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Vodafone response to Ofcom consultation

Prohibiting inflation-linked price rises

13 February 2023

Executive Summary

- **Vodafone agrees with Ofcom's sentiments** that consumers of phone and broadband services should be clear about what they will pay throughout the duration of their contract.
- **Demand is soaring**, with customers using more data per device, connecting more devices per user, and driving more data across our mobile and broadband networks than ever before.
- **High quality, resilient networks that are both highly secure and constantly invested in are vital** to satisfy the growing needs of UK consumers now, and in the future.
- **The cost of delivering these networks is great**, but the UK mobile sector is currently experiencing record low levels of profitability, reducing share prices, and increasing uncertainty, while also undergoing significant operational cost increases from usage and energy inflation. Wholesale broadband providers incur the same costs and pass a significant portion on to us.
- **Vodafone's everyone.connected programme seeks to close the divide between people with and without connectivity,** including the provision of social broadband and protection of financially vulnerable customers from annual price rises. It has been recently reported that operators are subsidising the provision of social tariffs by an estimated £62m a year (Assembly Research: Value of Telecoms report Dec 2023).
- **The UK mobile market is highly competitive**, and competition is the single most important driver of positive consumer outcomes and competitive markets encourage operators to find the delicate balance between pricing levels and investment without intervention.
- **Operators are under significant pressure** from other MNOs, very large-scale converged operators and network-light MVNOs that enjoy highly competitive wholesale network pricing from MNOs. If Vodafone and other MNOs price too high, they lose share and customers; too low and they destroy value. Either scenario means that UK network investment is jeopardised.
- **Regulatory frameworks in highly technical, innovative, rapidly changing markets must encourage investment.** Ofcom should ensure it approaches all regulation with a balance on the impacts on consumers, business, competition, and investment.
- **Ofcom has not sought to ban price rises** and appears to understand that retail price rises are essential in an industry where consumer demands, network security, resilience requirements, and operating costs all increase over time.
- **Vodafone has highlighted some practical implementation issues** that Ofcom should consider if they are to proceed with their proposals.

Key points to address

Introduction

Vodafone has carefully considered the proposals set out in Ofcom's December 2023 consultation. Vodafone agrees with Ofcom's sentiments that consumers of phone and broadband services should be clear about what they will pay throughout the duration of their contract. Vodafone believes that transparency is an important part of ensuring customers can make the right decisions. Ofcom's proposals appear to support this outcome.

Vodafone also considers that high quality, resilient networks that are both highly secure and constantly invested in are also vital to satisfy the needs of UK consumers. However, the cost of delivering these networks is great. Ofcom has not sought to ban price rises and appears to understand that retail price rises are essential in an industry where consumer demands, network security, resilience requirements, and operating costs all increase over time.

The costs operators in this industry face are, and have been, increasing. Many of these are linked to regulated fees and products that are linked to inflation - Ofcom itself has accepted inflation in its own regulatory approach in many areas, building inflationary price increases into annual licence fees paid for spectrum, automatic compensation for broadband customers, and certain regulated Openreach prices. This all means that this industry is one where costs do increase annually broadly in-line with inflation and therefore consumer prices also need to increase, but we agree with Ofcom that this needs to be done in a clear and transparent way.

At the same time, it is important not to lose focus on ensuring that the market can provide the right support to customers, including those most in need. We believe connectivity is essential, and everyone should have access to the opportunities it provides. Vodafone's everyone.connected initiative aims to help four million people and businesses cross the digital divide by 2025. The digital divide is the gap between people with internet access and skills and people without. The digital divide between those who have access to digital technology, and the 1.7 million households who do not, is at risk of widening further, so Vodafone is committed to taking action to close the divide in a number of ways:

- Donating connectivity and tech: Working with partners we will continue to donate mobile connectivity and technology to those who need it most.
- Affordable and accessible services: Offering targeted, affordable tariffs and services that make being connected super accessible.
- Upskilling businesses and communities: Working with partners to provide free support to digitally transform and upskill businesses and communities

As part of this, we provide social broadband which is not subject to price rises and we exclude all financially vulnerable customers from annual price rises. Protecting our most vulnerable customers will continue to be a key focus for Vodafone.

