Vodafone's response to Ofcom's consultation

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

13 March 2013

Summary and conclusions

Vodafone welcomes the opportunity to respond to Ofcom's consultation 'Price rises in fixed term contracts – options to address consumer harm' published 3 January 2013.

Vodafone understands Ofcom's interest in price rises in fixed-term contracts, but it must make sure that any regulatory intervention is proportionate and evidence-led. It is vital that Ofcom's intervention does not in fact create worse consumer outcomes by damaging what is, as Ofcom itself accepts, a competitive and well-functioning market currently delivering good value to customers, high smartphone penetration and innovative services.

At the very front of this consultation, Ofcom sets out its central principle that: *"Where prices rise, consumers should be able to avoid their effects".*[1] We agree.

For some reason, Ofcom does not apply this principle consistently throughout the consultation and instead goes against its own previous regulatory practice.[2] Instead, Vodafone believes Ofcom must distinguish between those services for which a customer is committed to pay under the terms of a fixed contract[3] and additional services which are, by their very nature, additional and avoidable.

Typically, customers are committed to pay the monthly subscription fee or line rental for a set allowance of minutes, texts and UK data which can be characterised as the 'core' of the contract. Other services such as calls to international destinations or premium rate numbers which are paid for separately and for which the consumer is under no obligation can be characterised as 'non-core'. While this distinction is not static (competition between operators has expanded the typical core services over time and this trend may be expected to continue) core services are easily understood as all those services that are included for a particular customer within their recurring charge.

Vodafone does not object to regulation which limits core price rises within the fixed term of a contract. We do not believe Ofcom has made the case that rises limited to inflation are necessarily unfair, especially as they have been considered fair by other regulators applying consumer protection legislation. However, Vodafone's primary concern focuses on Ofcom's proposed intervention in price changes for non-core services. Here, Ofcom is seriously at risk of creating far more significant problems for consumers than the one it purports to solve.

[1] 'Price rises in fixed term contracts – options to address consumer harm' 3 January 2013 at 1.5.
[2] See in particular 'Ofcom Review of Additional Charges' Statement, December 2008, updated March 2010 and discussed further at Section 2 below.
[3] We use the term 'fixed contract' throughout this response to match Ofcom's terminology within the consultation although, strictly speaking, mobile contracts are typically minimum term contracts in that they continue in force after expiry of the initial term.

As written, Ofcom's proposed draft of GC9 would:

- reduce handset subsidies and increase the up-front cost of smartphones[4] by materially restricting operators' ability to react to changes in their costs;
- require Communications Providers to 'spam' notify *every* customer of *every* change to the price of *any* service including clearly inappropriate notifications such as advising children of changes to adult premium rate prices or notifying rate changes for obscure international destinations that a customer had never called;
- create customer confusion as non-core charges would be locked in at different rates depending upon the date of joining. A customer who wanted to know their cost for a non-core service would have to wade through variously dated price-lists to find the one that applied to them;
- lead to the inefficient and unfair cross-subsidy of existing customers' non-core charges by new joiners; and
- ultimately, lead Communications Providers to withdraw certain services including directory enquiries, premium rate services and some international calling and roaming destinations where they cannot accurately or consistently predict their wholesale costs.

Any Ofcom intervention must be guided by the evidence before it and limited to the concern expressed by consumers; namely unexpected price increases for core services. Even setting aside its manifest limitations, Ofcom's evidence simply does not support the kind of radical intervention it is proposing.

Instead, Vodafone believes Ofcom should limit increases to core service charges to the rate of inflation (as measured by the annual rise in RPI) while retaining the 'material detriment' test for non-core services and non-price changes. This would more properly and proportionately respond to consumers' key concerns without the undesirable side-effects noted above.

Finally, Vodafone supports Ofcom's recognition that any change to the General Condition could only be prospective as current contracts were made and costed on the basis of the current regulations.

