sold the phone first to resolve a problem and then probably escalate it to the MSP. Under these circumstances, only complaints which are still unresolved after contacting the MSP are likely to reach us. A large number of independent retailers are relatively small and, based on the limited complaint information received by us, it would be difficult to identify small outfits engaging in mis-selling.
- 3.35 In addition, unlike the enforcement powers available to Ofcom for enforcing GCs we are limited in the type of remedies we can employ under the EA. We cannot, for

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<sup>14</sup> [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_985/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_985/).

example, require the contravening party to remedy the consequences of contravention, for example by providing compensation. Furthermore, we do not have the power under the EA to fine a contravening party.

- 3.36 Moreover, as set out in section 4.46 of the 2008 Consultation, in particular in cases of cashback, when independent retailers start to generate complaints, insolvency may swiftly follow. This would make any forward looking EA enforcement action of limited value.
- 3.37 In section 4.17 below we include evidence that small and medium sized enterprises (SMEs) are also affected by mis-selling. The consumer protection regime under the EA does not extend to SMEs. (Section 52 of the Act however does require Ofcom to secure effective protection for domestic *and* small business customers.)
- 3.38 Despite the limitations noted above, we do believe that EA investigations have an important role in tackling mis-selling in particular circumstances. Generally, EA investigations are more effective and resource efficient for large scale investigations, e.g. dealing with a relatively large organisation generating substantial complaints. In this situation it is relatively easy to gather the evidence required for the investigation since the number of complainants is high and the potential for larger scale impact justifies the resource requirements.
- 3.39 On the issue of general contract law (section 3.32), whilst we accept that, under certain circumstances, contract law might be used to hold the MSP liable for unacceptable behaviour of an independent retailer selling the MSP's service, we note that this approach very much relies on the ability to establish an agency relationship between the MSP and the independent retailer in question. Whether or not such an agency relationship can, indeed, be established depends on a number of factors; in particular the wording of the contract the customer signs, the way the relationship between MSP and retailer is presented to a customer during the sales process and on the exact wording of the contract between the MSP and the retailer (which in some cases is explicitly drafted in a way to attempt to exclude an agency relationship). Therefore, it does not appear possible to state in general terms that MSPs can always be held liable for the actions of their retailers in all cases. This would have to be tested on a case-by-case basis.

### **Other enforcers of existing legislation**

- 3.40 Local TSS also have powers to tackle mis-selling under various consumer protection legislation, including under Part 8 of the Enterprise Act. TSS would usually take action against local businesses causing harm to consumers. TSS gather and monitor complaints received from consumers via Consumer Direct and take action as appropriate. However, like us, TSS has finite resources. Whilst our experience to date is that TSS have been able to pursue retailers in some cases (particularly for cashback mis-selling) and this is effective for retailers who generate a large number of complaints, given the sheer number of mobile re-sellers and retailers, it is practically impossible for TSS to tackle every business that generates complaints and causes consumer harm.

### **Costs of using the Enterprise Act**

- 3.41 An enforcement approach using the EA involving the collection of data and the investigation of numerous independent retailers will have different costs to one based on a GC where Ofcom sets out provisions for the MSPs to require minimum standards of the retailers with whom they contract.

- 3.42 The costs associated with an EA investigation and enforcement will vary significantly depending on the case in question, thus the estimates below represent rough approximations. We estimate that undertaking a six month EA investigation costs us around £45,000. If the case has to go to Court it could lead to further costs in the region of £20,000. As a very rough estimate if we pursued 10 of the most vociferous mis-sellers per year then our costs of investigation might amount to around £450,000 and could be significantly higher if the cases were disputed.
- 3.43 However, due to the large number of mobile phone retailers (as set out in section 3.33), without facing a significant increase in costs, we would only be able to tackle a small proportion of the mis-selling retailers. If the mis-selling retailers perceived a low probability of investigation, the deterrent effect may be limited. To achieve a greater deterrent we would need to undertake a significantly larger number of investigations per year (with an associated increase in costs).
- 3.44 This is in contrast to the arrangements proposed in the 2008 Consultation, whereby Ofcom would investigate and enforce a GC in respect MSPs (significantly smaller in number than retailers) and the MSPs would put in place, through contracts, certain minimum standard provisions in respect of the sales and marketing behaviour of their retailers. We believe that this would be likely to be a more effective approach both with fewer, more targeted investigations as appropriate and through a more effective deterrent.

### **Summary of mis-selling and existing legislation**

- 3.45 Mis-selling arises because the independent retailer possesses information that is not (easily) accessible to the consumer but would be valuable when deciding whether to purchase the product. It may also be the case that independent retailers abuse the trust of consumers and use deception to obtain sales by convincing consumers that contracts are more attractive than they really are.
- 3.46 There are several ways to tackle the information asymmetries mentioned above. One option to correct the asymmetry is to provide consumers with clearer information and educate them to read terms and conditions so they are less susceptible to retailer manipulation. We believe this would be a helpful first step to combat mis-selling – but might not be enough on its own. A different approach would be to discourage mis-selling by monitoring retailer behaviour (e.g. via complaints analysis) and imposing penalties against those with bad practices (monitoring and sanctions could be undertaken by a number of organisations including the MSP, TSS and us).
- 3.47 A limited number of legal instruments currently exist to tackle bad practices, mainly consumer protection legislation enforceable under the EA. However, as described above the option to use EA enforcement powers is subject to certain limitations. Whilst we and TSS have taken targeted action against mobile mis-selling using existing legislation (e.g. our investigation into Phones4U) existing legislation does not appear to be sufficiently effective given the scale and types of mis-selling arising.
- 3.48 Overview of implementation 2.8 – 2.11, the Code was introduced on 31 July 2007.
- 3.49 Provisions on MNOs and third parties cover a wide number of areas under the Code including awareness of the Code, training, customer contact, provisions regarding the

entering into a contract, sales incentives, due diligence, compliance monitoring and complaints handling<sup>15</sup>.

- 3.50 We have asked MNOs as part of a statutory information request to provide us with a description of how they have implemented the provisions in the Code. Below we provide an overview of the information provided.

### **Creating awareness of the Code**

- 3.51 According to MNOs' responses, retailers and distributors were made aware of the Code in 3 different ways by them:

- Four MNOs circulated sales bulletins setting out the introduction of the Code;
- Two of these MNOs required retailers to sign and return copies of the news bulletins announcing the introduction of the Code so as to confirm they had understood and would comply with the requirements therein; and
- The remaining MNO advised Ofcom that it has made adherence to the Code a formal requirement contained within its business terms with sales partners.

### **Monitoring compliance with the Code**

- 3.52 According to the information provided, MNOs typically monitor compliance with the Code by reviewing the volume and nature of customer complaints they receive about a retailer. Complaints indicating possible non-compliance with the Code (or sales practices that are not in line with an MNO's expectations) are generally discussed with the retailer through a dedicated account manager or account management team.

- 3.53 Some MNOs carry out additional activities in respect of compliance monitoring, such as:

- Suspending the relationship with a retailer pending an investigation into non-compliance with the Code;
- Conducting an annual audit on a sample of its retailer base;
- Reviewing retailers' KPIs (for instance regarding customer acquisition, churn, bad debt) on a monthly basis; and
- Mystery shopping exercises and visiting retailers' premises;

- 3.54 Two MNOs referred to dedicated processes for dealing with mis-selling complaints. One MNO stated that it has a programme in place whereby one of its managers will contact a customer directly about a mis-selling complaint.

### **Records of monitoring activity**

- 3.55 We also asked MNOs whether they record the findings of their monitoring activity and how long they keep these records for. For those who did keep records of monitoring activity, the length of time they did so ranged from 12 months to 6 years. One MNO stated that it did not keep written records of monitoring activity and explained that any issues are dealt with as they and when they arise with retailers.

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<sup>15</sup> The Code can be found in Annex 8 of the 2008 Consultation.

### **Information provided to the customer upon entering into a contract**

- 3.56 MNOs responded that they provide most of the information set out under the Code when customers enter into a contract. However, there was limited mention of whether customers were informed of any early termination fees that may apply.
- 3.57 One MNO noted that it does not currently require retailers to provide specific information to customers but intends to implement this provision in early 2009.

### **Maintaining sales and marketing records**

- 3.58 The Code states a requirement that organisations must maintain sales and marketing records and that these should contain sufficient information to identify representatives involved in the purchase of a mobile phone contract.
- 3.59 All but one of the MNOs indicated that they stored sales details recorded at the time of purchase. Electronically storing sales details was generally the preferred method of record retention although one MNO set out that they only store paper copies of sales details. The MNOs that provided information kept sales details on file for at least the minimum period of time outlined in the Code (six months).
- 3.60 The details recorded include basic customer details (name, address), handset details, airtime agreement (tariff, contract length) the sales mode (retail sales, telesales, online sales) and sales details (location for in-store, staff details).

### **Training**

- 3.61 For their own staff, all MNOs indicated that they have either adopted the provisions in the Code related to training or that its existing practices at the time of implementation already reflected the provisions in the Code.
- 3.62 All but one of the MNOs provided training and/or training material to retailers. One MNO indicated that it had a dedicated team responsible for the training of independent retailers. One MNO considered it was not responsible for training the staff of retailers. They asserted that retailers are provided with the information required and it is the responsibility of the management within the retailer organisations to ensure their staff has sufficient understanding of the MNO's products.
- 3.63 Two MNOs indicated that they have contractual provisions with distributors, where distributors have the responsibility to train the retailers they contract with.

### **Due diligence**

- 3.64 In terms of due diligence, all MNOs' responses indicated thorough company and company director checks were carried out. The frequency of due diligence varied from quarterly to annual checks.
- 3.65 One MNO has a dedicated team perform due diligence on financial status, company directors and legal history. This MNO also noted that it was a distributor's responsibility to perform due diligence in the channels they managed.

## Sales incentives

- 3.66 Most responses to the information request stated that MNOs require their retailers to comply with all provisions regarding sales incentives.
- 3.67 One MNO stated that they had recommended to retailers that cashback offers be calculated on a 100% take-up rate. 3 out of 5 MNOs require their retailers to send customers who have entered into a contract via a telesale a written confirmation of a sales incentive.
- 3.68 One MNO has a dedicated team to review every disputed cashback case to ensure fair terms have been applied and executed. It has also warned retailers that in disputes where the customers has grounds to complain, the MNO will potentially claw the retailers' commissions back.

## Conclusion on implementation of the Code

- 3.69 The Code has now been in place for 18 months and we believe that this is sufficient time to judge whether it had a satisfactory effect on complaint numbers. We recognise that the Code appears to have brought about a reduction in cashback problems and complaints. However, the Code has not reduced complaints numbers as significantly as hoped for in relation to the general mis-selling categories (as we set out in sections 4.9 to 4.12 and shown in Figure 4.1). In addition, Consumer Direct reports a substantial number of complaints relating to mobile mis-selling and complaints increased by 18% in 2008 relative to 2007.
- 3.70 We believe that the Code may not have been fully effective because:
- It is a Code with no formal penalty for non-compliance so MSPs might be less rigorous in enforcement. In addition, this would make a less powerful deterrent since retailers may have little added incentive to comply; and
  - It appears to have been applied inconsistently across MSPs. This could mean an uneven playing field is created or maintained as some MSPs incur a greater cost and burden of enforcing the Code than others. The overview above regarding the implementation of the Code shows examples of differences which could lead to differences in costs, burden and ultimately to an uneven playing field.

## Self-regulatory initiatives

- 3.71 In December 2008 we published a statement 'Identifying appropriate regulatory solutions: principles for analysing self- and co-regulation'<sup>16</sup> ('the December 2008 statement') setting out the approach we intend to adopt in the future to determine whether self- or co-regulation is likely to succeed in delivering our statutory duties in respect of consumers and citizens.
- 3.72 The statement referred to Section 3(4)(c) of the Act which provides that, in performing our statutory duties, we must have regard to:

*"the desirability of promoting and facilitating the development and use of effective forms of self-regulation."*

Further, according to Section 6(1) of the Act, Ofcom must:

<sup>16</sup> This document can be found at <http://www.ofcom.org.uk/consult/condocs/coregulation/statement/>.

*"keep the carrying out of their functions under review, with a view to securing that regulation does not involve:*

- a) the imposition of burdens which are unnecessary; or*
- (b) the maintenance of burdens which have become unnecessary."*

Section 6(2) of the Act provides that, in reviewing its functions under Section 6, Ofcom has the duty:

- "(a) to have regard to the extent to which the matters which they are required under section 3 to further or to secure are already furthered or secured, or are likely to be furthered or secured, by effective self-regulation; and*
- (b) in the light of that, to consider to what extent it would be appropriate to remove or reduce the regulatory burdens imposed by Ofcom."*

3.73 In the December 2008 statement we note that we need to consider on a case-by-case basis whether self-regulation can be an effective option. We described a set of analytical steps we will follow when assessing the likely success of self-regulation, based on understanding the collective incentives of industry to resolve an issue in a way that addresses the best interest of citizens and consumers. These are:

- i) Do the industry participants have a collective interest in solving the problem?
- ii) Would the likely industry solution correspond to the best interests of citizens and consumers?
- iii) Would individual companies have an incentive not to participate in any agreed scheme?
- iv) Are individual companies likely to "free-ride" on an industry solution?
- v) Can clear and straightforward objectives be established by industry?

3.74 We also set out a list of best practice criteria we will refer to when contributing to the development of new schemes.

3.75 While these principles are designed to be forward looking, it might be useful to consider their relevance for self-regulation of mis-selling in the context of this statement. We provide a brief assessment below.

3.76 In terms of mis-selling and cashback issues, we believe it is in the best interests of citizens and consumers:

- To be given correct and accurate pre-sales advice regarding contracts when expressing interest in a mobile telephony service;
- Not to be switched from one operator to another without their knowledge and/or consent;
- To obtain sales incentives promised; and

- To have confidence in the mobile telephony market.
- 3.77 Industry participants appear to have a collective interest in solving the problem to some extent. Lack of consumer confidence in the mobile industry, where consumers are reluctant to shop around and / or change provider, could damage all players. On the other hand however, as set out in paragraphs 3.9 – 3.14 above, there is a risk that publicly stated interests (such as the principles set out in the Code) can in some cases be overridden by the desire to increase sales.
- 3.78 The incentives to sign up to the Code may be weak in some cases due to cost considerations. Currently, only the 5 MNOs are signatories to the Code. Other MSPs have not signed up. The costs of compliance will depend on the processes MSPs currently have in place. Putting in place new processes (or significantly adjusting existing ones) and monitoring the behaviour of independent retailers would lead to an increase in costs, which would either have to be absorbed by the MSP, or (partly) passed on to their customers, either of which could affect their competitive position.
- 3.79 Companies also may have incentives to cheat and “free-ride” on a self-regulatory solution. Since there are no formal penalties for non-compliance, individual companies could ‘on paper’ say they comply with all provisions, whilst in practice not enforcing against independent retailers who mis-sell, or engaging in mis-selling themselves, since they believe they would benefit from an increase in sales.
- 3.80 In addition, it may not always be in the short term interest of an MSP to penalise a retailer who acquires many new customers for an MSP, but engages in mis-selling behaviour, because of the revenues generated by this retailer. One of the good practice criteria to establish schemes is around enforcement measures, where the statement sets out that schemes may need to have sanctions that provide an incentive to comply.
- 3.81 The Code has no formal penalties for non-compliance. Although MSPs can impose sanctions on retailers, there is not always an incentive to comply. Especially where MSPs engage in mis-selling themselves, this incentive can be limited. A regulatory solution where an independent party would investigate alleged breaches would obviously not take commercial interests between MSPs and independent retailers into account and would penalise parties who have been found to be in breach, based on the specifics of the mis-selling behaviour.
- 3.82 In addition, we believe that with a self-regulatory initiative such as the Code, different MSPs could, when they decide to enforce, enforce similar breaches in different ways. Some MSPs could give retailers more time to improve the situation, issue written warnings, whereas others could decide based on the same breaches to suspend dealing with certain retailers.
- 3.83 One other criterion is a system of redress in place where there are independent appeals mechanisms ensuring that complaints are resolved quickly and effectively, and where there is the possibility of escalation to an independent arbiter. As set out above, the MNOs have different processes to deal with complaints, and there is no option to refer a complaint to such an independent party.
- 3.84 Based on the above analysis, we believe that there are three main factors that may have contributed to the Code being less successful in certain areas than hoped:

- i) We consider that the collective interests of the industry and the public interest may not have always been aligned with the private interest of companies because of their desire to increase sales;
- ii) The Code did not set penalties for non-compliance which means that penalties have to be determined by the parties who may have a commercial interest in certain practices continuing in the short term; and
- iii) We believe individual companies may have had an incentive not to participate in a voluntary scheme because of cost considerations.

## Section 4

# Level of complaints and consumer harm

- 4.1 In the 2008 Consultation we explained that important evidence leading Ofcom to propose further intervention was:
- the number of complaints received by Ofcom, Consumer Direct and other consumer agencies; and
  - the level of harm experienced by consumers on the basis of information from the complaints we have received and from market research we commissioned.
- 4.2 In this section we revisit that evidence, examining the trend in complaints and reporting updated and additional market research we have carried out into general mis-selling. We use this data to estimate the current ongoing level of financial harm to consumers from general and cashback mis-selling.

## Complaints data

- 4.3 In the 2008 Consultation we set out complaints data from three principal sources:
- Ofcom's Advisory Team (OAT);
  - Consumer Direct (the government's telephone and online consumer advice service); and
  - Citizens Advice Bureaux.

## Complaints to OAT

- 4.4 The OAT receives customer complaints about a wide variety of issues. In the 2008 Consultation we reported that the number of complaints about general mis-selling of mobile services and about problematic cashback deals had increased significantly.

## Mis-selling

- 4.5 Mis-selling complaints comprise three main categories:
- General mis-selling, where a contract is agreed without the consumers' full understanding, or where the customer has been deliberately misled;
  - 'Slamming' where a customer is being entered into a new mobile contract without their consent and/or knowledge; and
  - Misconduct where the party selling the mobile service is aware that customer is not fully capable of understanding the offer (for example, through ill health, general infirmity or language problems) or where a consumer feels threatened into agreeing to entering into a contract.
- 4.6 Examples of general mis-selling complaints recorded by the OAT include:

- Misleading/inaccurate information about the product or service. For example, a customer may sign up to a service after being told coverage in their area is good but then find that they have little or no reception;
- Misleading/ inadequate information about tariffs and/ or features of the service or phone resulting in the customer being sold features of a package/service and costs that differ from those that are actually delivered. For example a customer may find themselves signed up to a more expensive tariff than agreed at point of sale or may find that the functionality of the phone differs from that sold;
- Misleading information about the transfer process from the customer's existing service or billing implications of the transfer resulting in a customer receiving two bills and /or being charged a termination fee for the previous contract. For example, a customer may upgrade their contract with their current provider or move to a different provider after being told by the sales representative that they are nearing the end of their existing contract and then subsequently find that this is not true;
- Misleading/ inadequate information about the terms and conditions of the new contract, such as the length of the new contract and notice period. A common example is where customers upgrade their 12 month contract believing they are signing up to another 12 month contract and then subsequently find themselves entered into to a new 18 month contract; and
- Misleading/inaccurate information about competition/ future mergers and acquisitions of providers in a customer's coverage area to give the impression of limited choice of providers.

## Cashback

4.7 Cashback complaints to the OAT comprise three main categories:

- Cashback refused, where the customer has not been able to redeem the full cashback, for instance because they allegedly do not comply with the terms and conditions of the cashback terms and conditions;
- Cashback out of business, where the independent retailer who offered the cashback has gone into administration and is unable to honour his payments to customers; and
- Products not given, where a customer has been unable to obtain any goods that have been offered free of charge or at a reduced retail price as a sales incentive, for example an MP3-player or games console.

4.8 Hereafter, we refer to these first two categories as 'bad cashback' deals, i.e. cashback deals which rely on artificially lowering redemption rates or simply not paying out. 'Acceptable' or 'sustainable' cashback deals are those where the amount offered is based on expected commissions and a redemption rate which is not artificially lowered by independent retailers putting in place barriers to claiming.

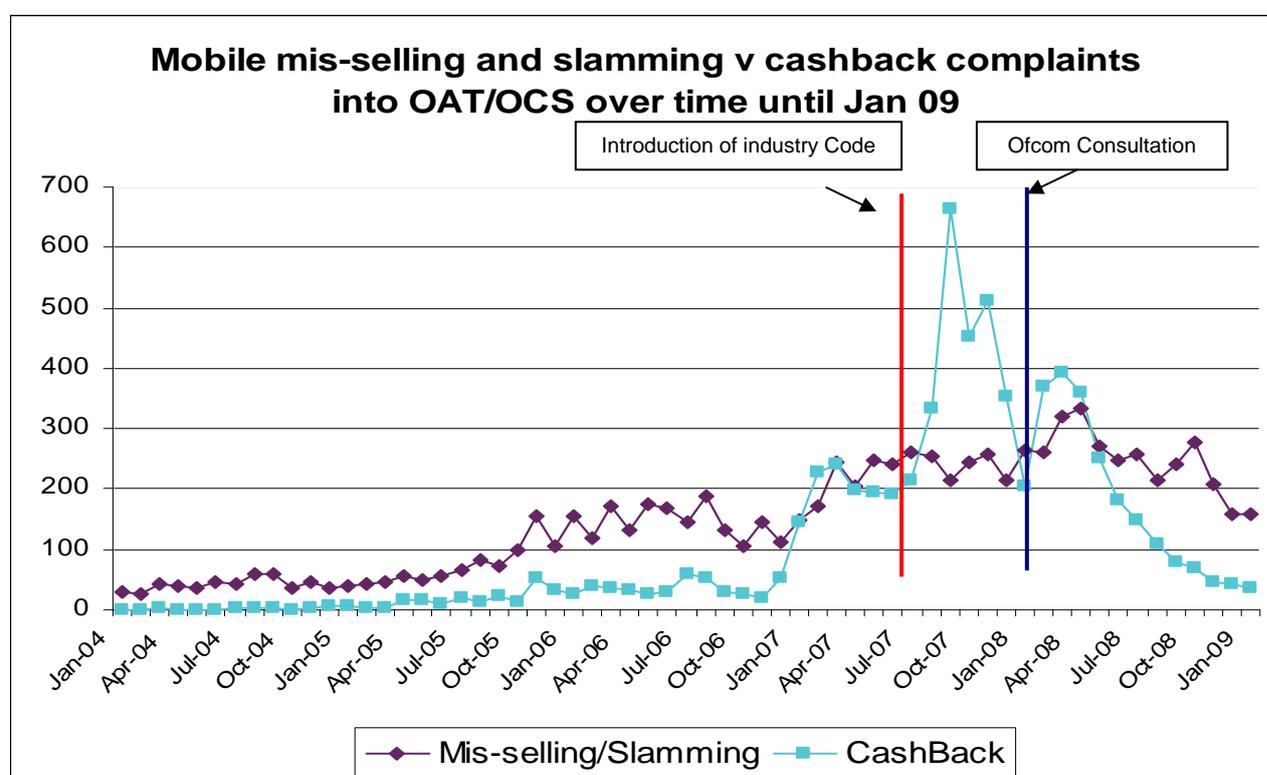
## Complaints data

- 4.9 Figure 4.1 below shows the monthly average number of general mis-selling and cashback complaints to the OAT over time. From 2004 onwards the monthly average number of complaints into the OAT regarding general mis-selling and slamming increased significantly, from 42 in 2004 to 225 in 2007. From July 2007 until February 2008, monthly complaints numbers were broadly steady; they then rose by April 2008 to over 300 and then fell away to between 200 and 300. From October 2008 onwards there has been a slight decrease in mis-selling complaints to OAT bringing the level down to the trend before the Code was introduced<sup>17</sup>.
- 4.10 From October 2006 the average monthly number of complaints regarding cashback increased significantly, from an average of 36 over the whole of 2006 to 311 in 2007, reaching a peak in September 2007 of 665 following the introduction of the Code. These peaks are likely to reflect two factors:
- a) The media attention may have made consumers more aware of the cashback issues, which could have led to an increase in the number of complaints into OAT.
  - b) Implementation of the Code meant independent retailers were no longer able to impose onerous terms and conditions in respect of cashbacks, which meant that the redemption rates rose. A likely result of this is that a number of independent retailers, who had based their business models on low redemption rates, were unable to honour all their cashback payments.
- 4.11 Complaints about cashbacks fell to around 400 a month by the time Ofcom published the 2008 Consultation. Following the consultation, complaints have fallen sharply: in December 2008 Ofcom received only 28 complaints about cashbacks. It is difficult to be certain about which particular factors caused this decline. For example it could have been caused by the implementation of the Code, or by cashback becoming a less attractive commercial proposition for retailers, or by consumers becoming increasingly cautious about cashback terms after publicity around cashback problems. It may also be that the threat of Ofcom introducing formal regulation has encouraged MSPs and retailers to address the problems associated with some cashback deals (if this is the case then if we were to withdraw the threat while continuing to rely on the Code, complaint levels might increase again). In practice, potentially all these factors may have been at play.
- 4.12 As set out in more detail in section 8, we believe the following factors may have contributed to a decrease in the number of complaints:
- i) MSPs appear to have reviewed the sales practices of their independent retailers resulting in a reduction in the number of retailers offering 'unsustainable' cashback deals.
  - ii) Anecdotal evidence suggests that the number of cashback deals on offer has decreased; in part due to the introduction of the Code and also due to retailers switching away from offering cash in favour of other inducements (e.g. electronic entertainment products such as MP3-players or games consoles).

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<sup>17</sup> The recent decline in complaints about general mis-selling has been in a similar proportion to a decline in complaints to Ofcom about telecom services generally at the end of 2008/early 2009.

- iii) Furthermore, consumers may be more wary of cashback deals following media coverage/own experience of difficulties claiming and retailers going out of business leaving cashback customers out of pocket.



**Figure 4.1: Mis-selling and slamming complaints from January 2004 – January 2009**

- 4.13 We have carried out some further analysis in respect of the OAT complaints data. Complaints information regarding mis-selling from December 2007 until January 2009 into the OAT shows that almost 90% of complaints are related to mis-selling, with the remaining complaints relating to slamming.
- 4.14 We also analysed mis-selling and cashback complaints generated by MSPs and retailers, per type of contract and per customer segment. Based on information into the OAT from January 2007 until January 2009, 74% of total complaints were generated by independent retailers, the remaining 26% by MSPs.
- 4.15 Almost 90% of complaints generated by MSPs are related to pay monthly contracts, 1% is related to pay-as-you-go and for the remainder no information was provided regarding the type of contract. For the independent retailers, we only started distinguishing between pay monthly and pay-as-you-go contracts from August 2008 onwards. Based on this information, 99% of complaints are generated by pay monthly contracts, and the remaining 1% by pay-as-you-go.
- 4.16 Pay-as-you-go sales may generate a lower level of complaints because:
  - i) The terms and conditions of sale tend to be simpler which means consumers are less reliant on sales advice;

- ii) Consumers are more easily able to control their expenditure (i.e. through top-up), rather than being contractually bound to a minimum spend for at least 1-year;
  - iii) Customer lifetime value is likely to be lower with pay-as-you-go than pay monthly sales and hence commissions are lower so there is less to be gained from mis-selling;
  - iv) Cashback is rarely offered on pay-as-you-go; and
  - v) Pay-as-you-go do not have a contractual tie in (i.e. if the consumer is unsatisfied they can change provider without incurring costs on their current contract).
- 4.17 In respect of mis-selling and cashback complaints generated by customer segments, although most complaints are reported by individual customers, we have also received complaints from businesses, small businesses and home offices. From January 2007 until January 2009, we received a total number of 320 complaints from businesses, 186 of which were related to SMEs and home offices. Although this number may not be substantial in itself, we are concerned about these complaints. SMEs typically tend to enter into contracts including multiple users, which could lead to greater financial harm in the case of mis-selling or cashback issues. In addition, SMEs tend to depend on their mobile phones for their business, and issues such as slamming, or trying to cancel contracts could lead to a serious disruption of their day-to-day activities. Furthermore, as set out in section 3.37 above SMEs tend not to be covered by general consumer protection laws (enforceable under the EA), leaving us currently with little ability to protect them in case they suffer harm from mis-selling and/or cashback.

### Complaints to Consumer Direct

- 4.18 In the 2008 Consultation we included complaints data provided by Consumer Direct. As set out in our 2008 Consultation, from January to October 2007 Consumer Direct received approximately 43,000 complaints regarding mobile phones. Based on the relevant category Codes used by Consumer Direct, we estimated around 6,000 may relate to mis-selling and cashback issues.
- 4.19 We have updated this analysis for the full year 2007, and total number of complaints related to mobile phone contracts and handsets are 52,900. We have amended some of the complaints codes we believe can include mis-selling and/or cashback complaints. The codes we have included are shown in the table below.

**Figure 4.2: Complaints Codes Consumer Direct which may relate to mobile mis-selling and cashback issues**

|  |
|--|
| Complaints codes                               |
| (01D) Breach of contract                       |
| (04B) Misleading quote/estimate                |
| (06A) Failure to observe cancellation rights   |
| (07A) Unsolicited goods                        |
| (07B) High pressure selling                    |
| (07D) Direct marketing to vulnerable groups    |
| (07G) Bogus selling                            |
| (08A) Verbal misrepresentation/misdescription  |
| (08E) Failure to supply full information       |
| (08H) Incorrect/misleading pre-shopping advice |
| (12C) Harassment                               |

4.20 Consumer Direct received over 9,000 complaints for these categories regarding mobile phones in 2007. We have carried out the same analysis for 2008. Over this period, Consumer Direct received a total number of around 51,400 complaints about mobile phone contracts and handsets. Mobile phone contracts are the second most complained about category in the UK.

4.21 Based on the same complaints categories we used for our 2008 Consultation, around 10,600 complaints may relate to mis-selling and cashback issues. Figure 4.3 below gives an overview of these numbers.

**Figure 4.3: Complaints Codes Consumer Direct which may relate to mobile mis-selling and cashback issues. Source: Consumer Direct**

| Mobile phone contracts and handsets | Total Consumer Direct complaints | Complaints related to mis-selling and cashback |
|-------------------------------------|----------------------------------|--|
| 2007                                | 52,900                           | 9,000  |
| 2008                                | 51,400                           | 10,600   |

4.22 Over 2007 and 2008, the complaints categories ‘Verbal misrepresentation / misdescription’ (around 40% of total complaints), ‘Failure to observe cancellation rights’ (around 23%) and ‘Breach of contract (around 15%) are the main contributors to the total number of mis-selling and cashback related complaints into Consumer Direct.

4.23 Consumer Direct has also provided us with information regarding pay-as-you-go contracts. Their analysis confirms the findings of our complaints analysis. From October 2007 until May 2008, Consumer Direct only received 30 complaints where pay-as-you-go was specified by the complainant.

### Complaints to Citizens Advice Bureaux (CAB)

4.24 Citizens Advice has provided us with the number of problems regarding mobile telephones that their bureaux in England and Wales have dealt with over the last 3 years. Like CD, CAB do not have dedicated mis-selling and cashback complaints categories. However, they do have a category called ‘Selling methods and techniques’ which will include mis-selling problems. Figure 4.4 below provides an overview of total problems regarding mobile telephones over the past 3 financial years. Please note that the numbers for 2008/9 have been extrapolated based on the Q1-Q3 numbers.

**Figure 4.4: Mobile phone problems reported by CAB in England and Wales.**

|                     | 2006/7 | 2007/8 | 2008/9* |
|---------------------|--------|--------|---------|
| Mobile phone issues | 8,458  | 12,537 | 9,601   |

\*: estimate based on figures for Q1-Q3 2008 Source: CAB

4.25 From this table, it can be seen that there has been a strong increase in mobile phone related problems in 2007/8, compared to the previous year. If the Q1-Q3 trend over

2008/9 continues, the number of mobile phone problems will go down compared to 2007/8.

- 4.26 Figure 4.5 shows that the share of 'Selling methods and techniques' in the total number of mobile telephone related problems has remained relatively stable over time and is around 11%, although estimates based on Q1-Q3 2008-9 suggest that there may be a fall in 2008-9.

**Figure 4.5: Percentage of mobile phone problems relating to 'selling methods and techniques' reported by CAB in England and Wales. Source: CAB**

| Category                       | 2006-7 | 2007-8 | 2008-9* |
|--------------------------------|--------|--------|---------|
| Selling methods and techniques | 11.2%  | 11.7%  | 9.6%    |

\*: estimate based on figures for Q1-Q3 2008

- 4.27 CAB also record client profile information, including ethnicity, type of household, average income, disability, age, gender and area on an anonymised basis. Please note that not every case will include comprehensive client profile information (for example where a client may not wish to divulge their level of income), and that certain aspects can be missing. The numbers below are therefore for indicative purposes only.
- 4.28 Based on this profile information, we have looked at the main changes from 2007/8 to Q1-Q3 2008/9 in respect of CAB clients whose problems were related to the selling methods and techniques of mobile telephones. The main change in respect of consumer profile was the ethnic group, which showed a significant change, from 64% of CAB clients being white in 2007/8 to 76% in Q1-Q3 2008/9. Our market research into cashback which was carried out in 2007 indicated that contract customers from ethnic minority groups were more likely to take out cashback deals. Based on this information, the percentage of ethnic minorities who have taken out a cashback deals appears to have decreased<sup>18</sup>.
- 4.29 Another, less significant, change is in respect of geographical region of the complainants. In 2007/8, 21% (and this was the majority of complainants) of CAB clients who came to bureaux about problems relating to mobile phone selling methods and techniques lived in the Midlands. In Q1-Q3 2008/9 this percentage had reduced to 17% and was overtaken by the south east in terms of the origin of the majority of clients. Based on anecdotal evidence and on a number of retailer insolvencies in the Midlands we are aware that the Midlands may have had a higher than average proportion of cashback issues late 2007 and early 2008. The new geographical information seems to suggest that the geographic concentration of complainants has decreased, indicating a more even spread of complaints over the country.

## Conclusion based on complaints information

- 4.30 Based on our analysis of complaints, we conclude the following:

<sup>18</sup> In sections 5.113- 5.114 we explain that, in line with these findings, we have not developed specific proposals and made decisions to address particular minorities or geographic areas. Our proposals and decisions aim to reduce the incidence of mobile phone mis-selling across the population, including ethnic minorities and all geographic areas.

- Cashback complaints into the OAT have fallen sharply from October 2007 onwards possibly for the reasons set out in section 4.11 above;
- Mis-selling complaints into OAT have remained more or less stable over time, although a slight decrease can be observed over the past few months;
- Mis-selling and cashback issues mainly affect pay monthly contracts; both Ofcom and Consumer Direct have received few mis-selling and cashback complaints regarding pay-as-you-go;
- Mis-selling and cashback issues also occur in the SME and home office segment;
- Although the total number of mobile phone related complaints into Consumer Direct has gone slightly down in 2008 compared to 2007 (by 2%), the number of complaints in the categories that may include mis-selling and cashback issues has gone up by about 18% in 2008; and
- CAB show a slight decrease in complaints regarding mobile phones over 2008/9 and the higher incidence of complaints in ethnic minorities and specific regions reported in 2007/8 appears to have levelled out.

### Quantification of consumer detriment

4.31 In Annex 5 of the 2008 Consultation we estimated the consumer harm arising from 'bad' cashback deals using two methods:

Method 1: Combining data on cashback owed from complaints into the OAT, and data from the market research survey on consumers unable to claim cashback.

Method 2: Using data received from independent retailers on the average cashback amount and the average redemption rate.

4.32 At the time of the 2008 Consultation we considered the potential consumer harm arising from consumers not being able to claim the cashback to which they were entitled was in the range £50-60 million over a 1-2 year period (i.e. the range of contract durations considered). Assuming an average contract duration of 18 months we calculate the annual amount of unclaimed cashback to be £33-40 million. When this analysis was undertaken the Code had only been in place for 4-5 months thus this quantification largely represents the cashback harm prior to the Code coming into full force. Further details are provided in Annex 2.

### Update following the 2008 Consultation

#### Update to Method 1 and Method 2 estimates for 'unclaimed' cashback

4.33 The estimates of consumer harm provided for the 2008 Consultation were based on information from different sources gathered from August 2007 to January 2008. We recognise that the full impact of the Code might not have been realised during this period because it takes some time for MSPs to implement the provisions and filter them down the distribution chain. In this update we estimate the level of ongoing consumer harm having given the Code time to take effect i.e. we are trying to quantify the incremental consumer detriment remaining after the Code has been implemented. Details regarding the assumptions and sample used can be found in Annex 2 of the statement.

- 4.34 Using method 1 we estimate that the ongoing amount of cashback which consumers are unable to claim lies in the range £22-£33 million over the contract duration. Assuming an average contract duration of 18 months we calculate the annual amount of unclaimed cashback to be £15-£22 million.
- 4.35 Using method 2 we estimate that the total cashback consumers are unable to claim is approximately £13 million over the length of the contract. The annualised estimate of unclaimed cashback is £9 million (based on an average contract length of 18 months).
- 4.36 Based on both methodologies the amount of 'unclaimed' cashback has decreased relative to the estimates presented in the 2008 Consultation. If we were to assume that the Code is the main factor driving the amount of cashback unclaimed down then this difference could be interpreted as representing the benefit arising from introducing the Code. The reduction in harm from the Code would therefore be significant. However, a substantial amount of unclaimed cashback would remain, and other factors might explain the reduction as well as the Code (e.g. retailers offering non-cash inducements).
- 4.37 In addition, we cannot rule out the possibility that mis-selling of cashback deals has fallen in response to the high level of attention by the media and us, and could rise again if formal regulations were not introduced which enabled us to take prompt corrective action where bad practices are discovered. Our announcement of a review of sales practices in the mobile market in October 2007, and with that, the threat of formal regulation, may have also influenced market participants and contributed to the downward trend in cashback promised. This might suggest a smaller reduction in cashback unclaimed if the impact of the Code could be separately identified from the effects of our subsequent review of sales practices and engagements with market participants.

### Alternative measure of 'unclaimed' cashback – Method 3

- 4.38 In Annex 2 of this statement we recognise that Methods 1 and 2 have certain limitations when used to try and estimate the reduction in consumer welfare arising due to 'bad' cashback deals (e.g. the method 1 estimate might be overstated because people are more likely to contact the OAT if cashback unclaimed is large and under method 2 we assume those unable to claim have been mis-sold). Therefore we have calculated an alternative measure of unclaimed cashback which uses the consumer survey estimate for the number of people unable to claim and the independent retailer estimate of cashback promised.
- 4.39 We have used the consumer survey estimate for those unable to claim (6% of cashback customers or 82,800 people) because we assume these people positively identified mis-selling as a reason for not getting their cashback (e.g. it excludes those that forgot).
- 4.40 We have used the independent retailer estimate for cashback promised (£190 over the contract duration) because this is more likely to represent a 'sustainable' cashback offer<sup>19</sup> i.e. it is not inflated by deals which are 'too good to be true'<sup>20</sup>.

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<sup>19</sup> We have used large established independent retailers to who have offered cashback for several years to reduce the chance that deals are unsustainable.

4.41 We are uncertain whether those unable to claim had actually received no cashback or made partially successful claims. Therefore we have presented the Method 3 estimate on three bases:

- i) Assuming that all those 'unable to claim' receive no cashback meaning the amount unclaimed is the full £190 cashback promised at the outset.
- ii) Assuming 50% of those unable to claim get no cashback and 50% get half the cashback promised. In this case the average amount of cashback unclaimed is £143.
- iii) Assuming that all of those 'unable to claim' receive half the cashback promised. In this case the average amount of cashback unclaimed is £95.

