

## **Price rises in fixed term contracts**

### **Response by KCOM**

**14 March 2013**

#### **1. Executive summary**

KCOM recognises that the cost of communications services is important to consumers, and as such we welcome the opportunity to respond to Ofcom's consultation on price rises in fixed term contracts.

While KCOM understands the desire for greater transparency around price changes, we do have concerns around Ofcom's specific proposals. We note that this issue has come to prominence through quite specific concerns raised over monthly subscription price increases in the consumer mobile market. We see it as a significant extrapolation for Ofcom also to include the fixed services market, small business contracts and other non-subscription prices in the scope of its proposed remedy. In these areas, we question whether Ofcom has sufficiently robust evidence supporting the proportionality and justification for its preferred option.

Our view is Ofcom has not adequately attempted a better enforcement-based option as an initial response, such as publishing guidance, and is instead opting for the most intrusive option to address the potential for consumer harm identified. We are supportive of greater consistency in the application of current rules and expect more transparency for consumers could be achieved through published Ofcom guidance in relation to General Condition (GC) 9.6. We consider this would have the added benefit of better alignment with the Unfair Terms in Consumer Contracts Regulations (UTCCR), ensuring Ofcom does not introduce more consumer confusion given the prevalence of bundles that often include products not covered by the GCs. Ofcom could then evaluate the effect of such guidance in the market alongside more robust research, re-consulting further down the line if necessary.

#### **2. Introduction**

KCOM Group PLC delivers communications services to a range of businesses and consumers throughout the UK under a number of different brands. Kcom provides communications services for national multi-site enterprise and public sector organisations across the UK. In Hull and East Yorkshire, KC provides a range of communications services to businesses and consumers. Nationally, Eclipse Internet delivers a portfolio of internet based communications services with a focus on the SME market.

We have considered this consultation both from the point of view of KC and Eclipse. In the remainder of response we have commented on each of the questions posed in Ofcom's consultation document.

### **3. Consumer harm (Section 4 of the consultation)**

#### ***3.1 Do you agree with the consumer harm identified from Communications Providers' ability to raise prices in fixed term contracts without the automatic right to terminate without penalty on the part of consumers?***

KCOM does not dispute that there is potential for consumer harm when a consumer does not expect yet experiences an increase to a regular monthly payment during a contract with a minimum term. However we do not believe Ofcom has adequately demonstrated that this consumer harm is present to a significant extent in the fixed telecoms market. Ofcom has previously considered the need for consumer protection measures separately for the fixed and mobile markets; notably in the respective reviews into mis-selling, leading to GCs 23 and 24. In the statement for the former, Ofcom stated it was "not persuaded by the value of like-for-like comparisons between the fixed and mobile voice sectors given that market dynamics are very different"<sup>1</sup>.

We note Ofcom's analysis of the complaints it has received, both in the original consultation document and the two subsequently published breakdowns, do not split out the mobile and fixed sectors. In light of the well-publicised Which? campaign, we expect these complaints will be heavily skewed towards the mobile sector. Nevertheless we consider spikes in consumer complaint volumes into Ofcom should not be treated as sufficient evidence for regulatory intervention in of itself, but the rather a trigger for further investigation and evidence gathering.

Ofcom's consumer harm argument suggests poor consumer awareness of providers' ability to increase prices can impair transactional decisions. While we accept there will be cases when this is true, we believe Ofcom incorrectly draws the conclusion this is as a result of a failure in the existing regulation.

We consider a transactional decision is only potentially impaired if a change is to a service that a consumer regularly makes use of, for example, regular monthly subscription price. Even if consumers are not aware of the potential for small immaterial price increases, such as out of bundle directory enquiries or 09x call charges, it can only harm the consumer if the increase is for a service actually consumed. Furthermore it seems to us there is only a potential transactional decision issue if price rises apply to some providers and not others. We believe the structure of the fixed market in the UK means unavoidable cost increases are often incurred by most communications providers (CPs) simultaneously; this is particularly

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<sup>1</sup> Paragraph 5.80,  
<http://stakeholders.ofcom.org.uk/binaries/consultations/mobmisselling/statement/statement.pdf>

true with non-geographic termination charges. In such cases there is limited chance that a consumer, by switching, could avoid a price increase.

Clearly if a provider materially increases a subscription price and does not give its customers the opportunity to leave, it would constitute consumer harm. However in such a situation said provider would already be in breach of GC9, subject to enforcement action by Ofcom.