[4] Ofcom itself acknowledges this outcome within the consultation at 6.43

The rest of this response is structured as follows:

- **Section 1** sets out the state of the current UK telecommunications market which is recognised to be highly competitive and delivering good consumer outcomes. It is against this backdrop that Ofcom must consider its regulatory intervention.
- **Section 2** expands upon the distinction between inclusive core services and avoidable non-core services; a distinction which Ofcom itself has previously recognised and relied upon in its policy-making. It is plainly wrong for Ofcom to assert that, even if made out, the same level of consumer harm applies in both cases.
- **Section 3** details the detrimental consumer outcomes which are likely to arise from applying the proposed wording of GC9 to non-core services;
- **Section 4** examines the evidence that Ofcom has gathered; evidence which, as far as it goes, points to a much narrower consumer concern than Ofcom currently proposes to address.
- **Section 5** puts forward an alternative construction of GC9 that would both meet the key concerns expressed by consumers while avoiding the detrimental effects described in Section 3.
- **Annex 1** responds to the specific questions Ofcom asks in its consultation.
- **Annex 2** provides a legal analysis of Ofcom's duties, an analysis of its evidence-base, discusses the approach it is required to take when proposing regulatory intervention, and explains the rationale behind Vodafone's proposed alternative.
- **Annex 3** sets out tables of ladder pricing imposed by BT**,** in support of points made at Section 3.

1. The UK market

UK market among the most competitive in the world

Ofcom must recognise that it regulates an intensely competitive, well-functioning market. It is therefore essential that any intervention is proportionate, to avoid the adverse effects of and unintended consequences of over-regulation. The UK market is marked by being one of the cheapest in the developed world, with high handset subsidies and high smartphone penetration.[5] UK consumers benefit directly from competition in terms of prices, quality and range of services and innovation. These benefits are not to be lightly squandered. The sections below demonstrate some of the characteristics of the UK market, which Ofcom should take great care not to undermine.

Cost of mobile services

In 2011 when looking at 'comparative international pricing' Ofcom found that: *"mobile pricing was significantly lower in the UK than in the other comparator countries*"[6]. This was true over all nine of Ofcom's 'baskets' of mobile services, from basic usage, through intermediate, to advanced.

In 2012 Ofcom summarised that: "*Prices in the UK compared favourably to those in the other five countries covered by our price benchmarking work. All five of the lowest weighted average single-service basket prices and four of the five lowest possible basket prices were found in the UK."* The reason for this being that: "Low basket prices in the UK were largely due to mobile prices being the lowest among our six countries[7]." In the report itself, Ofcom went on to note that: "As was the case in 2011, our analysis found that UK mobile prices were the lowest among our six comparator countries in 2012, and the UK offered the lowest 'weighted average' prices for all nine of the connections included within our baskets in 2012".[8]

Subsidy and smartphone penetration

In 2011 Ofcom carried the headline: 'A nation addicted to smartphones'. The release noted that: *"Over a quarter of adults (27 per cent) and almost half of teenagers (47 per cent) now own a smartphone".*[9]

[5] See Ofcom Communications Market Reports and International Communications Market Reports 2011 and 2012.
[6] International Communications Market Report, 2011, p.82.
[7] UK, France, Germany, Italy, Spain and the US (Illinois used as a representative state).
[8] International Communications Market Report, 2012, p.102.
[9] Communications Market Report, 2011, headline and summary.

The 2012 Communications Market Report noted that: "*Total internet access has edged up to eight in ten homes, in part aided by the continued rise of smartphone ownership (39%).*"[10]

The headline point in the telecoms summary of the 2012 'International Communications Market Report' was that: *"The UK consumed the most mobile data per connection. 424MB of data was downloaded per mobile connection in 2011: more than in any of the other comparator countries."*

What this demonstrates is a healthy market with widespread, world-leading smartphone penetration. Access to the internet, including access through a mobile device, is widely seen as vital to people both as citizens and as consumers. This is something that the UK market delivers well. A key feature is the model where customers can get high-end, internet-enabled smartphones for free or with a heavy subsidy. This drives take up, drives connectivity and is good for UK plc.

Competition and the consumer

Effective competition drives Communications Providers to focus their attention on those aspects of pricing and service provision that matter most to customers. If they don't, they will suffer commercially as customers vote with their feet to find alternative Providers who better understand their needs and preferences[11]. Competition in the mobile market is not just about call prices, important though they are. Competition is also about new services and innovation, and a key part of that is the capability of mobile networks and user devices – handsets, tablet computers etc. Networks and handsets have to be compatible for services to work end to end, so new innovative services require investment not just in network infrastructure but in the user equipment needed to take full advantage of it. There would be no picture messaging without camera phones, no market for mobile apps without an ecosystem of smartphones with compatible operating systems to support it, and no market for downloads or streaming without networks capable of downloading or streaming at an acceptable bit rate.