4.42 Multiplying the cashback owed for each scenario by the number of consumers unable to claim (i.e. 82,800 people) gives the following estimates for 'unclaimed' cashback under Method 3:

**Figure 4.6: Estimate for unclaimed cashback under Method 3**

| Scenario                            | £ million cashback 'unclaimed' over contract duration | Annualised estimate for £ million cashback 'unclaimed' (assuming average contract is 18 months duration) |
|-------------------------------------|---|--|
| 1) Average amount unclaimed is £190 | 16  | 11   |
| 2) Average amount unclaimed is £143 | 12  | 8  |
| 3) Average amount unclaimed is £95  | 8   | 5  |

4.43 Assuming an average contract duration of 18 months we calculate the annual amount of unclaimed cashback to be £5-£11 million, with a central estimate of £8 million (i.e. assuming 50% of those unable to claim get no cashback and 50% get half the cashback promised).

4.44 We believe that Method 3 has some advantages over the other methods and represents a conservative approach to estimating ongoing consumer harm. For these reasons we propose to use the Method 3 estimate of cashback harm in assessing the impact of our preferred option.

#### Estimate of consumer detriment arising due to general mis-selling

4.45 Since the 2008 Consultation we have conducted some consumer research to estimate the number of people aged 16+ who have suffered from 'general' mis-selling i.e. all other types of mis-selling excluding cashback. The research suggested that 2% of pay-as-you-go and 7% of contract mobile adults suffered some form of general mis-selling (excluding cashback problems<sup>21</sup>). This amounts to 4% of all mobile phone consumers which equates to about 1.6 million people. Below we include a summary of the assumptions and findings; more details can be found in Annex 2 of this statement.

<sup>20</sup> We want to exclude unsustainable deals because a consumer might reasonably realise that there is a risk of non pay-out on these deals. Including such cashback deals would bias the estimate of consumer harm upwards.

<sup>21</sup> No consumers mentioned cashback when asked about mis-selling issues.

- 4.46 We asked those who had suffered from mis-selling to estimate roughly how much money they lost because of the incorrect advice given. The financial loss amongst this sample of consumers ranged from £0 to over £500 with an average loss of £119 (over the life of the contract). Around two thirds of those mis-sold made a complaint, and one fifth of the people who complained received some compensation. The amount of compensation received amongst this sample of consumers ranged from £5 to £90.
- 4.47 The average consumer loss is calculated from a small sample of respondents, so we do not consider it prudent to use this to estimate the aggregate consumer harm arising due to mis-selling<sup>22</sup>. Instead we have taken a conservative approach to estimate the lower bound for the aggregate harm.
- 4.48 Around two thirds of the survey respondents reported that the loss arising from mis-selling was £20 or above - we think this is a reasonable proxy for a conservative average loss.
- 4.49 Using the £20 estimate for average loss, a conservative estimate for aggregate consumer harm arising from mis-selling is in the order of £32 million<sup>23</sup>. This represents the loss incurred over the contract duration. Assuming an average contract length of 18 months we estimate that the annual harm arising from general mis-selling is around £21 million.

#### Cost to consumers in terms of time spent in dealing with cashback and general mis-selling problems

- 4.50 Our market research reported that around two thirds of people who suffered from general mis-selling made a complaint. Making complaints and dealing with mis-selling problems can be time consuming.
- 4.51 Time spent dealing with mis-selling problems is an opportunity cost. The time saving benefits that consumers get from a reduction in mis-selling problems could be a proxy for the reduction in inconvenience.
- 4.52 We consider that a conservative estimate of the average amount of time dealing with a mis-selling issue is half an hour.
- 4.53 Based on the market research carried out in August 2008 we estimate that around 1.6 million people suffered from general mis-selling and 82,800 people had problems claiming cashback. This totals 1.68 million people suffering from mobile mis-selling and equates to 0.84 million hours spent dealing with mis-selling issues (based on the assumption on time spent above).
- 4.54 To estimate the value of time (VoT) we have used the 2002/3 estimate of non-commuting leisure time given by the Department for Transport<sup>24</sup> (DfT) and converted it to a 2008/9 price following DfT guidelines and using the methodology set out in Annex 2.80.

<sup>22</sup> We are unable to establish from the current data whether the sample of mis-selling cases captured is representative of mis-selling problems in aggregate.

<sup>23</sup> Number of people mis-sold (1.6 million) multiplied by estimate of financial harm (£20)

<sup>24</sup> [http://www.webtag.org.uk/webdocuments/3\\_Expert/5\\_Economy\\_Objective/3.5.6.htm](http://www.webtag.org.uk/webdocuments/3_Expert/5_Economy_Objective/3.5.6.htm), Section 1.2.20

4.55 Based on this methodology the value of non-working time in 2008/9 is £5.87 per hour<sup>25</sup>. This means the total time cost for dealing with mis-selling problems is estimated at about £5 million<sup>26</sup>. This is based on the 'stock' of people who have suffered mis-selling problems with their current mobile contract. If we assume that the average contract length is 18 months then an annualised estimate for the time cost is around £3 million.

## Summary

4.56 We have conservatively estimated the current ongoing value of financial harm to consumers as:

- General mis-selling - £21 million per year.
- Cashback mis-selling - £8 million per year.
- The cost of time spent dealing with general and cashback mis-selling problems - £3 million per year.

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<sup>25</sup> For comparison, the value of working time is around £30 per hour.

<sup>26</sup> Calculated as number of people mis-sold (including cashback) \* time spent \* value of time.

## Section 5

# Options to tackle general mis-selling

- 5.1 In this section we provide an overview of the options that we set out in the 2008 Consultation to address general mis-selling, including our preferred option. We summarise and update the qualitative assessment of the options and then discuss stakeholders' comments and set out our responses to their comments. We then set out our preferred option in respect of general mis-selling. We have estimated the costs and benefits of our conclusion in Section 8 and Annex 2<sup>27</sup>. We have taken account of our qualitative and quantitative assessment in reaching our conclusion.
- 5.2 In sections 6 and 7 we repeat this analysis in respect of cashback issues and retailer insolvency, respectively.

### Options to deal with general mis-selling

- 5.3 We identified two options in the 2008 Consultation:
- A) Continue with the existing Code and existing legislation; and
  - B) Regulate MSPs by introducing a new General Condition (GC).

#### A. Continue to rely on the existing Code and existing legislation

- 5.4 Under this option no new formal regulation would be introduced, however, the Code would be retained and we would be able to pursue sellers (independent retailers or MSPs) under existing legislation (e.g. the Enterprise Act) if this was deemed appropriate.
- 5.5 Under section 6 of the Communications Act, we have a duty to ensure that we do not impose or maintain unnecessary burdens. A 'no change' option is appropriate if:
- the Code has achieved an adequate outcome and/or
  - the existing legislation is adequate and/or
  - there is no clear evidence that mis-selling in mobile telecommunications is a significant problem and/or
  - the costs of formal regulation exceed the benefits and/or
  - the Code needs longer to take effect.
- 5.6 As set out in section 4, we believe the Code has not reduced complaints as significantly as hoped for the general mis-selling categories as shown in Figure 4.1) We also set out our reasons why the Code might not have been fully effective.
- 5.7 In sections 3.29 – 3.39 we set out why the limitations of the existing legal instruments mean they are inadequate to tackle mobile mis-selling.

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<sup>27</sup> Due to the large no of options identified it would not be proportionate to carry out a quantitative assessment for all the options considered.

### Issues for consumers: option A

- 5.8 As noted above, in the case of potential mis-selling in the mobile retail market the option of enforcement under the Enterprise Act alone does not appear to guarantee sufficient protection on its own. Therefore the main issue for consumers is the possibility that mis-selling is not significantly reduced under this option.

### Issues for MSPs: option A

- 5.9 This option has low incremental costs for MSPs as it maintains the status quo.
- 5.10 If mis-selling problems persist then industry reputation may be damaged. However, this could benefit MSPs if mis-selling means they can charge prices above the competitive level.

### Issues for independent retailers: option A

- 5.11 This option represents no change for independent retailers so those who engage in mis-selling may not be discouraged from doing so without further action from MSPs. The threat of legal action under existing legislation (e.g. consumer protection laws under the EA) should discourage independent retailers from mis-selling. It would be difficult and costly to pursue all independent retailers under the legislation so in reality the current threat of action is not a strong deterrent for all retailers.

### Issues for competition: option A

- 5.12 Mis-selling could lead to a reduction in the intensity of competition if consumers lose confidence in the market. Furthermore, where certain independent retailers exploit consumers through mis-selling and thereby gain an unfair competitive advantage this is clearly undesirable since it is not competition on the merits.
- 5.13 The voluntary nature of the Code also implies that while some MSPs could take a severe stance against mis-selling and cashback issues, others could take a more lenient approach. This could distort the market leading to a competitive advantage for more lenient MSPs.

## **B) Regulate MSPs through a General Condition (GC)**

- 5.14 This option would involve introducing formal regulation requiring MSPs (and indirectly those they contract with) to comply with a number of rules. The regulation would incorporate parts of the Code, plus requirements not to engage in misleading or deceptive conduct. Trying to ensure the application of the same set of rules across all retailers (both the MSPs' direct retail arm and their retailers) would help create a level playing field and would ensure a uniform approach to the application of the rules as opposed to the differences in the implementation of the Code. In addition, the possibility of incurring a penalty for non compliance means it is more likely that MSPs will enforce the rules vigorously.
- 5.15 Our powers under the Act only relate to providers of Electronic Communications Services or Networks (ECSs or ECNs), which means that, under this regime, we cannot directly regulate the actions of independent retailers under the Act because they are not a provider of ECSs or ECNs.
- 5.16 However, independent retailers usually have a contractual relationship with the MSPs (who are providers of ECSs or ECNs) and must comply with the MSP's contract

terms. From the MSP's perspective these terms can help ensure benefit to them (and to the independent retailers) through the sale of their services and conversely can protect them from being impacted by bad practices by prohibiting certain behaviours by the independent retailers. As a result we can at least indirectly influence the actions of independent retailers via regulating MSPs, who in turn exert control over independent retailers through their contracts<sup>28</sup>.

5.17 As part of the 2008 Consultation we asked MSPs, independent retailers and other organisations for feedback on the proposed GC. Comments received are summarised below in sections 5, 6 and 7 of this statement. In light of these comments, and following further discussion with MSPs, we made some amendments to the GC. In particular, we have recognised that it is difficult for MSPs to control the actions of independent retailers they do not contract with directly. Therefore, we have proposed a different approach to enforcing the rules in the GC depending on the relationship the MSP has with the party ultimately selling its mobile services as follows:

- Where the MSP contracts directly with the party who has the customer contact (a retailers) it must ensure through contractual provisions (and the enforcement thereof) that any provisions in the GC and certain behavioural requirements are appropriately communicated, monitored and enforced.
- Where the MSP does not contract directly with a retailer it must use reasonable endeavours to ensure that such provisions and behavioural requirements are appropriately communicated to the retailer, monitored and enforced e.g. by requiring distributors or other intermediate parties to include appropriate contractual provisions in their contracts with retailers.

5.18 The GC formalises the main rules of the Code and adds three targeted provisions as follows:

- General mis-selling prohibitions are not included in the Code, but are included in the GC (GC 23.2, 23.4.b.(i)-(iii)). These are however normal standards we would expect businesses to comply with.
- The requirements regarding creating and keeping records about sales incentives (GC 23.6) are different to those in the Code. The Code sets out a 6 month retention period, whereas we propose a time period of not less than 90 days after the date by which the incentive is fully redeemable. This is because sales incentives may be redeemed after six months which could be the earliest point a mis-sell may become apparent. In this case it is useful to have the original records as evidence. If the sales incentive is redeemed within 3 months the record retention requirement in the GC is not more onerous than that in the Code.
- The types of information that have to be provided to the customer at the point of sale set out in GC23.5 and GC23.10 go beyond those set out in the Code. We think the additional information e.g. cost of key charges is useful to consumers when making the purchase decision. In addition, the GC requires that customers entering pay-monthly contracts by telesales are sent information in a durable medium (e.g. letter) within good time. This is to ensure that consumers buying a contract over the phone are furnished with the facts in writing within a time period which will enable them to cancel the contract within the statutory 'cooling off'

<sup>28</sup> Where the MSP does not have a direct relationship with the retailer we would expect them to exert influence by requiring intermediaries to include clauses in their contract with the retailer.

period should they choose. Furthermore, the information might be useful for future reference (when memory of a telesales conversation may have faded).

- 5.19 We believe these provisions address weaknesses in the current Code. The GC and set of accompanying guidelines are provided in Annex 6 and 7.
- 5.20 We believe a GC has a number of advantages over the Code and using existing legislation to tackle mis-selling as follows:
- MSPs are more likely to vigorously enforce and police a GC because of the threat of investigation by us and possible penalties in the event of a breach. This helps to engender a level playing field because all MSPs must comply with the GC, whereas under the Code more vigilant MSPs may be disadvantaged because they incur higher costs (e.g. for compliance monitoring and enforcement) and could potentially lose out on sales if they require independent retailers to comply with stricter rules relating to mis-selling (e.g. because retailers decide to sell another MSPs services). In addition, the Code only had the 5 MNOs as signatories. This means the GC would be more effective and its impact more widespread than the Code.
  - We consider the GC will be a greater deterrent to MSPs than the Code, because we can enforce it, fine contravening companies and require companies to compensate consumers in case they have found to be in breach. Thus the GC is likely to prevent future harm arising, in addition to being a means to take action against those found to mis-sell.
  - We consider the threat of prompt corrective action taken by the MSP when mis-selling is uncovered would provide a greater deterrent to some retailers than potential action under the EA. This is because we rely on OAT complaints data to determine which retailers to pursue. But the OAT only receives a small proportion of total mis-selling complaints and we are likely to use the EA only where significant mis-selling was uncovered.
  - The range of remedies available under a GC address different issues and add value to remedies available under the EA e.g. we can issue a fine or require a company to remedy the consequences of the contravention e.g. provide compensation.
  - As set out before, SMEs are not protected by general consumer protection laws (enforceable under the EA).

#### Issues for consumers: option B

- 5.21 The main issue for consumers is how effective the rules are at preventing mis-selling given that they are indirectly imposed on independent retailers via MSPs. This approach relies on MSPs monitoring independent retailer behaviour. MSPs ultimately benefit from independent retailers selling their services. Therefore, we would expect them to exercise a degree of control over how their services are sold.
- 5.22 When enforcing a GC we could – where we are satisfied that a contravention has occurred – require an MSP to provide consumer compensation in order to remedy the consequences of the contravention. This remedy is not available under the Enterprise Act.

- 5.23 If implementing and enforcing the GC imposes substantial costs over the Code it is possible that MSPs will try and recoup some of these costs by increasing prices to consumers. However, our analysis in Annex 2.99 – 2.104 suggests that even if this were to happen the impact per subscriber is likely to be very limited. In any case, the GC should make it less likely that consumers will suffer mis-selling and cashback problems which result in financial harm as noted above.

#### Issues for MSPs: option B

- 5.24 We accept that, because it is a formal obligation, compliance with a GC might entail a greater burden than compliance with a voluntary code of practice. However, we consider that where an MSP is already complying with the Code the incremental cost of the GC should be relatively low – because the GC broadly contains the same provisions as the Code (with the addition of the provisions set out in section 5.18).
- 5.25 Some MSPs (e.g. MVNOs) did not sign the Code and it is possible that they will incur higher costs because more work will be required to comply with the GC. We have discussed the GC with these organisations and the costs of implementation are included below.
- 5.26 Based on information provided by MSPs we estimate that the one off and annual ongoing costs for all MSPs of implementing and complying with the GC for would be £0.6 million and £0.9 million respectively (see Annex 2 for further details). This amounts to an ongoing cost per sale of 4p based on MSPs achieving about 22 million<sup>29</sup> direct sales per year.
- 5.27 MSPs would be required to monitor behaviour and take action against independent retailers who fail to comply with the rules. However, most MSPs should already be monitoring independent retailers to ensure compliance with Code so this should not be unduly onerous.

#### Issues for independent retailers: option B

- 5.28 Independent retailers will experience some changes to their contract terms, may be required to undertake additional training courses and provide more information at the point of sale. It is likely that compliance costs will vary from independent retailer to independent retailer depending on their current business practices.
- 5.29 Based on information from independent retailers we estimate that the one off and annual ongoing costs of implementing and complying with the GC would be £1.1 million and £3.4 million respectively. This amounts to an ongoing cost per sale of 19p based on indirect sales of about 18 million<sup>30</sup> direct sales per year.
- 5.30 The anticipated costs are higher for independent retailers when compared to MSPs, but the cost per sale is still relatively low. The higher implementation costs for independent retailers could reflect a number of factors:
- A greater level of change required for systems and processes. This would be unusual since both MSPs and independent retailers should be following the Code. This might suggest that independent retailers have been less diligent in following the Code (which might suggest that implementing a GC would be beneficial to ensure the rules are taken seriously).

<sup>29</sup> Based on information provided by MSPs for direct and indirect sales in 2008.

<sup>30</sup> Based on information provided by MSPs for direct and indirect sales in 2008.

- The additional provisions in the GC over and above the Code might have a greater impact on independent retailers (e.g. the requirement to provide extra information at point of sale).
- Independent retailers might have taken a more conservative approach to cost estimation.

### Issues for competition: option B

5.31 MSPs and independent retailers will be subject – albeit directly and indirectly, respectively – to the same GC so this should not distort competition at the point of sale. As noted above, ensuring that all MSPs enforce the rules with the same vigour should help to create a level playing field. It is possible that monitoring compliance will require additional resource from MSPs and therefore they may reduce the number of independent retailers used in order to limit this burden. This could have the effect of reducing to some degree competition and consumer choice at the point of sale.

### **Stakeholders' responses**

5.32 Below we give an overview of the non-confidential comments received in respect of our general mis-selling proposals. Many respondents made more general comments regarding the proposed GC in this section and did not restrict themselves to comments on the general mis-selling proposals. In this section we therefore set out both the general comments regarding the proposed GC and the mis-selling specific comments. Specific stakeholders' comments in respect of the cashback proposals are included in section 6, comments on our proposals regarding retailer insolvency can be found in section 7.

5.33 Many respondents made detailed comments on other matters as well. An overview of these comments, including our response and/or action taken is provided in Annex 4.

5.34 A number of common themes emerged from the responses. We will group the stakeholders' responses according to these themes, and will address each of them using the same structure. The answers to questions 1 and 2 of the 2008 Consultation are incorporated in this structure. The themes we used for grouping stakeholders' comments are:

- Evidence related comments;
- Necessity to intervene / adequacy of other tools;
- General comments on the proposed GC;
- Specific comments on the proposed GC; and
- Legal comments.

### **Evidence related issues**

#### Stakeholder comments

5.35 Two MSPs (T-Mobile, O2) considered that Ofcom should not only rely on the number of customer complaints into its contact centre to assess the seriousness of mis-selling issues, since this would not provide the whole picture. O2 added that the

number of complaints should be considered in the context of the market and should be compared to the number of contracts sold.

- 5.36 In addition, they suggested that Ofcom could 'name and shame' companies, highlighting those who generate high complaints numbers in respect of mobile mis-selling.
- 5.37 They were also interested to see the number of mis-selling complaints in relation to small and medium Enterprises (SMEs), given that increased protection of SMEs was one of the reasons used by Ofcom to propose a GC.
- 5.38 One TSS office suggested including an option where MSPs would be prompted to investigate independent retailers once a certain threshold of complaints has been received.
- 5.39 O2 were not clear whether Ofcom's analysis of consumer harm of cashback takes into account the effect of rescue packages (e.g. downgrading tariff plans) which have been offered by MNOs to some consumers who were unable to claim cashback.

### Ofcom's response

- 5.40 In terms of the criticism regarding Ofcom's reliance on using complaints numbers into its contact centre to assess the seriousness of mis-selling, as can be seen in the consultation and also in this statement, we have used complaints information (both qualitative and quantitative) from different sources (Consumer Direct, Citizen Advice Bureaux, Trading Standards). We have also commissioned independent market research to quantify the harm related to cashback and, as set out in section 8, additional information on general mis-selling. The details of the market research can be found in Annex 9.
- 5.41 We do believe, as O2 suggested, that complaints numbers should be considered in the context of the market, i.e. as a proportion of the number of the so called gross additions<sup>31</sup>. However, in terms of a decision on whether to introduce a new GC, they should also be considered in the context of a range of factors including the level of harm and trends in complaints over time. In terms of enforcement of a new GC, we would require the MSPs to provide us with the number of gross additions per time period to monitor the ratio of complaints to gross additions.
- 5.42 As regards the suggestion to 'name and shame' companies, we believe (as the information from Consumer Direct suggests) that the complaints numbers into Ofcom only represent a very small part of total complaints and may not always be representative of the proportion of total complaints. In addition, if an MSP were to generate a high level of complaints into its own organisation, but were efficient in dealing with them at a first instance, customers would not typically escalate these complaints into Ofcom. Naming and shaming in these instances could under-represent the complaints about certain providers.
- 5.43 The number of complaints regarding SMEs is discussed in section 4.17.
- 5.44 The TSS suggestion where MSPs would be prompted to investigate retailers once a certain threshold of complaints has been received is a useful one. According to information provided to us by the MSPs, most MSPs already have monitoring

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<sup>31</sup> By gross additions we mean the number of newly acquired customers by a provider, including the number of existing customers who have renewed their subscription with their existing provider.

processes in place for their retailers and distributors and complaints information is an important driver for these processes. As set out before, the number of complaints generated by a retailer typically depends on the number of contracts sold, and therefore absolute thresholds will be hard to define. In addition, we believe setting a relative threshold would be very prescriptive, and would probably require us to define types and relative seriousness of breaches as well. We therefore decided not to include this requirement in the GC.

- 5.45 In respect of O2's comment regarding the effect of rescue packages, we stated in section A5.13 of the 2008 Consultation that these have not been included in the analysis and recognise that may result in our estimate overstating the amount of cashback unclaimed. We do not have enough information on the value of rescue packages offered to include this effect explicitly in the analysis but we have adopted a conservative approach in cost benefit assessment (see Annex 2).

## **Necessity to intervene / adequacy of other tools**

### Stakeholder comments

- 5.46 A number of TSS offices considered that more use could be made of existing legislation under the Enterprise Act, existing fraud legislation and the new Unfair Consumer Practices Directives ('UCPD').
- 5.47 The Office of Fair Trading ('OFT') agreed with the options identified to tackle general mis-selling. They agreed that in the circumstances set out by Ofcom, a GC would appear the most appropriate option. They did however point out that in certain circumstances existing consumer protection legislation, enforced under the Enterprise Act, could provide Ofcom with a tool for tackling problem traders.
- 5.48 Citizen Advice Bureau ('CAB') supported Ofcom's proposal to introduce a new GC. In addition, they suggest exploring the possibility of joined up enforcement action with the Office of Fair Trading ('OFT') and TSS who can enforce consumer protection legislation against retailers, in particular the Unfair Consumer Protection Directives which came into force in May 2008.
- 5.49 All MSPs believed that Ofcom already has the powers under the Enterprise Act to tackle mis-selling. O2 added that if Ofcom believe its powers under the Enterprise Act are not fit for purpose, this is a separate issue which needs to be addressed. In addition, based on their experience with slamming, O2 believe that the majority of problems are caused by a small number of organisations. O2 questioned Ofcom's comment that it would be inefficient and ineffective to take targeted action against those that are generating the highest levels of complaints.
- 5.50 T-Mobile stated that given that Ofcom has relationships with the larger retailers, where they are deemed to be in breach, Ofcom should deal directly with those retailers.
- 5.51 3 were disappointed that in their view, existing enforcers such as the OFT and TSS are not effectively using their existing enforcement powers.
- 5.52 They also claimed Ofcom have not produced evidence to show what efforts have been made to tackle mis-selling and bad cashback using TSS investigations and do not estimate the cost of such an approach when asserting using existing legislation and enforcement bodies would be inefficient and too resource intensive.

- 5.53 Orange considered that although Ofcom could be right in their assertion, Ofcom seem to have overlooked that MSPs are faced with the same issue as Ofcom in dealing with a high number of retailers and the complexity related to this.
- 5.54 All MSPs set out that Ofcom has not allowed sufficient time for the Code to take its full effect.
- 5.55 Scottish and Southern Energy ('SSE') supported Ofcom's proposed approach covering a set of high level obligations, combined with the development of guidelines. But they believe that the proposed GC is in places still too prescriptive. They believe prescriptive detail should either be avoided altogether or should be subject to a sunset clause of no longer than two years.
- 5.56 Orange suggested a third option to tackle mis-selling, involving Ofcom engaging regularly and meaningfully with all the relevant parties in order to facilitate discussions between them and find more imaginative solutions which would specifically target those market players who were causing harm.
- 5.57 3 would like Ofcom to utilise the information sharing provisions under the Code and that this, combined with Ofcom using its Enterprise Act powers could tackle mis-selling, without the need for statutory regulation.

#### Ofcom's response

- 5.58 A number of stakeholders asked why Ofcom would not use its existing powers under the Enterprise Act. In order to avoid any confusion, as set out in sections 3.31 we have used and will use these powers when we think it is appropriate to do so.
- 5.59 In our 2008 Consultation and in sections 3.33 – 3.38 above we identified a number of issues potentially arising from an exclusive reliance on the EA in specific circumstances and also set out why additional enforcement powers under a GC and the Communications Act would add value and complement our existing powers in order to effectively tackle issues arising from mobile mis-selling.
- 5.60 In the 2008 Consultation, we also considered the fragmented nature of the sales channels, where there is a very large number of independent retailers selling mobile telephony services. In sections 3.41-3.44 above we give an indication of the costs of using the Enterprise Act in the case of mis-selling and cashback investigations.
- 5.61 Orange mentioned that they also face the issue of fragmented sales channels and that they could therefore not be expected to police a high number of independent retailers. We believe, however, that MSPs have a much closer relationship with retailers than Ofcom, and are able, through contractual provisions, to influence to a certain extent retailers' behaviour.
- 5.62 In addition, as we set out in the 2008 Consultation, in section 6.11, MSPs ultimately benefit from independent retailers selling their services, and we would therefore expect them to exercise a degree of control over how their services are sold. In addition, we believe it is in the interest of the MSP to ensure that their services are sold responsibly and that their reputation won't be affected by bad sales practices of independent retailers.
- 5.63 As set out above, we do take targeted action using the EA, wherever we believe this is appropriate and we do not consider the EA and a GC to exclude, but rather to

complement each other. We believe that we should assess, in each individual case, which legal instrument is the most appropriate to tackle a certain issue, based on:

- The effectiveness of the available legal instruments and its remedies for the case at hand;
- The urgency of the matter; and
- The costs and resources required to tackle the issue.

- 5.64 In respect of the assertion from 3 that they are disappointed that other existing enforcers, such as TSS and the OFT are not effectively using their powers, we have seen a number of examples of TSS offices opening investigations under the EA into alleged mis-selling. Our recent investigation into Phones4U was in close collaboration with Staffordshire TSS<sup>32</sup>.
- 5.65 In terms of us not allowing sufficient time for the Code to take effect, as set out before, the Code had been in place for 8 months when we proposed the introduction of a GC. And by the time this statement is published, it has been in place for 18 months which appears to us to be a sufficiently long time period for it to take effect. And although the number of cashback complaints has gone down, the general mis-selling complaints numbers have not decreased as much as we hoped.
- 5.66 Regarding SSE's comment to make prescriptive provisions in the proposed GC subject to a sunset clause, we will monitor the effectiveness of the proposed GC, and if evidence suggests changes should be made, we will consult on those changes when we believe that would be appropriate.
- 5.67 We believe it is a good suggestion by two of the MSPs to engage on a regular basis with all relevant parties in order to specifically identify and target those market players who are causing harm. To this end, we plan to provide MSPs on a regular basis with information regarding their own performance in terms of cashback and mis-selling issues relative to total industry. We also have access to Consumer Direct data, and will on a regular basis look at their information in respect of mis-selling.
- 5.68 However, we do not believe sharing information alone will be sufficient to tackle mis-selling as the complaints we receive tend to be a late stage in the complaints process (when customers have not been able to resolve complaints with providers) and give a narrow picture of potential problems in the market place. Providers also receive complaints directly and are usually the first and main point of contact for the customer. These should provide a broader view and also allow them to act earlier to address problems.

## **General comments on the proposed GC**

### Stakeholder comments

- 5.69 TSS offices made the following comments on the proposed GC:
- The proposed GC would add little to the Code, and they considered it unlikely to be of significant benefit to consumers.

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<sup>32</sup> More information can be found at [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_985/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_985/).

- The requirements in the proposed GC do not significantly go beyond what is currently required in law, but would mainly move the responsibility from enforcers to MSPs.
  - Some TSS offices considered that the proposed GC would not be effective in addressing a situation where the customer wants to cancel a disputed contract, and the airtime supplier disagrees.
- 5.70 O2 expressed concerns regarding the effectiveness of the GC, should it be introduced. In addition, they questioned whether a GC would be more effective than the Enterprise Act in requiring compensation in respect of cashback, or more generally.
- 5.71 Based on the Ofcom complaints statistics for fixed mis-selling, they also stated that the introduction of a GC for fixed line mis-selling has not delivered better results than the Code.
- 5.72 3 also believed that the approach followed by Ofcom in the mobile mis-selling review is different from that followed in the fixed line mis-selling review, where more time was taken for the self regulatory initiative to take effect.
- 5.73 Vodafone questioned Ofcom's assertion that its policy on Mobile Number Portability (MNP) is consistent with its stance on clamping down on mobile mis-selling.
- 5.74 BT pointed out that although Ofcom asserted that the proposed GC should not create significant additional costs for those who already comply with the Code, BT has not signed up to the Code and that therefore any costs were likely to be additional to BT. They would welcome an Ofcom-facilitated consultation on the monitoring, record-keeping and reporting proposals.
- 5.75 Virgin Mobile considered it disproportionate that they would have to comply with this regulation because they generate very few mis-selling complaints. Virgin Mobile also questioned whether they would have the commercial leverage to effectively influence the behaviour of large independent retailers. They therefore suggested that they should be given a period of voluntary regulation (they have not signed up to the Code) similar to the 5 MNOs who signed up to the Code. In case issues arose, Ofcom would have the option to impose formal regulation on Virgin Mobile.
- 5.76 3 were concerned that the Impact Assessment (IA) assumes that the additional impact of moving from the Code to a GC would be minimal. They think that the IA is contradictory because it plays down the impact of the GC by arguing that MSPs are already performing most of the obligations under the Code, but also argues that the Code has failed to address mis-selling and therefore statutory regulation is required. They consider that there is a risk that communications providers will be discouraged from developing self-regulation for fear that this will count against them in any assessment by Ofcom of the need for statutory regulation.
- 5.77 3 also comment that making the MSP responsible for retailer's failures to comply with their own legal/regulatory responsibilities (and the fact that distributors will no longer be ultimately responsible for managing their stockists) may potentially result in MSPs reducing the number of distributors and/or retailers they deal with. This would result in a potential reduction of competition and consequently consumer choice.

## Ofcom's response

- 5.78 One TSS office commented that the proposed GC would add little to the Code, and therefore the benefit to consumers would be limited. In sections 5.14 – 5.20 we set out what we believe are advantages of a GC over the Code and which additional benefits to consumers we believe a GC would bring.
- 5.79 Regarding the TSS comment that the proposed GC would not be effective in addressing a situation where the customer wants to cancel a disputed contract, and the airtime supplier disagrees, we believe that a number of the provisions in the proposed GC should help resolve disputes, for instance:
- The requirement on MSPs and on independent retailers (through contractual provisions) to create and keep records about the sale of a mobile telephony service;
  - The requirement on MSPs to ensure that before entering into a contract for a mobile telephony service the customer is authorised to do so and intends to enter into this contract.
- 5.80 O2 made two comments regarding the effectiveness of the proposed GC:
- They questioned whether the proposed GC would be more effective than the EA in requiring compensation in respect of cashback. In sections 5.14 – 5.20 above we have set out the advantages of a GC over the Code.
  - We note their comment on the effectiveness of the current fixed-line voice rules for mis-selling and that they have not delivered better results than the Code in the mobile market. However, we are not persuaded by the value of like-for-like comparisons between the fixed and mobile voice sectors given that market dynamics are very different. In addition, where we have investigated named Communications Provider in the fixed line sector, action taken by Ofcom has had a positive impact on those parties investigated. We are currently reviewing fixed-line mis-selling rules, and are consulting on introducing additional safeguards to deliver further improvements in this area<sup>33</sup>.
  - The approach adopted to address fixed line mis-selling is similar to that adopted for mobile mis-selling where appropriate for example through a high level prohibition on mis-selling, supported by guidelines. The principle differences reflect the different retail channels to market. For instance, because of the significance of third party retailers in the mobile retail market, GC23 has provisions to carry out due diligence checks on third party retailers and requirements on MSPs to use reasonable endeavours to ensure that third party retailers meet certain provisions.
- 5.81 With regards to 3's comment pointing out the difference in time given to the self-regulatory initiative to work (i.e. the longer period in the case of fixed-line voice mis-selling), it is important to note that the Code and subsequent Ofcom review in the fixed sector were carried out in the early days of the development of WLR and where direct selling techniques were still coming into the market place. Complaint levels were therefore much lower than mobile mis-selling complaints. We decided to make

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<sup>33</sup> Consultation document *Protecting consumers from mis-selling of fixed line telecommunications services* published 16 March 2009.

proposals to intervene when complaints increased and direct selling techniques increased the potential for harm.

- 5.82 In terms of Vodafone's comment regarding Number Portability, we note that since this comment was made, the Competition Appeal Tribunal ('CAT') in September 2008 remitted the decision regarding Number Portability to Ofcom<sup>34</sup>. Ofcom has recently started a new project on mobile number portability. Whatever the outcome of that work, the measures being introduced by Ofcom in this statement will remain important safeguards for consumers against mis-selling.
- 5.83 Arising from BT's and Virgin's comments in particular, we have considered whether it is appropriate to apply the GC to MVNOs on the same basis as MNOs given that: 1) they currently generate a low number of mis-selling/cashback complaints and 2) they have no experience of enforcing or monitoring the Code on which the GC is based.
- 5.84 We note BT's point that, whilst we set out in the 2008 Consultation that we considered the proposed GC should not create significant additional costs for those who already comply with the Code, BT has not signed up to the Code, and that as a result there may be additional costs for BT.
- 5.85 However, we do not believe it is appropriate to disapply the GC to MVNOs in any other way for the following reasons:
- a) We would be differentiating between firms competing in the same market based solely on current complaint numbers which is not a robust justification (complaint numbers are likely to fluctuate through time).
  - b) Other MSPs may also bargain for leniency and request exemptions based on complaint numbers which could increase complexity and introduce greater subjectivity into regulatory enforcement. This could lead to an opaque situation where it is unclear exactly which rules apply to each MSP and could create confusion for consumers.
  - c) Applying the rules differently to MNOs and MVNOs could distort the market and create an unlevel playing field because some firms would incur higher regulatory compliance costs than others. This might affect competition in the market.
  - d) Retailers would be subject to different checks and monitoring depending on whether they were selling for an MNO or MVNO. This could create confusion. Retailers might try to 'game' the system because they perceive the level of monitoring and penalties for non compliance are lower for MVNOs.
  - e) Only applying the rules to MNOs may be short sighted. Mis-selling problems could arise for MVNOs in the future and we would then face a lengthy delay before the GC could be extended to MVNOs.
- 5.86 However in reaching this conclusion it is important to note that, following discussions with a number of MSPs, we have made some slight changes to the proposed GC and we believe that the effect of these changes will result in significantly lower costs of implementing its provisions including for MVNOs in particular.
- 5.87 One of those changes is - discussed in Annex 5, under GC23.1 - the exclusion of the sale of pay-as-you-go phones from a number of provisions in the GC. We believe

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<sup>34</sup> The judgement can be found at [http://www.catribunal.org.uk/files/Judgment\\_1094\\_180908.pdf](http://www.catribunal.org.uk/files/Judgment_1094_180908.pdf).

these exclusions will have a relatively more positive impact on those MSPs whose sales comprise a higher proportion of pay-as-you-go phones. Based on information provided by MNOs and MVNOs, MVNOs sell proportionally fewer contract phones than MNOs (and hence proportionally more pay-as-you-go phones). This change should therefore proportionality a bigger impact on reducing MVNOs costs.

5.88 In terms of 3's concern regarding the IA being contradictory, we consider the following:

- The GC adopts a number of provisions of the Code, but it adds provisions which we believe are required to effectively tackle general mis-selling;
- In addition, we believe the additional provisions represent good practice which providers should already be following
- As set out in section 3.64 - 3.65, the Code has been implemented and applied in different ways throughout the industry.
- We accept that the additional obligations and the move to formal regulation could result in additional costs for MSPs.
- However, and as set out in more detail in section 8.54 – 8.60, the benefits of introducing the GC are likely to yield a positive net benefit.

5.89 As set out in section 8 below, we are allowing additional implementation time for MSPs to prepare and make any necessary changes.

5.90 We do not share 3's concern that the proposed GC could sometimes absolve the retailer of their regulatory and legal obligations. Retailers will remain responsible for compliance with relevant regulations and law, especially general consumer protection laws, which, under the EA, can be enforced against them.

5.91 3 also commented that introducing the proposed GC could potentially result in MSPs reducing the number of distributors and/or retailers they deal with. This would result in a potential reduction of competition and consequently consumer choice. In making our proposals, we did not opt for more intrusive options such as requiring MSPs to change commission arrangements or pay back cashback directly to customers – which could have had a significant impact on the MSP/retailer relationship and consequently the level of competition. As a result, we believe our preferred option appropriately balances the need for protection with the potential negative impacts on the level of competition.

### **Specific comments on the proposed GC**

5.92 In addition to the comments mentioned in this section, many respondents made detailed comments on the proposed GC. These comments and Ofcom's response to them are included in Annex 4.

### **Legal comments**

#### Stakeholder comments

5.93 A number of MSPs (O2, Vodafone, T-Mobile, Mobile Broadband Group), considered that they could be limited in their ability to enforce or restrict offers made to customers by third parties for competition reasons and that MSPs could run a risk of

'double jeopardy', where compliance with the GC could infringe competition law prohibitions.

- 5.94 They expressed concerns that the type of behaviour required under the proposed GC could create tensions for them with regards to their obligation to adhere to European and UK competition law. In particular, Vodafone considered the obligation requiring providers (a) to ensure (to a certain degree) that retailers would not use unduly restrictive terms and conditions with regards to cashback offers and (b) to carry out certain due diligence checks on their retailer might conflict with their obligation not to restrict the ability of retailers (which could be their direct competitors on the retail level) to compete.
- 5.95 3 considered that Ofcom's approach in dealing with mis-selling and cashback issues is not consistent with its obligations under section 6 of the Act, under which Ofcom is required to have regard to the extent to which the matters which are required under section 3 of the Act are already furthered or secured, or are likely to be furthered or secured, by effective self-regulation.
- 5.96 A number of TSS offices claimed that MSPs could be held responsible and liable for the actions of their agents (the independent retailers) according to contract law.
- 5.97 Some TSS offices also considered that a common understanding should be created as to how distance selling rules apply to mobile phone contracts, especially where the supply of the handset and the airtime are linked.
- 5.98 One individual suggested that retailers should not be allowed to use telesales to sell their services.
- 5.99 Another individual considered that heavy fines should be issued and criminal proceedings be started in case retailers engage in general mis-selling.
- 5.100 The London Trading Standards Authority Group thought that the proposals of how different groups were impacted had not been addressed. They thought that certain ethnic groups may be disproportionately affected by mobile mis-selling and suggested that vulnerable groups may be targeted by unscrupulous retailers. Such customers may be more vulnerable to exploitation where English is a second language and they do not fully understand the implications of the contract they are signing.
- 5.101 3 pointed out that under the Act Ofcom is required to "have regard to the extent to which the matters which they are required under section 3 to further or to secure are already furthered or secured, or are likely to be furthered or secured, by effective self-regulation; and in the light of that, to consider to what extent it would be appropriate to remove or reduce regulatory burdens imposed by Ofcom".