In this response we focus on the two most important issues that Ofcom should always consider in respect of regulatory intervention:

- the fact that the UK mobile market is highly competitive, and competition is the single most important driver of positive consumer outcomes, and
- regulatory frameworks in highly technical, innovative, rapidly changing markets must encourage investment.

We also comment on the implementation issues that Ofcom should consider if they are to proceed with their proposals.

Competitive markets encourage operators to find the balance between pricing levels and investment without intervention

This is an extremely competitive market with operators under significant pressure from other MNOs, very large-scale converged operators and network-light MVNOs that enjoy highly competitive wholesale network pricing from MNOs. If Vodafone and other MNOs price too high, they lose share and customers; too low and they destroy value. Either scenario means that network investment is jeopardised, resulting in a delicate balancing act between the two forces. We therefore undertake price rises with those twin pressures in mind, and strive to find the right balance between the two. The need to strike this balance is driven by competition and will continue following Ofcom's proposed intervention.

Customers are using more data per device, connecting more devices per user and driving more data across our mobile and broadband networks. To keep up with consumer demand and strike the right balance between investment and price rises we need to invest more in our network whilst also undergoing significant operational cost increases from usage and energy inflation that's why price rises are so important. We see this pressure across our mobile and broadband network; however, our wholesale broadband providers incur the same costs and pass a significant portion onto us via CPI based price rises.

Regulatory frameworks must encourage investment

The issue of mid-contract price rises is one which has seen persistent intervention by Ofcom and other regulators over the past several years. We expand on this in Annex 1, but we note that Vodafone's historic approach to using inflationary price indexes aligned with our understanding of Ofcom's preference for the use of CPI. Ofcom's current proposals look to set a new approach for customers that sign up following Ofcom's implementation deadline.

In December 2022 we welcomed the publication of Ofcom's conclusions from their future approach to mobile markets review. In particular, we welcomed Ofcom's recognition of the important influence regulation can have on investment.

> *We recognise that regulation can influence investment incentives by affecting the expected future returns of potential investments, and the uncertainties associated with making those investments. We are therefore taking steps to clarify aspects of our future regulatory approach*

> *to encourage investment and help MNOs and others to better navigate the uncertainty generated by changing market conditions.*[1]

The last few years have seen several significant pieces of regulatory implementation, not least the introduction of pre contract summaries and information, which Vodafone implemented on time and in a robust fashion (which was not the case for all operators).

Regulatory interventions incur significant implementation costs. Over the last three years, implementing new consumer regulation alone has cost Vodafone [CONFIDENTIAL], not including resource costs, any loss of revenue, and the ongoing operational costs of maintaining previous regulatory requirements. Wide-ranging, unspecific, uncertain regulatory announcements have the potential to affect future revenues and will detrimentally impact current levels of industry investment.

The impact of regulation on the communications sector does not only come from Ofcom. The recent introduction of the Consumer Duty by the FCA has introduced significant, wide-ranging obligations which have generated considerable implementation challenges and costs. Furthermore, the Advertising Standards Agency has itself recently intervened in relation to the advertising of mid-contract price rises; having implemented changes to adapt to this new regulation, Vodafone now faces the prospect of having to make further changes – as much of what Ofcom now proposes supersedes the ASA's regulation. While we understand that Ofcom considers that the ASA's guidance does not adequately remedy the consumer harm it identifies, it must recognise that frequent, discordant intervention by a variety of regulators is disruptive and costly for industry. We also note that both of these changes had longer implementation periods than that which has been proposed by Ofcom.

The UK mobile sector is one that is currently experiencing record low levels of profitability, reducing share prices and increasing uncertainty. Indeed, there is widespread uncertainty regarding future investment in many regulated sectors in the UK. This is why groups like the regulatory reform group[2] have been set-up to consider what regulators can do to encourage increased sector investment. As part of the government's smarter approach to regulation, Ofcom will have to consider the future growth of the communications sector.[3] We urge Ofcom to consider these wider sector issues when considering regulatory interventions in the future.