This means that to bring new services to market so that consumers can benefit from them it is necessary to get advanced devices – highly sophisticated miniature computers – into people's hands. The retail price of high-end handsets is several hundred pounds, and an up-front outlay of that amount would be a serious barrier to take-up by all but the most enthusiastic and affluent early adopters were it not for the subsidy model that has existed in the UK since the earliest days of mobile. This model was initially driven by competition between networks for customers and it is network and service competition that continues to fuel the market for new innovative products

[10] Communications Market Report, 2012, p.3.

[11] Indeed, if Ofcom is correct that consumers highly value their monthly costs, it would appear that competition is already delivering these options via the 'Orange and T-Mobile' 'Fix the price of your monthly plan' option and the recent statement by Tesco Mobile. We note that, for all of the reasons set out in Section 3, it is unsurprising that in both cases the 'fix' refers to line rental only. See http://orange.co.uk/pricechanges/fymp.html and http://phone-shop.tesco.com/tesco-mobile/about-us/press-release.aspx.

and services. Digital phones replaced analogue phones. Then ever newer, smaller and slicker phones succeeded one another. Then the birth of mobile data required GPRS or '2.5G', succeeded by 3G and now 4G.

Handset subsidy

Smartphones now retail at many hundreds of pounds, but the consumer's initial outlay to acquire such devices is a fraction of that cost as the device is heavily subsidised by the Communications Provider or offered for free. In return the consumer is required to stay with the Provider for a minimum period, commonly two years. This allows customers to access higher-end devices than otherwise might be affordable. Examples of standard, current offers are below, setting out the per month and one-off cost, compared to the device's Recommended Retail Price:

- iPhone 5 64: £47 per month plus £169 one-off cost
    - RRP £699[12]
- iPhone 4S 16GB: £42 per month plus £29
    - RRP £449
- Samsung GALAXY SIII: £42 per month plus £29 one-off cost
    - RRP: £395[13]
- iPhone 4: £24 per month plus FREE device
    - RRP £319

The handset subsidy is a popular feature of the UK market which new Ofcom regulation must take care not to endanger.

Cancellation without penalty business model

At paragraph 6.45 of its consultation, Ofcom refers to a different business model which already exists which takes into account the risks of enabling customers to terminate without penalty. It gives the example of set-top boxes for TV services where the customer has to return the equipment to the provider on cancellation of the agreement:

> *We also note that some Communications Providers already allow consumers to exit the contract without penalty on any price rise. This demonstrates that there is a business model that exists which takes into account the risks of allowing consumers to exit the contract without penalty if price rises have to made during fixed term contracts.*

Ofcom must appreciate however that cancellation without penalty is a far more significant factor in the mobile sector than it is in some other sectors of the telecoms market. Open technical standards allow widespread interoperability so that, in general, most phones will work on most networks. This is important because it is not simply the capital cost of user equipment that bears on the risk of stranded investment. If a satellite or cable TV company subsidises a set top box, they will also want to ensure

[12] iPhone pricing from Apple UK online store – www.apple.co.uk .
[13] Pricing from www.amazon.co.uk .

that they can recoup their investment over the course of the customer contract with them. But there is not the same incentive for a customer to break their contract early as there is with mobile phones.

With mobile devices, the question has to be: if a consumer can access a heavily subsidised device and then walk away from the contract that pays for it without penalty, why wouldn't they? The consumer can almost certainly use the phone on another network – or even the same network – for less each month on a SIM-only package (because there is no handset subsidy to recover). And even if the customer had no interest in using this expensive piece of kit himself, a quick profit can be made by selling it[14]. Therefore, as described further in Section 2, Vodafone contends that Ofcom's proposal to allow customers to cancel during their fixed term without penalty in response to any price change is tantamount to prohibiting such price changes altogether. By contrast, the market for proprietary second-hand set-top boxes which cannot function independently of the platform owner is limited, for fairly obvious economic reasons.

Split contract model

An alternative approach would be for Communications Providers to provide access to their services by selling devices on a consumer credit model. Whilst there are no significant legal barriers to such approach there are serious practical impediments.

There is greater contractual complexity for consumers who are provided with a number of contracts, which would be the case in this model. It is recognised that these contracts incorporate summary boxes to assist consumers in understanding their legal obligations and rights however the ultimate result is a customer being faced with more contractual terms which they are unlikely to read fully prior to signing.

Consumer credit arrangements are regulated by the Financial Services Authority ("FSA"). This means by offering consumer credit agreements to customers, Communications Providers would face dual regulation by both Ofcom and the FSA. This not only impacts Communications Providers but it also impacts the consumer. Dual regulation creates complexity and uncertainty for consumers and Communications Providers. Who do they contact if there are complaints? Which regulator is going to give them the best outcome quicker?