### Ofcom's response

- 5.102 Some MSPs set out concerns that the type of behaviour required under the proposed GC could create tensions for them with regards to their obligation to adhere to European and UK competition law. In particular, the obligation requiring providers (a) to ensure (to a certain degree) that retailers would not use unduly restrictive terms and conditions with regards to cashback offers and (b) to carry out certain due diligence checks on their retailer might conflict with their obligation not to restrict the ability of retailers (which could be their direct competitors on the retail level) to compete.

- 5.103 However, respondents did not set out in further detail, in which way such obligations would conflict with competition law (other than stating in general terms that “restrictions on the activity of independent third party distributors would generally be prohibited” – a statement which in this generality is not entirely correct). In our view, nothing required of MSPs under the GC puts them into a situation where they would have to either breach competition law rules (in order to comply with the GC) or infringe the provisions of the GC (in order to comply with UK and/or EC competition law). In particular, we believe that the due diligence checks required under GC 23.8 do not force MSPs – as was feared by some respondents – “to instruct third party distributors not to engage or to terminate the contract of a particular reseller”. We also set out in our Guidelines (see Annex 7), as was requested by some respondents, what we believe to be “unduly restrictive terms and conditions” to clarify that we would not wish MSPs to violate competition law rules in order to comply with the GC.
- 5.104 Regarding 3’s comments on the extent to which self-regulation has been effective, we refer to our comments in section 3.48 – 3.84.
- 5.105 In respect of the comment that our approach followed in the mobile mis-selling review would not be consistent with our obligations under Section 6 of the Act whether we can further the interests of consumers by effective self-regulation, we believe that our approach is fully consistent with our duties under section 6.
- 5.106 We do not accept that our approach on the fixed-line and mobile voice mis-selling reviews were materially different in nature. Indeed, in both instances we opted to first work with the industry in order to achieve a self-regulatory solution which would address mis-selling difficulties and only moved to consultation following what we considered to be an appropriate period for the agreed measures to take effect and make an impact and where the evidence suggested this was not the case.
- 5.107 A number of TSS stated that MSPs can already be held liable for the actions of their retailers because of the agency relationship between MSPs and retailers under contract law. Whilst we accept that this might be the case under certain circumstances we note that whether or not an agency relationship can be established depends on a number of factors; in particular the wording of the contract the customer signs, the way the relationship between MSP and retailer is presented to a customer during the sales process and on the exact wording of the contract between the MSP and the retailer (which in some cases is drafted in a way to try to explicitly exclude an agency relationship). Therefore, it is not possible to state in general terms that MSPs can always be held liable for the actions of their retailers in all cases.
- 5.108 TS referred to a number of issues under the Distant Selling regulation, and considered that a common understanding should be created as to how distant selling rules apply to mobile phone contracts, especially where the supply of handset and the airtime are linked.
- 5.109 Regarding the suggestion to forbid independent retailers from using telesales to sell their services, we believe that the specific telesales provisions in the proposed GC requiring information to be sent to the consumer, as well as the general provisions on sales and marketing practices, are sufficient in dealing with telesales concerns. A complete prohibition would be disproportionate as it would significantly constrain their ability to market services and reduce choice for consumers without bringing much additional benefit.

- 5.110 Regarding the suggestion to issue heavy fines and start criminal proceedings in case retailers engage in mis-selling, Ofcom's powers in the circumstances discussed here do not extend to criminal law sanction against retailers. It would be for the Crown Prosecution Service to issue criminal proceedings where they believe criminal behaviour, such as fraud etc. might have occurred. In addition our powers to issue fines against retailers (outside the framework of the Act) are limited.
- 5.111 With regards to comments by the London Trading Standards Authority Group on how the proposals affected different groups, in the 2008 consultation we noted that complainants to the CAB were often from low income households and/or from ethnic minorities possibly with a poor understanding of English.
- 5.112 We believe that the introduction of the GC will help to reduce the incidence of mobile phone mis-selling across the sections of the population. For example, the requirement that sales incentive terms and conditions are not unduly restrictive should help to enable that **all** consumers are able to claim what they are owed. In addition, MSPs will be required to monitor retailers and use reasonable endeavours to ensure they do not engage in dishonest, deceptive or misleading conduct (which would include exploiting vulnerable customers). Requirements around the provision of information at the point of sale should also assist all customers understand the service they are purchasing and help reduce the incidence of mis-selling.
- 5.113 Therefore, we have not carried out a separate Equality Impact Assessment in relation to race equality or equality schemes under the Northern Ireland and disability equality schemes at this stage. This is because, as set out in section 4.28 above we are not aware that the proposals being considered here are intended (or would, in practice,) have a significant differential impact on different racial groups, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. Similarly we have not made a distinction between consumers in different parts of the UK or between consumers on low incomes. As set out above we believe that the decision will not have a particular effect on one group of consumers over another.
- 5.114 We believe that the introduction of the GC will help to reduce the incidence of mobile phone mis-selling across the population, including ethnic minorities. For example, the requirement that sales incentive terms and conditions are not unduly restrictive should help to enable that all consumers are able to claim what they are owed. In addition, MSPs will be required to monitor retailers and use reasonable endeavours to ensure they do not engage in dishonest, deceptive or misleading conduct (which would include exploiting vulnerable customers).
- 5.115 We recognise that consumers who have a poor understanding of English might benefit from additional protection (e.g. terms and conditions provided in their own language, in-store translators). However, we do not think it would be proportionate to mandate that MSPs and their retailers provide such additional information. Nevertheless, we would encourage retailers to provide information in alternative languages where local circumstances make this appropriate – indeed, doing so may increase the addressable market for retailers in such areas.
- 5.116 3 considered that there was a risk that communications providers would be discouraged from developing self-regulation for fear that this will count against them in any assessment by Ofcom of the need for regulation.
- 5.117 Our decision, in this case, to introduce formal regulation following the Code is not intended to discourage MSPs from developing self-regulation. We set out in section 3

our principles for analysing self- and co- regulation in assessing appropriate regulatory solutions.

## Conclusion

5.118 Our preferred option remains B): regulating the MSP through a GC. The GC will require the MSPs to comply with a set of rules and prohibitions to address mis-selling. The reasons for our decision can be summarised as follows:

- We estimate conservatively that around £21 million of ongoing financial harm per year arises due to general mis-selling (see Annex 2 for details).
- The Code has not brought about an adequate reduction of harm due to general mis-selling. Furthermore, the number of complaints to us about mobile mis-selling has not decreased significantly.
- The current consumer safeguards do not provide sufficient consumer protection on their own against mis-selling of mobile telecommunications services and small business customers are not protected.
- As a result we believe that further measures are required. We consider that instances of mis-selling can be distressing to those consumers involved, and this can work against the interests of consumers and undermine consumer confidence in the mobile market.
- We consider that the proposed GC would ensure that consumers (including small business customers) are better protected. It sets out requirements to address mis-selling and if a breach is identified we will be able to investigate and enforce its provisions.
- We believe that in certain circumstances, the GC will be more effective than existing legislation. Where problems of mis-selling arise action can be taken promptly by us with the GC in place and we have a wider range of remedies available, for example the ability to require an MSP to remedy the consequences of the contravention or to fine the contravening MSP.
- Our analysis suggests that the introduction of the proposed GC is likely to result in net benefits (see section 8.50-8.66 below and Annex 2 for details)<sup>35</sup>.

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<sup>35</sup> For practical reasons, the quantified cost benefit assessment considers the total costs of implementing the GC which covers all three issues - general mis-selling, cashback and retailer insolvency. However, in the base case the incremental benefits from reducing general mis-selling harm are larger than the total costs.

## Section 6

# Options to tackle cashback issues

- 6.1 In this section and section 7 we provide an overview of the options that we set out in the 2008 consultation to address cashback problems, including our preferred options.
- 6.2 We summarise and update the qualitative assessment of the options and then discuss stakeholders' comments and give our response to their comments. We then set out our conclusions in the light of this assessment and the response. We have estimated the costs and benefits of our preferred option in section 8 and Annex 2<sup>36</sup>. We have taken account of our qualitative and quantitative assessment in reaching our conclusion.
- 6.3 The options to deal with cashback problems have been split into two areas; 1) onerous/misleading contractual terms and conditions making it hard to claim (dealt with in this section 6) and 2) independent retailers ceasing to trade (dealt with in section 7).

## Options

- 6.4 The specific options dealing with independent retailers ceasing to trade are discussed in section 7 below. In some cases an option deals with both areas (those which tackle both are marked with an asterisk (\*) below). Below is a list of options we considered (including sub-options).
- A) Rely on the Code and existing regulation;
  - B) A consumer education campaign; and
  - C) Regulate MSPs through a GC. The GC might include one or more of a range of requirements or prohibitions including:
    - i) Providing more information at point of sale;
    - ii) Prohibiting unacceptable terms;
    - iii) Changing the independent retailer commission structure;
    - iv) Automating cashback;
    - v) Introducing an approved independent retailer scheme;
    - vi) Allowing cashback only at the start of the deal\*;
    - vii) Requiring MSPs to pay cashback (through reductions in independent retailers' commissions)\*; and
    - viii) Banning cashback\*.

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<sup>36</sup> Due to the large no of options identified it would not be proportionate to carry out a quantitative assessment for all the options considered.

## **A) Rely on the existing Code/legislation**

- 6.5 Under this option no new formal regulation would be introduced. However, we would rely on the status quo, i.e. the Code, which includes provisions on unfair terms in relation to sales incentives, would be retained and we would be able to pursue independent retailers under the Enterprise Act if this was deemed appropriate.
- 6.6 The Code is discussed in sections 3.48 – 3.70. As noted above we do believe the Code has brought about some positive developments in the market. In particular, the number of cashback complaints has fallen as shown in figure 4.1. However, the reduction in the number of cashback complaints could also reflect the demise of cashback deals offered in the market – for example as a result of retailers substituting to other forms of incentive such as free ‘goodies’ e.g. laptop or because MSPs are imposing tighter rules surrounding cashback offers.

### Issues for consumers: option A

- 6.7 As explained above, it would be very difficult to pursue all potentially violating independent retailers using existing legislation. We do not believe using existing legislation would be as effective as a GC. In addition pursuing an independent retailer under the EA is unlikely to result in consumers getting some form of compensation for any cashback which they are otherwise unable to claim.

### Issues for MSPs: option A

- 6.8 Continuing bad press regarding mis-selling and cashback deals is detrimental to the industry reputation and could damage consumer confidence in the market. Even though MSPs are not responsible for independent retailer cashback offers, consumers frequently blame MSPs when cashback is difficult to claim (as the cashback is perceived to be associated with the airtime contract).

### Issues for independent retailers: option A

- 6.9 Independent retailers who follow ‘best practice’ and only offer fair terms and conditions may find their offers are less attractive in face value financial terms than retailers offering deals which rely on artificially lowering the redemption rate. As a result, they may face a competitive disadvantage. As mentioned above, consumers will typically have difficulties in distinguishing independent retailers offering ‘bad’ cashback deals from those offering acceptable deals.
- 6.10 Effective policing of the Code by the MSPs and the threat of legal action under existing legislation may discourage independent retailers imposing unfair terms and conditions. The impact of existing legislation depends on whether independent retailers see the threat of action by us as credible. This will depend on the probability of enforcement action and the severity of the punishment if the independent retailer is found guilty. If independent retailers perceive a low probability of enforcement or the penalty is small then the threat of using legislation may have reduced impact.

### Issues for competition: option A

- 6.11 There is no evidence that cashback activity has affected competition between MSPs (MSPs do not offer cashback on direct sales). Nevertheless, there may be some distortion of competition if certain independent retailers exploit consumers by offering ‘bad’ cashback deals (and thereby gaining an unfair competitive advantage) while others do not.

## B) Consumer education campaign

- 6.12 A significant part of the problem with 'bad' cashback is consumers not understanding the full terms and conditions of the contracts they are signing. For example, some may believe cashback is provided by the MSP rather than the independent retailer, or some consumers may not understand that line rental offers are quoted net of cashback (which must be claimed separately). Prior to a sale, consumers may not read the detailed terms which set out the steps they must fulfil to successfully claim cashback. If they understood better these aspects they might in some cases be able to make a more informed choice about the probability of making a successful claim. Under this option, a campaign would be undertaken to try and improve education so consumers are more informed about the contracts they are taking. The practical implications for organising the campaign would need to be considered, in particular responsibility for funding and running the campaign.

### Issues for consumers: option B

- 6.13 Consumer education is desirable as it would enable more informed choices. Under Section 26 of the Act we are able to arrange for publication of information and advice about matters in relation to our duties.
- 6.14 We regularly publish information for consumers and providers on our website. However, in this case we consider providing general consumer information may not be very effective. Identifying consumers who are purchasing or likely to purchase services with cashback and ensure they are aware of the information on our website will be difficult. In addition around 35% of households do not have internet access<sup>37</sup>.
- 6.15 Using more extensive advertising and public information campaigns could be a large, costly and difficult exercise. In addition, the impact would be limited in the longer term, unless the education effort is repeated on a regular basis. In addition, the cause of 'bad' cashback offers would not be addressed.

### Issues for MSP/independent retailer: option B

- 6.16 None.

### Issues for competition: option B

- 6.17 Same as under option A above.

## C) Regulate MSPs through a GC

- 6.18 Under the Act, it is not possible for us to directly regulate the actions of independent retailers (where they are not also providers of ECS or ECN). However, independent retailers must comply with contractual terms in their relation with MSPs with whom they directly contract, so we can indirectly influence the actions of independent retailers via regulation of MSPs, providing the MSPs exert control over independent retailers.
- 6.19 Some of the advantages of using a GC over the Code and existing legislation are discussed in section 5.20. We believe a GC will be more effective than existing legislation because we have a wider range of powers and corrective action can be

<sup>37</sup> <http://www.ofcom.org.uk/research/tce/ce08/>

taken in a more timely manner with a GC. A number of specific options which could be incorporated into a GC have been considered:

**i) Providing more information at the point of sale**

- 6.20 Part of the problem with cashback deals is consumers do not fully understand how to claim the cash (e.g. they send the claim too late or too early). Under this option, the GC would require MSPs to ensure that more information is given at the point of sale, for example the independent retailer explaining to customers exactly what they need to do at each point in time to ensure the claim is successful. This option could be used in conjunction with other options listed below.

Issues for consumers: option C i

- 6.21 Providing more information at the point of sale may help some customers make successful claims for cashback and other sales incentives. Customers would be able to consider whether the terms were unduly onerous and better assess the likelihood of making successful claims.

Issues for MSPs: option C i

- 6.22 The MSP would need to insist that independent retailers provide the information required at the point of sale and take action if they are not.

Issues for independent retailers: option C i

- 6.23 Independent retailers would need to fully explain the cashback contract terms and conditions to consumers – this may discourage the imposition of onerous terms and conditions. There may be some additional cost to independent retailers in providing this information.

Issues for competition: option C i

- 6.24 None.

**ii) Prohibiting unacceptable terms**

- 6.25 The GC for mis-selling, proposed above, would cover sales incentives and state that the terms and conditions of such incentives should not be unduly restrictive (the proposed provisions would be similar to those in the Code).

Issues for consumers: option C ii

- 6.26 This option should help to ensure that all customers are offered fair terms and conditions. Consumers would still have to follow the independent retailers' processes to claim cash or other incentives (for example remembering to send bills at various points in the contract).

Issues for MSPs: option C ii

- 6.27 MSPs would need to monitor the terms and conditions offered by independent retailers to ensure they complied with the GC. We would have powers to ensure that the MSPs took steps to enforce the provisions on independent retailers.

### Issues for independent retailers: option C ii

- 6.28 Independent retailers should already be following the requirements of the Code so this option should not result in a significant change for compliant independent retailers.

### Issues for competition: option C ii

- 6.29 The effect of the GC would apply equally to MSPs and independent retailers so should not distort competition between the parties.

### **iii) Changing the independent retailer commission structure**

- 6.30 Commission structures are negotiated between the MSP and the independent retailer and vary widely. Larger independent retailers tend to operate under revenue sharing agreements where part of the commission is earned over the life of the contract. Smaller independent retailers tend to receive more commission upfront (with a variety of models which fall in between).
- 6.31 Under this option, the GC would require MSPs to incentivise good practices in independent retailers by paying out some commission payments at a later stage in the customer's contract or clawing back commission payments if 'bad' practices involving cashbacks were uncovered.
- 6.32 As explained in Section 3 of the 2008 Consultation, some MSPs already operate similar schemes, for example, offering a quality/performance bonus later in the contract – see Section 3 of the 2008 Consultation for more details.

### Issues for consumers: option C iii

- 6.33 Consumers will need to communicate their cashback experiences/problems to MSPs in order that MSPs can reflect this in commission payments.
- 6.34 This option is more likely to mean that cashback is spread out over the contract (to match commission payments) which may not be ideal e.g. in the event that an independent retailer ceases trading.

### Issues for MSPs: option C iii

- 6.35 MSPs use commissions to incentivise independent retailers. Typically we would expect independent retailers to prefer earlier commission payments, so if one MSP pays a commission later than other MSPs their products may be viewed less favourably with a probable impact on promotion and sales effort by independent retailers.
- 6.36 It may be difficult for the MSP to administer the scheme e.g. they will require information on who has not received cashback, check the claim validity and then alter commission payments accordingly.
- 6.37 Changing commission structures may be a costly, complicated and onerous process for MSPs. In terms of enforcement, it would be difficult for us to determine the balance between incentivising sales and ensuring that cashback is paid.

### Issues for independent retailers: option C iii

- 6.38 This is an intrusive option. Commissions are important for business funding purposes (they form part of the independent retailers' working capital). Changing the commission basis may have funding implications e.g. a sudden change from upfront to instalment commission payments may have cash flow implications and create short term problems for even viable business models. The option is more likely to have an impact on smaller independent retailers who tend to receive more commission up front.
- 6.39 Changing the commission structure may have implications for the independent retailer in the event that the consumer falls into arrears on the contract payment e.g. the MSPs may decide not to pay any ongoing commissions. This means MSPs can transfer some of the risk of early termination to independent retailers who may be less well placed to manage or absorb such risks. To some extent MSPs already share the risk of early termination with independent retailers as commissions can be clawed back if the consumer falls into arrears within a given number of months. Similarly, with revenue sharing (which is currently in place for some independent retailers) the exposure to early termination is shared between the MSP and the independent retailer. It is not possible to gauge exactly how much risk will be transferred from MSPs to independent retailers as commission structures vary widely.

### Issues for competition: option C iii

- 6.40 Commission payments are used to incentivise independent retailers, so intervening may indirectly affect how MSPs compete with each other for independent retailer 'effort' (i.e. it reduces flexibility in the incentive structures offered to independent retailers). As all MSPs would be subject to the same conditions this is unlikely to have a significant impact on competition. Changing the commission structure may impact on competition between MSP direct sales and independent retailers.

### **iv) Automating cashback**

- 6.41 Under this option the GC would require that cashbacks are only allowed where they are paid automatically by the independent retailer at the appropriate time. The method of payment would not be prescribed e.g. it could be by direct debit, standing order or by a cheque sent through the post. The key feature is no action would be required by the customer to generate payment, such as sending in copies of bills.

### Issues for consumers: option C iv

- 6.42 Automation makes the cashback process much simpler for consumers. Consumers would need to provide independent retailers with updated details if they change their address or bank account (if paid by direct debit or standing order).
- 6.43 Automated cashback schemes tend to offer a smaller amount of cashback as the redemption rate is 100% with certainty (market research suggests about 5% of consumers forget to claim cashback which independent retailers may legitimately factor into the amounts offered). One question is whether consumers prefer to receive a smaller amount with ease and certainty or favour taking a risk on a larger amount which is more difficult to obtain.

#### Issues for MSPs: option C iv

- 6.44 In order for an automated scheme to work independent retailers need to be able to identify which consumers are still honouring the contract and which have defaulted/cancelled/ changed contract. If a consumer cancels/defaults on a contract (and is no longer paying fees to the MSP) or changes tariff plan they should not receive any ongoing cashback (as independent retailers will be subject to claw back on commissions). MSPs would need to provide information on live consumers to independent retailers.
- 6.45 The option would therefore require some MSPs to develop new systems and processes, so the option could not be implemented swiftly. There would be setup and administration costs for MSPs and independent retailers.
- 6.46 MSPs would need to insist that independent retailers automated cashback payments as a condition of contract.

#### Issues for independent retailers: option C iv

- 6.47 As mentioned above the independent retailer would need to be able to identify consumers still in contract which requires additional information from the MSP. The process may be complicated as in some cases MSPs and independent retailers do not have direct contact but work via a distributor. The information would need to be provided in a timely manner to ensure cashback payments were stopped promptly.
- 6.48 A guaranteed redemption rate of 100% would force independent retailers to operate sustainable cashback models (i.e. not offering large cashback amounts which rely on erecting artificial barriers to consumers being able to successfully claim cashback in order to remain viable). This would also reduce the probability that an independent retailer ceases to trade due to cashback claims being larger than expected.

#### Issues for competition: option C iv

- 6.49 None.

#### **v) Introducing an approved independent retailer scheme**

- 6.50 Under this option the GC would require the MSPs to operate an approved independent retailer scheme. This could be done in a number of ways including an approved industry body. Approved independent retailers would need to fulfil a number of conditions to prove they were fit for approval; which could include some of the other options outlined for example, automation of cashback payments and passing due diligence and other checks conducted by MSPs (designed to reduce the probability of insolvency).

#### Issues for consumers: option C v

- 6.51 It would need to be clear to consumers which independent retailers were operating under the approved scheme and the potential consequences of taking a contract with a non approved independent retailer (i.e. consumer education required). There would still be scope for non-approved independent retailers to deceive consumers.

### Issues for MSPs: option C v

- 6.52 Setting up the scheme and monitoring compliance would be a significant resource burden.

### Issues for independent retailers: option C v

- 6.53 There would be some cost to independent retailers to prove compliance with the conditions – for independent retailers already operating a reasonable business model the cost should be small.

### Issues for competition: option C v

- 6.54 There are unlikely to be significant issues for competition. In theory an approved independent retailer scheme could result in selective distribution in the independent retailer network which could reduce intra-brand competition (i.e. fewer independent retailers for each brand). However, whether this is likely depends on how much the specific scheme would act as a barrier to entry for legitimate independent retailers.

## **vi) Allowing cashback only at the start of a deal**

- 6.55 Under this option the GC would require all cashbacks to be paid upfront at the start of the contract. Realistically the cashback would need to be paid at the end of the customer statutory 'cooling off' period which is the time during which they can cancel the contract with no penalties. Otherwise customers could claim the cashback and then exercise their right to terminate the contract – and the independent retailer may find it difficult to recover the cashback paid.
- 6.56 Such upfront cashbacks already exist in the market. They tend to be lower value than cashbacks staged throughout the contract.

### Issues for consumers: option C vi

- 6.57 A significant advantage of this approach is the consumer is not adversely impacted if the independent retailer ceases trading after the contract is taken – as the independent retailer does not have any ongoing financial obligation to the consumer.
- 6.58 Market research conducted by us suggests that 41% of consumers would prefer upfront cashback versus 31% who prefer several staggered payments (29% had no preference). Some independent retailers have suggested that consumer defaults increase when incentives are offered up front (i.e. consumers take the contract to receive the incentive without the intention of honouring contractual obligations).

### Issues for MSPs: option C vi

- 6.59 MSPs would need to ensure that independent retailers offering cashback provided it at the start of the deal which would clearly require some monitoring and enforcement on the part of the MSPs.

### Issues for independent retailers: option C vi

- 6.60 In some cases the MSP has revenue sharing arrangements with the independent retailer or retains a proportion of the commission which is paid later in the contract providing the consumer pays their bills. It might be argued that the cashback deals where payments are spread over time encourage consumers to stay with their

network for the whole contract which enables the independent retailer to earn the full commission. If consumers cancelled the contract before the end of the term independent retailers would need a mechanism to claw back the cashback paid up front – this might be an onerous process for independent retailers.

- 6.61 Independent retailers will face a problem if upfront cashback deals result in a large number of consumers defaulting on contracts – as cashback will have been paid but commissions on defaulted consumers can be clawed back by the MSP from the independent retailer, or later commission instalments will not be paid. To compensate for the higher level of defaults the independent retailer may reduce the amount of cashback paid meaning that compliant consumers effectively subsidise defaulting consumers. However, if independent retailers react by reducing upfront cashback amounts this may hamper their ability to compete with direct sales channels.
- 6.62 Offering cashback upfront means the cash is likely to be paid before the full commission is received. The independent retailer would also make one large payment rather than smaller payments spread through time. This may have funding implications for independent retailers and independent retailers may need to manage this carefully to avoid liquidity problems.

#### Issues for competition: option C vi

- 6.63 None.

#### **vii) Requiring MSPs to pay cashback directly to the consumer (with reductions in commission payments to independent retailers)**

- 6.64 Under this option the MSP would pay the cashback directly to the consumer as a deduction on the monthly bill. The MSP would make a corresponding deduction from the independent retailer commission.
- 6.65 This option avoids the need for a separate contract between the independent retailer and the consumer for the cashback component of the deal<sup>38</sup>. A single contract between the consumer and the MSP would incorporate both the airtime contract and cashback elements. This is illustrated in the following example:

Contract length: 12 months  
 Monthly contract fee (as charged by MSP): £30 (total annual charge £360)  
 Independent retailer commission: £100 (assume paid up front)  
 Independent retailer cashback to consumer: £5 a month (total cashback over contract £60)

Under this option the MSPs would be required to net off the line rental and cashback, and make an appropriate deduction of the total independent retailer commission to account for the cashback paid. So in the above example:

Net monthly contract cost to consumer: £30-£5 = £25  
 Net total commission to independent retailer: £100 - £60 = £40

<sup>38</sup> Typically when the independent retailer offers cashback it is via a separate contract with the customer. So the customer has a contract with the MNO for airtime and a contract with the independent retailer for cashback.

- 6.66 A number of permutations for the 'cashback' agreement are possible for example, pay all the cashback at the start of the contract, provide initial months free in lieu of cashback.

#### Issues for consumers: option C vii

- 6.67 The cashback payment is provided automatically as a deduction from the contract fees which is both reliable and convenient for the consumer. Significantly, problems relating to independent retailer insolvency during the contract would be eliminated, as the MSP is paying the cashback.

#### Issues for MSPs: option C vii

- 6.68 This approach places an extra burden on the MSP as they would have to deal with the cashback directly. Potentially they would have to calculate and process the commission/contract fee on each contract separately. Significant system changes for the MSPs' billing systems would be necessary requiring both investment and time to implement. This option is likely to be significantly more costly compared to the counterfactual of continuing with the existing Code. The five MSPs who signed the Code indicated that this option would be costly and have a long lead time.
- 6.69 In the extreme as a response to the administrative burden the MSPs may simply refuse to deal with independent retailers offering cashback - so the outcome could be equivalent to banning cashback (see below). An alternative would be to allow independent retailers to offer a limited number of cashback offers – but this might stifle competition between MSPs and independent retailers.

#### Issues for independent retailers: option C vii

- 6.70 The independent retailer would be forced to consider the consequences of cashback more carefully – as it would be deducted directly from their commission. There is a possibility that independent retailers will try and evade these rules by offering incentives other than cash e.g. MP3 players which may be subject to the same problems if provided during the course of the contract (e.g. consumer having to comply with onerous conditions to claim the incentive).

#### Issues for competition: option C vii

- 6.71 The MSP would have information on the cashback discounts offered by independent retailers to consumers. Potentially they could use this information to compete more effectively through their own retail arm (e.g. undercut the independent retailer and avoid commission payments). It is possible that MSPs could 'force' the independent retailers to only allow for certain types or amounts of discount, thereby taking away some of the pricing freedom of the independent retailers (e.g. because it may be unduly costly for MSP systems to deal with more than a limited number of discount packages).

### **viii) Banning cashback**

- 6.72 Under this option the GC would require MSPs not to deal with any independent retailer offering cashback. However, an undesirable consequence is that acceptable cashback deals would also be eliminated.

### Issues for consumers: option C viii

- 6.73 This solution would harm any consumers who benefit from the effective discounts which result from cashback deals.

### Issues for MSPs: option C viii

- 6.74 MSPs would be required to ensure that independent retailers did not offer cashback which would involve costly monitoring and enforcement effort which they do not currently undertake.

### Issues for independent retailers: option C viii

- 6.75 Banning cashback reduces the number of variables independent retailers can compete on which may erode their competitive position relative to MSPs' direct sales. Independent retailers may respond by offering non-cash incentives (e.g. MP3 players) which may be subject to the same problems if provided during the course of the contract (e.g. consumer having to comply with onerous conditions to claim the incentive). Banning all inducements would severely restrict independent retailers which seems disproportionate.

### Issues for competition: option C viii

- 6.76 As outlined above, banning cashback reduces the number of variables that an independent retailer can compete over. This would stifle one means by which independent retailers have innovated on price competition. This option may give an advantage to MSPs who have a wider range of variables to compete over (e.g. offer extra minutes/discounts on contract fees).
- 6.77 It is possible that independent retailers may cease to be a significant outlet for mobile handset/contract sales. Consumers could lose out as a result of reduced competition (e.g. they have fewer deals to choose from and/or pay more over the lifetime of a contract). Alternatively, independent retailers may innovate and compete along different lines (e.g. pre-sales advice, better handsets, sales of peripherals).

## **Stakeholders' responses**

- 6.78 Below we give an overview of the comments received in respect of our cashback proposals.

### **Other options to tackle issues with onerous/misleading cashback terms and conditions**

#### Stakeholder comments

- 6.79 We received a number of suggestions in respect of other options to tackle cashback issues (question 3 in the 2008 Consultation).
- 6.80 TS offices made the following comments:
- Coventry TSS suggested that Ofcom should issue guidance to retailers and/or MSPs to draft simpler, clearer terms and conditions.
  - It also stated that information regarding key contract issues should not only be provided in writing, but also verbally.

- East of England TSS Association Limited suggested another option, requiring the retailer to disclose the amount of commission at the point of sale to customers, similar to disclosure of commission on financial products.
  - A number of TSS offices point out that there is a disproportionate share of ethnic groups for whom English is a second language, pensioners and people on benefits, who take out cashback offers. They suggest more protection, such as information regarding incentives being made available in other languages, should be considered for those groups.
  - Leicester City TSS state that Ofcom should address the circumstances under which MSPs claw back commission, where MSPs allegedly not only clawback commission in instances of fraud, but also when customers make late payments or miss a payment.
  - Newham TSS suggested that if the cashback promised to a customer was not forthcoming, the customer should be able to withdraw from their airtime contract with the MSP, since a fundamental clause of the contract the customer signed up to has changed.
- 6.81 The OFT agreed with the options identified to tackle cashback issues. They agreed that in the circumstances set out by Ofcom, a GC would appear the most appropriate option. They did however point out that, similar to general mis-selling, in certain circumstances existing consumer protection legislation, enforced under the Enterprise Act, could provide Ofcom with a tool for tackling problem traders.
- 6.82 SSE believed MSPs will have a strong incentive to ensure that terms and conditions for sales incentives used by their agents are reasonable and clear as soon as their primary obligation not to mis-sell takes effect. They therefore consider the provision under GC 23.9 should be subject to a sunset clause.
- 6.83 Some MSPs made the following suggestions regarding other options to tackle cashback issues, generally similar to their general comments regarding the proposed GC:
- 3 proposed that, similar to their comments made in respect of general mis-selling, Ofcom should have identified and provided detailed evaluation of the use of existing laws and regulation to tackle unduly restrictive cashback terms and conditions.
  - Orange reiterated their option proposed to tackle mis-selling, involving Ofcom engaging regularly and meaningfully with all the relevant parties in order to facilitate discussions between them and find more imaginative solutions which would specifically target those market players who were causing harm.

### Ofcom's response

- 6.84 In respect of the comments made by Coventry TSS, we do not intend to issue guidance to MSPs and/or retailers to draft clearer terms and conditions, since this is an area which is very close to the commercial propositions of MSPs and retailers and we are concerned that guidance in this area could affect competition. In addition, we do not consider we have the detailed knowledge required to put forward such guidance. As set out in the proposed GC 23.5, we do set out which information should be made available to the customer, and that this information should be

provided in a clear, comprehensible and accurate manner. We believe this should be sufficient for a customer to understand the contract they are entering into.

- 6.85 Ofcom requires that where this information is provided verbally during a sales call, it should be sent to the customer in a durable medium. In respect of shop sales, we expect sales staff to provide information regarding the key features (as set out in GC23.5) of a mobile phone contract to the customer but we believe it will be sufficient for a retailer to provide the customer with the information on paper only.
- 6.86 In respect of the suggestion to disclose the retailer's commission in the contract, we have two concerns in this respect. The 2008 Consultation, in sections 3.24 – 3.28 explains the structure of commissions. As set out, not all commissions are paid upfront to retailers, commissions can be spread out over the lifetime of a customer contract, and can contain quality bonuses, revenue sharing elements or even preferential commercial terms in case retailers meet certain key performance indicators. If the total commission is not paid upfront, it will not be possible to determine beforehand what the right amount is. In addition, we are not sure that this information will be meaningful without any additional explanation. We believe it would take a significant educational effort to advise customers what the relationship between commissions and cashback is.
- 6.87 Like many TSS offices, we also noticed through our market research (see Annex 9.20 in the 2008 Consultation) and information from CAB that the subgroups with potentially higher cashback problems appear to be ethnic minority groups and regions of the UK with higher than average ethnic minority populations. We recognise that consumers who have a poor understanding of English might benefit from additional protection (e.g. terms and conditions provided in their own language, in-store translators). However, we do not think it would be proportionate to mandate that MSPs and their retailers provide such additional information in such a manner, because of the number of languages the terms and conditions would have to be translated into and the costs associated with this. Nevertheless, we would encourage retailers to provide information in alternative languages where local circumstances make this appropriate – indeed, doing so may increase the addressable market for retailers in such areas. In terms of the other groups identified by TSS, such as pensioners and people on benefits, we believe that providing all groups with the relevant information (as set out in the GC) in a clear, comprehensible and accurate manner should be sufficient to enable them to make an informed decision.
- 6.88 In respect of issues regarding clawbacks, Ofcom has started a project called the Mobile Sector Assessment ('MSA')<sup>39</sup>. This project assesses Ofcom's overall approach to the regulation of the mobile sector in the medium term, including consideration of possible approaches to the future regulation of the sector and the definition of principles to inform Ofcom's work. As part of its Competition Workstream, the MSA will look into clawback of commissions by the MSPs.
- 6.89 Regarding the suggestion that a customer should be able to withdraw from their airtime contract with the MSP if the cashback offered by the retailer does not materialise, in the case of cashback, the customer typically enters into two contracts, one with the MSP regarding the airtime component of the contract and one with the retailer regarding the cashback component of the contract.

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<sup>39</sup> More information about this project can be found at <http://www.ofcom.org.uk/consult/condocs/msa08/>.

- 6.90 In certain circumstances, where based on the facts of a sales situation the customer is made to believe that they enter into one contract only and that the retailer acts as an agent for the MSP, customers may be able to receive (and have, indeed received in the past) redress in the small claims courts or via Alternative Dispute Resolution, or were able to cancel their contracts with their MSP.
- 6.91 GC 23.9 sets out that the MSP should use best endeavours to ensure that the customer is provided with information regarding the sales incentive, including the legal entity offering the sales incentive, a description of the sales incentive and its terms and conditions. This way, it should be clear to the customer that they enter into two separate contracts. In addition, we believe that the prohibition of terms and conditions being unduly restrictive should prevent customers from being unable to redeem. We consider that the combined effect of these two measures will be sufficient in tackling the problem of customers being unable to redeem their cashback, since unduly restrictive conditions are prohibited and the customer should have the relevant details of their sales incentive when entering into a contract, and therefore be able to make an informed decision. In addition, we believe this is a better solution than allowing customer to cancel their airtime contracts, since it provides customers with all relevant information at the point of sale, based on which they can make an informed decision, instead of remedying a situation where the customer has been unable to make such a decision.
- 6.92 The OFT suggest that in addition to the proposed GC, existing consumer protection legislation could provide Ofcom with a tool for tackling problems. Ofcom agrees that there are cases where it would be appropriate to consider using existing consumer protection legislation such as the Enterprise Act 2002. When considering a problem, Ofcom will always look at the full range of powers available to it and use the most appropriate tool in any given set of circumstances to tackle the problem most effectively and efficiently. Examples of where we have taken action using existing legislation can be seen on our Consumer and Competition Enforcement Bulletin.<sup>40</sup>
- 6.93 SSE suggest making GC 23.9 subject to a sunset clause, because MSPs will have a strong incentive to ensure that terms and conditions used by their retailers reasonable and clear, as soon as their primary obligation not to mis-sell takes effect. We believe it is too early at this stage to decide to introduce sunset clauses for certain provisions. Once we have introduced the GC, we will review its effectiveness on a regular basis, to ensure that all provisions are still fit for purpose.

## **Ofcom's preferred option to tackle cashback issues**

### Stakeholder comments

- 6.94 Most TSS offices agreed with the introduction of a GC, but considered Ofcom's preferred option would not lead to an improvement and preferred the more extreme options set out under the proposed GC, such as requiring MSPs to guarantee or underwrite cashback promotions offered by their retailers.
- 6.95 The London TSS Authorities group stated that a GC does not address protection for consumers who are unable to redeem their cashback and that therefore the proposed GC would not be effective in tackling cashback issues. In addition they believed more robust measures need to be introduced.

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<sup>40</sup> [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_985/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_985/).

- 6.96 LACORS considered that Ofcom's preferred solution would add little and would not be enough to prevent detriment. They have expressed a strong preference for requiring MSPs to pay cashback to the customer directly.
- 6.97 MSPs reiterated most of their more general comments made in section 5 above in respect of cashback issues, generally considered the Code should have been given longer to take effect, were against formal regulation, and suggested existing law should be used instead to go after companies in breach.
- 6.98 BT agreed with Ofcom's preferred option, and expected Ofcom to take into account the work it is undertaking in relation to migrations and mis-selling in the fixed market, and aim to achieve consistency between the two sets of proposals.
- 6.99 CAB supported the introduction of a GC, however, they preferred the option where MSPs pay cashback directly to the customer (option c vii set out above).