Regulatory interventions incur implementation costs and increase sector risk by their very nature - this increased risk premium discourages investment and makes the investor demand a higher return. This is a conflicting vicious cycle, increased costs and increased risk leads to lower returns yet higher returns being demanded by investors - this is precisely why telecom share prices are falling and attracting investment is becoming more challenging.

Ofcom has described this intervention as one of transparency and, as mentioned above, whilst we do understand some of Ofcom's concern, we also have concerns that this intervention moves close to the area of retail price regulation. While Ofcom has not regulated the quantum of any price variation, it has sought to limit the way in which communications providers can construct their retail pricing. We will monitor the final proposals very closely to ensure the focus remains purely on transparency and does not move towards more evident price regulation.

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[1] Para 5.19, Conclusions paper: Ofcom's future approach to mobile markets and spectrum
[2] Regulatory Reform Group — WPI Strategy (wpi-strategy.com)
[3] Consultation on extending the Growth Duty to the economic regulators Ofgem, Ofwat and Ofcom: government response (publishing.service.gov.uk)

As we head into the future, Vodafone believes it is important for Ofcom to refocus on its bias against intervention, and to ensure that it approaches all regulation with a balance on the impacts on consumers, business, competition, and investment.

Implementation issues

In the event that Ofcom proceeds to confirm its proposals, we believe that there are certain changes it should make. We set those out below.

Extension of implementation period

Ofcom has proposed a four-month implementation period from the date of which it issues its final decision.

Ofcom correctly notes that some providers would need to change the way they set in-contract price rises as a result of our proposed amendments to the GCs.[4] It goes on to say that "This may entail some systems changes to operationalise the new pricing structures, training customer-facing staff to explain new contract terms, changes to the way price rises are presented and explained in advertising and marketing and require amendments to providers' Contract Information and Contract Summary."[5]

Ofcom is correct that its changes will require at least the activity outlined above. However, Ofcom has made several assumptions around the complexity of the above activity and around the necessity of other changes that have resulted in it setting an implementation period which is not realistic.

Ofcom has stated that it does not believe that providers will have to "build new systems to implement the changes, and we understand that some providers' systems may already have the capability to implement pounds and pence increases."[6] Ofcom has not explained its reasoning for believing this to be the case, and has only cited that it knows of two CPs that already have capacity. This is not an adequate basis on which to conclude that no provider will have to build a new system to implement these changes.

Furthermore, while Ofcom's proposals explicitly require changes to the customer journey and the contract summary, these are not the only changes that operators will have to make. The current terms for price rises are not only mentioned in these locations and there are several other material changes required, including:

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Furthermore, from a development perspective, Ofcom's proposals will require development across multiple platforms, including:

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As such, Ofcom needs to consider the knock-on impact that its proposals will have in determining the appropriate implementation length.

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[4] Paragraph 4.108, December 2023 consultation
[5] Paragraph 4.108, December 2023 consultation
[6] Paragraph 4.108, December 2023 consultation

We also note that Ofcom's four-month implementation deadline is not in line with the implementation periods permitted for other similar regulatory interventions. For example, the ASA's recent guidance in relation to mid-contract price rises allowed for a six-month implementation period, despite having a more limited scope than Ofcom's proposed new rules.

Finally, Ofcom must also consider other significant regulatory changes that operators are currently implementing and be mindful that any regulatory intervention requires the diversion of resources away from other activity designed to deliver value to customers. Each of these new areas of regulation require significant resource investment, and many of their implementation deadlines are likely to overlap.

Given the above, we believe that it would be reasonable for Ofcom to extend its proposed implementation date to eight months from the date on which Ofcom issues its final decision.

Ofcom must ensure that it properly presents its final decision to avoid further customer confusion.

Following the publication of its proposals, it was widely reported in the media that Ofcom had banned mid-contract price rises. While Ofcom's press release does include information on the specifics of its proposals, this detail was not easily understood by the press or the markets. Vodafone found that it was required to clarify the detail of Ofcom's proposals with a number of members of the press and investors.

While we do not believe that Ofcom sought to present its proposals in a way that gave the impression of a full ban on mid-contract price rises, we would ask that it carefully considers the presentation of its final proposals to ensure that the nuances of its decisions are clear and properly understood.

