

Telefónica UK Limited's ("O2") response to Ofcom's Review of the market for standalone landline telephone services

Introduction

O2 welcomes Ofcom's review of the market for standalone landline telephone services and largely agrees with much of Ofcom's analysis.

Ofcom intends to address the consumer detriment it has identified in the market for SFV through a combination of retail price controls and measures to change consumer behaviour so as to promote competition. Consequently Ofcom proposes to impose "*a price reduction consistent with promoting competition*"¹ rather than the "*maximum price reduction*".

The rationale for Ofcom's choice of price reduction is to allow "*...some room for competitors...to re-enter the market and profitably compete for BT's customers.*"² However, it is O2's firm view that measures to change consumer behaviour have very little prospect of success and that any further time and resource Ofcom and others will have to spend considering such options is a bootless errand. On this basis, and as Ofcom itself suggests, O2 considers it necessary "*...to go further in the level of the price control*"³ and impose the maximum price reduction.

O2 also has concerns regarding the effects of excessive pricing practices on the broader telecoms and media market. In particular, the harm caused through the accumulation of excess profits and how such profits may have been unfairly deployed so as to allow undue advantage in other markets. O2 therefore asks Ofcom to broaden the scope of its review and assess and address the wider harm and consumer detriment.

O2 notes the Conservative Party's manifesto promise to impose price caps in the energy market rather than pursue methods to encourage switching between providers. Similar to Ofcom's findings in SFV, a key issue in the energy market is lack of switching, with 56% of households having never switched energy provider.⁴ This is in fact better than the situation in SFV where 70% of the market has never switched. It is in this context, and in view of Ofcom's statutory duties, that Ofcom should conclude that it is not appropriate to address the detriment in the market for SFV by trying to promote competition.

Wider Competition Effects

Ofcom's consultation seeks to address BT's ability to continue to earn large excess profits from SFV customers going forward. However, Ofcom has not considered the impact of the excesses BT has earned since 2009. O2 has concerns surrounding the broader effects on the market and the impact of BT's ability to charge excessive / uncompetitive prices has had in other markets in which BT operates.

We note that Ofcom has "*...considered the risk that BT could look to recover lost revenue on SFV services by increasing prices in other markets...*" but that it is unable to identify a "*...clear causal mechanism to connect a reduction in prices in BT's SFV services with higher prices in other markets in which BT operates.*"⁵ However, despite acknowledging BT's potential desire to recover the lost

¹ Consultation, paragraph 8.7, p 92.

² Consultation, paragraph 6.19, p 67.

³ Consultation, paragraph 6.19, p. 67.

⁴ <http://www.bbc.co.uk/news/business-39683815>

⁵ Consultation, paragraph 8.36.

revenue which be as high as £340 million.⁶ Ofcom has not made any reference to how BT has used these gains.

It is O2's view that there is likely to be a waterbed effect in the current SFV market. Ofcom has identified the excess but failed to consider how this excess has been "spent". It seems likely that BT will have used these profits in other markets, distorting competition. Ofcom should consider this explicitly as well as any implications on the proposed remedies.

BT's ability to earn excess profits from SFV customers and deploy them in other markets strengthens the case for Ofcom to apply the maximum price reduction on BT and abandon its proposals to promote competition.

Promoting Competition

Theoretically, an increase in consumer engagement could lead to increased competition in the market for SFV. However, the particularities of the various barriers Ofcom has identified and which, to date, have prevented such competition developing mean that encouraging competition through consumer engagement has no reasonable prospect of success. Even if the remedies were successful in increasing consumer engagement, this extremely unlikely to translate into increased levels of competition.

The reasoning for this view is set out below but one issue that pervades all others is that the engagement remedies are not actually capable of addressing the barriers for developing a more competitive market, let alone overcoming them. Ofcom's own assessment of barriers to entry and expansion⁷ present a pretty bleak outlook for growth in competition and its conclusion that promoting competition is appropriate does not follow from the preceding analysis.

Loyalty, customer trust and willingness to switch

Ofcom has identified and repeatedly cited customers' loyalty to BT as a barrier to competition developing in the market for SFV.⁸ It also identifies an increase in customer trust as a potential adverse consequence associated with two of the four remedies it has proposed.⁹

The proposed remedies do not (and should not) address the issue of customer loyalty and trust in BT. If Ofcom and other CPs are unable to persuade customers that they should either trust BT less or other CPs more, this dramatically reduces any chance of the proposed package of remedies having any effect. Even if customers become better informed this will not impact upon their *willingness* to switch.