### Ofcom's response

- 6.100 A number of stakeholders agreed with our preferred option to introduce a GC, but preferred MSPs underwriting cashback offers, or MSPs paying the cashback directly. We still consider, as set out in the 2008 Consultation and above, when discussing the impact of the options on consumers, MSPs, retailers and competition, that these options would involve a higher level of risk for MSPs and could be very costly to implement. This could lead to MSPs refusing to deal with retailers offering cashback, which would decrease the number of outlets through which mobile phone services are sold and would negatively impact on consumer choice and competition.
- 6.101 In respect of the comment that a GC does not offer protection for consumers who are unable to redeem their cashback, we believe the proposed GC will be effective to deal with this issue based on the arguments set out in section 5.20.
- 6.102 Ofcom's response in respect of the preferred options of the MSPs (which are similar to comments they make under general mis-selling) are set out in section 5 above.

### **Conclusions**

- 6.103 Our preferred approach remains options C i) and C ii): to use a new GC to prevent unduly restrictive cashback terms and conditions in conjunction with more information at the point of sale. The reasons are summarised below:
- Cashback, as a sales incentive, is a legitimate form of price competition when offered with reasonable terms and conditions. However, we consider that problems arising due to onerous or misleading cashback terms and conditions can be distressing to those consumers involved and this can work against the interests of consumers and undermine consumer confidence in the mobile market.
  - Although the Code has reduced cashback harm we estimate that the ongoing detriment caused by unclaimed cashback is still around £8 million per year.
  - We consider that the balance of evidence indicates the current consumer safeguards are not sufficient on their own to address problems arising from overly onerous or misleading cashback terms and conditions. In addition they do not protect small business customers.

- We consider that the provisions in the proposed GC regarding terms and conditions of sales incentives and the provision of information to the customer would ensure that consumers (including small business customers) are better protected.
- We will be able to investigate and enforce the GC. If problems in respect of sales incentives should continue or arise in another form in the future, action can be taken promptly by us under a GC, including requiring the contravening party to remedy the consequences of any breach.
- Options which make it harder to offer cashback or ban it outright may make it harder for independent retailers to compete with MSPs' direct offers (as MSPs can offer a wider range of tariffs which are not always available to independent retailers).
- Any option putting a significant additional burden on the MSP (compared to the Code) might make the provider decide to stop selling its services through independent retailers, or only use a small sub-set of independent retailers instead. This could reduce competition in the mobile retail market.
- Our analysis suggests that the introduction of the proposed GC is likely to result in net benefits (see sections 8.50-8.66 below and Annex 2 for details)<sup>41</sup>.

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<sup>41</sup> For practical reasons, the quantified cost benefit assessment considers the total costs of implementing the GC which covers all three issues - general mis-selling, cashback and retailer insolvency. In the base case the incremental benefits from reducing cashback harm are smaller than the total costs, but the costs incremental to cashback are anticipated to be significantly lower than the total costs.

## Section 7

# Options to tackle retailer insolvency

7.1 In this section we provide an overview of the options that we set out in the 2008 consultation to address retailer insolvency, including our preferred option. We summarise and update the qualitative assessment of the options and then discuss stakeholders' comments and set out our responses to their comments. We then set out our conclusions in respect of retailer insolvency.

### Options to deal with independent retailer insolvency

- 7.2 In this instance we are dealing with a situation where an independent retailer is no longer able to make cashback payments because they have ceased trading. This includes independent retailers with acceptable cashback deals who have run into financial difficulties and independent retailers who offered cashback deals on an unsustainable business model.
- 7.3 These options do not prevent independent retailers from engaging in 'bad' cashback schemes directly but they may alter the behaviour of MSPs and independent retailers indirectly with respect to the deals they offer.
- 7.4 Businesses cease to trade across all industries for many reasons leaving creditors who are owed money. There is a system for dealing with firms that fail with creditors usually going through legal channels to recover monies owed. By intervening in this process where independent mobile retailers fail we are suggesting that this is a special market which requires extra protection. This is not unknown (e.g. in the UK an insurance scheme is provided for bank deposits in the event of a bank failure) but is an unusual step and such intrusive intervention which would require strong justification (e.g. unacceptable level of financial harm, strong information asymmetry). In addition, it introduces the issue of moral hazard<sup>42</sup> as customers may take 'high risk' contracts as they know any failure will be bailed out.
- 7.5 We have identified the following options to deal with independent retailer insolvency:
- a) Do nothing more i.e. MSPs carry out due diligence as stipulated under the Code;
  - b) Introduce GC requiring MSP to carry out due diligence;
  - c) MSPs allow consumers to cancel contract or change price plan;
  - d) Independent retailers take insurance;
  - e) Independent retailers provide guarantees; and
  - f) MSPs guarantee cashback payments.
- 7.6 As noted above, some of the options to deal with onerous terms and conditions for cashback eliminate the consumer problems related to independent retailer insolvency

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<sup>42</sup> Moral hazard arises because the individual does not bear the full consequences of their actions, and therefore has a tendency to act less carefully than they otherwise would, leaving another party to bear some responsibility for the consequences of those actions.

as the independent retailer does not have an ongoing obligation to the consumer (i.e. options C vi to C viii discussed in section 6 above). Therefore if we decided to implement options C vi to C viii above no further intervention would be needed to tackle insolvency.

### **A) Do nothing i.e. maintain the Code which requires the MSP to carry out due diligence checks on independent retailers**

7.7 Under this option, the MSP has to carry out due diligence on all organisations with whom they contract and appoint to promote the operator's services to ensure the independent retailer is credible in line with the requirements in the Code.

#### Advantages

7.8 This option would entail the least intervention by us. If operated and policed effectively by the providers, it should reduce the instances of independent retailer insolvency with the consequent consumer harm that entails. Some of the more intrusive options listed below effectively 'bail out' the consumer in the event of retailer insolvency which introduces the issue of moral hazard, as consumers may take high risk contracts knowing that any failure will be bailed out.

#### Disadvantages

7.9 If the providers' did not adequately carry out due diligence, we would not have direct enforcement powers to address the problem.

7.10 This option aims to reduce the probability of independent retailer insolvency but does not provide any relief for consumers in the event that an independent retailer ceases to trade.

### **B) Introduce a GC requiring the MSP to carry out due diligence checks on independent retailers<sup>43</sup>**

7.11 Under this option, the GC would require the MSP to conduct certain due diligence checks to ensure the independent retailer is credible. This would include the provisions in the Code e.g. requiring the MSP to carry out credit reference checks and check that the company directors have not previously filed for bankruptcy.

7.12 Under a GC, we could monitor and enforce compliance and ensure a framework of due diligence checks was in place that should reduce the instances of independent retailer insolvency and the consequent consumer harm.

#### Advantages

7.13 This option is not overly intrusive for the MSP or independent retailer and essentially formalises the due diligence processes which we would expect to be in place under the Code. The incremental cost should be low as MSPs should already have the processes in place under the Code.

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<sup>43</sup> Where the MSP does not have a direct contractual relationship with the independent retailer the MSP must use reasonable endeavours to ensure that the MSP, or someone acting on their behalf, completes the due diligence checks.

### Disadvantages

- 7.14 This option aims to reduce the probability of independent retailer insolvency but does not provide any relief for consumers in the event that an independent retailer ceases to trade. The success of this option depends on MSPs (or their delegates) making thorough checks which might incur some cost .

### **C) MSPs allow consumers to terminate contract/move to a lower tariff level if requested**

- 7.15 If an independent retailer becomes insolvent the consumer still has to pay contract fees to the MSP even though the cashback payment stops. At the point of purchase the consumer might have viewed the contract and cashback as part of the same deal (and budgeted on that basis). Without the cashback payments the consumer may struggle to afford the contract fees or end up with a contract which is sub-optimal after purchase (i.e. they would have been better off with a different contract if they had known at the time of purchase that the cashback would not be paid in full). One solution to avoid financial distress is to allow the consumer to terminate the contract without penalty if desired. Another alternative would be to allow migration to a lower tariff level. The MSP would need to work with the consumer to find the best solution.

### Advantages

- 7.16 Compared with options D-F this option is not as intrusive for the MSP or independent retailer. This approach allows flexibility for the MSP and consumer to work towards a mutually acceptable solution.

### Disadvantages

- 7.17 Allowing consumers to terminate contracts early may have significant financial implications for the MSP which will be exacerbated if the MSP has already paid independent retailer commission on the contract.
- 7.18 It is possible that the consumer might find the solutions offered significantly inferior to the original contract plus the cashback deal that was expected.

### **D) Require independent retailer to take insurance**

- 7.19 Independent retailers would be required to take out insurance against failure to make cashback payments if they cease trading. MSPs would require independent retailers to take insurance as a condition of their contract. This option is dependent on the availability of an appropriate insurance product.

### Advantages

- 7.20 Consumers would receive cashback payments as originally anticipated so financial harm would be reduced.
- 7.21 Forcing the independent retailer to bear the cost of the risk of insolvency via an insurance premium is intuitively more logical than transferring the risk and cost to the MSP (as in option F) below).
- 7.22 It is possible that insurers might introduce premiums scaled to the risk of business failure which would also encourage good business practices in the independent

retailer. For example, evidence of a good business model (such as honouring all prior cashback claims) could be provided as a condition of a lower premium.

### Disadvantages

- 7.23 This option would be costly for independent retailers so may simply discourage cashback deals. This could have implications for competition as reducing cashback would make it harder for independent retailers to compete with MSP direct sales (MSPs can offer line rental discounts/free minutes promotions which are not available to independent retailers). Independent retailers may evade this regulation by offering other incentive schemes e.g. MP3 players, which under the option above would not be subject to an insurance requirement like cashback.
- 7.24 Smaller independent retailers may find it harder to afford the insurance premiums so be at a disadvantage under this option.

### **E) Independent retailers must obtain a guarantee**

- 7.25 The independent retailer would be required to provide a guarantee that a minimum amount of funds/assets would be ring-fenced to pay cashback obligations in the event of insolvency. The guarantee could be provided by the independent retailer itself (e.g. against property/assets owned by the business owner), by a Parent Company or a bank. The MSP would be required to ensure the guarantee was in place and for a sufficient minimum amount given the scale of the independent retailer cashback business.

### Advantages

- 7.26 Funds would be set aside for payment of cashback in the event of insolvency so consumer financial harm would be minimised. The guarantee would have to be provided by the independent retailer which is intuitively more logical than forcing the MSP to bear the cashback obligations in the event of independent retailer insolvency.

### Disadvantages

- 7.27 Small independent retailers may find it difficult to provide a guarantee (e.g. if their assets were small or access to capital was limited). It may be difficult to decide how much the minimum guarantee should be for – as it could be difficult to forecast cashback obligations in the future. Nevertheless, similar requirements are not uncommon in banking and the minimum could be reviewed at periodic intervals.
- 7.28 The MSP would incur some costs checking that guarantees were adequate and valid.

### **F) MSP to guarantee payments**

- 7.29 Under this option MSPs would take over the cashback payments of the independent retailer in the event of insolvency<sup>44</sup>.

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<sup>44</sup> This option assumes the probability of MSP insolvency is lower than independent retailers.

### Advantages

- 7.30 This would encourage the MSP to ensure that the independent retailers were financially viable and take greater responsibility for the independent retailer network. Consumer harm in the event of independent retailer insolvency would be eliminated.
- 7.31 This would encourage the MSP to ensure that the independent retailers were financially viable and take greater responsibility for the independent retailer network. Consumer harm in the event of independent retailer insolvency would be eliminated.

### Disadvantages

- 7.32 This approach would place a considerable burden and risk on MSPs and may simply encourage them to only to sell through direct retail outlets. In effect this may foreclose independent retailers which could reduce intra brand competition.
- 7.33 Forcing MSPs to 'bail out' independent retailer cashback obligations in the event of insolvency would not encourage prudent risk management by independent retailers, i.e. independent retailers may continue to pursue a high risk strategy since the incentives and expected costs of doing so would be unchanged from now.
- 7.34 This option would be very costly for MSPs in the event of independent retailer failure.

### **Stakeholders' responses**

- 7.35 Below we give an overview of the comments received in respect of our retailer insolvency proposals.

### **Other options to tackle issues regarding retailer insolvency**

- 7.36 Stakeholders made no additional suggestions in respect of options to tackle retailer insolvency issues (question 5 in the 2008 Consultation).

### **Ofcom's preferred option to tackle retailer insolvency**

- 7.37 Coventry TSS considered that Ofcom's preferred option would not resolve a situation where a company will set up based on an unsustainable cashback business model.
- 7.38 East of England TSS Association Limited ('EETSA'), LACORS, and Leicester City TSS preferred option F, where the MNO has to guarantee cashback, stating this would be the best way to promote fair competition in the market. The potential liability on the MSPs would focus their efforts and diligence more effectively.
- 7.39 In sections 7.32-7.34 above we set out the disadvantages of this option and we consider these disadvantages to outweigh the advantages, especially since we have not seen any retailer insolvencies due to cashback over the past months.
- 7.40 CAB's preferred option was cashback option C7, set out in section 6 above. This arrangement would mean that even following insolvencies among independent retailers, customers would not lose out. MSPs would also be more aware of the types of deals entered into by independent retailers and would have a strong interest in ensuring these offers were properly structured and supportable.

- 7.41 We believe that because of the reasons set out in section 6.67 – 6.70 and because of the sharp decline in the number of cashback complaints it would be disproportionate to introduce such an intrusive option.
- 7.42 The OFT agreed with the introduction of a GC.
- 7.43 [X]<sup>45</sup> welcomed the proposals and recommended that the processes put in place by MSPs are proportionate compared to the retailer they are checking.
- 7.44 Vodafone's comment regarding our proposed due diligence requirement and its alleged tensions with EC and UK competition law is addressed by Ofcom in section 5, under Legal Comments.
- 7.45 The MSPs made a number of detailed comments on the proposed GC 23.8. These comments and Ofcom's response are included in the tables in Annex 3 below. Ofcom's response in respect of the preferred options of the MSPs (which are similar to comments they make under general mis-selling) are set out in section 6.

## Conclusions

- 7.46 Our preferred option remains option B): to require MSPs, through the GC, to carry out due diligence when using independent retailers. The reasons for this are as follows:
- Some checks are required to ensure new retailers entering the market are financially sound and are not 'rogue traders' who have no intention of honouring customer agreements. Formalising this into a GC means enforcement action can be taken in the event that MSPs fail to meet the requirements in the Code.
  - The problem of independent retailer insolvency as a result of cashback should naturally diminish because of the new GC rules, set out in section 6, requiring MSPs to ensure independent retailers do not impose overly onerous or restrictive terms and conditions on consumers with regards to their ability to claim the cashback offer. This means independent retailers will not be able to rely on artificially low redemption rates when offering cashback, which can lead to financial problems if redemption rates turn out to be higher than expected. Given that we expect problems with insolvency to diminish, using the more intrusive options listed above seems disproportionate.
  - Most MSPs already undertake checks and this option formalises the main requirements of the Code and ensures consistency, so the option should not create a significant additional burden.
  - Any option putting a significant additional burden on the MSP (compared to the Code) might encourage the MSP to stop selling its services through independent retailers, or only use a small sub-set of independent retailers instead. This could reduce competition in the mobile retail market.
  - Our analysis suggests that the introduction of the proposed GC is likely to result in net benefits (see sections 8.50-8.66 below and Annex 2 for details)<sup>46</sup>.

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<sup>45</sup> X means that the identity of the respondent has been withheld for confidentiality reasons.

<sup>46</sup> We have not separately quantified the incremental benefits from tackling retailer insolvency i.e. including due diligence requirements in the GC. We believe the incremental costs arising from

## Section 8

# Ofcom's decision

8.1 In sections 3 and 4 we set out the levels of complaints about mobile mis-selling and cashback seen by Ofcom and other bodies and assessed the implementation and effectiveness of the Code. In sections 5, 6 and 7 we set out the consultation options, including a qualitative impact assessment on different groups of stakeholders, summarised and commented on stakeholders' responses and set out our preferred option in light of the comments made. In this section we draw together our conclusions from the analysis in those previous sections and quantify the costs and benefits of our preferred option.

### Introduction of a General Condition

8.2 Having considered all responses to our consultation and all available evidence, we consider that it is appropriate to introduce a new GC with provisions on general mis-selling, sales incentives and due diligence.

8.3 The new General Condition requires MSPs to comply with a set of rules and prohibitions and, in respect of a number of those provisions, to use reasonable endeavours to ensure that any third party through whom they sell and market their services also complies with certain rules and prohibitions.

8.4 In reaching this decision Ofcom has taken account, amongst other things, of:

- **The level of complaints.** Complaints to Ofcom relating to general mis-selling have not decreased significantly from the levels just before the Code was introduced. In the six months prior to the introduction of the Code general mis-selling complaints averaged 228 per month; between August 2008 and January 2009 complaints averaged 212 per month. They have however fallen from a peak of over 300 per month reached during the 2008 Consultation.

In addition, Consumer Direct report that mobile phone service agreements are the second most complained about item in the UK (behind used car sales). Of all mobile phone related complaints in 2008 (51,400), we estimate that around 10,600 complaints may include mobile mis-selling issues (up from 9,000 in 2007).

- **The level of consumer harm.** As discussed in sections 4.31-4.56, we conservatively estimate the current ongoing value of financial harm to consumers:
  - from general mis-selling at £21million a year;
  - from cashback mis-selling at £8million a year; and
  - from the cost of time spent dealing with mis-selling and cashback problems £3million per year.
- **The additional provisions in the GC.** The GC includes a general prohibition on mis-selling and requires specific information about the service being purchased to

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including due diligence requirements in the GC are likely to be low because the GC only includes requirements which are already in the Code (in fact the GC contains fewer provisions than the Code).

be provided to the customer. These provisions are not included in the Code and are intended to provide additional protection for consumers and reduce the instances of mis-selling.

- **The additional enforcement powers that the GC will provide.** As set out in section 5.20, the range of remedies available to Ofcom under a GC is different from those currently available under the EA. They include the ability to issue a fine or require a company to remedy the consequences of contravention, for example by providing compensation. This should give Ofcom complementary powers needed to effectively address ongoing harm and act as a deterrent to mis-selling in future.
- **The costs of implementing the GC relative to the benefits.** Our analysis suggests that the introduction of the proposed GC is likely to result in net benefits, as is set out in sections 8.50 – 8.66 below.

### **General Condition 23 on Sales and Marketing of Mobile Telephony Services**

8.5 The notification and the details of the new GC 23 can be found in Annex 6. Guidelines which are intended to assist the MSPs in their compliance are provided in Annex 7. The guidelines set out examples and guidance on the approach Ofcom is likely to take to enforce GC 23 and are produced by Ofcom to help MSPs and customers to understand their rights and obligations under GC 23. They are intended to assist MSPs in achieving compliance by seeking to provide clarity on the meaning of terms and concepts used in GC 23. However, they do not form a part of the GC itself and obligations which will apply to a MSP will be determined solely according to GC 23.

8.6 A high level overview of the provisions of the GC 23 is set out below:

- The MSP is required to make the GC available to its customers (GC23.3) and should ensure their independent retailers are aware of the GC (GC23.4). This is intended to allow that the standards in respect of expected sales and marketing behaviour are known by all parties involved in selling and marketing mobile services, including customers.
- The MSP should not engage in mis-selling behaviour (GC23.2) and should ensure that there are provisions in place which require the retailer not to engage in such behaviour (GC23.4 (b) (i)-(iii)). This prohibition is intended to prevent unacceptable sales and marketing behaviour and resulting harm related to mis-selling.
- The MSP must monitor retailers' compliance with the GC (GC 23.4 (c)) and must sanction non-compliance by retailers appropriately (GC23.4 (b)). These provisions shall ensure that mis-selling is identified and addressed by MSPs.
- The MSP must use reasonable endeavours to ensure that the customer intends and is authorised to enter into a contract and that the customer is provided with details about the company, the service, and the terms and conditions applicable to the deal (GC 23.5). In the event that a customer enters into a contract via telesales, the retailer should send the relevant information in paper or another durable medium to the customer in good time after the contract has been entered into. This should ensure that customers receive confirmation of the contract, setting out the relevant information with sufficient time to verify the details and, if necessary, exercise their cancellation right under distance selling provisions. This

is intended to ensure that the customer has all relevant information based on which they can make an informed decision whether or not to enter into a contract. It also addresses the risk of 'slamming'.

- The MSP itself must retain records regarding the sale for a time period of not less than six months (GC 23.6) or where there is a sales incentive for not less than 90 days after the date by which the sales incentive has been fully redeemed (but not less than six months). This should allow customers who have problems redeeming their cashback sufficient time to resolve their complaint and request details of the contract entered into, when necessary. The MSP must use reasonable endeavours to ensure that the retailer also retains such records for the same period of time (GC 23.4 (b) (iv)). This allows all parties involved (including Ofcom) to quickly gather relevant evidence if there are allegations that mis-selling occurred or that a 'bad' cashback deal was offered. The requirement should, therefore, ensure that adequate information is available in the event that Ofcom takes enforcement action for a breach of this GC. A period of six months is consistent with that applied to the fixed-line sector.
- The MSP must use reasonable endeavours to ensure that processes are in place which assure that retailers are appropriately trained for the purpose of selling mobile services (GC23.7). This should reduce instances where the customer misunderstands the contract based due to inaccurate or false information being given.
- The MSP must use reasonable endeavours to ensure that, where an independent retailer offers a sales incentive, from which the Customer does not benefit immediately, the customer is provided with details about the company offering the incentive and relevant information regarding the sales incentive itself (GC 23.10 b). This should clarify the process for the customer and reduce confusion about who is providing which part of the deal, when to claim and when the incentive will be received.
- The MSP must use reasonable endeavours to ensure that the terms and conditions of sales incentives offered by their independent retailers are not unduly restrictive (GC 23.10). This should reduce instances where customers are unable to redeem incentives due to overly onerous terms and conditions.
- The MSP must carry out a number of due diligence checks (or require their distributors to carry out such checks) and a number of checks in respect of independent retailers to ensure that the relevant company and its directors are 'sound' (GC 23.8). This should reduce the number of 'rogue' retailers entering the market who want to offer unsustainable cashback deals.
- When monitoring retailer's compliance with the GC, the MSP must use any information obtained from the retailer only for the purpose for which it was supplied and keep it confidential (GC 23.9). This is to ensure that the information cannot be used for commercial advantage by the MSP or any other party.

8.7 These provisions are mainly as those proposed in the 2008 consultation. The differences are set out in detail in Annex 5. The principle changes, made as a result of comments received from stakeholders, are:

- Pay-as-you-go and SIM- only services have been excluded from several provisions. This change has been made primarily because pay-as-you-go presents a lower risk of harm for consumers (consumers can more quickly

identify charges and can exit their contract without penalty) and is sold in different way (less pre-sales advice is typically required). As a result we believe that the imposition of exactly the same obligation applicable to pay monthly contracts would be disproportionate.

- We have clarified that mobile broadband and wi-fi services are excluded from the GC. It was not our intention to include them in the GC as set out in the 2008 consultation.
- We have modified requirements that MSPs use 'best endeavours' to ensure Mobile Service Retailers comply with provisions to ones that require them to use 'reasonable endeavours'. We believe that 'reasonable endeavours' more fairly reflects the level to which MSPs can ensure compliance by independent retailers.
- We have changed the requirement for MSPs to keep records from 12 to 6 months for non-cashback sales because this level is thought to be adequate for any Ofcom investigations that may occur to enforce the GC and follows Ofcom practice in the GC that address the sales and marketing of fixed-line services (GC14.5)
- We have modified the requirement to send information in respect of telesales from 'within 3 working days' of the sale to 'in good time'. This change has been made to allow providers more flexibility to reflect their business' and customers' needs and to reflect the provisions in the Distance Selling Regulations<sup>47</sup>.

## The Legal Framework for setting General Conditions

8.8 When setting GCs, Ofcom is required to meet various tests set out in the Communications Act 2003 ('the Act'). In this subsection we describe how we have taken regard of our duties under the Act when deciding to set GC23 in order to tackle mis-selling in the mobile sector.

### Ofcom's general duties

8.9 Section 3 (1) of the Act sets out the principal duty of Ofcom:

- To further the interests of citizens in relation to communication matters; and
- To further the interests of consumers in relevant markets, where appropriate by promoting competition.

8.10 Ofcom is required by this section to carry out its functions in line with these duties. We consider that in setting GC23 we fulfil our duty under section 3, in particular as GC23 will further the interests of consumers and citizens by reducing the risk of harm due to general mis-selling and onerous or misleading cashback offers.

8.11 We further believe, that our decision is also in line with our duty to review regulatory burdens under section 6 of the Act and that the setting of GC 23 does not impose burdens which are unnecessary. In particular as we set out in section 3.64 - 3.76 we do not consider that the self-regulatory initiative of the mobile industry, i.e. the setting of standards in Code, has been effective in furthering or securing what is required under section 3.

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<sup>47</sup> Further details can be found at [http://www.ofcom.gov.uk/advice\\_and\\_resources/resource\\_base/legal/distance-selling-regulations/](http://www.ofcom.gov.uk/advice_and_resources/resource_base/legal/distance-selling-regulations/).

## European Community requirements for regulation

8.12 Section 4 of the Act requires Ofcom to act in accordance with the six European Community requirements for regulation. In summary these requirements are to:

- Promote competition on the provision of electronic communication networks and services, associated facilities and the supply of directories;
- Contribute to the development of the European internal market;
- Promote the interests of all persons who are citizens of the European Union;
- Not favour one form or means of providing electronic communications networks or services, i.e. to be technologically neutral;
- Encourage the provision of network access and service interoperability for the purpose of securing:
  - i. efficient and sustainable competition; and
  - ii. the maximum benefit for customers of communications providers; and
- Encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of communications providers.

8.13 In doing so, Ofcom has to read these requirements in accordance with the requirements of Art. 8 of the Framework Directive<sup>48</sup>. These include, in particular, the obligation to:

- Ensure that users, including disabled users, derive maximum benefit in terms of choice, price and quality (Art. 8 (2) (a));
- Ensure a high level of protection for consumers in their dealings with suppliers (Art. 8 (4) (b)); and
- Promote the provision of clear information, in particular requiring transparency of tariffs and conditions for using publicly available electronic communications services.

8.14 For the reasons set out in this document, and in particular for the reasons set out below, Ofcom believes that our decision to set GC23 meets the above requirements:

- The GC will create an even playing field for MSPs and independent retailers by imposing the same set of rules and behavioural requirements on all parties. The GC will also contribute to market where consumers shop around with confidence, hence making competition more effective;
- The GC will ensure a high level of protection for both individual consumers and SMEs. The remedies available under the GC will be complementary to the ones under the EA and will enable us to require the contravening party to compensate

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<sup>48</sup> Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services; OJ L108/33.

customers who have been subject to mis-selling and to fine contravening companies.

- Provisions 23.5 and 23.10 set out clearly which types of information should be provided to a customer and that this information should be provided in a comprehensible and accurate manner. Based on this information, consumers should be able to make an informed decision as to whether or not to enter into a contract.

### **Power to set general conditions**

- 8.15 According to section 45 (1), (2) (a) and (3) of the Act Ofcom has the power to set those general conditions which contain provision authorised or required by one or more of sections 51, 52, 57, 58 or 64.
- 8.16 Matters to which general conditions may relate under section 51 (1) of the Act include, pursuant to subsection (a), conditions appropriate for protecting the interests of end-users of public electronic communications services ('PECS'). This includes, according to section 51 (2) conditions relating to the supply, provision or making available of goods, services or facilities in association with the provision of PECS. The Authorisation Directive<sup>49</sup>, which this section intends to implement, further sets out that conditions which can be attached under Art. 6 (1) and section 8 of Annex A of said Directive explicitly include consumer protection rules specific to the electronic communications sector.
- 8.17 Sections 51 (1) and 52 (2) (e) of the Act further set out that it is Ofcom's duty to set such general conditions as we consider appropriate for securing that providers establish and maintain procedures, standards and policies necessary to secure the effective protection of domestic and small business customers of such providers. (A definition of "domestic and small business customers can be found in section 52 (6) of the Act.)
- 8.18 Since GC23 is intended to require MSP to establish and maintain certain procedures, standards and policies to effectively protect both domestic and small business customers of mobile communication services from undue harm caused by general mis-selling of such services or onerous or misleading cashback offers related to the provision of such services, we believe that we have the power under the Act to set GC23.

### **Test for setting general conditions**

- 8.19 Section 47 requires us to satisfy ourselves, before setting a general condition, that the test of section 47 (2) is met. This test is that the setting of the general condition is:
- Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - Proportionate to what the condition is intended to achieve; and

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<sup>49</sup> Directive 2002/20/EC on the authorisation of electronic communications networks and services; OJ L108/21.

- In relation to what it is intended to achieve transparent.

The setting of the general condition is objectively justifiable

- 8.20 We consider, for all the reasons set out in this document, that the setting of GC23 is objectively justifiable, in particular since it is likely to:
- increase protection for consumers from irresponsible and inappropriate sales and marketing activities;
  - ensure that terms and conditions around sales incentive offers are fair and consumers are able to redeem offers; and
  - support, and promote, competition in retail mobile communications to the benefit of customers.

The setting of the general condition does not discriminate unduly against particular persons

- 8.21 We consider that GC23 does not discriminate unduly between particular persons as it applies equally to all MSPs.
- 8.22 The provisions in GC23 are worded in such a way that they apply to MSPs where the MSP is a retailer, and to all independent retailers through which the MSPs sell their services.

The setting of the general condition is proportionate

- 8.23 We consider that the requirements and obligations imposed through GC23 represent the least intrusive option to effectively tackle the problems we have identified surrounding mis-selling in the mobile sector. We conclude, in particular, from our cost-benefit analysis summarised in sections 8.50 – 8.66 below that the benefits of our regulation are likely to outweigh the costs of regulation.
- 8.24 The provisions in the GC that are additional to those in the Code are targeted to address specific areas of concern:
- a general mis-selling provision intended to address the on-going complaints received by Ofcom and Consumer Focus about general mis-selling;
  - a requirement to keep records of sales incentives for a time period not less than 90 days after the date by which the incentive is fully redeemable. This is intended to ensure evidence is available in the event of a dispute or investigation; and
  - a requirement that customers entering pay-monthly contracts over the phone are sent information about the cost of key charges in a durable medium within good time. This will ensure they are furnished with relevant facts within the statutory cooling off period, during which they can cancel the contract, and allow them to mitigate harm from any mis-selling.
- 8.25 Without this GC we believe, as we have set out in this document, consumers of mobile communications services would be subject to unacceptable risks of harm caused by mis-selling and the offering of onerous or misleading cashback terms.

The setting of the general condition is transparent

- 8.26 We consider that GC23 has been drafted for maximum clarity and, in conjunction with this statement and the attached Guidelines, clearly sets out what is expected of providers as a consequence of our decision, the purpose of the obligations and the reasons for imposing it.

### **Procedure for setting general conditions**

- 8.27 Pursuant to section 48 of the Act, before setting a GC Ofcom has to publish a notification proposing the condition, setting out the effects of the proposed condition, giving reasons for our proposal and allowing stakeholders a reasonable time (normally no less than one month) to make representations about the proposals.
- 8.28 Ofcom published a 2008 Consultation on 18 March 2008 which incorporated the required notification and met all of the above requirements. Having considered every representation made about our proposal we consider that we now may give effect to the proposed condition with slight modifications which seek to address comments made during the consultation process.
- 8.29 Having acted in accordance with all relevant duties under the Act we believe we can set GC23 as set out in Annex 6.

### **Implementation time**

#### *Implementation time responses based on consultation questions*

- 8.30 As part of the 2008 Consultation we invited MSPs to comment on the proposed transitional period of 2 months<sup>50</sup> to implement the GC. Most of the MSPs who responded to this question argued that the proposed transitional period was too short. The responses are summarised below:
- O2 had not been able to undertake an impact analysis but suggested that at least 3 months should be allowed to enable communication of the requirements in respect of new channels. They further commented that the timescale will depend on whether they are required to 'ensure' compliance or 'communicate' the rules.
  - T-Mobile thought a minimum of 6 to 9 months is a reasonable period of time during which relevant processes and procedures can be put in place to comply with the GC. They also thought the GC should be subject to a sunset clause so the obligation would lapse after a period unless a positive need is demonstrated for retention. SSE also thought the GC should be subject to a sunset clause of no longer than 2 years.
  - BT thought that 2 months would be a very challenging period in which to implement the necessary systems and processes. They said that (unlike the MNOs) BT has not been required to put in any voluntary processes to date and the resource pools and margins available to MVNOs are significantly smaller than MNOs.
  - Orange had not carried out the full internal impact assessment necessary to determine how long the GC would take to implement, but thought the proposed transition period of 2 months was inadequate and fell a long way short of the time required to implement such wide scale changes to sales processes. They thought that at least 6 to 8 months would be required to carry out the work required.

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<sup>50</sup> 2 months would be allowed from the day the GC comes into force.

- 3 thought that a move from self to statutory regulation would result in additional compliance and monitoring requirements which had not been adequately factored into Ofcom's analysis. They estimated that a transition period of 8 months would be required
- One confidential respondent [X] commented that they expected the requirements to have little impact on their current working practices, but requested feedback on some aspects of the proposals which might require a longer implementation time e.g. whether pay-as-you-go services were captured under the record keeping and information at point of sale requirements.

*Implementation time responses based on statutory information request*

- 8.31 Based on consultation responses and further discussions with MSPs and retailers, we made a number of changes to the proposed GC. Since some of these changes were quite substantial we asked MSPs and retailers to provide us with an updated estimate of costs and implementation time on a voluntary basis. In addition to providing us with some information regarding costs and implementation time, a number of MSPs and retailers also commented on this amended version.
- 8.32 Based on those comments we submitted a second update of the proposed GC, and sent MSPs and a number of retailers a statutory information request asking them to provide us, among other things, with cost estimates and implementation time estimates for the proposed GC. Below we give an overview of the implementation time estimates we were provided with.
- 8.33 [X] stated that compliance to the records management provision (GC23.6) would involve the most time to implement. This MSP stated that if compliance with GC23.6 required the electronic scanning and storage of all signed contracts, then it would take them between 6-8 months to implement.
- 8.34 [X] stated that to ensure compliance with GC23, they would need to re-issue contracts with retailers. To do this, [X] would need to draft new contracts, serve 30 days notice of termination of existing contracts on retailers, issue new contracts, engage in bilateral discussions and await final signature and return of contracts. According to them, this would take a minimum of 6-9 months.
- 8.35 Other MSPs stated that any changes to contracts as a result of GC23 could be included as part of a general contract update (instead of issuing new contracts). One MSP stated that if they are amending a contract then they would just send a page with the amendments. Another MSP commented that regulatory obligations are not usually a commercial matter for negotiation, but an obligation, and therefore the introduction of GC23 would only require a contract amendment.
- 8.36 Another MSP considered that six months would be a much more viable timescale to introduce the additional measures in GC23. For them, the difference between three and six months was significant as it is in the process of expanding its welcome letter coverage to new and upgraded customers. [X] stated that it was not certain it could do this in the proposed transition period despite having undertaken a significant amount of work on the programme already.
- 8.37 [X] and [X] stated that ensuring compliance with GC23.4 (*Obligation with regards to Mobile Service Retailers*) would be difficult within the proposed transition period and would involve significant cost to the MNO. [X] noted that in order to ensure compliance with GC23.4 it would need to carry out additional activities, including,

briefing and re-training own retail staff, communicating the new regulatory requirements to its retailer network and distributors, introducing a formalised monitoring programme, recruiting new staff to monitor, audit and manage sanctions processes, and carrying out general system enhancements to enable records to be stored and. [3<] stated that all of the above would take anywhere between 6 and 8 months.

- 8.38 In contrast to the above, other MSPs did not consider that ensuring compliance with GC23.4 would involve having to take significant additional time.
- 8.39 [3<] did not note any difficulties with implementing the GC provisions within six months.
- 8.40 For a mobile service retailer,[3<], the amount of time needed to implement GC23 would depend on the requirements imposed by MSPs. Their main concern was in respect of MSPs’ training requirements and the time taken to carry out this training. [3<] believe that a six month implementation period would be sufficient.
- 8.41 [3<] stated that the obligation to retain records, particularly around sales incentives offered to telesales customers, would require the development of new systems and work on several subsidiary systems. At this stage, [3<] believed this would require closer to 6 rather than 3 months to complete.
- 8.42 [3<] considered it would take between four and six months to become compliant with GC23.5 (*Mobile Service – Information at Point of Sale*).
- 8.43 [3<] stated that it would take six months for all sales staff to receive the training required under 23.7. [3<] believed that it would need to carry out a training session with every member of sales staff to ensure they fully understood their legal requirements.
- 8.44 Figure 8.1 below provides an overview of the estimated implementation time and main issues identified by MSPs and retailers:

**Figure 8.1: Estimated implementation times and main issues regarding the proposed GC**

| Operator/ Retailer | Issue   | Suggested time   |
|--------------------|---|------------------|
| MSP1 [3<]          | Electronic records retention                                      | 6 – 8 months     |
| MSP2 [3<]          | Increased monitoring requirements                                 | 6 - 8 months     |
| MSP3 [3<]          | New contracts with retailers                                      | 6 - 9 months     |
| MSP4 [3<]          | Ensuring all new and upgrading customers receive contract details | 6 months         |
| MSP5 [3<]          | Training retail staff   | 6 months         |
| MSP6 [3<]          | Sales incentive record retention                                  | 6 months         |
| MSP7 [3<]          | None  | Within 6 months. |
| Retailer1 [3<]     | Information at point of sale                                      | 4 – 6 months     |
| Retailer2 [3<]     | Training retail staff   | 6 months         |

- 8.45 From the above it can be seen that those who provided an estimate suggested an implementation time of between at least 4 to 9 months (except for one MSP that commented that it should be possible to implement the proposed GC within six months). Given the number of responses on this subject and the fact that they point

in a similar direction, we have reconsidered the proposed implementation period. In addressing this issue, we have also taken account of the fact that some of the requirements in the GC go beyond those in the Code and these provisions may take longer to implement.

- 8.46 The three areas where the GC is more onerous than the Code are listed below:
- Mis-selling prohibitions are not included in the Code, but are included in the GC (GC 23.2, 23.4.b.(i)-(iii)). These are however normal standards we would expect businesses to comply with and, in our view, would not require particularly long implementation periods.
  - The requirements regarding creating and keeping records about the sale of sales incentives are more onerous than in the Code. The Code sets out six months, whereas we propose a time period of not less than 90 days after the date by which the incentive is fully redeemable.
  - GC23.5 and GC23.10 go beyond the Code in respect of the types of information that have to be provided to the customer and the fact that information regarding contracts entered into via telesales should be sent to the customer in good time.
- 8.47 Apart from these differences, we appreciate that statutory regulation may require additional compliance and monitoring requirements compared to self-regulatory initiatives such as the Code. However, we also recognise that allowing a longer time for transition could result in continued consumer harm because of ineffective enforcement against retailers engaging in poor sales practices. In addition, a substantial amount of the GC was taken from the Code so should already be incorporated into MNOs' systems and processes.
- 8.48 Based on the above we have decided to allow an implementation period of six months for the GC for all MSPs. We have decided not to differentiate between MNOs (who signed up to the Code) and MVNOs (who haven't) because the MVNOs who have responded indicated they would be able to implement the GC within six months.
- 8.49 Therefore, we expect that GC23 will come into effect six months after its publication in the annexed notification. After that time, we will monitor compliance and take enforcement action as appropriate. In considering whether to take enforcement action we will expect to apply our usual criteria for prioritising our use of resources, both across the range of issues within mobile mis-selling and across the wider range of issues causing consumer harm where Ofcom regulates.