If the intention of Ofcom's proposed changes is to improve rights and access to practical remedies it is unlikely that the creation of forum shopping between regulators will achieve this objective.

[14] High-end used handsets have high re-sale values. A second-hand iPhone 5 64, when network-locked and slightly scratched, would command prices of over £400. See www.cashconverters.co.uk for examples.

Scope of core services has expanded over time

Against these alternative and unpopular models, the existing subsidy model has proven very effective in delivering good consumer outcomes. Over time, consumers in the UK market have found that the core services offered in the contract have expanded rather than contracted as competing Communications Providers saw ways to enhance value to customers by offering price certainty over an ever-wider range of inclusive services. Today it is common-place for calls to land-lines and off-net mobiles to be included within a bundle, but this was not always the case.

The two key factors that have enabled this move are cost certainty and competition. The pattern that first applied to voice calls is now being repeated with data. And it is not just a question of which types of service are available within a bundle, but how much of them. This trend, driven by competition and customer demand, has been to ever bigger and more generous bundles. Against this background, the idea (with no evidence adduced to support it) that a failure to tighten regulation will drive this trend into reverse does not bear close scrutiny.

In conclusion

UK mobile consumers have benefited enormously from this cycle of competition and innovation, driving prices down and smartphone penetration up. But this can only continue if it makes commercial sense. The handset subsidy is only sustainable if Communications Providers have a reasonable expectation that customers will stay for the fixed term (the minimum contract period). But if customers can walk away from their contracts without penalty during the fixed term in response to any price change, no matter how small, and whether or not it relates to the core contract, this model unravels. It is vital therefore that any new regulation recognises and respects the critical distinction between the ‘core’ and ‘non-core’ elements of a Communications Provider’s service if Ofcom is to develop a proportionate intervention.

2. The distinction between core and non-core services

The title of Ofcom's consultation itself makes clear that Ofcom is fundamentally concerned with *fixed-term contracts*. The reason for this is plain. If prices vary but the customer is not obliged to purchase the services in question, the customer has a clear choice whether to consume those services at the new price, to scale back their consumption in response to a price increase, to upgrade their core service to a larger inclusive bundle, add a bolt-on service or simply to avoid using those services altogether. For this reason, pre-pay mobile subscriptions and rolling monthly SIM-only contracts, where the customer is not subject to an on-going monthly commitment, are fundamentally different from fixed term contracts involving minimum spending commitments over the term of the contract. Ofcom's concern in the latter case is that consumers are 'locked in' to the contract, in that typically they cannot cancel the contract before its term expires (at least, not without incurring early termination charges).

It is important, therefore, to consider what it is that a customer is *committed* to do under the terms of a fixed term contract and to distinguish those unavoidable commitments from *options* that a customer choses to take up free of any commitment. Typically, post-paid mobile contracts offer core services up to pre-defined limits which are included within the customer's monthly line rental, plus a range of additional services that fall outside the inclusive allowance and, if consumed, must be paid for separately and in addition.

Ofcom additional charges guidance

This distinction between the core of the contract and non-core services is thus highly relevant in the current context, because while the core entitlement reflected in the customer's monthly line rental is 'fixed' for the duration of the contract, no similar commitment extends to non-core additional services outside the inclusive bundle. This is a point Ofcom has clearly recognised and, indeed, has attached significance to it previously when discussing Early Termination Charges ("ETCs"). Put simply, Ofcom reasoned that Communications Providers should not be able to factor in any loss of out-of-bundle revenue when calculating ETCs precisely because the customer was not contractually obliged to spend anything on out of bundle services. This was the express basis for Ofcom's stipulation that ETCs can never exceed minimum line rental commitments for the unexpired contract term.

Vodafone finds the following statements by Ofcom instructive; they clearly show that in another context Ofcom understands this distinction between core charges which customers cannot avoid, and charges for non-core services which customers do not have to use:

6.155 In practice then, suppliers will often determine their commercial offerings and set the price of a contract to reflect the expectation that, on average, the consumer will exceed their contractual commitments in these ways. Given that this is how offers and prices are set, some suppliers believe it should also be possible to reflect this expectation in the calculation of the ETC. Some said they should be able to recover these 'lost profits' in line with the ordinary common law position that would apply on breach of contract.