***3.2 Should consumers share the risk of Communications Providers' costs increasing or should Communications Providers bear that risk because they are better placed to assess the risks and take steps to mitigate them?***

We acknowledge there will be costs that are possible to anticipate to a certain degree, particularly wholesale inputs subject to an Ofcom charge control. We expect CPs will already assess the likely known cost changes across the duration of a contract and will plan them into their cost base. However, as Ofcom points out at paragraph 5.33 of its consultation, there will be periods of time, where CPs are awaiting Ofcom's statement on the next charge control period, where forward-pricing will be more difficult.

Our view is the problematic issue here is input costs that are not predictable and therefore cannot be mitigated, in particular termination cost changes for non-geographic numbers. We are concerned the effect of CPs having to absorb cost increases is that some consumers will end up paying for services consumed by others, particularly out of bundle usage of non-geographic premium rate services. We would also have some specific compliance concerns in the Hull area which we discuss in more detail in section 4.2 of our response.

***3.3 Do you agree with the consumer harm identified from Communications Providers' inconsistent application of the "material detriment" test in GC9.6 and the uncertainties associated with the UTCCRs?***

KCOM agrees that greater consumer certainty and awareness of contract terms can only be a good thing. We believe Ofcom could address the potential for consumer harm by providing guidance around the term, which we discuss in more detail in sections 3.5 and 5.2 of our response.

***3.4 Should Communications Providers be allowed (in the first instance) to unilaterally determine what constitutes material detriment or should Ofcom provide guidance?***

As we set out in our comments below, we would be supportive of guidance on what constitutes material detriment.

***3.5 What are your views on whether guidance would provide an adequate remedy for the consumer harm identified? Do you have a view as to how guidance could remedy the harm?***

KCOM believes publishing guidance could remedy the potential consumer harm Ofcom has identified and would be an appropriate remedy as a first instance response.

We consider inconsistent application of what level of increase constitutes “material detriment” and the potential for multiple variations over the length of the contract would be causes of concern to consumers. Ofcom in any guidance could offer greater certainty around “material detriment” in relation to monthly subscription, linking it to the provisions in the UTCCR. Although we recognise any guidance would not be legally binding, assuming Ofcom follows through as part of its enforcement programme, a consumer expectation would be firmly set around when they would expect to be allowed out of a contract without penalty. This would leave decisions on how to develop different tariff propositions up to CPs, but better transparency would allow competitive pressure to meet any demand for guaranteed fixed price products.

We have set out some further comments on how guidance might achieve Ofcom's desired outcome in section 5.2 of our response.

***3.6 Do you agree with the consumer harm identified from the lack of transparency of price variation terms?***

As we have discussed in our answer to question 3.1, we believe it is wrong to assume the transparency issues are the same in the fixed services market as mobile. We argue there is a greater consumer awareness of the chance of price increases in the fixed market, particularly in relation to line rental. We believe the onus should be with Ofcom to demonstrate any harm in the fixed market through consumer research and mystery shopping as it has with the mobile market.

We consider a requirement that would trigger formal notifications of price increases following every price change, regardless of how minor, would contribute to the desensitisation of consumers to respond unless they were otherwise considering switching. We believe that having an appropriate notification trigger point is the only way to balance the meaningfulness of the information.

***3.7 Do you agree that transparency alone would not provide adequate protection for consumers against the harm caused by price rises in fixed term contracts?***

KCOM agrees that transparency alone may not be sufficient to address some of the concerns raised as it would not be that useful where the application of the rules themselves is inconsistent. We believe Ofcom should seek to create an industry standard expectation through published guidance.

In order to not introduce greater confusion for consumers, KCOM's position is there is a clear benefit of the GCs aligning with the UTCCR. Without alignment we believe there will be a false expectation created among pay TV bundle customers that they would be able to leave pay TV contract elements in the same manner as they would telecommunications elements.

#### **4. Other issues (Section 5 of the consultation)**

##### ***4.1 Do you agree that any regulatory intervention should protect consumers in respect of any increase in the price for services provided under a contract applicable at the time that contract is entered into by the consumer?***

KCOM believes any regulatory protection measures should apply to the price consumers have actually paid for services, rather than any price for services they could theoretically access under contract. We consider that any regulatory intervention should focus on the specific harm it seeks to address, in light of the reality of how the majority of consumers make their purchasing decisions.

In practice a catch-all remedy would allow cases where consumers could leave a contract without penalty following very minor price rises that may be attached to services not actually used by the consumer. We believe there is a clear distinction between out of bundle charges, which only some customers will pay, to subscription charges which all customers pay.