In Ofcom's own assessment of the ability convince customers to switch, it notes SFV access customers have *both* low levels of engagement *and* low willingness to switch suppliers¹⁰ and it is the two factors taken together that "*...result in particularly high acquisition costs for BT's rivals to win new SFV customers from BT.*"¹¹ Despite identifying this, Ofcom's proposed remedies do not address consumer willingness to switch, most likely as it is not possible to.

This point is supported by Professor Amelia Fletcher's report for Which? as cited in Ofcom's provisional conclusions:

⁶ Consultation, paragraph 6.5.

⁷ Consultation, paragraphs 4.29 – 4.46 and each "Initial Assessment" subsections in Section 7.

⁸ See for example Consultation, paragraphs 4.41, 4.45, 4.78.2, 5.2.

⁹ Consultation, Information on savings: paragraph 7.27 and Information on switching: paragraph 7.37.

¹⁰ Consultation, paragraph 4.39.

¹¹ Consultation, paragraph 4.42.

“...even where remedies are designed and implemented as well as they can be, the difficulty inherent in trying to change real consumer behaviour means they still may only be partially effective. It may simply be impossible to ensure that consumers fully take in, digest, and act upon the relevant information in a way that significantly improves their decision making.”

The identified loyalty of BT’s customers will affect their decisions and the likelihood that they will act rationally. Further, even if customers were to seek to switch, Ofcom notes that there is scope for BT to successfully engage in targeted retention activities.¹² Whilst this may result in a good outcome for the consumer, it entirely undermines the attempt to promote competition in the market for SFV.

Given that BT has nearly 80% of the market for SFV, convincing customers to switch is crucial to any set of remedies designed to improve competition in the market. The proposed remedies do not address this.

Engagement of other CPs

At present, the proposed remedies rely on engagement from CPs other than BT to compete for BT’s customers. Ofcom’s market review does not provide the requisite reassurance that there is a willingness from other CPs to compete.

At present, there does not appear to be sufficient support from other CPs to make Ofcom’s proposals viable. Ofcom has identified that *“...some CPs – particularly larger ones – expressed no interest in marketing to SFV access customers.”*¹³ More worrying still, one CP actually said that it *“...no longer offers SFV access services to new customers and mentioned that it has no appetite for re-entering the market.”*

Ofcom has identified that some CPs *“expressed an interest”* in winning more SFV customers. However, this does not guarantee that they will compete, neither is it possible to oblige them to. Absent competitors, there is simply no reasonable prospect of success in encouraging competition in the market for SFV.

Impact of the price reduction

The engagement of CPs must also be considered in the correct context. Ofcom is looking for CPs to engage and compete with BT immediately after all of BT’s SFV customers will have received a reduction of between £5-7 a month. Not only is this likely to affect BT’s customers’ willingness to switch, acting as a disincentive, it will also affect the engagement of other CPs. The price reduction remedy will dramatically reduce both the available margins and incentive for competing CPs. O2 is interested as to whether CP views on customer acquisition were given in contemplation of the proposed price reduction.

Ofcom does not appear to have fully considered the financial incentive for CP’s to enter the market following the price reduction and the fact the price reduction is itself a disincentive to CP’s incurring acquisition costs. Ofcom’s proposals do not appear to have assessed the impact this will have on the potential for the proposed remedies to be successful.

¹² Consultation, paragraph 4.40.

¹³ Consultation, paragraph 4.78.

Declining and Small Market

Ofcom has identified that the SFV market is declining at a rate of around 15% per annum.¹⁴ One CP has also cited the small and declining market as a reason why it does not market to SFV access customers.¹⁵

The fact of the matter is that the SFV market will continue to decline and, ultimately, is likely to cease to exist. Again, this is a factor that no remedy is able to address. In these circumstances, it does not seem proportionate for Ofcom continue to assess and seek to develop a package of remedies that may encourage competition.

