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Dear Carmen,

Price rises in fixed term contracts – options to address consumer harm

I am pleased to set out in the following TalkTalk's response to the above consultation.

1. Introduction

Ofcom's proposal represents a significant increase in the regulatory burden currently imposed by General Condition (GC) 9.6 which currently requires notification and penalty free exit only to customers to whom a price increase is likely to be of "material detriment". Instead stricter regulation on all communications providers who sell to consumers and small businesses will require CPs who wish to increase the price for any service by any amount to notify the customers of such change and allow them penalty free exit (regardless of whether the subscriber actually uses that particular service or not)¹.

Although TalkTalk agrees with the fundamental importance of ensuring a high level of consumer protection in relation to price increases, we consider that Ofcom's proposal is seriously flawed in two particular respects:

- (i) First, Ofcom has not presented any evidence of consumer harm being caused by price increases in the fixed line sector. The only evidence in the consultation document refers to the mobile sector. TalkTalk therefore believes it would be disproportionate and not objectively justifiable to amend GC 9.6 in so far as the fixed line sector is concerned.
- (ii) Second, and in the alternative, TalkTalk believes that GC 9.6 should be amended but only in so far as fixed monthly charges are concerned because that is where the consumer harm is being caused. There is little or no evidence that consumer harm is being caused in relation to other charges (e.g. out of bundle calls) that cannot be remedied by applying the current wording of GC 9.6 where customers are already

¹ Ofcom proposes to amend GC 9.6 in line with Option 4 in its consultation document.

able to leave a contract without penalty if a charge increase is to their material detriment. Furthermore, out of bundle charges are highly distinguishable from fixed charges in a way that makes them even less suitable for the amendment: they represent a smaller and declining proportion of revenue; they are avoidable; and the wholesale costs of these products are not controlled by the retail communications provider and can be very volatile.

Section 47 of the Communications Act 2003 requires Ofcom to take particular care when imposing or modifying General Conditions on communications providers. New obligations must be objectively justified, not unduly discriminatory, proportionate, and transparent in relation to what it is intended to achieve. Placing a very high burden of proof, this provision is intended to protect communications providers against unwarranted and unsubstantiated regulatory interference. This requires in essence a balancing of the benefits and the costs of such measures and that Ofcom has robust evidence not least of the consumer harm that would be remedied by the proposed change to GC9.6 but also evidence of the costs of such measures. As we explain, we consider that Ofcom has failed to equip itself with appropriate evidence and/or conduct any such proper analysis.

More generally and put quite simply, Section 47 is intended to protect business from red tape. It is the Government's stated objective to reduce red tape as this will help businesses to remain competitive and help restore the UK economy to growth.² As a regulator of an industry that represents a significant part of the UK economy, Ofcom cannot be blind to this overall objective and desire but must be particularly alert to concerns over overregulation in these recessionary times.

We expand on these points in the following two sections.

2. Absence of evidence of consumer harm in relation to fixed line services

We are highly concerned about the fact that most (if not all) of the evidence presented in the consultation document refers to complaints and views from mobile customers whereas Ofcom appears to have very little evidence that any consumer harm is being caused to customers of fixed communications providers.

We note that Ofcom believes it has identified consumer harm arising from prices rises during fixed term contracts and that these issues "*were further highlighted by price increases announced by several Communications Providers in late 2011 and during 2012.*" Ofcom states that it examined 1,644 consumer complaints but concedes these "*principally concerned prices [sic] rises in fixed term contracts for mobile services.*"³ Ofcom also considered evidence submitted by Which?'s "Fixed means Fixed" campaign but again notes that this "*focuses on price rises in fixed term contracts for mobile consumers.*"⁴

² See, e.g., <http://www.redtapechallenge.cabinetoffice.gov.uk/about/>

³ Paragraph 1.7 of the consultation document.

⁴ Paragraph 1.10 of the consultation document.

The consultation document (including the two further updates that Ofcom published) does not appear to contain any information as to how many customers complained about fixed line price increases. Absent any further clarification from Ofcom, this leads TalkTalk to believe that there were not any such complaints (or very few such complaints).

[CONFIDENTIAL] It therefore seems to us that for whatever reason, customers of fixed communications providers do not believe that price increases are a significant concern to them. If they did, it is reasonable to assume that Ofcom's contact centre would have received complaints.

Despite the admission by Ofcom that *"most of the evidence from consumer complaints and from Which? relates to consumer contracts for mobile"*, Ofcom says that it does not see *"why different principles should apply to the price for one set of services but not another."*⁵ Ofcom simply argues that *"the importance of price terms and the need for rules that are clear, certain and effective in securing a fair position for consumers should apply in respect of any regulated communications service."*⁶

TalkTalk believes that this 'one size fits all' approach is fundamentally wrong and at odds with the requirements for setting General Conditions under Section 47 of the Communications Act 2003. As Ofcom itself observes,⁷ in order to create or modify a GC, Ofcom must be satisfied that such a condition or modification is objectively justified, not unduly discriminatory, proportionate, and transparent in relation to what it is intended to achieve.