Our view is it would be inconceivable that if, for example, one directory enquiries provider increased their call charges, CPs would be forced to either absorb the price difference and offer access lower than the advertised rate, or to allow all customers under contract to leave without penalty. We consider that restricting access to certain non-geographic services would be an inappropriate course of action for any provider. However we fear Ofcom, with a catch-all approach, may create an incentive for CPs not to respect the any-to-any principle.

##### ***4.2 Do you agree that any regulatory intervention should apply to price increases in relation to all services or do you think that there are particular services which should be treated differently, for example, increases to the service charge for calls to non-geographical numbers?***

In line with our comments in 4.1 above, we believe only core component services need be included in any intervention, such as monthly bundle price, line rental, call package price and broadband price.

We do have specific concerns around the inclusion of call costs to non-geographic numbers.

In Hull, we have a strong compliance process to ensure we do not create competition law issues. As part of this, we need to ensure we do not create a margin squeeze. In terms of non-geographic termination rates this in practice means we cannot absorb any wholesale

termination rate increases. In order to comply we adjust our prices once a month for each changed 09x, DQ and 08x higher rate number range to match BT's pricing. If option 4 was implemented in Hull, we would have to formally notify all our customers within their initial contract period each month of increases and allow them to leave without penalty. We consider this would significantly increase our costs as well as rendering the mutual benefits of having a contract over one month redundant.

To illustrate our concerns we looked at the monthly 08x and 09x price increases we made in June 2012 to reflect BT's retail charges and compared against KC call traffic for all customers (residential and business) for the last four months<sup>2</sup>.

**Table 1 June 2012 KC price increases to 08x and 09x non-geographic number ranges and customer usage November 2012 - February 2013**

Number Range	Jun 2012 Change	Old Price (pre-Jun 2012)				New Price (Jun 2012 onwards)				Customers using range (Nov 12 – Feb 13)	Minutes per customer
		Fixed Charge (p)	Charge Per Minute (p)			Fixed Charge (p)	Charge Per Minute (p)				
			D	E	W		D	E	W		
0843 511x	MM02 → MF09	0	1.7	1.7	1.7	4.2	4.3	4.3	4.3	2	0.56
0844 446x	MM05 → MF09	0	4.3	4.3	4.3	4.2	4.3	4.3	4.3	34	0.30
0844 512x	MM11 → MF09	0	1.7	0.9	0.9	4.2	4.3	4.3	4.3	10	0.18
0871 743x	MM06 → MM10	0	5.1	5.1	5.1	0	8.5	8.5	8.5	0	0
0871 791x	MM07 → MM10	0	6.0	6.0	6.0	0	8.5	8.5	8.5	0	0
0871 812x	MM09 → MM10	0	7.7	7.7	7.7	0	8.5	8.5	8.5	4	0.5
0904 941x	PR00 → PR06	0	4.3	4.3	4.3	0	29.8	29.8	29.8	0	0

Source: KCOM data covering our KC residential and business customers in Hull and East Yorkshire

We also note that sometimes the price point of different number ranges is moved from fixed price to per minute pricing or vice versa, so it would be difficult to assess whether it constituted a price increase or not for the purposes of any the regulatory requirements. We have only shown clear cut examples in Table 1 above.

<sup>2</sup> We chose June 2012 as reasonable example of the type of increases we have to make each month, although the exact quantity of changes does vary. Four months call traffic data was used as it is the most data we can extract easily for the purposes of this example.

Taking the most frequently used number range where we had to increase the price in June 2012, 0844 446x, changed to include a fixed charge. In the four months to February 2013 just 34 KC customers made on average 1.6 calls to a number in this range – which equates to on average just 1.7p extra on 0.02% of customers' bills per month. We would argue this is hardly the sort of consumer harm Ofcom is intending to address. In many cases these increases have absolutely no impact at all on customers, so inclusion in any remedy seems to us disproportionate and frankly illogical.

We do not believe that an increase in an out of bundle service, rarely or never used by the customer, could logically be used as a reason to cancel a contract early. For the limited number of customers where changes such as this may have a materially detrimental impact, we would hope the vast majority of CPs would show flexibility under current rules and following analysis of the customer's bill, would allow them to leave with penalty.

We also believe it is important for Ofcom to consider the proposed changes to the structure of non-geographic call charges as part of this consultation. Under the proposed new rules, any changes in the service charge associated with any number range should not be covered by GC9.6 as only the access charge element would be under providers' control. Service charges for each given non-geographic number would be the same across all providers and as such consumers could not address any harm caused by the increase in a number's service charge by moving provider.