### **Quantitative cost benefit assessment for the preferred option**

- 8.50 Below we provide a quantitative cost benefit assessment for the preferred option i.e. introducing a GC to tackle general and cashback mis-selling. Further detail on the methodology used to quantify the benefits and costs is provided in section 4 and Annex 3 of this statement.

## Benefits

8.51 The anticipated benefit of introducing a GC to tackle mis-selling is a reduction in consumer harm<sup>51</sup>. We have conservatively estimated the current ongoing value of financial harm to consumers as:

- a) General mis-selling - £21 million per year.
- b) Cashback mis-selling - £8 million per year.
- c) The cost of time spent dealing with general and cashback mis-selling problems - £3 million per year.

8.52 The detailed methodology for the calculation of each type of harm is provided in Annex 2. We have used a variety of sources of information to estimate the harm arising from mis-selling including Ofcom consumer survey data (e.g. to estimate the number of people mis-sold and financial harm from general mis-selling) and information from independent retailers (e.g. to estimate the amount of cashback unclaimed). In some cases our inputs have been estimated from a small sample of data or using judgement. Where there was uncertainty around specific input values used to calculate the consumer harm we have generally taken a conservative approach which is likely to have understated the benefits, for example:

- When estimating the harm arising from general mis-selling we used a conservative value of £20 financial loss per mis-sell (see section 4.48)
- We estimated the cashback harm using three methods, and used the most conservative method in our assessment of the GC.

## Costs

8.53 To estimate the costs of introducing the proposed GC we formally asked MSPs and a few independent retailers to provide us with information on anticipated implementation and compliance costs. Based on the cost information provided the one off and ongoing annual costs are estimated at £1.7 million and £4.3 million respectively (for MSPs and independent retailers combined)<sup>52</sup>. Further information is provided in Annex 2.

## Effectiveness of GC

8.54 We recognise that the proposed GC is unlikely to eliminate all the ongoing harm arising due to mis-selling. To approximate how effective the GC might be we have tried to find a comparable case where we introduced a GC for consumer protection purposes so we could analyse how the introduction of the GC impacted on the level of consumer harm over time. For this purpose we have used the impact of the introduction of GC 22 relating to Broadband Migrations in February 2007.

8.55 We have analysed the trend in complaints received by the OAT before and after the introduction of GC 22 to estimate the reduction in consumer harm arising due to the GC. The detailed analysis and assumptions used are provided in Annex 2. Based

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<sup>51</sup> See for more background on consumer harm sections A2.2 – A2.13.

<sup>52</sup> The estimates were derived by summing the incremental costs of implementing the GC provided by MSPs and independent retailers. The cost estimates provided by independent retailers were scaled (based on sales) to represent the whole independent retailer market.

on this analysis we estimate that the proposed mobile mis-selling GC will reduce ongoing harm by 30% in the first year and by 50% in subsequent years, compared to the level of harm without the GC.

- 8.56 We recognise that this is a starting point for the analysis of effectiveness and that the effect of GC 22 on complaints may be an imperfect proxy for the effectiveness of the proposed mis-selling GC. In Annex 2 we present some sensitivity scenarios and breakeven analysis to show how sensitive the final outcome is to changes in the assumptions about the effectiveness of the GC.

### Net present value for the introduction of the GC

- 8.57 We have combined the costs and benefit estimates to calculate the net impact of introducing the proposed GC. The net present value (NPV) has been calculated over a 5 year period. The method used to project each of the costs/benefits forward is described in Annex 3. The proposed intervention has been assessed against the counterfactual of a continuation of the Code. The base case results are as follows:

**Table 8.2: NPV for base case**

|                                       | PV over 5 years (£ million) |
|---------------------------------------|-----------------------------|
| Reduction in cashback harm            | 16                          |
| Reduction in general mis-selling harm | 45                          |
| Time savings                          | 8                           |
| Costs (one off and ongoing)           | -23                         |
| <b>NPV</b>                            | <b>45</b>                   |

- 8.58 With our base case assumptions we expect the introduction of the proposed GC to result in a net benefit of £45 million over 5 years. It is notable that even if we take out the benefit from reducing cashback harm the proposed intervention would still have a positive net benefit.

### Sensitivity analysis

- 8.59 To recognise the uncertainty around input assumptions and to explore the robustness of the positive net benefit, we have conducted a range of sensitivity analyses in Annex 2, including individual scenarios, low and high cases, and break-even analysis.
- 8.60 The individual scenarios are conducted for the nine input assumptions subject to greatest uncertainty to determine which inputs the base case NPV is most sensitive to. Each input is changed by +/-20% while keeping the other input values fixed at base values. The range around the base case NPV of £45 million is £32-£59 million.
- 8.61 Having determined the five key inputs the base case NPV is most sensitive to, we then constructed a low and high case scenario by varying the key inputs simultaneously. Our approach in constructing low and high cases was not to identify the extreme bounds of possible NPVs but to identify a plausible range around the base case NPV. The 'low case' scenario is created by setting the key inputs to the values that imply lower benefits and higher costs. The 'high case' scenario reflects more optimistic values for the key inputs: larger benefits and lower costs. The input values used to create the low and high case are set out in Annex 2. The NPV for the low and high case are as follows, compared to the base case:

**Table 8.3: Low and high case NPV scenarios**

| Scenario  | NPV £ million |
|-----------|---------------|
| Base case | 45            |
| Low case  | 1             |
| High case | 111           |

- 8.62 The analysis of low and high cases suggests that there is a positive net benefit unless a number of input assumptions are simultaneously significantly less favourable. We could not rule out the possibility of a negative NPV because our low and high cases are not intended to be the extreme bounds. However, we consider that scenarios with negative NPVs are less likely, as they rely on all of the key inputs simultaneously taking much lower values than in the base case.
- 8.63 The breakeven analysis is used to determine how much each of the key inputs could change individually before the NPV is zero. In this analysis each key input was varied individually while the other are held constant at the base case value (see Annex 2). The breakeven analysis suggests that the net benefit remains positive even with relatively large variation in individual input assumptions e.g. the GC would have to be 66% less effective than the base case, or one-off and annual ongoing costs more than three times as large. Even if the financial harm arising due to general mis-selling was £0 (this might be the case if all those mis-sold managed to get adequate compensation), the projected benefit from the GC from time savings and cashback problems would still generate a small positive NPV.

## Conclusion

- 8.64 We recognise that there is uncertainty around some of the input values used in the cost benefit analysis. Where this is the case we have tried to adopt conservative assumptions.
- 8.65 In addition, we have not been able to quantify all of the possible benefits from a reduction in mis-selling. In particular, we have not quantified the benefits of reducing stress and anxiety that consumers may suffer from mis-selling or the potential for enhancing consumer confidence and consequently competitive intensity (see section A2.2 - 2.5). In addition, we have not included in the quantified analysis the possibility that, in the absence of the GC, the extent of mis-selling might increase from current levels (see section 4.32). Together with our generally conservative approach to the selection of input values, this means that any bias in our estimate of the overall benefits is more likely to be downwards than upwards.
- 8.66 The sensitivity analyses suggest that there would need to be significant downside variation in the (already conservative) input assumptions to generate a negative NPV. Overall, we consider that the introduction of the GC is likely to yield a positive net benefit.

## Annex 1

# List of respondents

A1.1 The following stakeholders have submitted non-confidential responses to the 2008 Consultation. The responses can be found at <http://www.ofcom.org.uk/consult/condocs/mobmisselling/responses/>.

- BT
- Citizens Advice Bureaux
- Mr I. Cameron
- Coventry Trading Standards
- East of England Trading Standards Association Ltd
- Mrs S. Frost
- Hutchison 3G UK Ltd
- Ms C. Isbell
- LACORS
- Leicester City Council
- London Borough of Newham Trading Standards
- Telefónica O2 UK Ltd
- Office of Fair Trading
- Orange Personal Communications Services Ltd
- Scottish and Southern Energy plc
- T-Mobile UK Ltd
- The London Trading Standards Authorities group
- The Mobile Broadband group
- Trading Standards South East authorities
- Virgin Mobile Telecoms Ltd
- Vodafone UK Ltd

A1.2 In addition, we have received two confidential responses.

## Annex 2

# Assessment of consumer harm and the costs and benefits of our preferred option

A2.1 This annex consists of 3 sections. The first section sets out the theoretical approach for assessing the consumer harm arising from mis-selling. The second section seeks to quantify particular aspects of the consumer harm. The third section sets out a quantitative cost benefit assessment for our preferred option (introducing a GC to tackle mis-selling and cashback issues).

### Section 1: Theoretical approach for assessing consumer harm arising from mobile mis-selling

A2.2 It is difficult to measure the emotional harm (e.g. stress and anxiety) caused by mis-selling in quantitative terms. However, the financial and other economic harm can be measured through an economic welfare analysis. We have identified three sources of consumer detriment from mis-selling:

- 1) Mis-selling results in a loss of confidence in the market meaning consumers are less likely to seek out the best deals and switch provider. This reduces the intensity of competition and could lead to higher prices.
- 2) MSPs/independent retailers are able to charge a higher price based on misleading information provided (e.g. consumers believe they are getting a higher specification service than turns out to be true).
- 3) Consumers spend time dealing with mis-selling and cashback issues (e.g. making complaints) which is an opportunity cost.

Each case is considered in turn.

### Case 1: Mis-selling results in reduced competitive intensity

A2.3 In this case fear of mis-selling might lead to a loss of confidence meaning consumers may prefer to stick with a 'tried and tested' product or brand, even if this means paying a higher price or getting a lower quality good/service than is available by switching. In addition, inertia in the market might discourage new entrants because consumers are less likely to switch and try new products/services even if the offers are attractive. Overall consumer inertia might reduce the intensity of competition resulting in higher prices (or lower quality of service, less choice and innovation etc). As a result of higher prices, producers gain at the expense of consumers.<sup>53</sup> In addition, there is an overall loss of economic efficiency.<sup>54</sup>

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<sup>53</sup> Higher prices reduce consumer surplus and increase producer surplus. The consumer surplus is the amount that consumers benefit by being able to purchase a product for a price that is less than they would be willing to pay. The producer surplus is the amount that producers benefit by selling at a market price that is higher than they would be willing to sell for.

<sup>54</sup> This is reflected in the reduction in sales caused by the higher price. The loss of consumer surplus is larger than the gain in producer surplus, which is called the deadweight loss.

- A2.4 The proportion of mobile users switching mobile supplier each year has declined from 16% in 2005 to 12% in 2008<sup>55</sup>. This might reflect a number of factors, for example consumers signing up for longer contracts or a higher level of satisfaction with the current provider. However, it is possible that mis-selling has contributed to this trend. Furthermore, continued mis-selling would lead to an increased probability that consumers lose confidence in the market.
- A2.5 For practical reasons we have not tried to quantify the consumer detriment arising under case 1. A quantification would require a significant degree of speculation about the nature and size of the effect on competition and hence on the market outcomes with and without mis-selling. This means that the quantified assessment will tend to understate the detriment (all other things being equal).

## **Case 2: MSPs/independent retailers are able to charge a higher price based on mis-leading information**

A2.6 In this case there are two possible scenarios to consider:

- 1) In the first scenario the consumer would have been willing to buy the mobile service at the original price in spite of the mis-selling i.e. they would have made the same purchase decision had full information been provided at the point of sale. This scenario does not result in the wrong purchase decision, because the purchase outcome is the same regardless of the mis-sell. However, sellers gain at the expense of consumers because they are able to charge a price above the competitive level based on the mis-leading information, i.e. there is a transfer of surplus from consumers to sellers.
- 2) In the second scenario misleading information entices the consumer into a contract which they would not otherwise have taken i.e. if they had full information at the point of sale they would have bought a different mobile service. As in the case above, there is a transfer of surplus from consumers to producers. But, in addition, in this case an incorrect purchase decision is made i.e. there is over consumption of mobile services if the consumer takes a higher tariff (with more call minutes/texts) than they would with full information.

A possible case in point is cashback mis-selling<sup>56</sup> when a consumer enters into contract on the expectation of being able to claim all the cashback offered but subsequently finds that they are unable to<sup>57</sup>. As noted in section 2.4, consumers may view the mobile service tariff paid to the MSP and cashback as offsetting components, and make purchasing decisions based on the 'net' price (i.e. tariff minus any cashback). Retailers usually receive higher commissions for selling the most expensive tariffs (which typically have a larger bundle of inclusive call minutes/texts and are likely to generate more income for MSPs). This means retailers tend to offer larger cashback payments on the expensive tariffs thus reducing the anticipated net price and making them appear relatively more attractive to consumers. Once the mobile service is purchased, consumers are contractually obliged to make the tariff payments to the MSP. If the cashback does not materialise (for the reasons described in section 2.5), the consumer effectively faces a higher price than anticipated because they are locked into paying the tariff but do not receive the

<sup>55</sup> Source: Ofcom Consumer Experience Report 2008, page 93.

<sup>56</sup> This scenario is equally applicable to general mis-selling but we have presented an example based on cashback mis-selling for illustration.

<sup>57</sup> This scenario might not apply in all situations where consumers did not receive the cashback they expected e.g. in some cases scenario 1 might apply.

offsetting cashback payments. This can result in market failure because some consumers end up selecting a tariff when they would have been better off on another deal, if they had known at the time of purchase that the cashback obligation would not be fulfilled<sup>58</sup>.

Effectively consumers are misled into purchasing a more expensive tariff because they expect a lower net price, based on the cashback. But when the cashback fails to be paid, they are unable to retract demand due to the binding contract with the MSP.

Should the change in producer surplus be offset against the loss to consumers?

A2.7 In first two cases mis-selling results in sellers gaining at the expense of consumers. So, if producer surplus is included in the welfare assessment, the net welfare loss from mis-selling is much smaller or in some cases eliminated altogether (as in 1) above).

A2.8 Generally, we would take account of both consumer and producer surplus and consider whether one (such as consumer surplus) should be given greater weight in the overall assessment than the other. In the case of mis-selling the increase in the producer surplus arises because the sellers deceive consumers and exploit the information advantage they possess. In our view, surplus gained from this type of activity should not be offset against the loss to consumers, because the sellers are gaining at the expense of consumers. To include such profit increases would imply that misleading consumers is legitimate business behaviour, when actually we believe that such activities are unfair and warrant action to protect consumers. In the circumstances applicable to this assessment, therefore, we do not place any weight on producer surplus that is gained through deception. This is consistent with our statutory duties to further the interests of consumers in communication markets and secure effective protection for consumers (see policy objectives in section 2).

Should the buyer beware?

A2.9 One approach would be to assume that the consumer was unaware that they were being mis-sold. However, in some cases it could be argued that the consumer should have realised that mis-selling was evident. For example, in 2007 some of the cashback deals effectively suggested that the consumer was getting a handset and mobile airtime service for free or for a notional amount, i.e. the cashback equalled the monthly contract fee (or in extreme circumstances the consumer was even getting paid for taking the contract). A number of consumers took multiple contracts because the deal was so good it appeared they would make money. It could be argued that a rational consumer should have realised the cashback deals were unrealistic and that the deal was 'too good to be true'. By taking such incredible deals the consumer was running a (calculated) risk that the cashback would not be paid, i.e. weighing up the risk of non payment and the potential gain. Under this assumption the loss of consumer surplus through mis-selling would be lower – because the consumer should rationally have anticipated a lower surplus at the outset.

A2.10 The definition of the 'rational' consumer has a significant impact on the level of consumer detriment. A research paper prepared by London Economics for the

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<sup>58</sup> We assume that the rational consumer believes that the cashback deal is genuine and cannot foresee that all or part of the cashback will not be paid – this is discussed later.

OFT<sup>59</sup> on consumer detriment under imperfect information notes that consumer detriment can be identified as the loss to consumers from making misinformed or uninformed choices. The research paper also states that not every case of choice made with less than maximum information potentially constitutes a detrimental choice. The paper considers the correct theoretical measure of detriment is one which compares the actual outcome of a consumer's choice with the best outcome that a consumer with rational<sup>60</sup> beliefs would achieve. The provision of misleading information results in a gap between actual and rational beliefs because the consumer is fooled into misperceptions. The quantification of consumer harm therefore hinges on whether a rational consumer would believe the mis-leading information.

- A2.11 In measuring the benefits from any regulatory intervention we have tried to capture the incremental harm arising due to mis-leading information. For example, in measuring the ongoing harm due to cashback problems we have tried to exclude harm which arises when consumers take deals which are 'too good to be true', where the possibility of low payout could be reasonably foreseen.

### **Case 3: Time spent dealing with mis-selling and cashback issues**

- A2.12 Consumers spend time dealing with mis-selling issues (e.g. making complaints) which could be used for other purposes. This is a direct loss to consumers, with no offsetting gain to producers.
- A2.13 In sections A2.76-A2.82 we include a quantification of this consumer detriment.

### **Section 2: Quantification of consumer detriment**

- A2.14 This section is split into two parts. First we present the analysis of cashback harm provided in the 2008 Consultation. At the time this analysis was undertaken the Code had only been in place for 4-5 months thus this quantification largely represents the cashback harm prior to the Code coming into full force.
- A2.15 In the second part, for comparative purposes, we update the analysis of cashback harm provided in the 2008 Consultation using more up to date information. We also present an alternative measure of cashback harm (so called 'Method 3') based on deals a rational consumer would reasonably expect to pay out (i.e. excluding cashback not paid on deals which are 'too good to be true'). In addition, we have estimated the consumer harm arising from general mis-selling and time spent dealing with mis-selling issues. Our approach in the second part is to estimate the ongoing harm having given the Code time to take effect.

### **Estimate of consumer detriment arising due to cashback deals – 2008 Consultation**

- A2.16 In our 2008 Consultation we reported that market research undertaken in November/December 2007 indicated that approximately 1.75 million people aged 16+ had a cashback element to their current mobile phone contract. Of these

<sup>59</sup> Consumer Detriment under conditions of Imperfect Information, August 1997. see [http://www.ofst.gov.uk/shared\\_ofst/reports/consumer\\_protection/ofst194.pdf](http://www.ofst.gov.uk/shared_ofst/reports/consumer_protection/ofst194.pdf)

<sup>60</sup> The rational consumer does not necessarily have full information but has the best information available having completed a rational search process.

people about 6% said they could not get their cashback<sup>61</sup> (equating to 105,000 people). The cashback problems appeared to be more common in particular geographic areas. For example, where an independent retailer trading in a particular area ceases trading a large number of people in that area may be unable to claim cashback – this might not be fully captured by our random sample taken across the UK and may mean that the number unable to claim is underestimated by the survey.

A2.17 In the 2008 Consultation we recognised that a significant number of consumers were able to claim cashback. Market research suggested that 79% of people found claiming their cashback very or fairly easy. There is no per se flaw with cashback schemes if the offers are legitimate; the amount offered is based on expected commission and the redemption rate is not artificially lowered by independent retailers. Cashback is one means by which independent retailers have innovated on price competition and can bring benefits to consumers.

A2.18 The size of the cashback problem depends on the amount of cash which consumers are entitled to but unable to claim, and the number of people affected. The amount of cashback offered, and the amount the consumer is typically able to claim varies widely across deals, contract length and independent retailer. In the 2008 Consultation we used two methods and a number of data sources in an attempt to quantify the aggregate monetary size of consumer detriment caused by 'bad' cashback offers:

Method 1: Combining data on cashback owed from complaints into the OAT, and data from the market research survey on consumers unable to claim cashback.

Method 2: Using data received from independent retailers on the average cashback amount and the average redemption rate.

#### Method 1:

A2.19 At the time of the 2008 Consultation we took a sample of 129 complaints on cashback deals received into the OAT. The sample contained complaints about solvent and insolvent independent retailers. Across the whole sample of complaints, the average cashback promised per person<sup>62</sup> was £504 and the average cashback owed at the time of the complaint was £482. For the subset of consumers who had not managed to redeem any cashback on their contract(s)<sup>63</sup> the average promised was £518 per person (which is clearly the same as the amount owed since no cashback was received). The cashback promised for the OAT sample is likely to be higher than that observed more generally, as we have assumed people are more likely to call the OAT if a large sum of money is at stake. In addition, the OAT data includes retailers who promised very high cashback payouts and ultimately went out of business because cashback was offered on an unsustainable basis. Thus Method 1 might capture some deals which were 'too good to be true'.

A2.20 Based on the November/December 2007 market research statistics an estimate for the number of people aged 16+ who were unable to claim cashback was 6% of cashback consumers, which amounts to 105,000 people. Multiplying the cashback

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<sup>61</sup> There may be valid reasons why a consumer was unable to claim cashback e.g. they changed their tariff package or failed to pay a bill which invalidated the cashback agreement.

<sup>62</sup> Some customers had more than one cashback contract. Based on the OAT data the average number of contracts per consumer was 1.27.

<sup>63</sup> Hence excluding customers who had claimed part of the cashback.

owed for consumers unable to redeem any cashback by the number of consumers unable to claim<sup>64</sup> gives an estimate for 'unclaimed' cashback of £54 million (i.e. £518\*105,000).

A2.21 On the one hand, this estimate may overstate cashback unclaimed. This is because:

- The high cashback amounts owed for OAT complaints are likely to be above the average due to selection bias (i.e. complaints are more likely if the sums involved are large).
- It is not clear whether survey respondents who reported that they could not get cashback had actually managed to partially redeem some of the cashback promised (e.g. only later claims had failed). Method 1 assumes that the survey respondents reported as unable to claim did not get any cashback. However, if some of the respondents included as 'unable' to claim have actually managed to redeem part of the cash promised then the true £ level of detriment will be lower than estimated by Method 1 (other things equal).
- In some instances MSPs have offered 'rescue' packages to consumers who have suffered due to independent retailer insolvency (e.g. downgrading tariff plan) which will have mitigated the harm to some extent.
- We have assumed that those 'unable to claim' did not get the cashback due to mis-selling e.g. onerous/misleading terms and conditions or failure of the retailer to pay out when a valid claim was made. It is possible that they were unable to claim due to other factors e.g. the terms and conditions were reasonable but the consumer failed to follow the correct processes (unable to claim does not include those who forgot to claim who have been separately classified).

A2.22 On the other hand it is possible that this method underestimates the true level of consumer harm at the time of the consultation. It is possible that the number of people unable to claim was underestimated as the national consumer survey did not reflect the concentration of cashback problems in particular geographic areas and amongst ethnic minority groups.

### Method 2:

A2.23 The second approach in the 2008 Consultation used information received from independent retailers. The method essentially compared:

- (i) what cashback consumers were due; with
- (ii) the estimated amount of cashback paid based on the redemption rates assumed.

The difference between (i) and (ii) above therefore gave an estimate of the potential consumer loss. There was uncertainty surrounding the values for some of the key assumptions and the values used for this analysis were only indicative.

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<sup>64</sup> We assume that consumers who reported in the market research that they could not claim cashback were unable to redeem any cash (i.e. no partial claims).

- A2.24 Some consumers will not receive their cashback either because they forget or because they are legitimately ineligible to claim (e.g. because they have defaulted on the contract or changed price plan). These factors need to be accounted for in the estimation of the cashback which they are due in order to give a more accurate representation of the potential consumer harm.
- A2.25 In calculating the amount due to consumers our analysis assumed that 5% of contracts forgot to claim<sup>65</sup> (based on the market research survey) and 22% of contracts were not eligible to claim for various reasons (e.g. consumer defaulted on contract). We assumed that the average cashback amount was £133, which when multiplied by the number of cashback contracts, which we estimated at just under 2 million per annum, and stripping out forgetful and ineligible consumers, gave an estimate of the amount due to consumers (ie quantity (i) above).
- A2.26 The amount we would have actually expected to be paid (quantity (ii) above) is obtained by multiplying the average redemption rate per contract (assumed to be 51% across all contracts) by the average amount of cashback per contract and the number of contracts.
- A2.27 Using this method we estimated that the total cashback consumers were unable to claim was approximately £60 million<sup>66</sup>.

### Sensitivity analysis

- A2.28 In the consultation document we took account of the uncertainty around the input values for both Methods 1 and 2 by creating some sensitivity scenarios in order to show how changing specific inputs affected the outcome (see Annex 5 of the 2008 Consultation for details).
- A2.29 Although the uncertainty in some of the key inputs to the two methods produced a potentially large range for the estimate of harm, the ranges for the sensitivity analyses for the two methods overlapped considerably and the base case estimates for the two methods were very close: i.e. £54 million and £60 million. We therefore considered that an order of magnitude estimate for the potential consumer harm arising from consumers not being able to successfully claim the cashback to which they were entitled was in the range £50-£60 million over a 1-2 year period i.e. the range of contract durations considered. The Ofcom Communications Market Report (August 2008) reported that the vast majority of new mobile contract connections were 18 months (84% in 2008 Q1)<sup>67</sup>. If we assume the average contract length is 18 months then the annualised estimate of the harm is £33-£40 million.
- A2.30 Clearly the consumer harm from other forms of mis-selling identified would have added to the overall estimate of potential consumer harm. These were not quantified in the 2008 Consultation but have been considered subsequently – see below.

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<sup>65</sup> When a consumer forgets to claim we assumed that they forget for all the contracts they have taken.

<sup>66</sup> Quantity i) is calculated as: number of cashback contracts \* % that remember to claim \* % that are eligible to claim \* cashback promised.

Quantity ii) is calculated as: number of cashbacks contracts \* cashback promised \* redemption rate.

<sup>67</sup> [http://www.ofcom.org.uk/research/cm/cmr08/cmr08\\_2.pdf](http://www.ofcom.org.uk/research/cm/cmr08/cmr08_2.pdf) page 330

## Update following the 2008 Consultation

### Update to Method 1 and Method 2 estimates for 'unclaimed' cashback

A2.31 The estimates of consumer harm provided for the 2008 Consultation were based on various information gathered from August 2007 to January 2008. We recognise that the full impact of the Code might not have been realised during this period because it takes some time for MSPs to implement the provisions and filter them down the distribution chain. In this update we attempt to estimate the level of ongoing consumer harm having given the Code time to take effect i.e. we are trying to quantify the incremental consumer detriment remaining after the Code has been implemented.

### Update to estimate of 'unclaimed' cashback under Method 1

A2.32 The estimate of consumer harm provided for the 2008 Consultation was based on a sample of OAT complaints gathered from August 2007 to January 2008 (to estimate the amount of cashback which people were unable to claim) and market research conducted in November/December 2007 (to estimate the number of people affected).

A2.33 To update the amount of cashback which people forgo when they are unable to claim we collected an additional sample of 189 complaints received into the OAT from January-September 2008 (the 'second' sample). We have conducted a further small market research survey to update the estimate for the number of cashback customers.

A2.34 The new OAT data showed that average cashback promised per person<sup>68</sup> for the second sample was lower than that reported previously (£398 versus £504). Similarly, for the subset of consumers who had not managed to claim any cashback<sup>69</sup> the average amount promised for the second sample was lower (£399 versus £518). Possible explanations for the fall in cashback promised are as follows:

- Some of the retailers who offered very high cashback may have gone out of business in 2007 (therefore the sample of complaints taken from 2008 had lower cashback amounts).
- Retailers may have moved away from offering cashback to other forms of sales incentive e.g. MP3 player, laptop.
- Enforcement of the Code may have had some effect, meaning retailers are no longer imposing certain onerous conditions on cashback claims (e.g. requiring customers to send bills within a short timeframe). This may have forced retailers to reappraise their cashback models and reduce the amount of cashback offered because more people are able to successfully claim.
- The announcement in October 2007 that we were going to review the sales and marketing practices in the mobile market and the effectiveness of the Code. This may have encouraged MSPs to clamp down on 'bad' cashback practices.
- Media and other reports of the financial harm suffered when cashback is not paid out may have discouraged consumers from taking deals which offer very high cashback payouts.

<sup>68</sup> Some people had more than one contract.

<sup>69</sup> i.e. excluding consumers who had claimed part of the cashback.

- A2.35 The large difference in the average cashback amounts between the two samples may suggest a 'structural break' in the series i.e. the decrease is because cashback models have changed between periods due to the factors mentioned above, rather than due to random fluctuations in the data. The reduction in the average cashback figures is consistent with our observation that MSPs have reviewed the sales practices of their independent retailers which has reduced the cashback amount on offer and the level of unclaimed cashback.
- A2.36 The new market research information suggests that between 1.02 and 1.75 million<sup>70</sup> people aged 16+ (an average of 1.38 million or 9% of contract mobile customers) have taken a cashback deal on their current phone contract. While not statistically significantly different (at a 95% confidence level) to the figures reported in the 2008 Consultation (an average of 1.75 million) they are indicative of a decline in the number of cashback customers. This is consistent with anecdotal evidence which suggests that the number of cashback deals on offer has decreased. In part this is due to the introduction of the Code (which imposes tighter restrictions on cashback deals) and also to retailers switching away from offering cash in favour of other inducements (e.g. MP3 players or game consoles). Furthermore, consumers may be more wary of cashback deals following media coverage/own experience of difficulties claiming and retailers going out of business leaving cashback customers out of pocket.
- A2.37 The sample size was not large enough to analyse and update the proportion of people unable to claim cashback. Therefore we continue to use the percentage of consumers unable to claim cashback from the earlier survey (estimated as 6% of cashback consumers). The limited information we have suggests that there has been no significant change in the proportion of cashback customers unable to claim cashback. Thus the estimate for the number of people who have been unable to claim cashback is 82,800 people<sup>71</sup>.
- A2.38 As noted in the 2008 Consultation there was some uncertainty surrounding whether those reported as 'unable to claim cashback' had actually received no cashback or made partially successful claims (e.g. where multiple claims are involved some claims were successful and others were not). Given this uncertainty we have presented the updated Method 1 results on three bases using the OAT figure for average cashback unclaimed appropriate to the scenario:
- 1) Assuming that all those reported as 'unable to claim' receive no cashback. The average cashback unclaimed for this scenario is £399 i.e. the average owed for people unable to claim any cashback.
  - 2) Assuming that all those reported as 'unable to claim' contains a mix of those getting no cashback and those receiving partial payments. The average cashback unclaimed for this scenario is £376 i.e. the average owed for those getting no cashback and those getting some cashback.
  - 3) Assuming that all those reported as 'unable to claim' have all got at least some (but clearly not all) cashback. The average cashback unclaimed for this scenario is £264 i.e. the average for those who have had partially successful claims.

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<sup>70</sup> Based on 46 million adults, 88% mobile penetration, 38% of mobile customers on pay monthly contracts and taking account of the 95% confidence intervals.

<sup>71</sup> This is calculated as estimate for cashback consumers (1.38 million) \* % of consumers unable to claim cashback (6%).

A2.39 Multiplying the cashback owed for each scenario by the number of consumers unable to claim gives the following estimates for 'unclaimed' cashback using the other base case assumptions for Method 1:

**Figure A2.1: Estimate for unclaimed cashback under Method 1**

| Scenario   | £ million cashback 'unclaimed' over contract duration | Annualised estimate for £ million cashback 'unclaimed' (assuming average contract is 18 months duration) |
|--|---|--|
| 1) Consumer receives no cashback                   | 33  | 22   |
| 2) Mix of consumers receiving some and no cashback | 31  | 21   |
| 3) Consumers receive some cashback                 | 22  | 15   |

A2.40 The above estimates suggest that the amount of cashback which consumers are unable to claim lies in the range £22-£33 million over the contract duration. As noted in the analysis provided for the 2008 Consultation, this might overestimate the consumer detriment for the reasons set out in section A2.21.

A2.41 Assuming an average contract duration of 18 months we calculate the annual amount of unclaimed cashback to be £15-£22 million. This estimate for ongoing cashback harm is significantly lower than that calculated for the 2008 Consultation.

### **Update to estimate of 'unclaimed' cashback under Method 2:**

A2.42 To update Method 2 we asked for further information from independent retailers for the period January to September 2008.

A2.43 We wanted information from independent retailers offering 'sustainable' cashback deals i.e. in aggregate the cashback can be funded out of commissions earned. We did not want to include retailers who offered unsustainable cashback deals i.e. those which were 'too good to be true' because a rational consumer might reasonably realise that there is a risk of non pay-out on these deals. Including such cashback deals would bias the estimate of consumer harm upwards. We took the view that it would be both difficult and disproportionate to conduct a detailed examination of which deals are and are not sustainable. So to reduce the risk of including unsustainable deals, we obtained information from large independent retailers who have been operating cashback deals for a number of years.

A2.44 Based on the information received from independent retailers, the average amount of cashback promised has increased to £190 per contract (from £133). This is in contrast to the trend implied by the OAT data suggested that the amount of cashback promised had decreased. There are a number of possible explanations for the increase in cashback offered by the sample of independent retailers including:

- It could reflect an increase in the sale of contracts with a longer duration meaning more revenue is generated per sale.
- It could reflect the sale of more expensive contracts (i.e. higher tariffs) which earn higher revenues and commissions.

- It could be a response to a more challenging and competitive marketplace, where offers have improved in order to attract customers.
  - Offering higher cashback amounts helps to encourage customers to stay with their contract for the duration (since customers have to be connected to claim), which helps to enable independent retailers to earn the full commission on the sale.
- A2.45 The updated information requested from January to September 2008 was provided as part of a formal information request whereas the information provided for the 2008 Consultation was given on a voluntary basis. We believe the updated information is likely to be a better estimate because it was obtained under formal powers.
- A2.46 The average redemption rate increased from 51% to 73%. This implies people are successfully able to claim a larger proportion of the cashback promised at the start of the contract (even though the average amount promised has increased). This is a positive development and might reflect the impact of the Code meaning that cashback is easier to claim. The updated estimate for the number of contracts not eligible to claim for various reasons is 15% (down from 22% in the 2008 Consultation).
- A2.47 Based on information from independent retailers the number of cashback contracts sold per year has decreased to around 931,000 (from around 2 million). We would expect the number of cashback contracts to have decreased – some of the reasons are set out in section A2.36.
- A2.48 Following the previous methodology, our analysis assumes that 5% of consumers forget to claim<sup>72</sup> (based on the 2007 market research survey).
- A2.49 Based on the inputs above (and following the methodology set out in the 2008 Consultation) we estimate that the total cashback consumers are unable to claim is approximately £13 million over the length of the contract. The annualised estimate of unclaimed cashback is £9 million (based on an average contract length of 18 months).
- A2.50 We assume that consumers were unable to claim this cashback due to unreasonable terms and conditions imposed by independent retailers. However, it is possible that there are other explanations, for example:
- The proportion of consumers that forgot to claim was higher than indicated by our consumer survey.
  - The terms and conditions were not unduly onerous, but consumers still failed to follow the correct processes and thus forfeited the cashback.
- A2.51 The above factors might mean the estimate of consumer detriment is overstated.
- A2.52 This estimate of unclaimed cashback is significantly lower than that provided in the 2008 Consultation (around £60 million over the contract duration). The difference is driven by two factors (which more than offset the increase in the average cashback promised):

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<sup>72</sup> When a consumer forgets to claim we assume that they forget for all the contracts they have taken.

- i) The increase in the redemption rate to 73% meaning that consumers are successfully able to claim a greater proportion of cashback promised. Keeping all other inputs equal, but using the 2008 Consultation estimate for the redemption rate (51%), would result in an estimate of unclaimed cashback of £53 million over the length of the contract.
- ii) The second reason, as noted above, is the estimate for the number of cashback contracts is lower than that used in the 2008 Consultation.

A2.53 Using the updated data, the estimate of unclaimed cashback under Method 2 is lower than Method 1. Two reasons for this difference are set out below:

- i) The estimate for the number of cashback contracts under Method 2 (931,000) is lower than the estimate for the number of people with cashback deals derived from the market research and used in Method 1 (1.38 million). The most plausible explanation for this difference is that Method 1 captures the stock of people with a cashback contract whereas Method 2 measures the flow of cashback contracts i.e. new sales over the year. The average mobile contract is around 18 months (see A2.29) so one would expect the stock of cashback contracts to be greater than the number of sales in a year. Using the stock of people with cashback from Method 1 results in a higher estimate for the amount unclaimed under Method 2. (Replacing the estimate of cashback contracts under Method 2 with the Method 1 estimate for the number of people with cashback deals while keeping all other Method 2 inputs constant would result in a higher estimate of unclaimed cashback under Method 2 (£20 million)<sup>73</sup>).
- ii) As discussed in the March 2008 consultation, Method 1 might overstate the cashback unclaimed because the estimate for cashback owed is derived from OAT complaints. OAT complaints are likely to be above the average due to selection bias (i.e. complaints are more likely if the sums involved are large).

A2.54 Based on both methodologies the amount of 'unclaimed' cashback has decreased relative to the estimates presented in the March 2008 consultation. If we were to assume that the Code is the main factor driving the amount of cashback unclaimed down then this difference could be interpreted as representing the benefit arising from introducing the Code. The reduction in harm from the Code would therefore be significant. However, a substantial amount of unclaimed cashback would remain, and other factors might explain the reduction as well as the Code (e.g. retailers offering non-cash inducements).

A2.55 In addition, we cannot rule out the possibility that mis-selling of cashback deals has fallen in response to the high level of attention by the media and us, and could rise again if formal regulations were not introduced which enabled us to take prompt corrective action where bad practices are discovered. Our announcement of a review of sales practices in the mobile market in October 2007 may have also influenced market participants and contributed to the downward trend in cashback promised (e.g. our announcement may have encouraged MSPs to clampdown on 'bad' cashback practices in an attempt to reduce complaints in order to pre-empt formal regulation). This might suggest a smaller reduction in cashback unclaimed if the impact of the Code could be separately identified from the effects of our subsequent review of sales practices and engagements with market participants.

### **Alternative measure of 'unclaimed' cashback – Method 3**

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<sup>73</sup> This assumes one cashback contract per person.