On the basis of the evidence presented in the consultation document, TalkTalk does not believe these criteria are met with regard to making the suggested change to GC9.6 in so far as fixed line services are concerned:

- (i) The change is not objectively justified because Ofcom has not shown that it has received any significant number of fixed line complaints (and therefore no prospect of a reduction in consumer harm as a result of the proposed regulation). Further, Ofcom has not considered the cost of providing notification or the confusion it imposes on customers;
- (ii) It is unduly discriminatory because Ofcom is seeking to extend regulation to fixed line services for a consumer harm problem identified solely in relation to mobile services;
- (iii) The change is not proportionate because, again, no consumer harm has been identified; and finally
- (iv) It cannot be considered to be transparent either because Ofcom has not explained in the consultation document why regulation should be increased for fixed line services when no evidence has been provided to stakeholders.

For the above reasons, TalkTalk believes that GC9.6 cannot and should not be amended as proposed by Ofcom in so far as fixed line services are concerned.

⁵ Paragraph 1.12 of the consultation document.

⁶ Paragraph 1.12 of the consultation document.

⁷ Paragraph 3.3 of the consultation document.

3. An amended GC9.6 should only apply to fixed monthly charges

Although we consider (as described above) that the amended GC9.6 should not apply to any charges for fixed line providers (given the lack of material evidence of harm) we consider that if Ofcom was to amend the condition for fixed line providers it should only apply to fixed monthly charges (i.e. subscription charges) and not to out-of-bundle charges (e.g. calls that are not part of the subscription).⁸

The overall reason for this is that the arguments based on objective justification and/or proportionality of applying the amendment to out of bundle charges are far weaker than for fixed monthly charges. If one were to apply Option 4 to the fixed line sector, TalkTalk believes that the evidence presented by Ofcom would allow this change to apply only to fixed monthly charges on the basis of which the customer agrees to take service from a communications provider. If the communications provider chooses to increase those fixed charges during the minimum term of the contract, it would be fair to allow the customer to leave without paying any early termination charges.⁹

However, we do not believe it is objectively justified or proportionate to apply to same rule to out-of-bundle call charges for the following reasons:

- (i) Unlike fixed monthly charges, we do not believe consumers generally enter into a contract with a provider on the understanding, implicit or explicit, that e.g out-of-bundle call charges would remain fixed throughout the minimum term contract period. Any consumer harm associated with increases to such charges would therefore arguably be much smaller compared to increases to fixed monthly charges. We agree entirely with Ofcom that *“the price is a key term of the contract, and consumers must know, and be able to evaluate and rely upon, the bargain they are striking.”*¹⁰ However, Ofcom makes the unwarranted and unsubstantiated leap in its reasoning that this fact alone would justify the imposition of Option 4 on out-of-bundle call charges. In fact, Ofcom has no apparent evidential support that price increases for out-of-bundle call charges is causing consumer harm. Indeed, Ofcom admits that *“most of the complaints made to [it] and via Which? appear to relate to monthly subscription charges.”*¹¹ If Ofcom thought that consumer harm was being

⁸ As an aside, we would note that although consumer pricing in the fixed line sector tend to be based on fixed monthly charges, there are important distinctions compared to the mobile sector (for which Ofcom presents evidence of consumer harm in the consultation document). For instance, fixed operators tend to make a very clear distinction between the monthly line rental charge and the monthly call and/or broadband package charge. In addition, the “trade-off” in consumers’ minds between obtaining the latest attractive mobile handset against a monthly fixed fee does not feature in the fixed market. That is not to say that consumers do not attach importance to the fixed monthly charge in the fixed line market but we would argue that the evidence in Ofcom’s consultation document quite clearly shows that potential for consumer harm is much less in the fixed line market, i.e. consumers seemingly tend to complain about mobile price increases but not so much about fixed line price increases although the latter do take place quite regularly (most often in relation to the line rental price).

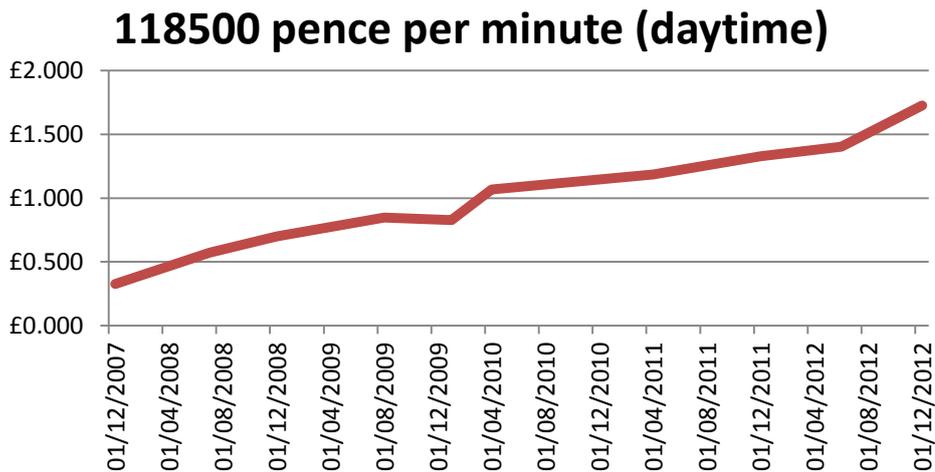
⁹ We believe it would be reasonable to adopt the same approach in relation to any increases in the early termination charge since this is a charge that the customer would not be able to avoid if they wanted to leave during the minimum contractual term.