***4.3 Do you agree that the harm identified from price rises in fixed term contracts applies to small business customers (as well as residential customers) but not larger businesses?***

Ofcom at paragraph 5.23 of its consultation admits that just 20 complaints have been received about changes to terms and conditions from small businesses, 1% of the total complaints on this issue. KCOM believes Ofcom, as an evidence-based regulator, should ensure it has robust evidence of harm. We consider Ofcom is over-extrapolating concerns raised about subscription charges in the mobile sector for residential customers to fixed small business customers with no real evidence justifying the proportionality of doing so. These markets are manifestly different in character and we do not consider it is enough to simply presume the potential for harm is the same.

For larger business, we consider that the greater bargaining power and access to legal resources ensures they are armed with the information and ability to negotiate contracts that suit their particular needs, including in relation to price. The bespoke nature of many contracts and complexity of some services delivered under them makes it inappropriate that they be captured (as well as being difficult for Ofcom to monitor or enforce). Therefore our view is it is absolutely essential that larger businesses are not captured by any proposed change.

***4.4 Do you agree that any regulatory intervention that we may take to protect customers from price rises in fixed term contracts should apply to residential and small business customers alike?***

Further to our comments in section 4.3 above, we do not consider there has been any evidence put forward suggesting the harm identified applies to small businesses. While we accept it is more likely small business customers will be on standard contracts, whether or not any remedy should be applied depends on how intrusive such a remedy would be. For example, we believe our proposed approach set out in section 5.2 would be workable for both residential and small business customers. However we do not believe Ofcom has sufficient evidence to justify the proportionality of option 4.

***4.5 Do you agree that our definition of small business customers in the context of this consultation and any subsequent regulatory intervention should be consistent with the definition in section 52(6) of the Communications Act and in other parts of the General Conditions?***

KCOM is of the view the definition of small business customers in the Communications Act is generally problematic in the application of the GCs. CPs rarely collect 'number of employees' information from business customers, so cannot firmly identify where the regulatory provisions apply. In practice we would transpose the requirements into the standard contracts for products which are primarily aimed at small business customers.

***4.6 Do you agree that price rises due to the reasons referred to in paragraph 5.29 are outside a Communications Provider's control or ability to manage and therefore they should not be required to let consumers withdraw from the contract without penalty where price rises are as a result of one of these factors?***

We agree tax changes such as VAT should be exempted as a qualifying price change. Consumers could not benefit by switching service as all CPs would likely pass on any VAT increase. The Government's ability to alter VAT we believe is well known among consumers and as such no transparency issues would arise.

***4.7 Except for the reasons referred to in paragraph 5.29, are there any other reasons for price increases that you would consider to be fully outside the control of Communications Providers or their ability to manage and therefore should not trigger the obligation on providers to allow consumers to exit the contract without penalty?***

Please see our comments in section 4.2 highlighting the need to ensure out of bundle non-geographic call charges should not trigger any exit without penalty obligations.

**4.8 Do you agree that Communications Providers are best placed to decide how they can communicate contract variations effectively with its consumers?**

We agree that CPs are generally best placed to decide how to communicate contract variations, although we have no objection to Ofcom identifying what it believes to be best practice.

**4.9 Do you agree with Ofcom's approach to liaise with providers informally at this stage, where appropriate, with suggestions for better practice where we identify that notifications could be improved?**

KCOM agrees this is a sensible approach.

**4.10 What are your views on Ofcom's additional suggestions for best practice in relation to the notification of contractual variations as set out above? Do you have any further suggestions for best practice in relation to contract variation notifications to consumers?**

KCOM agrees that examples listed at paragraph 5.46 of Ofcom's consultation document would generally represent good practice in relation to increases to regular tariff prices.

However we note that best practice for a subscription price increase is not necessarily the same as it would be for, as an example, a change to an out of bundle call charge. Were CPs required to send notifications for every non-geographic call charge increase, we would be concerned. If such notifications were given the same prominence as more significant price change notices, we fear some consumers may be desensitised to formal notifications and consequently would be less likely to take action if a change of genuine detriment was made.

**4.11 What are your views on the length of time that consumers should be given to cancel a contract without penalty in order to avoid a price rise? For consistency, should there be a set timescale to apply to all Communications Providers?**

KC in Hull gives one month notice prior to a material price increase as required by GC9. Customers can leave without penalty at any point between receiving this notice and one month after the price change has taken effect. We believe our approach is reasonable and would be comfortable if Ofcom were to suggest it in any published guidance.

We would have to reevaluate whether this would continue to be appropriate if Ofcom were to implement option 4 as currently set out.