6.156 As noted above, we appreciate this is how suppliers evaluate and set the prices of services they offer. However, we consider that the applicable legal rules on this point are sufficiently clear. <u>The consumer is not obliged by the contract to pay any more than the agreed (usually monthly) retail price</u>. And, in calculating the damages payable on breach of contract - and so by analogy the sum payable by way of a likely fair ETC - the law will not assume a (breaching) party to a contract would do more than he is legally obliged to do[15] (Emphasis added)

There are some examples in the current consultation where it appears that Ofcom does indeed recognise this distinction, for example in relation to optional 'bolt-ons', where Ofcom acknowledges that customers can avoid a price increase affecting a bolt-on by opting out of it, which they can do without affecting the core contract. However, this recognition is not consistently applied throughout the consultation and does not appear in Ofcom's preferred option.

Ofcom's brief discussion of this subject at 5.17-5.18 is worth reproducing in full:

5.17 Our further initial view is that a similar principle should also apply in respect of the prices payable for additional services provided under contracts that can properly be characterised as separate to the customer's main contract for services. For example, where, at some point during a fixed term contract for network services, the consumers [sic] *enters into a further contract for a 'bolt-on' service such as international calls.*

5.18 That is, the consumer should also be able to evaluate and rely upon the price agreed at the time that separate contact is entered into. The consumer should have adequate protection from an increase in that price during the period of the 'bolt-on'. <u>That would not mean the consumer should also be able to withdraw without penalty from the main contract for services, but should be able to do so in respect of the separate contract where the provider seeks to increase the price payable thereunder.</u> (Emphasis added)

This recognises that a change to a price that the consumer can avoid – in this case by cancelling the bolt-on or not using the service that has increased in price – should *not* confer a right to cancel the core contract. Ofcom is quite right to make this distinction. While Ofcom's analysis is couched in terms of separate contracts, the key issue of

[15] 'Ofcom Review of Additional Charges' Statement, December 2008, updated March 2010, p.86

principle is not actually about the precise contractual form so much as the substance of the issue. If the core contract does not oblige the customer to take additional ‘bolt-on’ services, and providing the customer has the option to avoid continued use of such services if a price change is not acceptable, there can be no automatic right for the customer to withdraw from the core contract without penalty. To suggest otherwise would be illogical and counter-intuitive.

Non-geographic numbers review

Non-geographic numbers provide another example of where a different Ofcom workstream seeks to make a clear distinction between the core of the contract and non-core services. In the current consultation Ofcom seems to suggest that a change in non-geographic call (“NGC”) prices should trigger notification requirements and rights to terminate, even where such calls fall completely outside of the core commitment to pay monthly line rental in return for an inclusive call allowance that *excludes* NGCs.

At 5.13 Ofcom states:

> *It is not clear to us why, for example, any different position should apply to costs such as those relating to non-geographical numbers, for example. Providers are able to, and do, make an unbiased forecast of these costs like any other costs and set prices for them periodically. They are able to make a commercial decision as to the frequency of price increases and notification to consumers. If it is of commercial importance to the Communications Provider to increase a price or prices contained in a contract with a consumer then the provider will have to notify the consumer and bear the risk that the consumer will choose not to accept the proposed increase.*

This analysis is misconceived in many fundamental respects. The idea that Originating Communications Providers can control or predict changes in NGC wholesale costs – which, in marked contrast to geographic or mobile termination costs, are currently unregulated – over a fixed term of as much as two years is simply false. As Ofcom well knows, the past few years have seen a free-for-all develop with NGC termination rates, resulting in involved commercial disputes and on-going litigation.

It is all the more surprising that Ofcom should make such a cavalier statement about NGCs when one considers that another part of Ofcom has been conducting an in-depth policy review of NGCs for the past two years, and is proposing a new regulatory model which explicitly recognises that most Originating Communications Providers have no effective control over the termination charges set by Terminating Communications Providers. Indeed, the unbundled model Ofcom has proposed – which Vodafone supports in principle – *requires* Originating Communications Providers to pass through any changes in third party service charges and recognises that since Originating Communications Providers have no say in how those charges are set the burden of communicating the service charge should rest entirely with the third party service provider. This is fundamental to Ofcom’s proposed new transparency model.

If Ofcom were seriously suggesting that Originating Communications Providers should simultaneously be required to pass on third party price changes, and required to notify all their customers of a right to terminate without penalty the result would clearly be absurd and unbundling would be rendered unworkable. Vodafone does not believe that this can be Ofcom's intention. Ofcom has already confirmed in the context of the NGC review that third party service charges fall outside of Originating Communications Providers' price transparency obligations under General Condition 10. The inescapable logic is that they must also fall outside of General Condition 9, and we trust Ofcom will indeed confirm that this is the case.