- A2.56 We recognise that Methods 1 and 2 have certain limitations when used to try and estimate the reduction in consumer welfare arising due to 'bad' cashback deals:
- Method 1 may include cashback deals which are 'too good to be true' and thus should not feature in the loss to consumer welfare because a consumer with rational expectations could reasonably foresee the risk of low payout.
  - Method 1 may also overstate consumer harm because it is based on cashback unclaimed from OAT complaint data and those calling the OAT are more likely to be above the average due to selection bias.
  - Under Method 2 we assume that the estimate of 'unclaimed' cashback is due to mis-selling (i.e. onerous terms and conditions). It is difficult to verify that this is the case – for example some of the cashback might not be claimed because consumers fail to meet reasonable terms and conditions.
- A2.57 In recognition of these limitations we have calculated an alternative measure of unclaimed cashback which uses the consumer survey estimate for the number of people unable to claim and the independent retailer estimate of cashback promised.
- A2.58 We have used the consumer survey estimate for those unable to claim (6% of cashback customers or 82,800 people) because we assume these people positively identified mis-selling as a reason for not getting their cashback (e.g. it excludes those that forgot).
- A2.59 We have used the independent retailer estimate for cashback promised (£190 over the contract duration) because this is more likely to represent a 'sustainable' cashback offer i.e. it is not inflated by deals which are 'too good to be true'.
- A2.60 As noted under the Method 1 discussion, we are uncertain whether those unable to claim had actually received no cashback or made partially successful claims. Therefore we have presented the Method 3 estimate on three bases:
- 1) Assuming that all those 'unable to claim' receive no cashback meaning the amount unclaimed is the full £190 cashback promised at the outset.
  - 2) Assuming 50% of those unable to claim get no cashback and 50% get half the cashback promised. In this case the average amount of cashback unclaimed is £143.
  - 3) Assuming that all of those 'unable to claim' receive half the cashback promised. In this case the average amount of cashback unclaimed is £95.
- A2.61 Multiplying the cashback owed for each scenario by the number of consumers unable to claim (i.e. 82,800 people) gives the following estimates for 'unclaimed' cashback under Method 3:

**Figure A2.2: Estimate for unclaimed cashback under Method 3**

| Scenario                            | £ million cashback 'unclaimed' over contract duration | Annualised estimate for £ million cashback 'unclaimed' (assuming average contract is 18 months duration) |
|-------------------------------------|---|--|
| 1) Average amount unclaimed is £190 | 16  | 11   |
| 2) Average amount unclaimed is £143 | 12  | 8  |
| 3) Average amount unclaimed is £95  | 8   | 5  |

- A2.62 Assuming an average contract duration of 18 months we calculate the annual amount of unclaimed cashback to be £5-£11 million, with a central estimate of £8 million (i.e. assuming 50% of those unable to claim get no cashback and 50% get half the cashback promised). The central estimate is similar to the Method 2 estimate of unclaimed cashback (£9 million pa).
- A2.63 Method 3 is still subject to certain limitations because we are unsure how many of those unable to claim managed to get part of the cashback and, in this case, what proportion of the cashback was obtained (we have made a central assumption that 50% got no cashback and 50% got half the cashback promised). This could be over or understated.
- A2.64 In addition, it is possible that some of the 6% of people reported as 'unable to claim' had chosen cashback deals which were 'too good to be true' thus should strictly be excluded from the measure of harm. As noted in the discussion of the Method 1, it is possible the harm is overstated because some consumers were 'unable to claim' for reasons other than mis-selling.
- A2.65 We have used evidence on cashback deals from the recent past to estimate the ongoing harm. It is possible that the ongoing harm will change in the future. For example, the harm might fall if the number of cashback deals decreases further e.g. if retailers switch from offering cashback to other sales incentives or if the redemption rate increases e.g. if the terms and conditions relating to cashback payments are made clearer and easier to follow. On the other hand, we cannot rule out the possibility that the number of cashback deals has temporarily fallen in response to attention from the media, Ofcom or greater consumer caution, and could rise again once this attention/awareness has subsided (as discussed in section A2.55).
- A2.66 For the reasons set out in section 4.44, we believe that Method 3 is the best estimate we are able to make of ongoing consumer harm from cashback. We propose to use the Method 3 estimate of cashback harm in assessing the impact of our preferred option (section A2.83 onwards).

### **Estimate of consumer detriment arising due to general mis-selling**

- A2.67 Since the 2008 Consultation we have conducted some consumer research to estimate the number of people aged 16+ who have suffered from 'general' mis-selling i.e. all other types of mis-selling excluding cashback. The research suggested that 2% of pay-as-you-go and 7% of contract mobile adults suffered

some form of general mis-selling (excluding cashback problems<sup>74</sup>). This amounts to 4% of all mobile phone consumers which equates to about 1.6 million people. Around two thirds of the sample had experienced the mis-selling in the last year (the research was conducted in August 2008).

- A2.68 We asked those who had suffered from mis-selling to estimate roughly how much money they lost because of the incorrect information given (we asked people to estimate the amount they were paying over and above that they were willing to pay for the service they actually received<sup>75</sup>). The financial loss amongst this sample of consumers ranged from £0 to over £500 with an average loss of £119 (over the life of the contract). Around two thirds of those mis-sold made a complaint, and one fifth of the people who complained received some compensation. The amount of compensation received amongst this sample of consumers ranged from £5 to £90.
- A2.69 The average consumer loss is calculated from a small sample of respondents, so we do not consider it prudent to use this to estimate the aggregate consumer harm arising due to mis-selling<sup>76</sup>. Instead we have taken a conservative approach to estimate the lower bound for the aggregate harm.
- A2.70 Around two thirds of the survey respondents reported that the loss arising from mis-selling was £20 or above - we think this is a reasonable proxy for a conservative average loss. To support this analysis we have compared the financial harm estimate with the average spend on mobile services. To proxy spend per person we have used the Ofcom Telecommunications Market Data Tables<sup>77</sup>, which publishes an estimate of the average retail revenue per subscriber for the 4 largest MNOs (by subscribers)<sup>78</sup>. Based on data for Q2 2008 the weighted average revenue per subscriber across the 4 MNOs was £51 per quarter (or £306 over the life of a contract assuming an 18 month duration). Therefore our estimate of mis-selling harm per person is only around 7% of revenue (spend) per subscriber over the contract length.
- A2.71 Further points to note include the following:
- We have not made any adjustment for compensation because only a small proportion of consumers received any recompense and we have already taken a very conservative view in estimating the financial harm due to mis-selling.
  - We have not made any adjustment for consumers that would have chosen the same contract/phone again in spite of being mis-sold. One approach would be to remove these people from the sample because their behaviour would have been the same regardless of the mis-sell. We could then recalibrate the estimate of harm on the smaller sample. This would result in a smaller number of mis-sold consumers but a higher estimate for the financial harm – so it is not clear whether the net impact on consumer harm would be positive or negative.

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<sup>74</sup> No consumers mentioned cashback when asked about mis-selling issues.

<sup>75</sup> The question asked was, "Try to compare the product you thought you were buying and the product you actually got. Roughly how much money would you say you have or might have lost because of the incorrect advice you were given? If you received any of your money back from your supplier can you please tell me how much money you had lost before you complained? Please exclude the cost of any phone calls you may have had to make [to complain]."

<sup>76</sup> We are unable to establish from the current data whether the sample of mis-selling cases captured is representative of mis-selling problems in aggregate.

<sup>77</sup> See [http://www.ofcom.org.uk/research/cm/tables/q2\\_2008/Q22008.pdf](http://www.ofcom.org.uk/research/cm/tables/q2_2008/Q22008.pdf)

<sup>78</sup> The MNOs are Vodafone, Orange, O2 and T-Mobile.

However, excluding these consumers would reduce the already small sample size and mean any statistics drawn from the sample were less robust.

- Around one third of the sample suffered mis-selling before the Code was introduced. Ideally we would just measure the ongoing harm based on a sample of complaints taken after the Code was implemented. However, this would mean reducing an already small sample (and the statistics from such a small sample size might not be reliable or representative). Therefore we have estimated harm across the whole sample, but offsetting any downward trend in harm following the introduction of the Code is the fact that we have deliberately selected a conservative level of harm (£20).

A2.72 Using the £20 estimate for average loss, a conservative estimate for aggregate consumer harm arising from mis-selling is in the order of £32 million<sup>79</sup>. This represents the loss incurred over the contract duration. Assuming an average contract length of 18 months we estimate that the annual harm arising from general mis-selling is around £21 million.

A2.73 We believe this estimate is a lower bound for the amount of financial harm arising due to general mis-selling and the actual harm could be significantly higher. To gather more information on the financial losses incurred due to general mobile mis-selling we also looked at a sample of 50 OAT complaints. For the sample of complaints examined the average loss due to mis-selling was reported as £372 – considerably higher than the estimate from the market research. However, the OAT data may overestimate the average financial loss per consumer for two reasons:

- We have assumed that consumers are more likely to make complaints to the OAT if the amount of loss involved is high, so there may be selection bias inflating the average.
- It is not clear whether consumers reported the incremental loss (i.e. just the loss they incurred due to the mis-information/mis-selling) or the entire cost of the contract. The measure we want to capture is the incremental loss, because in the latter case the loss might be inflated. For example, if a customer bought a contract believing the cost to be £10 a month but the actual cost, discovered after purchase, was £11 per month (e.g. because some call charges were not included in the package when the customer believed they were) then the incremental loss due to mis-selling is £1 a month, not the full £11 contract charge.

A2.74 If average mobile spend is £204 per year, a proxy for the incremental loss could be £372-£204 = £168. £168 is possibly an overestimate, but still over 8 times greater than our £20 estimate of financial loss.

A2.75 In addition, mis-selling can result in a number of other costs which we have not attempted to quantify, for example stress and anxiety when trying to resolve the issue. We have quantified the cost of time spent dealing with mis-selling problems below.

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<sup>79</sup> Number of people mis-sold (1.6 million) multiplied by estimate of financial harm (£20)

## Cost to consumers in terms of time spent in dealing with cashback and general mis-selling problems

- A2.76 Our market research reported that around two thirds of people who suffered from general mis-selling made a complaint. Making complaints and dealing with mis-selling problems can be time consuming, for example:
- Making phone calls to try and resolve mis-selling issues e.g. chasing up cash back payments.
  - Reviewing documentation and terms and conditions to prove a mis-sell has occurred.
  - Making phone calls/writing letters/visiting retail shops to complain to mobile retailers, MSPs and us or other consumer bodies.
- A2.77 Time spent dealing with mis-selling problems is an opportunity cost. 'Time saving' is commonly used to measure consumer convenience, for example in evaluating transport policies around the world<sup>80</sup>, to quantify benefits from easing Sunday trading restrictions<sup>81</sup>, and to measure expected benefits from e-government<sup>82</sup>. The time saving benefits that consumers get from a reduction in mis-selling problems could be a proxy for the reduction in inconvenience.
- A2.78 The amount of time spent dealing with mis-selling problems will vary from case to case. We consider that a conservative estimate of the average amount of time dealing with a mis-selling issue is half an hour.
- A2.79 Based on the market research carried out in August 2008 we estimate that around 1.6 million people suffered from general mis-selling and 82,800 people had problems claiming cashback. This totals 1.68 million people suffering from mobile mis-selling and equates to 0.84 million hours spent dealing with mis-selling issues (based on the assumption on time spent above).
- A2.80 We assume that people deal with mis-selling problems in their leisure time rather than working time, so the value of non-working time is used to convert time costs into money costs. This is a conservative assumption because it is possible that some people deal with problems during the working day and the value of working time is considerably higher than non-working time.
- A2.81 To estimate the value of time (VoT) we have used the 2002/3 estimate of non-commuting leisure time given by the Department for Transport<sup>83</sup> (DfT) and converted it to a 2008/9 price using historical price inflation (RPI). In addition, the DfT states that peoples' VoT grows with income so we have increased the VoT by the historical annual increase in average earnings (given by growth in real GDP per capita) multiplied by the elasticity of (non work) value of time to income (which is taken from the DfT).

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<sup>80</sup> <http://www.cfit.gov.uk/docs/2004/hsr/research/02.htm>

<sup>81</sup> <http://www.berr.gov.uk/files/file28193.pdf>

<sup>82</sup> [http://www.ogc.gov.uk/documents/HM\\_Treasury - Measuring the expected benefits of e-government.pdf](http://www.ogc.gov.uk/documents/HM_Treasury_-_Measuring_the_expected_benefits_of_e-government.pdf)

<sup>83</sup> [http://www.webtag.org.uk/webdocuments/3\\_Expert/5\\_Economy\\_Objective/3.5.6.htm](http://www.webtag.org.uk/webdocuments/3_Expert/5_Economy_Objective/3.5.6.htm), Section 1.2.20

A2.82 Based on the methodology above the value of non-working time in 2008/9 is £5.87 per hour<sup>84</sup>. This means the total time cost for dealing with mis-selling problems is estimated at about £5 million<sup>85</sup>. This is based on the 'stock' of people who have suffered mis-selling problems with their current mobile contract. If we assume that the average contract length is 18 months then an annualised estimate for the time cost is around £3 million.

### Section 3: Impact of the preferred option

#### Estimated costs of preferred option (implementing and complying with the proposed GC)

- A2.83 In the 2008 Consultation we assumed the incremental cost of introducing a GC would be small because it was largely formalising the Code which five MSPs had already signed up to and implemented. There were three areas where targeted provisions were added to the GC which were more onerous than the Code, as follows:
- To extend the length of time sales records have to be held from 6 to 12 months.
  - To send a confirmation letter containing certain information where a contract is entered into by telesales within 3 working days after the contract is completed.
  - To carry out certain due diligence checks on independent retailers which the MSP is already contracting with within 12 months from the GC coming into force.
- A2.84 Section 9.5 of the 2008 Consultation provides further details on the additional provisions. As part of the consultation we asked stakeholders to provide information on the costs associated with these additional provisions, and generally on the costs of formalising the Code into a GC. In light of comments received we decided to modify two of the targeted provisions noted above (requirement to keep records for 12 months and requirement to carry out due diligence on independent retailers that the MSP already contracts with). In addition, we changed the length of time allowed to send the confirmation letter for telesales from 3 working days to "in good time".
- A2.85 Through the consultation responses a number of MSPs indicated that costs would be incurred to implement the GC, but only one MSP was able to provide quantitative estimates. Most MSPs were able to identify which aspects of the proposed GC were most onerous for them. We have slightly modified the proposed GC in response to these comments - for example excluding pay-as-you-go from certain provisions (see Annex 5 for a full list of the changes). This should both reduce the burden on MSPs and substantially reduce the costs.
- A2.86 Based on the revisions the areas where we believe the GC goes beyond the Code are set out in section 5.18.
- A2.87 As part of the 2008 Consultation we also asked other stakeholders (e.g. independent retailers) to comment on the costs of implementing the proposals. Only a few independent retailers responded with comments.

<sup>84</sup> For comparison, the value of working time is around £30 per hour.

<sup>85</sup> Calculated as number of people mis-sold (including cashback) \* time spent \* value of time

A2.88 To conduct a thorough analysis we needed further information to determine:

- Whether changes made to the GC in response to consultation comments had reduced the anticipated compliance costs.
- Which areas of the GC still incurred incremental costs and the magnitude of these costs.
- How long it would take to implement the revised GC (and whether the implementation time would impact on the costs).

A2.89 Therefore we formally requested that MSPs provide us with detailed costs arising from implementing each provision in the GC. We also formally requested information on anticipated implementation costs from a few large independent retailers and informally from a number of smaller independent retailers and distributors.

A2.90 We had a very limited response to our informal request for information from retailers and distributors.

A2.91 Where cost estimates were provided in response to the formal request they varied widely depending on a number of factors, including:

- Current systems and processes.
- Interpretation of the GC
- The split of business between pay-as-you and pay monthly (costs for pay-as-you-go business are typically lower because a large number of the provisions do not apply to pay-as-you-go sales).

A2.92 Some respondents reported very low (or zero) anticipated costs on the basis that the requirements of the proposed GC were already covered by their existing processes. In addition, some of the respondents noted that some of the requirements could be included as part of the normal business process with lower cost if sufficient lead time was permitted.

A2.93 The implementation time is discussed in section 8. In light of responses to the consultation and our formal information request we have decided to increase the implementation time from 2 months (as proposed in the 2008 Consultation) to six months. This is to enable MSPs to incorporate some of the requirements of the GC as part of their normal business processes. (For example, allowing six months implementation means some MSPs might be able to include training on the GC as part of their planned program. A shorter period might mean holding bespoke training sessions).

A2.94 Some respondents noted that it was likely that implementation costs would be incurred for aspects of the GC, but could not estimate costs accurately because it was not possible to fully scope the changes required to processes/systems. Therefore it is possible that an element of costs has not been captured through the estimates provided to us.

- A2.95 Based on the information provided by MSPs we estimate that the one off and annual ongoing costs for all MSPs of implementing and complying with the GC would be £0.6 million and £0.9 million respectively<sup>86</sup>.
- A2.96 The cost estimates provided by independent retailers have been scaled<sup>87</sup> to represent the whole independent retailer market. We have assumed that the cost estimates provided are broadly representative across the industry. However, it is possible that the costs of compliance will be proportionately higher (relative to sales) for small retailers. This would be the case if some compliance costs are fixed regardless of scale. On the other hand, it is also plausible that smaller retailers would incur lower compliance costs per sale relative to larger retailers e.g. because it is easier to train staff about the GC in a smaller organisation (this would particularly be the case if staff turnover was lower). Because we have no prior knowledge on how costs vary by scale we have not made any adjustments to the cost information in this regard.
- A2.97 Based on the information provided by independent retailers we estimate that the one off and annual ongoing costs of implementing and complying with the GC would be £1.1 million and £3.4 million respectively. Possible reasons for the higher anticipated costs for independent retailers when compared against MSPs are discussed in section 5.30.
- A2.98 Based on the estimates provided, the one-off and annual ongoing costs for both MSPs and independent retailers are estimated at £1.7 million and £4.3 million respectively.

#### Potential impact of incremental compliance costs on consumers

- A2.99 The introduction of a GC will result in some MSPs and independent retailers incurring incremental costs, as described above. MSPs/retailers may react to these costs in a number ways:
- i) Pass the costs onto consumers in the form of a price increase (effectively this means that consumers would pay for the consumer protection measures we are proposing;
  - ii) Absorb the costs with no pass through to consumers (and thus incur reduced profits relative to the status quo).
  - iii) A combination of the above (i.e. pass part of the costs onto consumers and absorb the rest).
- A2.100 The more the costs of compliance are fixed and common costs (i.e. invariant to the number of sales), the less we would expect them to be passed through to subscriber bills.
- A2.101 In order to judge the potential impact of any cost pass through to consumers we have assessed the magnitude of the cost estimates in relation to total sales and revenue per subscriber. We requested information from MSPs on the number of total mobile sales made to individual consumers and SMEs from January to September 2008. Sales averaged 3.3 million per month which amounts to about 40

<sup>86</sup> To arrive at this estimate we summed the incremental costs of implementing the GC, no further adjustments were made to the data.

<sup>87</sup> The numbers have been scaled based on total pre and pay monthly sales by independent retailers to consumers and SMEs.

million over a year. Based on this information the extra ongoing cost per sale of introducing the proposed GC is around 11p (£4.3million ongoing cost divided by 40 million sales).

- A2.102 As noted above, the average revenue per subscriber is around £204 per year (based on the 4 largest MNOs). The ongoing cost per sale is tiny in relation to the revenue per sale (less than 0.1%). If MSPs/ independent retailers decided to pass costs through to consumers the increase in price would be very small in relation to annual spend on mobile services.
- A2.103 Based on the magnitude of the costs in relation to the number of sales and average revenue per subscriber we believe that in the event that MSPs/independent retailers did pass through annual ongoing costs it would have a negligible impact on typical subscriber bills.
- A2.104 Clearly the calculations above are sensitive to the number of sales per year and the average revenue per subscriber e.g. if the number of sales fell the cost per sale would increase. However, even if the number of sales halved to 20 million per year the ongoing cost per sale would only be around 22p which is still trivial in relation to revenues per sale. If the revenue per sale halved to £102 the ongoing cost per sale would still be less than 1% of average revenue.

### **Estimate for the net impact of the preferred option**

- A2.105 In section 2 above, and in the analysis of costs, we have attempted to quantify the current ongoing value of:
- 1) The financial harm arising from general mis-selling (£21 million per year).
  - 2) The financial harm arising from cashback mis-selling (Method 3 central estimate of £8 million per year).
  - 3) The cost of time spent dealing with general mis-selling and cashback problems (£3 million per year).
  - 4) The costs to MSPs and independent retailers for implementing and complying with the proposed GC (£1.7 million one off costs and £4.3 million annual ongoing costs).
- A2.106 In the next section we combine these estimates to calculate the net impact of introducing the proposed GC. Items 1-3 above reflect consumer harm currently occurring which we expect to be reduced by the introduction of the GC (i.e. the benefits of introducing the GC). Item 4 represents the estimated cost of introducing the GC.
- A2.107 We have assessed the impact of the proposed intervention by looking at the costs and benefits arising against the counterfactual of a continuation of the Code.

### **Estimate for reduction in harm following the introduction of the proposed GC**

- A2.108 Introducing a GC for mobile mis-selling should reduce consumer harm in two ways:
- 1) Direct enforcement of the rules leading to better sales practices.

- 2) The indirect threat of enforcement action may deter mis-selling meaning a lower level of consumer harm than would otherwise have been the case.

A2.109 It would be unreasonable to expect all of the ongoing harm from general mis-selling and unclaimed cashback to be eliminated by the introduction of the GC – i.e. that the GC would be 100% effective. To approximate how effective the GC might be we have tried to find a comparable case where we introduced a GC for consumer protection purposes so we could analyse how the introduction of the GC impacted on the level of consumer harm over time. For this purpose we have used the impact of the introduction of GC 22 relating to Broadband Migrations in February 2007<sup>88</sup>.

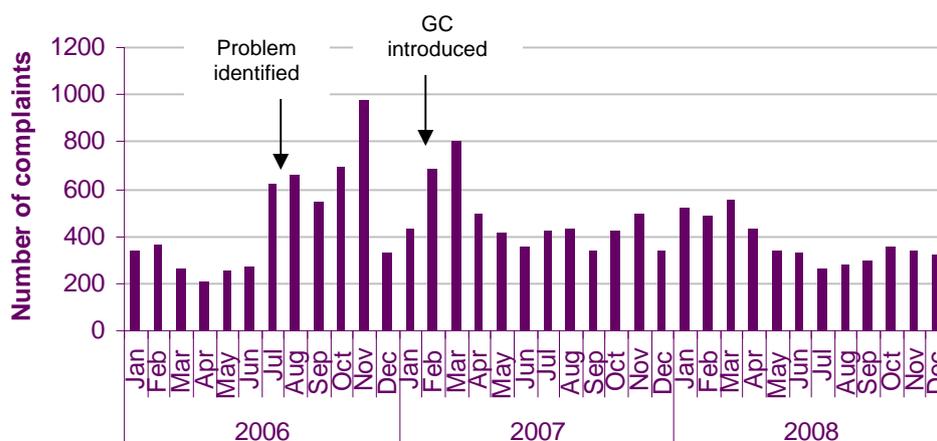
A2.110 We recognise that this is a starting point for the analysis of effectiveness and that GC 22 may be an imperfect proxy for the effectiveness of the proposed mis-selling GC. Later in this section we present some sensitivity scenarios and breakeven analysis to show how sensitive the final outcome is to changes in the assumptions about the effectiveness of the GC.

A2.111 Broadband services follow a Migrations Authorisations Code (MAC) Process. This requires the consumer to actively obtain a MAC from their existing internet service provider (ISP) and then submit it to their prospective provider before the switch can take place. Prior to the GC being introduced, the MAC process was incorporated within a Code of Practice which, while, having its advantages also suffered from a number of weaknesses - not least because the process depended on participation from the ISP losing the customer. During 2006 we saw evidence of increasing numbers of consumers facing disruption because they were unable to obtain a MAC from their existing ISP e.g. where there was an outstanding balance on their account. This had the effect of obstructing the switching process meaning the consumer was not able to take advantage of better deals in the market. This could result in financial harm if the consumer was unable to move to a cheaper package. We have assessed the amount of complaints relating to MACs received into the OAT before and after the introduction of the GC – the complaints reported per month are shown in the chart below.

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<sup>88</sup> We are using GC22 for comparison purpose rather than GC14.5 (on fixed-line mis-selling) because we believe the regulatory approach set out in GC22 is much closer to the approach intended under the mobile mis-selling GC, and because we are currently reviewing GC14.5 and consulting on changes to this GC.

**Figure A2.3 – MAC related complaints received by the OAT**



A2.112 In July 2006 MAC related issues started to generate significant complaints into the OAT. From July 2006 to February 2007 complaints relating to MACs averaged 619 per month<sup>89</sup>. Complaints decreased by about 30% in the year following implementation of the GC to an average of 429 per month<sup>90</sup>. More recently (from July to December 2008) complaints averaged around 309 per month, a decline of about 50%, compared to before the introduction of the GC.

A2.113 We use this experience in relation to broadband migrations as a proxy for the ongoing effectiveness of the GC on mis-selling. This includes any indirect ‘deterrent’ effect, i.e. any impact the GC might have over the Code in deterring mis-selling behaviour that might otherwise have resulted in harm. In doing so, we recognise that this evidence is an imperfect basis on which to make such an assessment. It assumes that the change in the number of complaints received is a reasonable proxy for the change in the general level of harm arising. It also assumes that the experience on the effectiveness of the GC in mis-selling will be comparable to that in broadband migrations. However, given that quantitative data on the effectiveness of a GC is sparse, we consider that this evidence is useful to inform our assumptions.

A2.114 We assume, therefore, that the proposed mobile mis-selling GC reduces ongoing harm by 30% in the first year and by 50% in subsequent years, compared to the level of harm without the GC.

A2.115 This assumption has been applied to all the anticipated benefits arising from the implementation of the GC (general mis-selling harm, cashback unclaimed and time savings) and factored into the calculation of the net present value.

### Net present value for the introduction of the GC

<sup>89</sup> The lower number of complaints reported in December 2006 is in part likely to reflect seasonal factors e.g. fewer calls received by the OAT due to Bank holidays.

<sup>90</sup> Excluding March 2007 because the rise in complaints was probably a result of increased publicity following the GC announcement and does not reflect the general downward trend.

A2.116 Each of the ongoing costs/benefits is projected forward for 5 years post implementation<sup>91</sup> and discounted back to the present time to calculate the net present value (NPV) of our proposed intervention<sup>92</sup>. The method used to project each of the costs/benefits forward is described in Annex 3. Two of these assumptions are summarised below:

- We assume the total number of mobile users grows in line with population projections taken from the ONS. In addition, we have assumed that the proportion of mobile users with pay monthly contracts (38% in 2008) will continue to grow in line with historic trends over 2002-08 (at 3.2% per year). It seems plausible that growth will continue at this rate over the next 5 years and implies that the proportion of mobile users with pay monthly contracts will be 45% in 2013/14.
- We have assumed that the ongoing MSP/retailer costs grow in line with the number of pay monthly users. This is because a significant proportion of the proposed GC (5 out of the 8 provisions) only applies to pay monthly contracts, thus we believe this to be the most appropriate cost driver. In addition, this is a conservative assumption because pay monthly contracts have been growing at a faster rate than pay-as-you-go, so any bias is likely to overstate costs.

**Figure A2.4: NPV for base case**

|   | PV over 5 years (£ million) |
|---|-----------------------------|
| Reduction in cashback harm (based on Method 3 central estimate of harm) | 16                          |
| Reduction in general mis-selling harm                                   | 45                          |
| Time savings  | 8                           |
| Costs (one off and ongoing)   | -23                         |
| <b>NPV</b>  | <b>45</b>                   |

A2.117 With our base case assumptions we expect the introduction of the proposed GC to result in a net benefit of £45 million over 5 years. It is notable that even if we take out the benefit from reducing cashback harm the proposed intervention would still have a positive net benefit.

## Sensitivity analysis

A2.118 Throughout this analysis we have used our best estimates for the input parameters. Where there has been significant uncertainty around specific inputs we have generally taken a conservative approach which is likely to have understated the benefits of implementing the GC. We recognise that there is uncertainty around

<sup>91</sup> It is likely that the costs and benefits of the proposed GC will continue to accrue beyond 5 years. Because the estimated ongoing benefits are larger than the ongoing costs increasing the number of years serves to increase the net benefit of the proposed GC. Therefore valuing the impact of the proposed intervention over 5 years is considered a conservative assumption.

<sup>92</sup> We assume that the ongoing costs and all the benefits arise in continuous time and thus use an exponential discount function for these items. The benefits and ongoing costs are modelled as arising once the GC is in force (i.e. after the implementation period). We assume that the one-off costs arise at a point in time (at the end of the 6 month implementation period) and these are discounted using a standard discount function. We use a 3.5% real discount rate taken from the HM Treasury Green Book – see [http://www.hm-treasury.gov.uk/data\\_greenbook\\_index.htm](http://www.hm-treasury.gov.uk/data_greenbook_index.htm)

the input values so we have created some sensitivity scenarios in order to show how changing specific inputs will affect the NPV.

A2.119 First, we have conducted the sensitivity analysis changing one input at a time, while holding the other inputs constant at the ‘base’ values. We refer to this exercise as the “individual sensitivity scenarios”. The approach taken is to vary each input by +/- 20%. The individual sensitivity scenarios generate a range of NPVs around the base case. They also enable us to determine which inputs the NPV is most sensitive to (the “key inputs”).

A2.120 Second, we have constructed low case and high case scenarios by taking the key inputs and varying them simultaneously. As a result, the range of NPVs between the low and high cases is significantly wider than for the individual sensitivity scenarios.

A2.121 Third, starting from the base case, we have identified the breakeven values of the key inputs. That is, the value of the input that would reduce the NPV to zero (with all other inputs at their base case values).

### Individual sensitivity scenarios

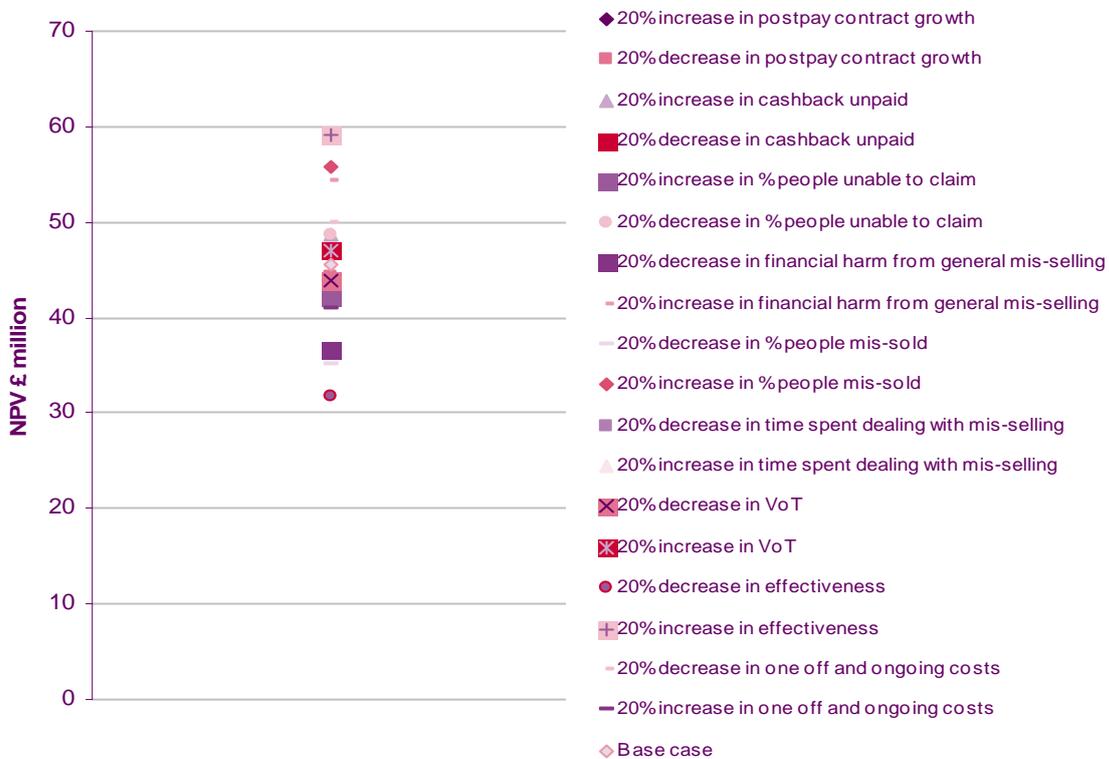
A2.122 The table and chart below presents the NPV for the individual sensitivity scenarios on nine input assumptions that are subject to greatest uncertainty.

**Figure A2.5: £million NPV for each individual sensitivity scenario**

| Scenario   |              | Base case value                          | Scenario value                               | NPV<br>£million | Change<br>relative to<br>base case<br>£ million |
|--|--------------|--|--|-----------------|---|
| <b>Base case</b>   |              | -  | -  | 45              | -   |
| <b>Pay monthly contract growth</b>   |              |  |  |                 |   |
| Growth in proportion of mobile users on pay monthly contracts compared to historic trend | 20% slower   | Growth = 3.2% per year                   | Growth = 2.6% per year                       | 44              | -1.1  |
|  | 20% faster   | Growth = 3.2% per year                   | Growth = 3.8% per year                       | 47              | 1.1   |
| <b>Cashback</b>  |              |  |  |                 |   |
| Cashback unpaid  | 20% decrease | £143                                     | £114   | 42              | -3.2  |
|  | 20% increase | £143                                     | £172   | 49              | 3.2   |
| Age of consumers unable to claim   | 20% decrease | 6%                                       | 5%   | 42              | -3.3  |
|  | 20% increase | 6%                                       | 7%   | 49              | 3.3   |
| <b>General mis-selling</b>   |              |  |  |                 |   |
| Financial harm from general mis-selling  | 20% decrease | £20                                      | £16  | 37              | -8.9  |
|  | 20% increase | £20                                      | £24  | 54              | 8.9   |
| Percentage of consumers mis-sold   | 20% decrease | 7% of pay monthly<br>2% of pay-as-you-go | 5.6% of pay monthly<br>1.6% of pay-as-you-go | 35              | -10.4   |
|  | 20% increase | 7% of pay monthly<br>2% of pay-as-you-   | 8.4% of pay monthly<br>2.4% of pay-as-       | 56              | 10.4  |

|                                     |              | go  | you-go  |    |       |
|-------------------------------------|--------------|---|---|----|-------|
| <b>Time savings</b>                 |              |   |   |    |       |
| Time spent dealing with mis-selling | 20% decrease | 0.5 hour                                      | 0.4 hours                                     | 44 | -1.5  |
|                                     | 20% increase | 0.5 hour                                      | 0.6 hours                                     | 47 | 1.5   |
| Value of time (non working)         | 20% decrease | £5.87   | £4.70   | 44 | -1.5  |
|                                     | 20% increase | £5.87   | £7.04   | 47 | 1.5   |
| <b>Effectiveness of GC</b>          |              |   |   |    |       |
| Reduction in harm due to GC         | 20% decrease | Harm reduction= 30% during Y1<br>50% after Y1 | Harm reduction= 24% during Y1<br>40% after Y1 | 32 | -13.6 |
|                                     | 20% increase | Harm reduction= 30% during Y1<br>50% after Y1 | Harm reduction= 36% during Y1<br>60% after Y1 | 59 | 13.6  |
| <b>Costs</b>                        |              |   |   |    |       |
| One off and ongoing costs           | 20% decrease | £1.7 million one off<br>£4.3 million          | £1.4 million one off<br>£3.4 million ongoing  | 50 | 4.5   |
|                                     | 20% increase | £1.7 million one off<br>£4.3 million ongoing  | £2.0 million one off<br>£5.2 million ongoing  | 41 | -4.5  |

Figure A2.6 – NPV for individual sensitivity scenarios



A2.123 The individual sensitivities yield the cluster of NPV results shown in the chart. The range around the base case NPV of £45 million is £32-59 million.

A2.124 Based on this analysis of individual sensitivities the five key inputs the base case is most sensitive to are:

- 1) The effectiveness of the GC (i.e. reduction in harm due to GC)
- 2) The percentage of consumers suffering from general mis-selling
- 3) Financial harm from general mis-selling
- 4) One off and ongoing costs
- 5) The percentage of consumers unable to claim cashback

### **Low and high case scenarios**

A2.125 The sensitivity scenarios capture the impact of changing one input at a time. We have also created a 'low case NPV' and a 'high case NPV' by changing the five key inputs simultaneously.

A2.126 In the absence of better information, we regard +/-20% as a reasonable variation in input values to construct the low and high cases. Although larger variations in the input values are possible, we have taken two considerations into account. First, the low and high cases involve simultaneous variation in the values of five inputs. This tends to suggest that the greater the variation in each input value, the less likely that such simultaneous variation would occur at the assumed low and high values<sup>93</sup>. Second, in constructing low and high cases, we are not intending to identify the extreme bounds of possible NPVs. Rather we are seeking to identify a plausible range around the base case NPV.

A2.127 To create the low and high case we have used +/-20% change from the base case for the following inputs:

- Effectiveness of the GC.
- Financial harm from general mis-selling.
- One off and ongoing costs.

A2.128 We have used the upper and lower 95% confidence intervals (based on our sample estimates) for the following inputs:

- The percentage of consumers suffering general mis-selling.
- The percentage of consumers unable to claim cashback.

A2.129 In statistical terms this is the range within which we can be 95% confident that the true population value lies, and we believe this is a more plausible measure of the possible low and high values that these inputs could take.

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<sup>93</sup> We have not attempted to construct probability distributions for each input value, but we generally consider it reasonable to regard the probabilities as being larger in the region of the base case value and lower for values further away (e.g. in the tails of the distribution).

A2.130 The 'low case' scenario is created by setting the key inputs to the values that imply lower benefits and higher costs. The 'high case' scenario reflects more optimistic values for the key inputs: larger benefits and lower costs. The values used for each scenario are set out below:

**Figure A2.7: Inputs for low and high case scenarios**

| Input  | Value for low case                           | Value for high case                          |
|--|--|--|
| <b>Cashback scenario inputs</b>                                |  |  |
| Percentage of consumers unable to claim (confidence intervals) | 2%   | 10%  |
| <b>General mis-selling</b>                                     |  |  |
| Percentage of consumers mis-sold (confidence intervals)        | 5% of pay monthly<br>1% of pay-as-you-go     | 9% of pay monthly<br>3% of pay-as-you-go     |
| Amount of financial harm (+/- 20%)                             | £16 over contract length                     | £24 over contract length                     |
| <b>Effectiveness of general condition</b>                      |  |  |
| Reduction in harm due to GC (+/-20%)                           | 24% year 1, 40% after year 1                 | 36% year 1, 60% after year 1                 |
| <b>Costs</b>   |  |  |
| One off and ongoing costs (+/- 20%)                            | £2.0 million one off<br>£5.2 million ongoing | £1.4 million one off<br>£3.4 million ongoing |

A2.131 Based on the above inputs the NPVs in the low and high cases are as follows, compared to the base case:

**Figure A2.8: Low and high case NPV scenarios**

| Scenario  | NPV £ million |
|-----------|---------------|
| Base case | 45            |
| Low case  | 1             |
| High case | 111           |

A2.132 Under the low case scenario the NPV of the proposed GC is only £1 million. Since, as explained above, our low and high cases are not intended to be the extreme bounds, we could not rule out the possibility of a negative NPV if there was substantial downside variation to several key inputs simultaneously. However, we consider that scenarios with negative NPVs are less likely, as they rely on all of the key inputs simultaneously taking much lower values than in the base case.

### Breakeven analysis

A2.133 To determine how much each of the key inputs could change individually before the NPV is zero we have conducted a breakeven analysis. In this analysis each input is varied individually while the others are held constant at the base case value. The results are shown below:

**Figure A2.9: Breakeven value for key inputs – other inputs at base values**

| <b>Input</b>   | <b>Base case value</b>  | <b>Break even value</b>   | <b>% change relative to base case</b> |
|--|---|---|---------------------------------------|
| Effectiveness of GC  | 30% reduction in harm during year 1<br>50% reduction in harm after year 1 | 10% reduction in harm during year 1<br>16.5% reduction in harm after year 1 | -66%                                  |
| Financial harm from mis-selling                            | £20   | £0 (NPV still positive ie £1 million)                                       | -100%                                 |
| Percentage of consumers suffering from general mis-selling | 7% pay monthly<br>2% pay-as-you-go  | 0.84% pay monthly<br>0.24% pay-as-you-go                                    | -88%                                  |
| One off and ongoing costs                                  | £1.7 million one off<br>£4.3 million ongoing                              | £5.0 million one off<br>£13.2 million ongoing                               | +204%                                 |
| Percentage of consumers unable to claim cashback           | 6%  | 0% (NPV still positive ie £29 million)                                      | -100%                                 |

A2.134 The breakeven analysis shows that – individually – the base case inputs can fall significantly before the NPV is zero.