**4.12 *What are your views on whether there should be guidance which sets out the length of time that Communications Providers should allow consumers to exit the contract without penalty to avoid a price rise?***

Further to our comments in 4.11 above, we would be comfortable with guidance that suggested CPs should allow customers one month either side of a potential materially detrimental price rise to exercise a right to exit without penalty.

**5. Options for addressing consumer harm (Section 6 of the consultation)**

KCOM's overall assessment of the options presented is they would benefit from a more detailed impact assessment, with comprehensive economic analysis of the potential consequences for the market and for consumers. We argue below that a refined version of option 2 would be the most suitable to address the concerns Ofcom has raised.

**5.1 *Option 1: Do you agree that this option to make no changes to the current regulatory framework is not a suitable option in light of the consumer harm identified in section 4 above?***

Ofcom's analysis of principle 1 in relation to this option suggests evidence of a lack of awareness among consumers in relation to mobile contracts. Even if one accepts that analysis, we would question what evidence Ofcom has of a similar issue within the fixed market. Ofcom is placing a heavy reliance on mobile operator complaints data and a Which? campaign focused on the mobile market as an evidence base for its proposals. We are surprised Ofcom has not sought to conduct wider consumer research covering the fixed market also before arguing a change in the regulatory framework is required.

KCOM notes that Ofcom does have robust enforcement powers in relation to the GCs and the UTCCR. We would argue the evidence points to a failure of compliance by certain providers and by extension Ofcom's current approach to enforcement, rather than an intrinsic failure of the wording of GC9.6 itself.

For the avoidance of doubt, we entirely accept that there is a legitimate consumer concern around the inconsistency in the application of the rules and the resultant price rises in fixed term contracts. We just consider there are options leading to improvement in consumer outcomes, such as a version of option 2, that do not require an intrusive amendment to the regulatory framework.

**5.2 *Option 2: Do you agree with Ofcom's analysis of option 2? If not, please explain your reasons.***

KCOM believes an iteration of option 2 is the best option in the circumstances and provides a workable way forward to address the consumer issues as an initial response.

## **Analysis of option 2 as set out by Ofcom**

We believe Ofcom's consideration of what option 2 would look like is somewhat of a straw man, in that Ofcom has characterised a guidance-based option as ineffective without considering the full potential of such an approach. We agree that transparency requirements alone are unlikely to be sufficient to allay concerns in this area, but guidance issued need not be constrained to transparency matters in isolation.

We consider the purpose of guidance is to give certainty of how Ofcom will go about assessing potential breaches of GC9.6. Clearly for that to be impactful Ofcom must be prepared to back that up in its enforcement programme. As Ofcom notes in its analysis, the current provisions of the UTCCR already sets a strict set of circumstances in which price increase contractual terms may cause unfairness. Ofcom must be prepared to make use of its existing powers in this area.

## **Alternative guidance option covering situations of material detriment**

At paragraph 6.22 Ofcom offers its view that "material detriment" could be preserved if it offered benefits for the consumer. Our view is by forcing CPs to forward price there will be less efficient pricing, resulting in consumers paying more over the length of the contract. Furthermore, retaining the existing wording of GC9.6 would ensure CPs did not have to recover increased non-geographic wholesale termination costs through subscription prices. This would benefit consumers who are not heavy users of such services as they would not have to effectively contribute to the out of bundle use of other end-users.

We consider option 2 is likely to address the potential for consumer harm if it was focused on changing CPs' behaviour rather than consumer behaviour through transparency alone. We suggest option 2 would be more credible if Ofcom offered a definition in guidance of what they believe material detriment is in the context of GC9.6, along with a compatible definition of what they would believe to be an unfair price change contractual term under the UTCCR.

We note Ofcom offers some limited consideration of this approach in its analysis of option 2 against principle 4. Ofcom cites the legal status of guidance as its primary concern. We would highlight this assertion assumes that Ofcom has adequately met the legal tests to pursue a legally binding option. As we set out later in section 5.4, we do not believe Ofcom has met these tests. In any event, we believe that guidance could still resolve the issues Ofcom is concerned about without having to modify the GCs and meet those tests.

If Ofcom were to set an expectation in the market through guidance of what level of price change would constitute "material detriment", how many increases could be made and to what, Ofcom would aid its own enforcement programme and industry is very likely to respond in the majority of cases. CPs would be aware that if guidance failed to have the desired effect, Ofcom would have a better justification at a later date to modify the GCs to hardcode a definition of material detriment or even consider option 4 if necessary.