The proposed remedies

The above sets out the broader reasons why O2 considers that Ofcom should not pursue measures to try and change consumer behaviour in this instance. However, in addition to the general comments, the table below sets out some specific comments on the proposed remedies.

| Remedy | Comment |
|---|--|
| Information on savings | <p>It is Ofcom's intention to try and promote competition. As such, any remedy that it develops relating to information on savings must include whole of market comparisons. If the proposal is simply to ensure customers are getting the best price from BT, the easiest way to ensure that consumers are getting the best value deal is to impose the maximum price reduction and a price freeze.</p> <p>It must also be shown that information will lead to people deciding to switch and that it improves consumer welfare. There is evidence to suggest that publishing more information either confuses consumers or they simply ignore it. There is a limit to how much information a consumer can or wants to absorb at the various steps of the purchasing process.¹⁶ Given the number of older and vulnerable consumers Ofcom has identified as being affected, this is particularly relevant.</p> |
| Information on switching process | <p>As with information on savings, Ofcom will need to ensure that additional information on switching actually has the desired effect and does not lead to consumers becoming confused.</p> |
| Introduction of a decision point | <p>Ofcom cites the success of the Commission's remedy in the Microsoft Internet Explorer case in support of introducing a new decision point. However, the present circumstances are very different from the Microsoft example and it is unlikely that a decision point in this case would yield the same effect, if any.</p> <p>In Microsoft, the decision point arose automatically when consumers first used the products. Consumers were effectively forced to make a</p> |

¹⁴ Consultation, paragraph 4.6

¹⁵ Consultation, paragraph 4.78.2

¹⁶ http://ec.europa.eu/consumers/eu_consumer_policy/our-strategy/documents/swd_know-enhan_cons-empwrmnt_2012_en.pdf, paragraph 3.1, pp 8-9.

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|---|---|
| | <p>choice before they could actually browse the internet i.e. it did not actually make consumers change from already using one browser on the device to using another. Further, no additional steps were required on behalf of the consumer.</p> <p>In the present case, Ofcom is seeking to get consumers to actually change what they are already doing. The proposed decision point will not force the consumer to act and so it is misleading to compare this to the Microsoft remedy. These are passive consumers who will likely take the path of least resistance which will mean staying with BT.</p> |
| <p>Remedies to facilitate response to this information</p> | <p>Even if responding to an initial prompt is relatively hassle free e.g. tear off-slip, it would still require relatively high levels of engagement and effort from the consumer to actually change supplier.</p> <p>If Ofcom is unable to develop a remedy that facilitates response such that it leads to a switch to another CP, then it is not going to improve competition in the market. Once more, the easiest way to ensure that consumers are getting the best value deal would be to impose the maximum price reduction.</p> |

Options for a price control remedy

Ofcom should impose the maximum price reduction on BT

Ofcom has identified that competition is not growing in the market and that remedies are required to promote competition. As is set out above, O2 does not consider there is a reasonable prospect of success that competition will develop sufficiently quickly, if at all. Even if it were possible to develop effective remedies, the requisite time required to test and trial them will delay competition developing in the market.¹⁷

Therefore, O2 believes that a safeguard cap is not appropriate because, at the very least, it would leave consumers paying higher prices for longer than necessary. As we do not think that competition in the market is capable of sufficiently developing, we urge Ofcom to impose the maximum price reduction on BT.

O2 considers that the appropriate option for addressing the consumer detriment in this market is Option 3 i.e. maximum price reduction on BT line rental followed by a price freeze.

This is clearly the most effective remedy as it would “...remove all the current price related consumer detriment...”¹⁸ O2 acknowledges that a remedy which also aims to promote competition may be both preferable and desirable. However, even on Ofcom’s own analysis, it seems unlikely to be achievable.

¹⁷ Ofcom suggests that such measures may take two years, Consultation, paragraph 9.17.

¹⁸ Consultation, paragraph 9.20.

Competition in other fixed markets

Ofcom notes on a number of occasions that it believes there is significant competition in other markets in which BT operates. However, the Citizen's Advice Bureau has recently undertaken a study in which it concludes that the broadband market is currently operating in such a way as to penalise loyal customers.¹⁹ The headline points are that the cheapest broadband prices increase by an average of 45% / £113 a year. Notably, BT is the worst offender with its 12 month contracts increasing by 67% / £198. CAB's report points to concerns and issues which are strikingly similar to those identified by Ofcom in the present case.

There also appear to be similar consumer harm issues to the ones addressed in this consultation and CAB identifying over 65s as more likely to be affected. CAB's report suggests that it may in fact be possible for BT to seek to recover lost profits in SFV from its loyal broadband customers. Further, CPs may also be in a position to earn excess profits from their customers, creating the ability to cross subsidise products in other markets. In light of this, we consider that Ofcom should reconsider other markets that use fixed line services to ensure that its initial conclusions are correct.

¹⁹ <http://www.bbc.co.uk/news/technology-39555140>