¹⁰ Paragraph 5.9 of the consultation document.

¹¹ Paragraph 5.7 of the consultation document.

caused by price increases for out-of-bundle call charges then Ofcom has a statutory duty to produce evidential support for this. In contrast, the available evidence clearly shows that there is a stark difference between fixed monthly charges and out-of-bundle call charges in terms of consumer harm.

- (ii) Unlike fixed monthly charges, a customer has a choice as to whether they continue incurring other call charges that are not included in the call bundle. By way of example, if a customer believes a price increase for a 118 DQ service makes the service too expensive to use, they are able to choose another DQ service in what is a competitive market. Furthermore, in an ever-converging market, customers are able to use to other means of communication such as Skype or the Internet to find the equivalent service or information. The customer therefore has several means of avoiding a particular charge increase and can therefore effectively mitigate any significant detriment to them.
- (iii) From a fixed provider's perspective, it is very important to note that they normally have very little choice but to increase retail charges since they are directly linked to wholesale price increases. By way of example, the wholesale pence per minute rate for calls to the 118500 DQ service has been increased 9 times in the last 5 years and in total by over 500% in that period (see graph below).



(Source: BT Carrier Price List)

Contrary to Ofcom's assertion,¹² TalkTalk does not agree that *"providers are able to, and do, make an unbiased forecast of these costs like any other costs and set prices for them periodically."* This is plainly wrong. The fact is that providers have no way of "forecasting" call charges for non-geographic numbers such as 09 and 118 numbers because they are completely out of their control and price increase notifications can literally happen at any time. By way of further illustration, on 7 March 2013, BT notified a charge increase for its 118606 DQ service according to which the termination rate for this service would increase by up to 4171.79%(!).¹³ During

¹² Paragraph 5.13 of the consultation document.

¹³ See BT Network Charge Control Notice No 1189, https://www.btwholesale.com/pages/static/Library/Pricing_and_Contractual_Information/carrier_price_list/ot_nccnjanuary2013march2013.htm

January to March 2013 (so far), BT have notified significant price increases for three different DQ services.¹⁴ TalkTalk fails to understand how Ofcom can claim that providers should be able to “forecast” such cost increases.

- (iv) It is generally accepted that providers would continue to allow its customers to dial all telephone numbers irrespective of any charge increases (perhaps with the exception of concerns around fraud and bad debt). Ofcom also expects all providers to offer end-to-end connectivity and has stated that it would seek to resort to formal regulation if markets concerns in this regard ever emerged.¹⁵ On this basis, TalkTalk believes it would be disproportionate to require providers to apply Option 4 to this type of charge increases since (i) providers have no control over when and by how much the wholesale price increases (which in itself increases cost because of the volatility in charges); and (ii) providers are effectively forced to increase their retail prices.
- (v) If providers were required to notify all customers as soon as they increased a single individual out-of-bundle call charge, they would arguably be forced to set their charges above a level reflective of cost (i.e. wholesale cost plus efficient retail cost) to protect against the risk that wholesale costs may suddenly increase at short notice. This would result in an “allocative inefficiency” because retail prices would not be close to cost which would distort competition and, ultimately, harm consumers who would have to pay higher retail prices.

TalkTalk accepts that out-of-bundle call charges (and other non-fixed monthly charges) may be represent a proportion of the monthly spend by customers. This is not the point here. However, customers would still be able to exercise their right to leave without penalty if the charge increase was to their material detriment in line with the current wording of GC 9.6. We therefore believe that the current wording offers consumers adequate protection in so far as out-of-bundle call charges are concerned. Ofcom has not produced evidence of consumer harm to supports an extension of Option 4 to out-of-bundle call charges and so cannot lawfully make this change to GC9.6 due to the requirements of Section 47 of the Communications Act 2003.

¹⁴

https://www.btwholesale.com/pages/static/Library/Pricing_and_Contractual_Information/carrier_price_list/ot_nccnjanuary2013march2013.htm

¹⁵ End-to-end connectivity, Ofcom Statement, 13 September 2006, paragraph 3.25.

Please do not hesitate to contact me should you have any questions concerning the above comments.

Yours sincerely,

Rickard Granberg
Head of Regulation and Compliance