While the exact guidance offered on material detriment would have to be considered in detail by Ofcom, we suggest the following assertions in guidance would go some way to remedying the specific enforcement issues.

*A price increase would likely be considered of material detriment under GC9.6 where a resultant regular core service price is increased above cumulative monthly RPI inflation, to the nearest month, compared to the comparable regular core service price at the start of the contract.*

*A contractual term would likely be considered unfair under the UTCCR if it permits a price increase where the resultant regular core service price could be increased above cumulative monthly RPI inflation, to the nearest month, compared to the comparable regular core service price at the start of the contract.*

We believe RPI inflation would be the most appropriate price increase benchmark for determining headline price changes of material detriment. We considered analysis around the SSNIP test as a tool to consider what an insignificant or immaterial price increase might be. Ofcom cites the European Commission's recommendation in its recent Narrowband Market Review consultation that "5-10% notional price increase is typically considered 'small' and 'significant'"<sup>3</sup>. By extension any increase less than 5% could be considered small and insignificant, unlikely to prompt consumers switching on the basis of this price change alone. We consider an RPI inflation threshold would broadly meet this, while maintaining a level of flexibility and responsiveness to the prevailing economic circumstances. We also consider it would be consistent with OFT guidance on price change terms in consumer contracts under the UTCCR, which states: "terms which permit increases linked to a relevant published price index such as the RPI are likely to be acceptable"<sup>4</sup>.

Ofcom could compliment this approach in any guidance by suggesting CPs make clear at the point of sale a statement along the lines of;

*We will not increase the regular monthly price of your contract by more than inflation during your initial contract period without offering you the right to leave without penalty.*

Noting what Ofcom sets out at paragraph 6.17, we agree that overloading consumers with information at point of sale is not desirable; however we consider our suggested guidance approach outlined above would create sufficient incentives for CPs that would remedy the identified potential consumer harm without need to amend the GCs. We expect providers uncomfortable with such a point of sale statement could offer guaranteed fixed contracts should they wish to. We consider that competitive forces would ensure any demand for such contracts would be met with this small change in the transparency requirements.

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<sup>3</sup> Paragraph 5.17, [http://stakeholders.ofcom.org.uk/binaries/consultations/nmr-2013/summary/NMR\\_Consultation.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/nmr-2013/summary/NMR_Consultation.pdf)

<sup>4</sup> Paragraph 12.4, [http://www.of.gov.uk/shared\\_of/reports/unfair\\_contract\\_terms/of311.pdf](http://www.of.gov.uk/shared_of/reports/unfair_contract_terms/of311.pdf)

If Ofcom followed our suggested approach, it would set the expectation that prices should never go up beyond inflation without consumers being offered the right to leave without penalty. Our suggestion would not preclude any other application or enforcement of GC9.6 in relation to other price or non-price changes, it would just set out a circumstance where the ability to leave contract without penalty should be offered. We expect it would have the added benefit of capturing the possibility of several incremental price increases across a contract as well as being applied to bundles with services not covered by the GCs. We consider this interpretation would also recognise that what is material detriment will vary for different consumers on the same tariff. For example, a price increase in month 17 of an 18 month contract would not be as harmful to a consumer on the same now-increased tariff, but in month 2. CPs would remain able to segment customers according to whether the RPI threshold is breached and ensure the appropriate right to leave is offered.

### **Analysis of our proposed guidance based option**

Below we have offered some initial consideration of our suggested approach against the principles Ofcom sets out in its consultation.

- **Principle 1 – consumers should have information that enables them to know what bargain they are striking, so they can make informed transactional decisions:** We consider the option described balances the need for consumer information with appropriate incentives on CPs, promoting consistent application across industry. As CPs would have to state at point of sale if they reserved the right to increase the monthly cost of a tariff by up to inflation, we expect some CPs may seek to introduce guaranteed fixed price tariffs assuming market demand.
- **Principle 2 – consumers should be protected against terms and practices that take them by surprise and which impose on them burdens and risks they should not fairly bear:** We believe Ofcom could achieve greater consistency in the application of GC9.6 by CPs, as well as with the contracts for bundled pay TV services through this approach. We expect this would increase consumer understanding of when they should expect to be allowed to leave without penalty and as such consumers would no longer be surprised. In terms of the potential for unfair increases, we believe the inflation interpretation of GC9.6 would ensure any price increases were fair.
- **Principle 3 – where potentially unfair terms and/or practices operate, consumers should be able to take steps to avoid their effects:** This option effectively lowers consumers' exit option threshold from what potentially could occur today. We believe that lowering this to 0% in nominal terms across all prices would have some perverse effects, as we discuss later, and that 0% in real terms has a more realistic chance of a better consumer outcome as the notices of any price changes would be more meaningful and more likely to result in a consumer response where appropriate.