Were it to be the case that there is a misconception that Ofcom's rules constitute a full ban, it could potentially undermine customers confidence in the market, create further customer confusion, and diminish the benefit that Ofcom believes its intervention will deliver.

Any changes to its proposals should result in re-consultation.

We are aware that since the publication of Ofcom's consultation, several developments and announcements may have subsequently shaped Ofcom's view of its proposals.

The first is BT's decision to adopt Ofcom's proposals prior to their becoming regulatory requirements. BT's decision and the specific pricing structure it has announced will give Ofcom some insight into how its proposals might play out in the markets it regulates. To the extent that this results in Ofcom making substantive changes to its proposals, we would expect to have an opportunity to comment prior to their becoming requirements.

The second is calls from some parties for Ofcom to go further in its proposals by requiring all price rises to be capped at inflation and to apply its proposed changes to all historic customers. We expect Ofcom will be giving these requests careful consideration, as it will all other input that it receives in response to its consultation.

For the avoidance of doubt, we believe that, should Ofcom decide to adopt such changes, it would it be incumbent upon it to reconsult. In particular, setting an absolute cap on the amount of any price rise would go beyond what Ofcom believes to be a transparency requirement, and instead represent a direct constraint on retail pricing. Furthermore, extending its remedy historically to customers who have already entered into contracts would also be a significant change requiring more detailed consideration.

Given that Ofcom is not currently proposing this, we have not submitted comments; however, should Ofcom wish to move to that position, Vodafone would expect the opportunity to comment on the proposal and on the evidence used to justify it.

For the avoidance of doubt, we believe that any further restriction of price rises beyond the scope set out in its December consultation is likely surpass what Ofcom can achieve within the boundaries of its current powers. Ofcom will be aware that under the Communications Act 2003, it is not able to regulate retail pricing without first finding significant market power. Given the intense competition that exists in both the retail mobile and broadband markets, we believe it is highly unlikely that SMP will exist.