## Annex 3

# Costs and benefits inputs

A3.1 This annex outlines how the mobile mis-selling ongoing cost and benefit inputs are forecast over 5 years in order to calculate the base case NPV for introducing the proposed GC. The projected costs and benefits are discounted at a 3.5% real rate consistent with the HM Treasury Green Book<sup>94</sup>.

### Cashback harm

A3.2 The number of people unable to claim cashback is calculated as follows:

UK adults \* % with a mobile phone \* % of mobile users that are pay monthly \* % of pay monthly users that take cashback \* % of cashback customers unable to claim

A3.3 The number of adults is assumed to grow in line with population growth (as predicted by ONS population projections<sup>95</sup>). The percentage of adults with a mobile phone is assumed to be constant at 88% (based on Ofcom's Communications Tracking Survey Q3 2008). Based on data from this survey 38% of mobile users were on a pay monthly contract. We have assumed that the proportion of mobile users with pay monthly contracts will continue to grow in line with the historic trend over 2002-08 (i.e. at 3.2% per year)<sup>96</sup>. It seems plausible that growth will continue at this rate over the next 5 years.

A3.4 We assume the percentage of pay monthly users taking cashback contracts is constant at 9% (based on Ofcom market research on cashback and misselling in August 2008) and the number of people unable to claim cashback is constant at 6% (estimated from Ofcom market research surveys on cashback and mis-selling in November 2007).

A3.5 We assume that the amount of cashback each person is unable to claim grows at the same rate as average spend on pay monthly mobile contracts. Ofcom's Communications Market 2008report<sup>97</sup> showed that average spend per pay monthly reduced at a real terms rate of 3.8% per year since 2002. Therefore we assume that the amount of cashback each person is unable to claim decreases by 3.8% per year.

### General mis-selling harm

A3.6 Both pay-as-you-go and pay monthly customers are affected by general mis-selling. The number of pay monthly users mis-sold is calculated as follows:

UK adults \* % with a mobile phone \* % of mobile users that are pay monthly \* % of pay monthly users suffering mis-selling

<sup>94</sup> see [http://www.hm-treasury.gov.uk/data\\_greenbook\\_index.htm](http://www.hm-treasury.gov.uk/data_greenbook_index.htm)

<sup>95</sup> [http://www.statistics.gov.uk/downloads/theme\\_population/NPP-2006/NPP06\\_NSOnline.pdf](http://www.statistics.gov.uk/downloads/theme_population/NPP-2006/NPP06_NSOnline.pdf)

<sup>96</sup> This assumption is changed in the sensitivity scenarios. The growth in pay monthly contracts is a percentage growth rate, not a percentage point growth.

<sup>97</sup> <http://www.ofcom.org.uk/research/cm/cmr08/>

- A3.7 As above, the number of adults is assumed to grow in line with general population growth. The percentage of adults with a mobile phone is assumed to be constant at 88%. The percentage of mobile users who are pay monthly is assumed to grow inline with historic trend over 2002-08 (at 3.2% per year). The number of pay monthly users suffering from mis-selling is estimated at 7% (based on the Ofcom market research survey of cashback and mis-selling August 2008) and this is assumed to remain constant.
- A3.8 The number of pay-as-you-go users mis-sold is calculated as follows:
- $$\text{UK adults} * \% \text{ with a mobile phone} * \% \text{ of mobile users that are pay-as-you-go} * \% \text{ of pay-as-you-go users suffering mis-selling}$$
- A3.9 The growth assumptions about UK adults and the % of adults with a mobile phone are as in A3.7. We assume that the number of pay-as-you-go users grows in a manner consistent with the total number of mobile subscribers and growth is the number of pay monthly contracts. The number of pay-as-you-go users suffering from mis-selling is estimated at 2% (based on the Ofcom market research survey of cashback and mis-selling August 2008) and this is assumed to remain constant.
- A3.10 We made a conservative estimate<sup>98</sup> that the average amount of financial harm suffered per mis-sell was around £20 over the contract duration (across both pay-as-you-go and pay monthly contracts). We have assumed that the amount of financial harm suffered grows at the same rate as overall mobile spend (i.e. the average across both pre and pay monthly users). Based on the Ofcom's Communications Market 2008 report<sup>99</sup> there has been a real reduction in spend of 2.1% per year since 2002. Therefore we assume that the amount of financial harm per mis-sell will decrease by 2.1% per year going forward.

### **Cost to consumers in terms of time spent in dealing with cashback and general mis-selling problems**

- A3.11 The harm arising from time spent dealing with cashback and general mis-selling problems is calculated as follows:
- $$(\text{Number of people unable to claim cashback} + \text{number of people suffering general mis-selling}) * \text{time spent dealing with problem} * \text{non working value of time}$$
- A3.12 The forecast for the number of people unable to claim cashback is the same as above – see sections A3.3 to A3.5. The forecast for the number of people suffering from general mis-selling is set out in sections A3.6 to A3.9.
- A3.13 We assume that the amount of time spent dealing with cashback or mis-selling is constant over time at 0.5 hours per problem.
- A3.14 To estimate the value of time (VoT) we have used the 2002-03 estimate of non-commuting leisure time given by the Department for Transport<sup>100</sup> (DfT) and converted it to a 2008-09 price using historical price inflation (RPI). In addition, the DfT states that peoples' VoT grows with income so we have increased the VoT by the historical annual increase in average earnings (given by growth in real GDP per

<sup>98</sup> The estimate was based on information from the market research survey (August 2008).

<sup>99</sup> <http://www.ofcom.org.uk/research/cm/cmr08/>

<sup>100</sup> [http://www.webtag.org.uk/webdocuments/3\\_Expert/5\\_Economy\\_Objective/3.5.6.htm](http://www.webtag.org.uk/webdocuments/3_Expert/5_Economy_Objective/3.5.6.htm), Section 1.2.20

capita) multiplied by the elasticity of (non work) value of time to income (taken from the DfT)<sup>101</sup>. Based on the methodology above the value of non-working time in 2008/9 is £5.87 per hour.

- A3.15 The value of non working time is assumed to increase at the rate of real GDP growth per person multiplied by the elasticity of non working value of time to income. The elasticity of non working value of time to income is taken from the DfT and assumed to be constant at 0.8. The GDP projections are taken from the HM Treasury Pre-Budget Report 2008<sup>102</sup>.

### **Estimated costs of implementing and complying with the GC**

- A3.16 The estimated ongoing costs for MSPs and independent retailers are assumed to grow in line with the number of pay monthly users. This is because a significant proportion of the proposed GC (5 out of the 8 provisions) only applies to pay monthly contracts, thus we believe this to be the most appropriate cost driver. In addition, this is a conservative assumption because pay monthly contracts have been growing at a faster rate than pay-as-you-go, so any bias is likely to overstate costs.

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<sup>101</sup> We have followed the DfT methodology to arrive at a 2008-09 estimate for the VoT.

<sup>102</sup> [http://www.hm-treasury.gov.uk/d/pbr08\\_annexa\\_339.pdf](http://www.hm-treasury.gov.uk/d/pbr08_annexa_339.pdf)

## Annex 4

# Detailed comments on the proposed General Condition

A4.1 In the tables below we set out, for each provision of the proposed General Condition, the detailed comments made by stakeholders and Ofcom's response, and where we have made changes, the action taken.

### *Scope of the General Condition: GC 23.1*

| Comment   | Organisation | Ofcom response and action   |
|---|--------------|---|
| A number of requirements cannot be complied with for prepaid services.              | MSPs         | Pay-as-you-go (as well as SIM-only) services have been excluded from several provisions of the GC. This change has been made primarily because pay-as-you-go presents a lower risk of harm for consumers (consumers can more quickly identify charges and can exit their contract without penalty). |
| Unclear whether the GC will apply to mobile broadband services.                     | 3            | We have clarified that mobile broadband services are excluded from the GC. It was not our intention to include them under the GC set out in the 2008 consultation, as we did not have evidence of mis-selling in respect of these services.   |
| The definition of mobile services would include all wireless services such as WiFi. | BT           | We have clarified that wi-fi services are excluded from the GC. It was not our intention to include them under the GC set out in the 2008 consultation as we did not have evidence of mis-selling in respect of these services.   |
| No evidence that mis-selling or cashback issues are a specific problem for SMEs.    | O2           | We have evidence of SMEs being mis-sold to. Because of the harm involved and the fact that the Enterprise Act does not cover SMEs, we consider SMEs should be included in the scope of the GC.  |

### *Mis-selling prohibition: GC 23.2*

| Comment  | Organisation | Ofcom response and action   |
|--|--------------|---|
| Questions whether the inclusion of another contract with the same MNO should be categorised as slamming. | Orange       | As set out in the 2008 consultation in section 2.4 we observed that slamming in the mobile market can be distinct from forms of fixed slamming. Since we have seen a significant number of complaints from customers being entered into a new contract from their existing supplier without their knowledge and/or consent, we believe it is useful to include this type of behaviour as mobile slamming. |
| Suggests adding the following at the end of 23.2: 'Where other companies act as agents for it, the MSP   | SSE          | In GC 23.4 the requirement for MSPs to ensure compliance with the rules set out in 23.2, is set out. We believe that the way this is defined in the proposed GC captures all relationships between  |

|   |  |   |
|---|--|---|
| must take all reasonable steps to ensure that any company dealing with a customer on its behalf also abides by those requirements.' |  | MSPs and retailers, and would therefore include agency relationships. |
|---|--|---|

*Publication of relevant obligations: GC 23.3*

| Comment   | Organisation | Ofcom response and action  |
|---|--------------|--|
| More appropriate, useful to customers and consistent with consumer related obligations of other GCs if the obligation to provide a copy of obligations under GC 23 related to the comprehensive summary of obligations rather than a copy of the GC itself. | SSE          | <p>We believe that if consumers are interested, they should be provided with a copy of the whole GC rather than the summary.</p> <p>We also note that the MSPs are under an additional obligation to provide a comprehensive summary of the obligations on their website where it should be easily accessible for consumers.</p> |

*Obligation with regards to Mobile Service Retailers: GC 23.4*

| Comment  | Organisation  | Ofcom response and action  |
|--|---------------|--|
| The use of the term 'best endeavours' should be changed to 'reasonable endeavours' throughout the GC.                              | MSPs, MBG     | <p>For a number of provisions, a 'best endeavour' obligation was originally included in the proposed GC. However, based on responses to the consultation we have changed the wording throughout the GC as follows:</p> <ul style="list-style-type: none"> <li>- where an MSP contracts with or appoints a retailer directly, the wording has been changed to 'must ensure'.</li> <li>- where a third party acting on behalf of the MSP contracts with or appoints a retailer, the wording has been changed to 'reasonable endeavours'.</li> </ul> <p>We believe that 'reasonable endeavours' more fairly reflects the level to which MSPs can ensure compliance by Mobile Service Retailers.</p> |
| Proposed requirement to monitor retailers should be proportionate. Checking material of retailers as this could be very expensive. | O2            | Checking retailers' material is only one possible way of ensuring compliance with the requirements so we have included it as such in the guidelines.   |
| 23.4.d requires greater clarification about what 'appropriate sanctions' might be, especially when an MNO might need to            | Virgin Mobile | The guidelines provide clarification "With regards to GC 23.4 (d), appropriate sanctions by the MSP might depend on the severity and possible recurrence of a breach. In Ofcom's view they could include giving verbal or written warnings to the retailer, requiring the  |

|                       |  |   |
|-----------------------|--|---|
| consider termination. |  | retailer to prevent recurrence in the future, requiring the retailer to remedy the breach or, in certain severe cases, ceasing to deal with a particular distributor or retailer. MSPs could require third parties acting on their behalf to undertake similar activities.” |
|-----------------------|--|---|

*Mobile Service – Information at Point of Sale: GC 23.5*

| Comment   | Organisation          | Ofcom response and action  |
|---|-----------------------|--|
| It is unclear how the MSP is to ensure the customer is authorised to enter into a contract are unclear.   | Orange                | <p>Ensuring the customer is authorised to enter into a contract could prevent instances of slamming, where organisations enter customers into a contract without any identification, and identity theft.</p> <p>We have changed the ‘best endeavours’ obligation to reasonable endeavours and excluded pay-as-you-go and SIM-only from this provision. We believe that ‘reasonable endeavours’ more fairly reflects the level to which MSPs can ensure compliance by Mobile Service Retailers.</p> <p>We have excluded pay-as-you-go and SIM-only has been made primarily because pay-as-you-go presents a lower risk of harm for consumers (consumers can more quickly identify charges and can exit their contract without penalty).</p> |
| 23.5.b requirement for the MSP to use best endeavours to ensure the customer understands and intends to enter into the contact would suggest that MSPs need to present at every sale. | Orange, MBG, T-Mobile | <p>We have changed best endeavours obligation to reasonable endeavours obligation</p> <p>We believe that ‘reasonable endeavours’ more fairly reflects the level to which MSPs can ensure compliance by Mobile Service Retailers and would not require the MSP to be present at every sale.</p>   |
| 23.5.c.ii: Not possible to comply with the requirement to send information in respect of telesales because of system limitations.   | Orange                | We have modified the requirement to send information in respect of telesales from ‘within 3 working days’ of the sale to ‘in good time’. This change has been made to allow providers more flexibility to reflect their business’ and customers’ needs and to reflect the provisions in the Distance Selling Regulations <sup>103</sup> .  |
| Proposed requirement 23.5.c to give the cost of charges is too detailed to cover in a telephone sales call.   | BT, Virgin Mobile     | It was not our intention for all charges to be provided. We have changed ‘the cost of charges’ to ‘the cost of key charges’ and specified what we mean by key charges in the guidelines.   |

<sup>103</sup> The Consumer Protection (Distance Selling) Regulations 2000 (SI 2000 No 2334)  
<http://www.opsi.gov.uk/si/si2000/20002334.htm>

*Records retention: GC 23.6*

| <b>Comment</b>  | <b>Organisation</b> | <b>Ofcom response and action</b>   |
|---|---------------------|--|
| The record keeping requirement is too onerous   | T-Mobile            | We have changed this provision. We have reduced the record keeping time period from 12 to 6 months, except for cashback offers, where the redemption period determines the period during which contracts must be kept. We have made this change because this level is thought to be adequate for any Ofcom investigations that may occur to enforce the GC and follows Ofcom practice in the GC that address the sales and marketing of fixed-line services (GC14.5) |
| Unclear as to whether the record keeping requirements are mandatory.                                    | Orange              | The requirements are mandatory.  |
| Should the requirement to record the date of contact with the customer be the date of contract instead? | O2                  | We have clarified in the GC that we intended this to be the date of sale.  |
| 'Where applicable' should be added at the end of the section where sales via internet are mentioned.    | SSE                 | This has been added to the provision.  |

*Training: GC 23.7*

| <b>Comment</b>   | <b>Organisation</b> | <b>Ofcom response and action</b>  |
|--|---------------------|---|
| Best endeavours obligation too onerous.  | O2, Orange          | We have modified requirements that MSPs use 'best endeavours' to ensure Mobile Service Retailers comply with provisions to ones that require them to use 'reasonable endeavours'. We believe that 'reasonable endeavours' more fairly reflects the level to which MSPs can ensure compliance by Mobile Service Retailers. |
| It should be the responsibility of the staff which are engaged in the sales process to ensure they are familiar with general consumer law. | T-Mobile            | We have taken out the reference to consumer law in the guidelines.  |

*Due diligence: GC 23.8*

| <b>Comment</b>   | <b>Organisation</b> | <b>Ofcom response and action</b>  |
|--|---------------------|---|
| Guidelines require MSPs to assess the viability of a retailer's business model. This would require the MSP | 3, MBG              | We have taken this out of the guidelines because it appears to be impractical for the MSP to obtain the |

|  |               |  |
|--|---------------|--|
| to know commercially sensitive information.  |               | information.   |
| An MSP cannot find out whether another MSP owes money to their customers.  | 3             | We have taken out this part of the provision because it appears to be impractical for the MSP to obtain the information.   |
| 23.8 (h) to request copies of retailers' terms and conditions and verify they are compliant with this GC would require the MSP to assume liability for compliance by retailers with general law. Such a requirement would be disproportionate.   | 3, Orange, O2 | We have taken out this part of the provision it appears to be impractical for the MSP to obtain and check the information for all their retailers.   |
| 23.8 (h) would require MSPs to legally sign off all retailers terms and conditions. This seems to be unjustified and disproportionate.   | O2            | We have taken out this part of the provision it appears to be impractical for the MSP to obtain and check the information for all their retailers.   |
| One MSP wonders whether Ofcom has made reporting arrangements with the OFT in respect of 23.8.e  | O2            | We have taken out this part of the provision it appears to be impractical for the MSP to obtain the information.   |
| Due diligence provisions are fundamentally flawed in that not all required information can be obtained from a credit check and it is unclear what MSPs are expected to do as a result of having obtained the information.  | Orange        | We believe all the information set out in the changed provision 23.8 can be obtained. We note that the due diligence provision in the Code, which Orange signed up to, goes beyond the changed provision 23.8. It was our intention not to be prescriptive as to how MSPs should use the due diligence information they have obtained, but rather leave it to the MSP's own discretion how to use this information as part of their normal business processes.   |
| Costs of due diligence obligations will be extremely high and disproportionate. In particular the requirements to check independent retailers within 12 months from the GC coming into effect, conduct appropriate checks to assess whether any due diligence information remains up to date and relevant and verify that the retailer is compliant with the GC and applicable consumer protection laws. | T-Mobile      | The requirement to check all independent retailers within 12 months has been removed on grounds of proportionality, as has the requirement to verify that the retailer is compliant with the GC and applicable consumer protection laws.<br><br>We have kept the requirement to conduct appropriate checks to assess whether any due diligence information remains up to date and relevant since a very similar requirement is included in the Code, and the MNOs, having signed up to this, should already be doing this. |

*Sales incentives – Information at Point of Sale: GC 23.9*

| <b>Comment</b>   | <b>Organisation</b> | <b>Ofcom response and action</b>  |
|--|---------------------|---|
| Best endeavours obligation disproportionate.   | O2                  | Best endeavours obligation changed to reasonable endeavours obligation. We believe that 'reasonable endeavours' more fairly reflects the level to which MSPs can ensure compliance by Mobile Service Retailers. |
| Ofcom should give a clearer definition 'unduly restrictive; terms and conditions to ensure compatibility with EC and UK competition law. | Vodafone            | We believe the examples given of 'unduly restrictive' in the guidelines are sufficiently clear. As set out in Section 4, we do not believe this provision goes against EC and UK competition law.               |

## Annex 5

# Table of changes

A5.1 Set out below are the differences between the GC set out in Annex 6 of this statement and the GC proposed in the 2008 consultation.

| GC No | GC text <sup>104</sup>  | Main changes from consultation   |
|-------|---|--|
| 23.1  | A Mobile Service Provider must comply with this GC with respect to a Customer of its Mobile Telephony Services, except that clauses 23.4(b)(iv) and 23.5 – 23.10 do not apply to Prepaid Mobile Telephony Service and SIM Only Contracts.   | Pay-as-you-go services and SIM-only contracts now excluded from several provisions.<br>Scope and definitions make clear that mobile broadband, Wi-Fi services and SIM- only services are excluded  |
| 23.2  | When selling or marketing Mobile Telephony Services, the Mobile Service Provider must not: a. engage in dishonest, misleading or deceptive conduct; b. engage in aggressive conduct; or c. contact the Customer in an inappropriate manner.   | No changes   |
| 23.3  | The Mobile Service Provider must: a. publish a comprehensive summary of its obligations under this GC 23 in an easily accessible and reasonably prominent manner on its website or, where there is no such website, by making it available in its registered office during normal office hours for inspection free of charge by members of the general public; and b. provide a copy of this GC to a Customer free of charge upon reasonable request.   | No significant changes   |
| 23.4  | Where the Mobile Service Provider contracts with or appoints a Mobile Service Retailer directly in order to sell or market the Mobile Service Provider's Mobile Telephony Services it must ensure, and where a third party acting on behalf of the Mobile Service Provider contracts with or appoints a Mobile Service Retailer in order to sell or market the Mobile Service Provider's Mobile Telephony Services the Mobile Service Provider must use reasonable endeavours to ensure, that:<br>a. the Mobile Service Retailer is aware of this GC;<br>b. provisions are in place which require the Mobile Service Retailer:<br>(i) not to engage in dishonest, misleading or deceptive conduct;<br>(ii) not to engage in aggressive conduct;<br>(iii) not to contact a Customer in an inappropriate manner; and<br>(iv) to create and keep records about the sale of the Mobile Service Provider's Mobile Telephony Services for a period of not less than six months and, where applicable, about a related sales incentive as referred to in GC 23.10, for a period of not less than ninety days after the date by which this sales incentive has to be fully redeemed, but not less | New distinction of level of obligation depending on the parties MSPs are contracting with: A "must ensure obligation" where the MSP contracts directly with the retailer and a "reasonable endeavour obligation" where third parties acting on behalf of MSP contract with the retailer.<br><br>Requirement in respect of retaining records relating to:<br>- sales modified from 'not less than 12 months' to 6 months.<br>- the sales incentive modified from 'not less than 12 months' to 90 days after the date by which this sales incentive has to be fully redeemed, but not less than six months |

<sup>104</sup> Please note that we re-produce the text of General Condition 23 here solely for reasons of comparison and to highlight the main changes. The text set out in this Annex 5 does not constitute the relevant text for the purpose of establishing CPs obligations. For the latter reason please refer to the original text set out in the Schedule to the Notification in Annex 6.

| GC No | GC text <sup>104</sup>   | Main changes from consultation  |
|-------|--|---|
|       | <p>than six months.</p> <p>c. the Mobile Service Provider monitors the Mobile Service Retailer's compliance with the provisions referred to in GC 23.4 (b); and</p> <p>d. non-compliance by the Mobile Service Retailer with the provisions referred to in GC 23.4 (b) is appropriately sanctioned by the Mobile Service Provider</p>  |   |
| 23.5  | <p>The Mobile Service Provider must use reasonable endeavours to ensure that before entering into or amending a contract for a Mobile Telephony Service the customer:</p> <p>a. is authorised to do so;</p> <p>b. intends to enter into this contract; and</p> <p>c. is provided with the information set out below in a clear, comprehensible and accurate manner in paper or another Durable Medium which is available or accessible to the Customer or, where the Customer enters into or amends the contract during a sales call, by telephone:</p> <p>i. the identity of the legal entity the Customer is contracting with; its address and telephone, fax and/or e-mail contact details;</p> <p>ii. a description of the Mobile Service; the cost of key charges (including minimum contract charges and any early termination charges, if applicable); payment terms; the existence of any termination right, including termination procedures; the likely date the Mobile Telephony Service will be provided, in case the provision of the Mobile Telephony Service is not immediate; and any minimum period of contract.</p> <p>Where the Customer enters into a contract during a sales call, in addition to the oral provision of this information the Mobile Service Provider must use reasonable endeavours to ensure that this information is sent to the Customer in good time in paper or another Durable Medium</p> | <p>Requirement modified from 'best endeavours' to 'reasonable endeavours'</p> <p>Timescales for sending information after a sales call modified from 3 working days to 'in good time'</p>   |
| 23.6  | <p>Where the Mobile Service Provider acts as a Mobile Service Retailer, it must create and keep records about the sale of its Mobile Telephony Services for a period of not less than six months and, where applicable, about a related sales incentive as referred to in GC 23.10, for a period of not less than ninety days after the date by which the this sales incentive has to be fully redeemed, but not less than six months. Such records must include the date of the sale, the means through which the contract was entered into and the place where the contract was entered into, where applicable</p>   | <p>Requirement in respect of retaining records relating to:</p> <ul style="list-style-type: none"> <li>- sales modified from 'not less than 12 months' to 6 months</li> <li>- the sales incentive modified from 'not less than 12 months' to a period of not less than ninety days after the date by which the this sales incentive has to be fully redeemed, but not less than six months</li> </ul> |
| 23.7  | <p>The Mobile Service Provider must use reasonable endeavours to ensure that processes are in place which assure that a Mobile Service Retailer is appropriately trained to comply with this GC.</p>   | <p>Requirement modified from 'best endeavours' to 'reasonable endeavours' and from 'to ensure' to 'to ensure that processes are in place'</p>   |
| 23.8  | <p>Where the Mobile Service Provider contracts with or appoints a Mobile Service Retailer directly in order to sell or market the Mobile Service Provider's Mobile Telephony Services it must ensure that, and where a third party acting on behalf of the Mobile Service Provider contracts with or</p>   | <p>Distinction between parties MSPs are directly contracting with (must ensure obligation) and third parties acting on behalf of MSP (reasonable endeavours obligation).</p>  |

| GC No | GC text <sup>104</sup>   | Main changes from consultation  |
|-------|--|---|
|       | <p>appoints a Mobile Service Retailer in order to sell or market the Mobile Service Provider's Mobile Telephony Services the Mobile Service Provider must use reasonable endeavours to ensure that, it, or a person acting on its behalf, carries out and retains a record of the following minimum procedures with regards to any Mobile Service Retailer, contracted or appointed to sell or market the Mobile Service Provider's Mobile Telephony Services:</p> <p>a. carry out a credit reference search and check that the Mobile Service Retailer does not have a history of failing to meet its financial undertakings to creditors;</p> <p>b. check that any director of a Mobile Service Retailer concerned has not been a director of a third party that has filed for bankruptcy or gone into administration; and</p> <p>c. conduct appropriate checks, to ensure that any due diligence information referred to in this GC remains up-to-date and relevant.</p> <p>These procedures must be carried out before contracting with or appointing the Mobile Service Retailer.</p>   | <p>.</p> <p>Requirements to:</p> <ul style="list-style-type: none"> <li>- check with information supplied by Ofcom or Trading Standards; and</li> <li>- request copies of terms and condition and verify compliance have been removed.</li> </ul> |
| 23.9  | <p>Where a Mobile Service Provider acquires information from a Mobile Service Retailer for the purpose of monitoring compliance with this GC, the Mobile Service Provider shall use that information solely for the purpose for which it was supplied and keep the information confidential. For the avoidance of doubt, the Mobile Service Provider shall not pass the information on to any other party (including its subsidiaries or partners) for whom such information could provide a competitive advantage.</p>  | <p>New provision</p>  |
| 23.10 | <p>The Mobile Service Provider must use reasonable endeavours to ensure that where a Mobile Service Retailer offers to a Customer a sales incentive, of which the Customer does not benefit immediately and which the Customer is entitled to receive after entering into the contract for the Mobile Telephony Service, that the terms and conditions of such an offer are not unduly restrictive and that a Customer is provided with the following information in a clear, comprehensible and accurate manner in paper or another Durable Medium, or, where the sales incentive offer is made during a sales call, by telephone:</p> <p>a. the identity of the legal entity which makes the sales incentive offer and undertakes to meet the obligation(s) tied to this offer; its address; and telephone, fax and/or e-mail contact details;</p> <p>b. a description of the sales incentive itself; and</p> <p>c. the terms and conditions of the sales incentive, including a detailed and clear explanation as to the process the Customer has to follow to obtain the sales incentive.</p> <p>Where the sales incentive offer is made during a sales call, in addition to the oral provision of this information, the Mobile Service Provider must use reasonable endeavours to ensure that this information is sent to the Customer in good time in paper or another Durable Medium.</p> | <p>Clarification that sales incentives only relate to the promise of a future benefit.</p> <p>Timescales for sending information after a sales call modified from 3 working days to 'in good time'</p>  |

## Annex 6

# Notification and schedule

## **NOTIFICATION OF THE SETTING OF A NEW GENERAL CONDITION UNDER SECTION 48(1) OF THE COMMUNICATIONS ACT 2003**

**The modification of the General Conditions to introduce General Condition 23 on Sales and Marketing of Mobile Telephony Services for the purpose of imposing requirements upon all Communications Providers providing a Mobile Telephony Service to Domestic and Small Business Customers to comply with the provisions of this General Condition.**

### **WHEREAS:**

- A. The Director General of Telecommunications (the 'Director') issued on 22 July 2003 the General Conditions Notification, which took effect on 25 July 2003 by way of publication of a notification pursuant to section 48 (1) of the Communications Act 2003 (the 'Act');
- B. OFCOM issued a notification pursuant to section 48 (2) of the Act on 18 March 2008 setting out their proposals for the insertion of a new General Condition 23 (the 'Consultation Notification');
- C. A copy of the Consultation Notification was sent to the Secretary of State in accordance with section 50 (1) (a) of the Act;
- D. In the Consultation Notification and its accompanying explanatory statement, OFCOM invited representations about any of the proposals set out therein by 29 April 2008;
- E. By virtue of section 48 (5) of the Act, OFCOM may give effect to any proposals to set conditions as set out in the Consultation Notification, with or without modifications, where:
  - (i) they have considered every representation about the proposals made to them within the period specified in the Consultation Notification; and
  - (ii) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;
- F. OFCOM received 21 non-confidential and 2 confidential responses to the Consultation Notification and have considered every such representation made to them in respect of the proposals set out in the Consultation Notification and its accompanying explanatory statement; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;
- G. For the reasons set out in the explanatory statement accompanying this Notification, OFCOM are satisfied that, in accordance with section 47 (2) of the Act, this modification is:

- (i) objectively justifiable in relation to the matters to which it relates;
- (ii) not such as to discriminate unduly against particular persons or against a particular description of persons;
- (iii) proportionate to what it is intended to achieve; and
- (iv) in relation to what it is intended to achieve, transparent;

**NOW, THEREFORE, OFCOM MAKES THE FOLLOWING DECISION**

1. OFCOM, in accordance with section 48 (1) of the Act, hereby make the following modification to the General Conditions Notification to insert new General Condition 23 on the Sales and Marketing of Mobile Telephony Services as set out in the Schedule to this Notification;
2. The effect of, and OFCOM's reasons for making, the modification referred to in section 1 above is set out in the accompanying explanatory statement to this Notification;
3. OFCOM considers that the modification referred to in paragraph 1 above complies with the requirements of sections 45 to 50 of the Act, as appropriate and relevant to each of the modifications;
4. In making the modification set out in this Notification, OFCOM has considered and acted in accordance with their general duties in section 3 of the Act and the six Community requirements in section 4 of the Act;
5. The General Condition 23 set out in the Schedule to this Notification shall enter into force on **16 September 2009**;
6. Copies of this Notification and the accompanying explanatory statement have been sent to the Secretary of State in accordance with section 50 (1) (a) of the Act;
7. In this Notification:
  - (i) "the Act" means the Communications Act 2003;
  - (ii) "OFCOM" means the Office of Communications; and
  - (iii) "Mobile Telephony Service" has the meaning assigned to it in the Schedule of this Notification.
8. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in this Notification (including the Schedule to this Notification) and otherwise any word or expression shall have the same meaning as it has in the Act.
9. For the purpose of interpreting this Notification:
  - (i) headings and titles shall be disregarded; and
  - (ii) the Interpretation Act 1978 shall apply as if this Notification were an Act of Parliament.

10. The Schedule to this Notification shall form part of this Notification.

***Claudio Pollack***

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

[16 March] 2009

## Schedule

# General Condition 23 on Sales and Marketing of Mobile Telephony Services

## 23. SALES AND MARKETING OF MOBILE TELEPHONY SERVICES

### Scope

- 23.1 A Mobile Service Provider must comply with this General Condition with respect to a Customer of its Mobile Telephony Services, except that clauses 23.4(b)(iv) and 23.5 – 23.10 do not apply to Prepaid Mobile Telephony Services and SIM Only Contracts.

### Mis-selling prohibition

- 23.2 When selling or marketing Mobile Telephony Services, the Mobile Service Provider must not:
- (a) engage in dishonest, misleading or deceptive conduct;
  - (b) engage in aggressive conduct; or
  - (c) contact the Customer in an inappropriate manner.

### Publication of relevant obligations

- 23.3 The Mobile Service Provider must:
- (a) publish a comprehensive summary of its obligations under this General Condition 23 in an easily accessible and reasonably prominent manner on its website or, where there is no such website, by making it available in its registered office during normal office hours for inspection free of charge by members of the general public; and
  - (b) provide a copy of this General Condition to a Customer free of charge upon reasonable request.

### Obligation with regards to Mobile Service Retailers

- 23.4 Where the Mobile Service Provider contracts with or appoints a Mobile Service Retailer directly in order to sell or market the Mobile Service Provider's Mobile Telephony Services it must ensure, and where a third party acting on behalf of the Mobile Service Provider contracts with or appoints a Mobile Service Retailer in order to sell or market the Mobile Service Provider's Mobile Telephony Services the Mobile Service Provider must use reasonable endeavours to ensure, that:
- (a) the Mobile Service Retailer is aware of this General Condition;
  - (b) provisions are in place which require the Mobile Service Retailer:
    - (i) not to engage in dishonest, misleading or deceptive conduct;

- (ii) not to engage in aggressive conduct;
  - (iii) not to contact a Customer in an inappropriate manner; and
  - (iv) to create and keep records about the sale of the Mobile Service Provider's Mobile Telephony Services for a period of not less than six months and, where applicable, about a related sales incentive as referred to in General Condition 23.10, for a period of not less than ninety days after the date by which this sales incentive has to be fully redeemed, but not less than six months.
- (c) the Mobile Service Provider monitors the Mobile Service Retailer's compliance with the provisions referred to in General Condition 23.4 (b); and
- (d) non-compliance by the Mobile Service Retailer with the provisions referred to in General Condition 23.4 (b) is appropriately sanctioned by the Mobile Service Provider.

### **Mobile Service – Information at Point of Sale**

23.5 The Mobile Service Provider must use reasonable endeavours to ensure that before entering into or amending a contract for a Mobile Telephony Service the customer:

- (a) is authorised to do so;
- (b) intends to enter into this contract; and
- (c) is provided with the information set out below in a clear, comprehensible and accurate manner in paper or another Durable Medium which is available or accessible to the Customer or, where the Customer enters into or amends the contract during a sales call, by telephone:
  - (i) the identity of the legal entity the Customer is contracting with; its address and telephone, fax and/or e-mail contact details;
  - (ii) a description of the Mobile Telephony Service; the key charges (including minimum contract charges and any early termination charges, if applicable); payment terms; the existence of any termination right, including termination procedures; the likely date the Mobile Telephony Service will be provided, in case the provision of the Mobile Telephony Service is not immediate; and any minimum period of contract.

Where the Customer enters into a contract during a sales call, in addition to the oral provision of this information the Mobile Service Provider must use reasonable endeavours to ensure that this information is sent to the Customer in good time following the call in paper or another Durable Medium.

### **Records retention**

23.6 Where the Mobile Service Provider acts as a Mobile Service Retailer, it must create and keep records about the sale of its Mobile Telephony Services for a period of not less than six months and, where applicable, about a related sales incentive as referred to in General Condition 23.10, for a period of not less than ninety days after

the date by which this sales incentive has to be fully redeemed, but not less than six months. Such records must include the date of the sale, the means through which the contract was entered into and the place where the contract was entered into, where applicable.

## **Training**

- 23.7 The Mobile Service Provider must use reasonable endeavours to ensure that processes are in place which assure that a Mobile Service Retailer is appropriately trained to comply with this General Condition.

## **Due diligence**

- 23.8 Where the Mobile Service Provider contracts with or appoints a Mobile Service Retailer directly in order to sell or market the Mobile Service Provider's Mobile Telephony Services it must ensure that, and where a third party acting on behalf of the Mobile Service Provider contracts with or appoints a Mobile Service Retailer in order to sell or market the Mobile Service Provider's Mobile Telephony Services the Mobile Service Provider must use reasonable endeavours to ensure that, it, or a person acting on its behalf, carries out and retains a record of the following minimum procedures with regards to any Mobile Service Retailer, contracted or appointed to sell or market the Mobile Service Provider's Mobile Telephony Services:

- (a) a credit reference search and check that the Mobile Service Retailer does not have a history of failing to meet its financial undertakings to creditors;
- (b) a check that any director of a Mobile Service Retailer concerned has not been a director of a third party that has filed for bankruptcy or gone into administration; and
- (c) appropriate checks to ensure that any due diligence information referred to in this General Condition 23.8 remains up-to-date and relevant.

These procedures must be carried out before contracting with or appointing the Mobile Service Retailer.

## **Use of information for the purpose of monitoring compliance**

- 23.9 Where a Mobile Service Provider acquires information from a Mobile Service Retailer for the purpose of monitoring compliance with this General Condition, the Mobile Service Provider shall use that information solely for the purpose for which it was supplied and keep the information confidential. For the avoidance of doubt, the Mobile Service Provider shall not pass the information on to any other party (including its subsidiaries or partners) for whom such information could provide a competitive advantage.

## **Sales Incentives – Information at Point of Sale**

- 23.10 The Mobile Service Provider must use reasonable endeavours to ensure that where a Mobile Service Retailer offers to a Customer a sales incentive, from which the Customer does not benefit immediately and which the Customer is entitled to receive after entering into the contract for the Mobile Telephony Service, the terms and conditions of such an offer are not unduly restrictive and that a Customer is provided with the following information in a clear, comprehensible and accurate

manner in paper or another Durable Medium, or, where the sales incentive offer is made during a sales call, by telephone:

- (a) the identity of the legal entity which makes the sales incentive offer and undertakes to meet the obligation(s) tied to this offer; its address; and telephone, fax and/or e-mail contact details;
- (b) a description of the sales incentive itself; and
- (c) the terms and conditions of the sales incentive, including a detailed and clear explanation as to the process the Customer has to follow to obtain the sales incentive.

Where the sales incentive offer is made during a sales call, in addition to the oral provision of this information, the Mobile Service Provider must use reasonable endeavours to ensure that this information is sent to the Customer in good time following the call in paper or another Durable Medium.

## Definitions

23.11 For the purpose of this Condition:

- (a) "Customer" means Domestic and Small Business Customer as defined in section 52 (6) of the Act;
- (b) "Durable Medium" means a medium on which a Customer can store and retrieve unaltered information for a period of time adequate for the purposes of the information;
- (c) "Mobile Service" means a service consisting in the conveyance of signals, by means of a mobile Public Electronic Communications Network, through the agency of Wireless Telegraphy to or from Apparatus designed or adapted to be capable of being used while in motion;
- (d) "Mobile Telephony Service" means a Publicly Available Telephone Service that is a Mobile Service (and includes any SMS service sold as part of the package);
- (e) "Prepaid Mobile Telephony Service" means a Mobile Telephony Service for which the Customer pays charges in advance of the service being provided;
- (f) "Mobile Service Provider" means the provider of a Mobile Telephony Service;
- (g) "Mobile Service Retailer" means any person who sells or markets a Mobile Telephony Service directly to a Domestic or Small Business Customer; and
- (h) "SIM Only Contract" means a contract for a Mobile Telephony Service where the Customer only obtains a Subscriber Identity Module ('SIM') card from the Mobile Service Provider and the notice period for cancelling this contract does not exceed one calendar month.

## Annex 7

# Guidelines to General Condition 23

## Guidelines to General Condition 23: Sales and Marketing of Mobile Telephony Services

### Introduction

- A23.1 General Condition 23 ('GC23') sets out a number of provisions in respect of the sales and marketing of Mobile Telephony Services with which the relevant Communications Provider providing a Mobile Service ('Mobile Service Provider' or 'MSP') must comply.
- A23.2 GC23 comprises provisions regarding the MSPs' own sales and marketing behaviour and requires MSPs to put in place certain minimum standard provisions in respect of the sales and marketing behaviour of their retailers.