- **Principle 4 – the rules that give effect to these principles should be clear, certain and effective in practice, and consistent with the general law (including the relevant provisions of the Universal Service Directive):** We believe CPs would respond to guidance, particularly if Ofcom accompany any such guidance with a fit-for-purpose enforcement programme. We consider that guidance around GC9.6 in the manner we have set out would be consistent with the UTCCR and would ensure that competition law issues are not raised in relation to non-geographic termination rates in Hull (as we have set out in section 4.2 of our response).

We believe that our suggested approach would meet the principles Ofcom has set out as well as being proportionate in the circumstances.

***5.3 Option 3: Do you agree with Ofcom’s analysis of option 3? If not, please explain your reasons.***

We agree with Ofcom that option 3 is unlikely to be a comprehensive remedy if it only focuses on transparency in isolation.

KCOM considers any outright requirement to offer guaranteed fixed contracts that extended to out of bundle call charges would present us compliance issues in relation to margin squeeze as well as being a disproportionate remedy, as we have set out earlier in section 4.2 of our response.

***5.4 Option 4: What are your views on option 4 to modify the General Condition to require Communications Providers to notify consumers of their ability to withdraw from the contract without penalty for any price increases?***

Option 4 is the most intrusive of Ofcom’s options and we cannot see how it can be justified based on the information presented in the consultation document. We do not agree with Ofcom’s dismissal of option 2 and believe it would need to try this approach before it could demonstrate option 4 is worth considering further. We have outlined some specific concerns around option 4 below.

**Interpretation of the Universal Service Directive (USD)**

KCOM notes Ofcom’s acknowledgement that this option represents a change to its existing interpretation of the revised USD. We believe Ofcom’s argument in May 2011 stands that the Framework should be implemented proportionally, consistent with general consumer protection principles and the UTCCR. We struggle to see what has changed in the fixed telecommunications market in that time to justify a departure from that approach.

We consider that Ofcom’s findings from its BEREK survey in this regard are potentially unhelpful. We note that not all national regulatory authorities (NRAs) have a uniform interpretation of the leave without penalty provision and we do not believe it is reasonable to

assume that such an interpretation is either effectively enforced or has had the desired effect in those countries.

We are concerned Ofcom does not appear to have asked other NRAs what their associated notification requirements are. Where some NRAs have offered this information unprompted (Germany and Greece), publication in the national press is deemed sufficient notification. We believe that the respective levels of severity of these two types of provision have to be considered together.

Ofcom currently has a very strong transparency requirement, where CPs have to notify all customers where a change of material detriment is to take place of both the change itself and their right to leave without penalty. While we support strong transparency requirements, we believe it is misleading for Ofcom to infer that just because other NRAs have implemented a more literal interpretation of Article 20(2) of the USD, consumer transactional decisions would be any better for consumers than in the UK under the current regime.

#### **Ability of CPs to predict price changes**

KCOM believe Ofcom has overestimated the ability of CPs to estimate prices particularly with out of bundle services such as calls to non-geographic number ranges as we have set out earlier in section 4.2 of our response.

#### **Legal tests**

Ofcom is required to ensure that any change to GC9.6 passes the legal tests required under section 47(2) of the Communications Act. Certainly for the fixed market, we do not believe Ofcom has demonstrated these tests have been met.

In particular, KCOM's primary concern is that Ofcom has not demonstrated option 4 is a proportionate intervention. Our view is Ofcom cannot demonstrate this in the fixed sector without having fully explored or tested less intrusive options.

In terms of whether option 4 is objectively justified, we cannot see how this test can be considered met when Ofcom has not conducted credible consumer research covering the fixed sector and has not considered pay TV, which is often sold as part of a bundle. We also fail to see any evidence-based reason consumer harm exists under the current rules for small business customers and regarding out of bundle charges.

At paragraph 6.48 of the consultation document Ofcom makes the point that option 4 is a relatively cheap option for Ofcom to enforce. We worry that Ofcom is proposing an easy to enforce change to the GCs, simply to suit its existing enforcement team resource. We believe consideration of this is not appropriate as it could skew its analysis on whether the change is objectively justifiable.

Absent of legal justification to make changes of this kind, we believe that issuing guidance in the manner we set out in section 5.2 of our response would best make use of regulations as currently worded to remedy any identified potential concerns.