Annex 1:The historic context of price rises and regulatory intervention

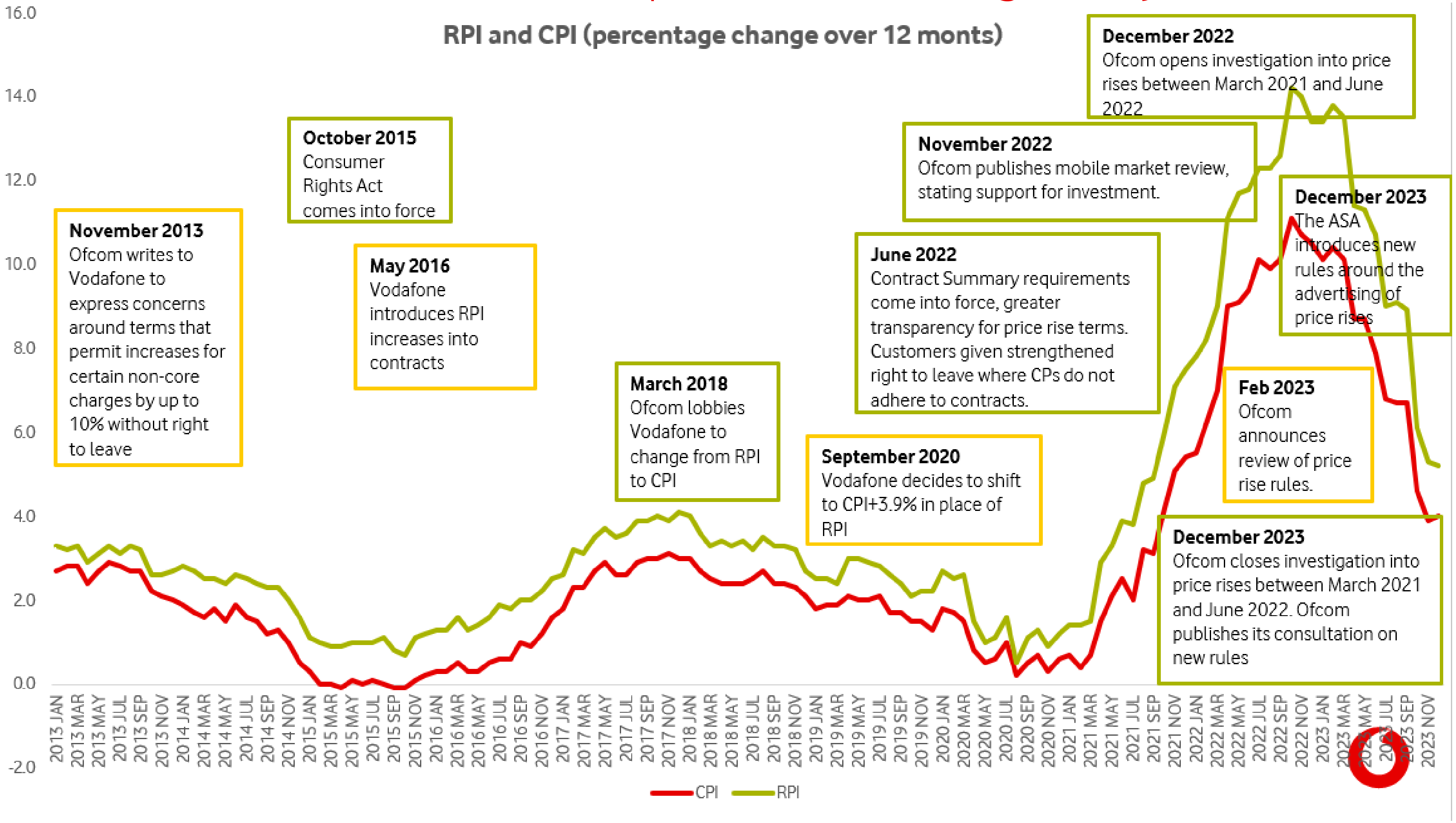

Figure A1: CPI, RPI and history of inflationary price rises

As set out in Figure 1 above, inflation-linked price rises have been a long-established part of the UK telecoms market, and one which has been the subject of several piecemeal interventions by Ofcom over the last ten years, as shown in Annex 1. Vodafone first introduced contractually permitted mid-contract price rises for our core charges in 2016, at which point they were linked to the retail price index (RPI). A decision was made to replace RPI-linked price variation terms with CPI+3.9% price variation terms in September 2020.

As you will be aware, Ofcom itself advocated for providers to switch from an RPI base to a CPI base in its price rise review. For example, in a letter from Lindsey Fussell (Ofcom Group Director) to Emma Reynolds (Head of Regulatory, Vodafone, at time of receipt) from 29 March 2018, Ofcom stated:

> *"We consider that it may be fair and reasonable for providers to recover cost increases, so the price stays the same in real terms over the period of a contract (i.e. to allow for inflation). Assuming it is, it may also be fair for the customer to agree that the price will vary with inflation, provided the terms are clear enough. It appears to us, however, that it is no longer appropriate for such terms to refer to the RPI and that the Consumer Price Index (CPI) should be used instead"*

While we note that in this letter Ofcom only ever expresses a view that CPI terms "may" be fair and reasonable, it would be reasonable for any operator to consider that settling on a CPI basis for price increases would be reasonable in that context.

In September 2020, Vodafone decision makers accepted a recommendation to move to a CPI+3.9% price increase. Ahead of this recommendation and decision, consideration was given to the likely increase that Vodafone would see in its costs over time. At the time, [CONFIDENTIAL]. These cost elements included:

- [CONFIDENTIAL]
- [CONFIDENTIAL]
- [CONFIDENTIAL]
- [CONFIDENTIAL]

However, Vodafone also considered the competitive landscape we faced at the time [CONFIDENTIAL]. It is therefore important to recognise that Vodafone's adoption of CPI+3.9% was informed by a desire to ensure that we balanced changes in our cost base against the need to remain competitive [CONFIDENTIAL].

Given the above, we believe it is important for Ofcom to recognise the path that was followed to reach the position that Vodafone and others in the market have adopted. Furthermore, as outlined in our submission, we believe this highlights the need for decisive, final intervention in this area, as opposed to a pattern of partial intervention over the course of several years.