### Purpose of these guidelines

- A23.3 These Guidelines are produced by Ofcom to help Communications Providers and customers understand their rights and obligations under the General Condition and are intended to assist Communication Providers in achieving compliance.
- A23.4 The Guidelines set out some summaries, examples and guidance on the approach Ofcom is likely to take when enforcing GC 23. In particular, these guidelines:
- seek to provide clarity on the meaning of some of the terms and concepts used in GC23 so as to inform Mobile Service Providers and stakeholders of Ofcom's general view on them; and
  - describe factors that Ofcom might consider when applying the relevant requirements or obligations set out in GC23.
- A23.5 For the avoidance of doubt, where the Guidelines set out examples of the way in which Ofcom considers a Communications Provider may comply with a General Condition Ofcom will at all times determine compliance on the basis of the individual circumstances of the case whilst having regard to these Guidelines. If in any given situation we decide to depart from the principles set out in these Guidelines we will normally set out our reasons for doing so.
- A23.6 These Guidelines are not in any way incorporated into the General Conditions set by Ofcom. The obligations which apply to a Communications Provider will be determined solely according to the General Conditions. However, when applying General Condition 23, as stated in A23.5 above, Ofcom will have regard to these Guidelines and will normally set out its reasons when departing from the principles set out therein. Ofcom advises Communications Providers to seek independent legal advice if they are unsure of their obligations under the General Conditions.

## Scope of General Condition 23

A23.7 GC 23.1 specifies that this General Condition is applicable to all Communications Providers which offer a Mobile Telephony Service to Domestic and Small Business Customers, with the exception of a number of provisions in respect of Prepaid Mobile Telephony Services and SIM Only Contracts. For the avoidance of doubt, mobile broadband and WiFi services are not captured by GC 23.

## Mis-selling prohibition

A23.8 GC 23.2 sets out prohibitions on the MSP regarding unacceptable types of sales and marketing behaviour (generally described as ‘mis-selling’). Such prohibited mis-selling behaviour includes, but is not limited to:

- the omission of relevant or the provision of false and/or misleading information (for example, about tariffs, potential savings or network coverage); such misleading conduct includes deceiving a customer or providing the customer with misinformation which is likely to affect a customer’s purchase decision;
- aggressive conduct, such as harassment, coercion, or applying unacceptable pressure on a customer to enter into a contract, such as threatening or intimidating behaviour or refusal to leave (in case of doorstep selling); and
- ‘slamming’, an extreme form of mis-selling, where mobile customers can find themselves, without their knowledge and/or consent, with a contract from another or same MSP. A specific type of mobile slamming occurs when mobile customers find themselves without their knowledge and/or consent with a contract from another MSP, while their existing contract can still be valid, or with an additional contract with their current MSP.

A23.9 Below we have included aspects of approaching customers that Ofcom is likely to consider to be inappropriate:

- Current or prospective customers should not be approached at an inappropriate time of day. For example, we would not expect any outbound customer contact, including doorstep selling and telesales to take place at an unreasonable time of day, say before 8.00am and after 8.00pm, unless the customer requests otherwise.
- For sales representatives not to introduce themselves clearly and fully and state the purpose of the contact at the start of any sales and marketing activity to current or prospective customers. The representatives should clearly state the name of the company or organisation they are working for, and that they are an authorised dealer for a certain MSP, where applicable. The expression ‘calling on behalf of [MSP]’ should not be used, unless the representative is an agent of the MSP.
- For sales representatives with direct customer contact to take advantage of vulnerable customers; e.g. those who are elderly or whose first language is not English.

## Publication of relevant obligations

A23.10 GC 23.3 sets out that the MSP has to make a comprehensive summary of its obligations under GC23 available on its website or, where there is no such website, in its head offices. Upon reasonable request, a copy of the GC should also be provided to customers, free of charge. The MSP could do this by providing the customer with a paper copy of the GC in their shops, by sending a hard or soft copy to the customer, or by making it available for download or printing on their website.

A23.11 In relation to the obligation to publish this information on a MSP's website, Ofcom considers 'an easily accessible and reasonably prominent manner' to mean providing a clear reference to the obligations under GC23 on a consumer related part of the MSP's website.

## Obligation with regards to Mobile Service Retailers

A23.12 Ofcom is aware that a number of different parties can be involved when selling a Mobile Telephony Service to a customer. These parties include:

- the MSPs themselves, for example through websales, direct retail outlets or telesales;
- direct retailers who act as agents of the MSP;
- distributors, who, whilst they may not work directly as agents for the MSP, usually have contracts with the MSP which enable them to authorise on behalf of the MSP a third party retailer to sell or market the Mobile Service for the MSP; and
- independent retailers who, typically, have no direct contractual relationship with the MSP, and are authorised to sell on behalf of the MSP through arrangements made with another party, usually either a direct retailer or a distributor.

A23.13 As can be seen from the examples above, the person who, in the end, has the direct contact with the customer to sell or market a Mobile Telephony Service might be the last link in what could be a long chain of persons involved in the sale and marketing process. It is the MSP's responsibility where it contracts directly with a retailer to put processes in place which ensure that the retailer does not engage in certain sales and marketing malpractices. Where a third party acting on behalf of the MSP contracts with a retailer, the MSP should use reasonable endeavours to ensure that these obligations are passed down the chain.

A23.14 As a result, GC 23.4 requires the MSP to ensure to a certain extent that all parties directly involved in selling a Mobile Telephony Service to the customer are:

- aware of GC 23;
- required to comply with a number of behavioural obligations;
- monitored with regards to their behaviour in respect of those obligations; and
- appropriately sanctioned if breaching those obligations.

A23.15 There are a number of ways for the MSPs of achieving these goals and we do not intend to prescribe exactly how the requirements are to be met. However, there are a number of practical steps that MSPs could take, in Ofcom's view, to assist them in meeting their obligations under General Condition 23.4. Such steps include:

- With regards to GC23.4 (a), in order to ensure awareness of the General Condition amongst retailers and third parties acting on their behalf, the MSPs could communicate the General Condition through account managers, in print through sales bulletins or newsletters, or on websites dedicated to distributors and retailers.
- With regards to GC23.4 (b), in order to put provisions in place which require retailers they contract with directly to comply with certain behavioural obligations, an MSP could include such requirements into contracts with the retailer. Similarly, where a third party is acting on behalf of the MSP, the MSP could require this third party to put provisions in the contracts these third parties have with their retailers.
- With regards to GC 23.4 (c), in order to ensure appropriate compliance monitoring, MSPs could look at numbers and types of complaints over time into their own organisations regarding retailers in relation to the volume of connections sold. If complaints information suggests a problem or issue, the MSP should take appropriate action. MSPs could also carry out spot checks, mystery shopping and sample checks of the retailer's marketing material. MSPs could require third parties acting on their behalf to undertake similar activities.
- With regards to GC 23.4 (d), appropriate sanctions by the MSP might depend on the severity and possible recurrence of a breach. In Ofcom's view they could include giving verbal or written warnings to the retailer, requiring the retailer to prevent recurrence in the future, requiring the retailer to remedy the breach or, in certain severe cases, ceasing to deal with a particular distributor or retailer. MSPs could require third parties acting on their behalf to undertake similar activities.

### **Information at Point of Sale**

A23.16 GC 23.5 contains a number of provisions relating to information requirements that MSPs must comply with at the point of sale, when the customer expresses a positive intention to take out a new contract or amend an existing contract.

A23.17 Ofcom requires MSPs to use reasonable endeavours to ensure these requirements are met. There are a number of ways for the MSPs of achieving this goal and we do not intend to prescribe exactly how the requirements are to be met in each case. However, there are some practical steps that MSPs could take, in Ofcom's view, to assist them in meeting their obligations, including:

- Regarding ensuring customers are authorised to take out a contract or amend a contract, MSPs may wish to consider whether to require sales records to include an explicit check of the customer's identity, age and/or address (for example, MSPs may wish to ask for utility bills, a copy of a passport or driving licence);
- Regarding the provision of information to the customer, MSPs may wish to ensure there is a check list available for sales representatives or include

such a checklist in their training material which ensures that customers are provided with all the relevant key information about a service as part of their decision making process. In essence, customers must be able to make an informed choice as to whether or not to enter into a new or amend an existing contract.

- Key charges to be provided under these obligations include in Ofcom's view the monthly fee payable for the mobile subscription, the charge for calls to own and other mobile networks and to calls to fixed networks, as well as charges for SMS-messages and accessing voicemail.
- Any claims, offers or incentives to attract customers must not mislead them by stating an untruth or half-truth or through failing to state or not make sufficiently prominent an important term or condition likely to affect their decision.

A23.18 Where the MSP does not have the direct customer contact itself, it should ensure that there are provisions in place which require the person with the customer contact to comply with these requirements.

## Records retention

A23.19 GC 23.6 requires MSPs to produce and keep records regarding the sales of their Mobile Service for a period of not less than six months from the date the record was created. Records regarding a related sales incentive as referred to in General Condition 23.10 (e.g. cashback offers), should be kept for a period of not less than ninety days after the date by which the sales incentive has to be fully redeemed, but not less than six months. For instance, if a sales incentive has to be redeemed over a time period of 12 months, records should be kept for 12 months + 90 days to allow for customers to complain or query in case something goes wrong in the process.

A23.20 Ofcom considers examples of records in this respect to include (but not be limited to) signed copies of contracts, either in electronic or paper form, call recordings (where they exist) or internet confirmation to buy a certain service.

A23.21 By 'the means through which the contract was entered into', we mean retail outlets (MSP's own and independent retailers' outlets), telesales or websales. In the event a contract was entered into at a retail outlet, the records should also contain sufficient information to be able to identify the outlet, for instance by providing the address of the outlet.

A23.22 These records should be such as to be capable of providing sufficient information to validate that the customer provided positive consent for the purpose of the transaction as well as information about the type of contract, the date the contract was entered into in case the customer questions having entered into a contract, or has complaints or queries regarding their contract.

## Training

A23.23 GC 23.7 requires MSPs to use reasonable endeavours to ensure that processes are in place assuring that any person selling their Mobile Telephony Service is 'appropriately trained' to comply with GC 23. There are a number of ways for the MSPs of achieving this goal and we do not propose to prescribe exactly how this requirement is to be met. However, there are some practical steps that MSPs can take to assist them to meet their obligations, including:

- putting contractual provisions in place in respect of training with their distributors and retailers;
- providing retailers with updates via sales bulletins, training courses, e-learning modules, manuals and product information regarding the Mobile Telephony Service;
- providing retailers with training courses, e-learning modules and manuals on using sales related systems;
- providing retailers with information on new products;
- providing training and information on sales related processes, such as ordering a new phone or customer credit checking.

A23.24 In respect of the training a retailer of Mobile Telephony Services should receive, Ofcom considers 'appropriately trained' to mean that the retailer has been made familiar with:

- the relevant provider's customer terms and conditions;
- the terms and conditions applied by the retailer (if applicable);
- the process for ordering the mobile handset and subscribing to the network service;
- the major elements of the MSP's services;
- details of the key charges offered by the MSP, charges that will be incurred by customers and methods of payment; and
- the relevant obligations under this General Condition.

## **Due diligence**

A23.25 GC 23.8 requires MSPs to carry out a number of due diligence checks in respect of new retailers through which they sell their Mobile Telephony Service.

A23.26 Due diligence is an important part of compliance with GC23 as it ensures that any parties with whom MSPs wish to contract, or who they wish to appoint, in order to sell their Mobile Telephony Services, have been subject to a number of checks and will be subject to similar checks in the future.

A23.27 The due diligence requirements set out at GC 23.8 specify a number of pieces of information that must be collected and maintained.

A23.28 There are a number of ways of carrying out the required due diligence exercise and we do not intend to prescribe exactly how this should be achieved other than setting out what we consider to be the minimum procedures necessary. There are a number of practical steps MSPs can take to meet their obligations. For example, producing a checklist, based on the requirements set out at GC.23.8 that ensures that the relevant information has been gathered.

A23.29 The MSP should use reasonable endeavours to ensure that parties it does not have a direct contract with and who sell the MSP's Mobile Telephony Service are also

subject to due diligence requirements. The MSP could achieve this by carrying out due diligence directly or requiring another party to undertake these activities, e.g. distributors.

A23.30 Ofcom expects that all parties involved in the required due diligence exercise will, where relevant, comply with all the data protection principles as set out in the Data Protection Act 1998.

### **Sales incentives – Information at Point of Sale**

A23.31 GC 23.10 contains obligations imposed upon the MSP regarding sales incentives offered by any person selling or marketing the MSP's Mobile Telephony Services. Sales incentive in this context means an offer to encourage a customer to enter into a contract of which the Customer does not benefit immediately (i.e. at the point of sale, or in case of telesales and online sales, when the contract is concluded), but which the Customer is entitled to receive after entering into the contract.

A23.31 Sales incentives could consist of the promise to receive certain goods or products (such as additional equipment, or MP3 players), or the promise to receive a payment of monies at a certain stage or at certain stages during the period of the contract for a Mobile Telephony Service.

A23.33 GC 23.10 stipulates that Mobile Service Providers should take steps to ensure that the terms and conditions of sales incentives are not unduly restrictive. When assessing whether terms and conditions are not unduly restrictive, we would take into consideration whether the terms are not unduly onerous so that customers can legitimately claim their entitlement to advertised sales incentives without much difficulties.

A23.34 Ofcom considers unduly restrictive terms and conditions in respect of sales incentives to typically include:

- a requirement that the customer submits an original bill – a copy of a bill should be acceptable proof;
- a charge for processing a claim in relation to the offer;
- a requirement that such claims are submitted within a period less than 60 days from the date the claim arises;
- a condition stating that a payment will not be made if the customer has an outstanding balance on their account. However, in the case of persistent or repeated non-payment on behalf of the customer or where the retailer and/or the MSP have evidence that a customer engages in fraudulent behaviour regarding their mobile subscription, no payment will have to be made to the customer.
- in the case of cashback, a condition stating that if a customer fails to obtain a first claim, this would invalidate all future claims.

A23.35 There are a number of ways for the MSPs of achieving this goal and we do not intend to prescribe exactly how the requirements are to be met. However, there are practical steps that MSPs can take to assist them in meeting their obligations, including:

- putting in place contractual provisions requiring retailers to clearly advise customers of the terms and conditions of the sales incentive sold in connection with the Mobile Telephony Service, and of the process to be followed to obtain the sales incentive, where applicable;
- carrying out spot checks and mystery shopping for sales incentives;
- analysing complaints regarding sales incentives;
- checking terms and conditions of sales incentives; and
- checking retailers' advertising material regarding sales incentives.

A23.36 The MSP needs to use reasonable endeavours that any party, who sells the MSP's Mobile Telephony Service through another party, is required to ensure that the terms and conditions of sales incentives offered by the party with the customer contact are not unduly restrictive.

A23.37 In addition, GC 23.10 requires MSPs to take steps to ensure that any persons selling or marketing the MSP's Mobile Telephony Service provide clear and accurate information about the sales incentive (including that there is a separate contract for the sales incentive to that of the airtime service, and that the customer might remain bound to the terms of the Mobile Telephony Service irrespective of the sales incentive contract including if the retailer goes out of business).

## Annex 8

# Glossary

|                           |  |
|---------------------------|--|
| <b>Act</b>                | Communications Act 2003  |
| <b>Cashback</b>           | A type of sales incentive where a retailer promises the payment of a certain amount of money to the customer when the customer takes out a mobile contract.  |
| <b>CAB</b>                | Citizens Advice Bureaux. CAB is an independent charity and membership organisation with Bureaux across England, Wales and Northern Ireland. They provide information and advice through face-to-face, telephone and email services and online at <a href="http://www.citizensadvice.org.uk">www.citizensadvice.org.uk</a> .    |
| <b>Code</b>               | Best practice guidelines/principles for sales and marketing of subscriptions to mobile networks which the mobile network operators introduced in July 2007.  |
| <b>Consumer Direct</b>    | A telephone and online consumer advice service, supported by the Department for Business and Regulatory Reform. <a href="http://www.consumerdirect.gov.uk/">www.consumerdirect.gov.uk/</a> .   |
| <b>Clawback</b>           | Part or all of the commission that can be recouped from the retailer/distributor by the mobile service provider under certain circumstances, e.g. the customer defaulting on its contract or downgrading to another mobile contract.   |
| <b>Distributor</b>        | A channel to market used by mobile service providers. Distributors can fulfil an intermediary role between mobile service providers and independent retailers and/or can also sell directly to end-users.  |
| <b>Enterprise Act</b>     | Enterprise Act 2002, which, among other things, empowers designated enforcers to enforce certain consumer protection legislation. Ofcom is one of the designated enforcers under the Enterprise Act. More information on the Enterprise Act can be found on OFT's website <a href="http://www.oft.gov.uk">www.oft.gov.uk</a> . |
| <b>General Conditions</b> | Set of conditions applying (depending on the specific General Condition) either to all or to certain categories of communication providers, imposing legal obligations on such providers.  |
| <b>KPIs</b>               | Key Performance Indicators are financial or non-financial measurements that help an organisation define, measure and monitor how well their business is progressing.   |

|                             |  |
|-----------------------------|--|
| <b>LACORS</b>               | The Local Authorities Coordinators of Regulatory Services. The local government central body responsible for overseeing local authority regulatory and related services in the UK.   |
| <b>MNO</b>                  | Mobile Network Operator (Vodafone, O2, Orange, T-Mobile, '3')  |
| <b>MVNO</b>                 | Mobile Network Virtual Operator – a communications provider which provides mobile telephony services to end-users, but typically uses (part of) an MNO's network to provide these services (for example Virgin Mobile, Fresh).   |
| <b>MSP</b>                  | Mobile Service Provider, i.e. MNO and/or MVNO.   |
| <b>OAT</b>                  | Ofcom Advisory Team - the team within Ofcom responsible for advising and dealing with complaints and enquiries from members of the public.   |
| <b>Ofcom</b>                | Office of Communications – the regulator for the communications industries, established by the Office of Communications Act 2002.  |
| <b>OFT</b>                  | Office of Fair Trading. The consumer and competition authority of the UK. <a href="http://www.of.gov.uk">www.of.gov.uk</a>   |
| <b>PECS</b>                 | Public Electronic Communication Services.  |
| <b>Pay-as-you-go</b>        | Mobile telephony services paid for in advance.   |
| <b>Prepaid services</b>     | Mobile telephony services paid for in advance (also known as Pay-as-you-go)  |
| <b>Redemption rate</b>      | The proportion of cashback which consumers are able to claim successfully.   |
| <b>Retailer</b>             | A channel with direct consumer contact used by Mobile Service Providers to promote and sell products and services to end-users, including mobile phone subscriptions, accessories, handsets and SIM-cards (whether the particular channel is part of the corporate structure of the MSP or not). |
| <b>Independent retailer</b> | A third party channel with direct consumer contract used by Mobile Service Providers to promote and sell products and services to end-users, including mobile phone subscriptions, accessories, handsets and SIM-cards (not part of the corporate structure of the MSP).                         |
| <b>Slamming</b>             | An extreme form of mis-selling, where customers find themselves with a service from a new provider, or new contract from their existing provider, without their knowledge and consent  |
| <b>SME</b>                  | Small or Medium-sized Enterprise.  |

**Trading Standards**

The Trading Standards Service enforce the laws that govern goods and services bought, hired and sold, including Trade Descriptions Act 1968, The Consumer Protection Act 1986, The Consumer Credit Act 1974, Enforcement provisions under Part 8 of the Enterprise Act.

**TSS**

The Trading Standards Service

## Annex 9

# Market research

## Background

- A9.1 Ofcom receives calls each month from consumers complaining that they have been mis-sold a mobile product or service. The volume of complaints made to Ofcom about mobile mis-selling issues fluctuates on a monthly basis.
- A9.2 The term 'mis-selling' covers a range of sales and marketing activities that can work against the interests of both consumers and competition and can undermine confidence in the industry as a whole. These include:
- the provision of false and/or misleading information (for example, about potential savings, or promising offers or gifts which do not actually exist);
  - applying unacceptable pressure to change provider, such as refusing to leave until the customer signs, or using threatening or otherwise intimidating behaviour; and
  - 'slamming', an extreme form of mis-selling, where customers are simply switched from one company to another without their knowledge or consent. Forms of slamming can include, for example, passing off (i.e. where representatives claim to represent a different company to the one they are actually working for), and customers being told they are merely signing for information and then being switched to another provider.
- A9.3 As set out in the 2008 Consultation and section 2.5, cashback schemes are a form of promotion or sales incentive offered by independent retailers to customers, in connection with a mobile network contract,. Ofcom has observed two different types of problems involving cashback schemes:
- Retailers refusing to honour cashback offers, purportedly on the basis that the customer has failed to comply with the terms of the offer; and
  - Retailers going out of business and therefore being unable to honour the cashback offers.
- A9.4 Ofcom conducted research in November 2007, published on the 2008 Consultation, which reported around 10% of mobile customers had taken a cashback deal and 6% said they were unable to get at least some of their money back.

## Objectives

- A9.5 The latest research conducted in August 2008 was designed to provide Ofcom with recent data in respect of;
- the extent of mis-selling (including slamming) in the mobile market; and
  - a broad understanding of the cost to consumers.

- A9.6 In addition the research updates Ofcom's data in relation to the size of the cashback market and how this market may have changed since the consultation document was published.

## Summary of findings

### Mis-selling in the mobile market is more common amongst contract customers

- A9.7 In August 2008 4% of all mobile customers said that when they entered into their current mobile contract, they had been told something which later turned out to be untrue. Contract customers were more likely to say they had been mis-sold to (7%) than pay-as-you-go customers (2%).

### The majority (two-thirds) of those mis-sold to made a complaint

- A9.8 The most common types of mis-selling noted in the survey were related to incorrect information being given about tariffs and packages – for example, paying more than expected, certain call types being charged for when advised these were free.
- A9.9 Two-thirds of the sample said they had made a complaint about this – mostly these consumers re-contacted their network operator or the independent retailer who had sold them the service. However, the vast majority of complainants (c. 80% of those mis-sold to) said they were not reimbursed. The remaining third did not complain.

### The proportion of mobile customers with a cashback deal remains unchanged

- A9.10 In August 2008 9% of mobile contract customers said they were currently on a cashback deal – this represents no significant change from the 13% reported back at the end of 2007.
- A9.11 A minority (3 out of the 53 respondents) of cash-back customers said they were unable to claim all or some of their money.

## Main findings

- A9.12 During August 2008 when the survey was conducted 88% of UK adults personally owned and used a mobile phone. Just over three in five (61%) said they used a pay-as-you-go package while the remainder (39%) used contract<sup>105</sup>. The proportion of contract customers has been increasing steadily over the past few years – up from 30% in 2005<sup>106</sup>.

### Total level of mis-selling in the mobile market

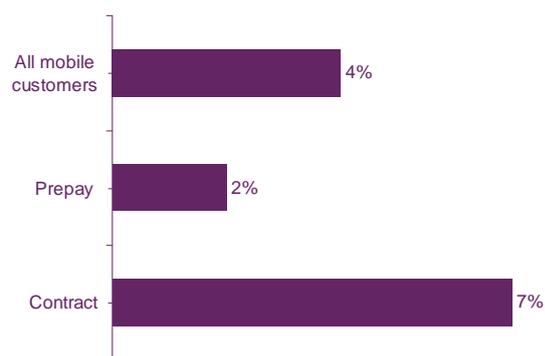
- A9.13 During August 2008 4% of mobile customers said they had been mis-sold to when they entered into their contract. The level of claimed mis-selling was significantly higher amongst contract customers (7%) compared to pay-as-you-go customers (2%)<sup>107</sup>.

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<sup>105</sup> Ofcom Technology Tracker, Q3 2008

<sup>106</sup> Ofcom's Consumer Experience Report, 2008

<sup>107</sup> Verbatim responses were analysed and any claimed 'mis-selling' which did not fall within Ofcom's definition were excluded from analysis.

**Figure A9.1: Extent of mis-selling in mobile market, weighted data**

Base: UK mobile customers (1737) Pay-as-you-go (1152) Contract (570)  
 Source: Ofcom research, conducted by TNS during August 2008.<sup>108</sup>

### Types of mis-selling

A9.14 Most mis-selling appeared to be due to incorrect information being given about tariffs and packages being more expensive than advertised. Around a third of those who said they had been mis-sold to said the package they signed up to was more expensive than they had been advised it would be. Others said they were paying for elements of their package that they had been advised were free (around a fifth of people who had been mis-sold to). Around one in ten mentioned an aspect of their agreement which had not materialised (e.g. an upgrade was promised) and a similar proportion said the provider did not take the action they had promised (e.g. cancel an existing service).

### Length of time since mis-selling occurred

A9.15 Around a quarter of this alleged mis-selling occurred within the three months prior to interview (i.e. between May and August 2008). A further quarter said they were mis-sold to between three and six months prior to interview and the remaining half said the mis-selling happened more than six months ago.

### Whether consumers made a complaint

A9.16 Around a third of those who had been mis-sold to said they did not contact anybody to complain or discuss this issue. Most of the two-thirds who did went back to their network operator or the independent retailer who had sold them the service.

### Estimates of amount of money lost due to mis-selling

A9.17 The average amount of money that the consumers subject to mis-selling ranged between £0 to more than £300.

A9.18 In total around three-quarters of the sample said they had lost some money. Taking the individual amounts stated by each respondent the average stated sum lost across the total sample was £119.

<sup>108</sup> The majority of the data contained in the rest of this report is based on a sample of 59 mobile customers who said they had been mis-sold to. As such the analysis has been run using un-weighted data. Please treat findings as indicative only.

A9.19 However, it should be noted that we are unable to establish how representative the consumers in the survey are of the total mis-sold population. Also, as noted above this analysis has also been run using a small sample of 59 respondents – and as such is subject to large error margins.

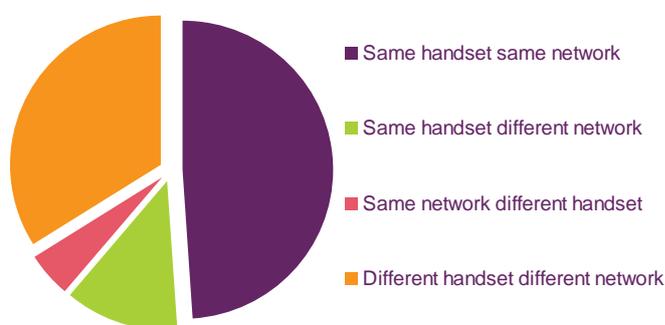
A9.20 The majority said they were not reimbursed any of these costs (c. 80%).

### Behaviour if had been given correct advice initially

A9.21 Consumers were then asked how they would have reacted if they had been correctly advised of the product they were planning to purchase.

A9.22 Consumer opinion on whether they would have selected the same network or not was polarised. Half claimed they would have selected the same network (and same handset) while just under half claimed they would have selected a different network.

**Figure A9.2: Change in behaviour if not mis-sold to, un-weighted data**



Base: UK mobile customers who were mis-sold to (\*59)

\*Small base size, treat as indicative only

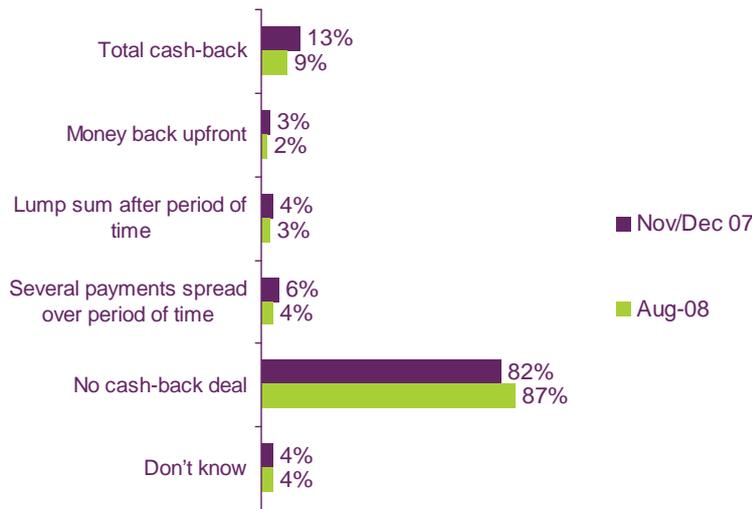
Source: Ofcom research, conducted by TNS during August 2008

### Trend proportion of cashback deals

A9.23 As noted above this research also focussed on consumers who had chosen a mobile cashback deal. Research at the end of 2007 identified just over one in ten mobile contract customers who had entered into a cashback deal.

A9.24 The recent research conducted in August indicates that there has been no significant change in the proportion of consumers signed up to a cashback contract. The data also indicates that there has been no change in the types of cashback deals consumers are opting for.

**Figure A9.3: Proportion of contract customers currently on a cashback deal**



Base: UK mobile contract customers (570)  
 Source: Ofcom research, conducted by TNS during August 2008

A9.25 Figure A9.4 outlines how many of the 53 cashback customers included in the research were unable to receive any of the money they were supposed to. Most (33 out of 53) said they had received all of their promised cash. Most of those who said they had only received some money back were on a staggered deal (7 out of 9) – therefore, potentially not yet eligible for all of their money. The data indicates that only a minority (3 out of 53) of respondents were unable to get all or some of the money they were promised.

**Figure A9.4: Whether cashback customers have received money back<sup>109</sup>**

|                                 | All cashback<br>(53 respondents) | Lump sum deal<br>(27 respondents) | Staggered deal<br>(26 respondents) |
|---------------------------------|----------------------------------|-----------------------------------|------------------------------------|
| Got all cash-back               | 33                               | 19                                | 14                                 |
| Forgot to get cash-back         | 3                                | 1                                 | 2                                  |
| In process of getting cash-back | 2                                | 1                                 | 1                                  |
| Got some cash-back              | 9                                | 2                                 | 7                                  |
| <b>Could not get cash-back</b>  | <b>3</b>                         | <b>-</b>                          | <b>1</b>                           |
| Not time to get cash-back       | 4                                | 4                                 | 0                                  |
| Don't know                      | 1                                | 0                                 | 1                                  |

Base: Cashback customers (53)  
 Source: Ofcom research, conducted by TNS during August 2008

<sup>109</sup> 2 respondents signed up to a lump sum deal and said they only received some cash back. These respondents have been classified within this report as 'not receiving cash back'. However, Ofcom is unsure whether any providers/retailers have responded to cash back requests in this way or whether there was some mis-understanding on the part of the respondent.

## Methodology

- A9.26 This survey was conducted during August 2008 for Ofcom by TNS amongst 2148 UK adults aged 16+ reflecting the UK profile of sex, age and working status. Data has also been weighted to ensure the sample is representative of the UK adult population. Because the survey was conducted amongst a sample of adults rather than the entire population the data may be subject to margins of error. The error margin for the entire sample is about +/- 2% but higher amongst smaller sub-groups. See Table 1 for examples of some of the error margins associated with the data contained in this report.
- A9.27 Results based on unweighted data and referred to as significantly different have been tested at the 95% level of confidence and hence are outside the error margins and can therefore, be considered real changes. Results based on weighted data and referred to as significantly different have been tested at the 99% level of confidence.
- A9.28 Data based on the total sample is weighted data, un-weighted base sizes are shown on charts and tables to show the number of consumers who were asked the question. Data based on sub-groups of mobile customers – such as those using a cash-back deal – are based on un-weighted data. All charts indicate whether figures are based on weighted or un-weighted data.

**Table 2: Error margins based on % and sample sizes**

| Un-weighted sample size            | % result  | Error margin at 95% confidence |             |
|------------------------------------|---|--------------------------------|-------------|
|                                    |   | Lower limit                    | Upper limit |
| 2,148 (UK adults)                  | 88%<br>(with mobile)                            | 86.63%                         | 89.37%      |
| 1,737 (mobile customers)           | 4%<br>(mis-sold to)                             | 3.08%                          | 4.92%       |
| 570 (contract customers)           | 7%<br>(mis-sold to)                             | 4.91%                          | 9.09%       |
| 1,152 (prepay customers)           | 2%<br>(mis-sold to)                             | 1.19%                          | 2.81%       |
| 59 (mobile customers mis-sold)     | 50%<br>(would have chosen same network/handset) | 37.24%                         | 62.76%      |
| 1040 (contract customers – Nov 07) | 13%<br>(with cashback)                          | 10.96%                         | 15.04%      |
| 570 (contract customers - Aug 08)  | 9%<br>(with cashback )                          | 6.65%                          | 11.35%      |

## Questionnaire

Q1. Do personally use a mobile phone?

- 01: Yes
- 02: No
- (DK)

(Route: ask Q.2 if 01 coded at Q.1, others close)

SHOW SCREEN

Q.2 Which of the following best describes the mobile package you personally use most often?

- 01: Monthly contract/subscription
- 02: Pay-as-you-go
- 03: Other (specify)
- (DK)

(route: ask Q.2a if 01 coded at Q.2, others go to Q.3)

SHOW SCREEN

Q.2a When you got your main mobile contract, did you get a free or discounted handset, or did you only get a SIM card?

- 01: Free\discounted handset
- 02: SIM card only
- (DK)

SHOW SCREEN (do not invert)

Q.2b And how long is your main mobile contract?

- 01: Less than 6 months
- 02: 6 months
- 03: 12 months
- 04: 18 months
- 05: 24 months
- 06: Longer than 24 months
- 07: Other (specify)
- (DK)

Q3. Thinking about when you signed up to your current mobile network, were you told anything which turned out to be untrue when you started using the service?

This might relate to incorrect information you were given about your handset capability, your network coverage, aspects of your tariff or package, the terms and conditions of your contract or something completely different.

- 01: Yes
- 02: No
- (DK)

(route: ask Q.4 if 01 coded at Q.3, others see Q.12)

Q.4 And what was it you were told which turned out not to be true?  
INTERVIEWER: PROBE FOR AS MUCH DETAIL AS POSSIBLE

(open-ended)

SHOW SCREEN (do not invert)

Q5. And how long ago did this happen?

- 01: In the last month
- 02: Between 1-2 months ago
- 03: More than 2 months ago but less than 3 months
- 04: Between 3-6 months
- 05: More than 6 months ago but less than a year
- 06: A year or more
- (DK)

SHOW SCREEN – MULTI CHOICE

Q6. Which company gave you the incorrect advice that we have been discussing?

- 01: Orange
- 02: TMobile (formerly One2One)
- 03: Vodafone
- 04: O2 (formerly BTCellnet)
- 05: '3'
- 06: Virgin Media/ Any Virgin
- 07: Tesco
- 08: An independent retailer such as Carphone Warehouse/The Link/Phones 4U(specify)
- 09: Other (specify)
- (DK\CR)

SHOW SCREEN – MULTI CHOICE (codes 01-07 only)

Q7. And did you contact anyone to discuss or complain about this?  
INTERVIEWER: IF RESPONDENT SAYS "YES", PROBE FOR WHO THEY CONTACTED,  
AND CODE ACCORDINGLY

- 01: My mobile operator
- 02: Other mobile company (scripter: fix code 02 under code 01 on inverted version)
- 03: Ofcom/the regulator
- 04: Citizen's advice
- 05: Consumer Direct
- 06: The independent retailer (e.g. Carphone Warehouse/The Link/Phones 4U) (specify)
- 07: Other (specify)
- 08: Did not contact anybody
- (DK)

Q8a. I'd now like you to try to compare the product you **thought** you were buying and the product you **actually** got. Roughly how much money would you say you have or might have lost because of the incorrect advice you were given?

If you received any of your money back from your supplier, can you please tell me how much money you had lost before you complained? Please exclude the cost of any phone calls you may have had to make.

£ (type-in box, max 3 digits)

(DK)

(N)

(route: ask Q.8b if DK coded at Q.8a, others see Q.9)

SHOW SCREEN (do not invert)

Q.8b You said you were unsure as to how much money you have or might have lost as a result of the incorrect advice you were given. Please look at the list below, and tell me whether the amount you lost/might have lost falls into any of these groups?

01: Nothing

02: £1 - £5

03: £6 - £10

04: £11 - £15

05: £16 - £20

06: £21 - £30

07: £31 - £50

08: £51 - £100

09: £101 - £200

10: £201 - £300

11: More than £300

(DK)

(route: ask Q.9a if 01-07 or DK coded at Q.7 AND any positive answer at Q.8a or 02-11 or DK coded at Q.8b, others Q.10)

Q.9a Were you reimbursed any of these costs?

01: Yes

02: No

(DK)

(route: ask Q.9b if 01 coded at Q.9a, others go to Q.10)

Q.9b And roughly how much money were you reimbursed?

£ (type-in box – max 3 digits)

(DK)

(route: ask Q.9c if DK coded at Q.9b, others go to Q.10)

SHOW SCREEN (do not invert)

Q.9c You said you were unsure as to how much money you were reimbursed. Please tell me whether the amount reimbursed falls into any of these groups?

02: £1 - £5

03: £6 - £10

04: £11 - £15

- 05: £16 - £20
- 06: £21 - £30
- 07: £31 - £50
- 08: £51 - £100
- 09: £101 - £200
- 10: £201 - £300
- 11: More than £300
- (DK)

Q10. If you had been given the correct information at the start, do you think you would still have purchased the same handset with the same network?

- 01: Yes same handset same network
- Yes same handset different network
- Yes same network different handset
- 02: Different handset and different network
- (DK)

**Q.11a** Approximately how much do you spend each MONTH on your main mobile phone network? Please include the cost of VAT, calls, line rental, text and photo messaging, and Internet type services.

- £ (type-in box – max 3 digits)
- (DK)
- (DK – pay as part of package)

(route: ask Q.11b if DK coded at Q.11a, others see Q.12)

SHOW SCREEN (do not invert)

Q.11b You said you were unsure as to how much you spend each MONTH on your main mobile network. Does the amount you spend fall into any of these groups?

- 01: Up to £10
- 02: £11 - £20
- 03: £21 - £30
- 04: £31 - £50
- 05: £51 - £100
- 06: £101 - £200
- 07: More than £200
- (DK)

(route: ask Q.12 if 01 coded at Q.2, others close)

SHOW SCREEN

Q12. Does your mobile contract include a cash-back deal where you get money back either upfront or after a certain amount of time?

- 01: Yes - money back upfront
- 02: Yes - money back after certain amount of time
- 03: No - did not take a money back deal
- (DK)
- (route: ask Q.13 if 01 or 02 coded at Q.12, others close)

Q.13 Are you entitled to receive one lump sum or several payments spread over the contract period?

- 01: One lump sum
- 02: Several payments
- (DK)

(route: ask Q.14a if 01 coded at Q.13, others see Q.14b)

SHOW SCREEN

Q.14a Which of the following best describes whether or not you have received your cash-back?

- 01: I have got all of my cash-back
- 02: I could not get any of my cash-back
- 03: I forgot to get my cash-back
- 04: I am trying to get my cash-back
- 05: I got some of my cash-back
- 06: It's not time to get my cash-back yet
- (DK)

(route: ask Q.14b if 02 coded at Q.13, others close)

SHOW SCREEN – MULTI CHOICE

Q.14b Which of the following best describes whether or not you have received your cash-back?

Please mention all that apply

- 01: I have got all of my cash-back – SINGLE CODE
- 02: I have got some of my cash-back
- 03: I could not get some of my cash-back
- 04: I could not get any of my cash-back – SINGLE CODE
- 05: I forgot to get some of my cash-back
- 06: I forgot to get all of my cash back – SINGLE CODE
- 07: I am trying to get some of my cash-back
- 08: It is not time to get some of my cash-back yet
- (DK)