***5.5 Do you agree with Ofcom's assessment that option 4 is the most suitable option to address the consumer harm from price rises in fixed term contracts?***

KCOM prefers option 2 for the reasons we outline in sections 3.5 and 5.2 of our response. Ofcom must consider how best, within its legal powers, it can address this issue in a well-rounded, proportional and consistent way, while best capturing all communications services consumers take, including those outside of the scope of the GCs, but within the UTCCR.

***5.6 Do you agree that Ofcom's proposed modifications of GC9.6 would give the intended effect to option 4?***

Below we have outlined a number of unintended but probable consequences were Ofcom to pursue option 4.

**Higher prices for consumers**

At paragraph 6.43, Ofcom suggests it believes that the competitive nature of the market will ensure CPs will not increase prices to take account of a newly increased risk level. However if competitive conditions forced CPs to price below the rate required to appropriately account for potential cost increases, there would be a scramble for new customers each time a minor unanticipated out of bundle cost increase had to be passed on. Many consumers would be unlocked from contract all at the same time. In such a case the level of switching would significantly rise to a rate perhaps over the healthy level for the market. Given the issues with fixed switching generally, this may cause diseconomies of scale in the Openreach switching process, again leading to greater costs and ultimately higher prices for consumers. We would like to see Ofcom conduct a more comprehensive economic analysis around these issues as part of its impact assessment before any changes are implemented.

**Disproportional negative impact on more vulnerable consumer groups**

In the fixed market, consumers within the initial contract on fixed telecommunications services will generally be the consumers who have recently switched provider. Ofcom research<sup>5</sup> suggests previous switchers are the most likely to shop around and switch when out of their initial contract period again in future. We are concerned some CPs would begin to increase prices for stickier out of contract customers to compensate for new restrictions

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<sup>5</sup> Page 3, <http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching/annexes/switching-bundling.pdf>

on cost recovery under option 4 for those within their initial contract period. Ofcom research<sup>6</sup> also suggests older consumers are less likely to switch than younger consumers. We note Ofcom has not considered the potential for this effect as part of its required Equality Impact Assessment.

### **Specific consequences in the Hull area**

We highlight that the market conditions in Hull, as a result of the market entry decisions of other CPs, mean that consumers have limited switching options when it comes to fixed telecoms services. We believe that any requirements to notify customers on a regular basis of insignificant price changes will only increase our cost base. This would only increase the costs we would ultimately have to recover from consumers while achieving no consumer benefit in the area.

### **Fewer good-value bundle propositions available to consumers in the market**

We also consider option 4 would effectively force CPs into the unbundling of tariffs, not just with handsets on mobile tariffs but all types of services as CPs may look to mitigate risk of churn. By ensuring separate contracts for each service, consumers would be less able to leave all services they take at once in the event of a price rise to one service. This creates new consumer harm in that the benefits of bundling services for consumers would no longer be realised and switching would actually become more complex for consumers.

### **Potential disincentive on CPs for transparency**

KCOM notes that GC9 only applies to regulated telecoms products, but in a national market where multi-service bundles are common we expect some additional confusion will be introduced where exit requirements do not apply to all services. Ofcom through option 4 may see some CPs attempt to shift price increases onto bundled services not covered by the GCs.

As we outlined in section 4.2 of our response, we expect we would have to send formal price increase notifications in relation to minor, often unused, non-geographic number ranges. We believe this would overload consumers with such notices, potentially desensitising consumers to this type of communication, ultimately making them less likely to respond to a notice that is a significant increase on their monthly bills.

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<sup>6</sup> Section 7.2.2, [http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-12/Consumer\\_Experience\\_Research1.pdf](http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-12/Consumer_Experience_Research1.pdf)

***5.7 What are your views on the material detriment test in GC9.6 still applying to any non-price variations in the contract?***

KCOM agrees that no change to the existing GC9 wording is required with respect to non-price variations in contracts.

***5.8 For our preferred option 4, do you agree that a three month implementation period for Communications Providers would be appropriate to comply with any new arrangements?***

We would hope to see detailed analysis of how option 4 may impact the switching process between providers using Openreach inputs to make sure there are not capacity issues likely to result. We expect such analysis should be considered as part of setting an appropriate implementation period, which we would suggest should not be shorter than six months.

***5.9 What are your views on any new regulatory requirement only applying to new contracts?***

KCOM believes it to be absolutely appropriate that any new regulatory requirements relating to contract terms only apply to new contracts. We consider any retrospective requirements on contracts already in place would be unacceptable and disproportionate given CPs would have had no opportunity to consider the new level of risk.