There remains the question of how NGCs should be treated prior to unbundling, given that the timetable for implementing the unbundled model fully is likely to be considerably longer than Ofcom is presently indicating in relation to changes to General Condition 9. The issue here turns on the extent to which consumers are committed in advance to use NGCs as part of their core fixed-term contract, or whether they are free to make such calls, or avoid making such calls, at the prevailing price without affecting their core commitment.

If Communications Providers chose to include NGCs – or particular NGCs – within an inclusive call package, but then reserve the right to change the price, there might be an arguable case for suggesting that price changes should trigger notification obligations and rights to cancel without penalty. In practice, it is rare for NGCs – or at any rate all NGCs – to be included within core packages. This is hardly surprising given that many NGCs contain a revenue share element that is entirely unregulated, and termination rates that are prone to change at short notice without any overarching safeguard cap.

Vodafone offers a 'bolt-on' for some of the more popular 08 numbers, but Ofcom has already recognised that bolt-ons are distinct from core contracts and changes to bolt-ons should not confer rights to exit the core contract. In the main, however, NGCs are 'out of bundle' i.e. not included within the allowance paid for by 'fixed' monthly line rental. This means that if NGC prices change, it is perfectly possible for consumers to avoid their affects by not making calls to those numbers (or making fewer or shorter calls).

Indeed, a large part of Ofcom's rationale for reforming the regulatory framework for NGCs is that consumers do indeed avoid the effects of non-core call costs. In many cases consumers perceive NGCs to be more expensive than they actually are and, as a result, avoid making such calls. This is the central issue that Ofcom's proposed new NGCS transparency model is intended to address. Ofcom's analysis recognises that the cost of NGC calls is often not a major consideration for customers when making subscription decisions and that mobile consumers typically focus on handset choice. When it comes to call prices, consumers (rationally) place greatest weight on majority call types that matter most in budgetary terms and form part of the core deal, the inclusive bundle. To suggest that the bargain that consumers strike with Communications Providers when they make their subscription decision is based on an intimate understanding of that Provider's rate card for all conceivable types of call is contrary to the evidence Ofcom has relied on to make its case for NGC reform. It is simply not possible to communicate this degree of information with equal prominence. It is also not realistic to suggest that, even if confronted with such a mass of information, consumers will absorb and be able to recall a vast array of prices for services and call types they may never, in fact, use.

This is the very reason that Ofcom has proposed that Communications Providers should have a single Access Charge (per tariff) in the unbundled model, so that customers can take account of it in their subscription decision, and thereafter when deciding which calls to make. In the context of the unbundled model, it may be reasonable to suggest that changes in the Access Charge should trigger notification requirements to those customers that use them. But it makes no sense whatsoever to suggest that increases in third party service charges – which Originating Communications Providers would be obliged to pass through to callers – should trigger rights to cancel the core contract with the Provider.

Non-core charges not generally a ‘key term’

Similarly to NGCs, Vodafone would contend that the price of directory enquiry calls or international call costs are in fact not a key term of the contract for the vast majority consumers. Indeed, as observed above, Ofcom itself relies on this approach in its approach to non-geographic calls regulation, where it recognises that the cost of NGC calls is often not a major consideration for customers when making subscription decisions.

Ofcom observes that: *“the price is a key term of the contract and customers must know, and be able to evaluate and rely upon, the bargain they are striking”* (5.9). Whilst this has resonance for the core of the contract, it surely does not for all charges for all non-core services. The chance that the price of a call to St Kitts & Nevis is a ‘key term’ of the contract is vanishingly small. To suggest all prices are a key term stretches any logical definition of the word ‘key’ beyond breaking point. And the suggestion that customers should be allowed to exit contracts without penalty but with a (subsidised) iPhone 5 on the change of the call price to a set of islands that customer has never called and has no intention of ever calling must be seen as grossly disproportionate.

There may be a handful of customers for whom the cost of particular calls or other atypical usage does indeed constitute a key term. If those call prices changed then they could find their overall bills rise significantly. However, these customers are *already* protected under the current regulations. These customers would be affected in a materially detrimental way by the price change and be able to exit their contract without penalty. Current regulatory protection reflects a significantly more proportionate approach; it targets protection at those adversely affected, rather than applying those rules indiscriminately to all customers.

In conclusion

The consultation asserts that: "*It does not appear to Ofcom to make any material difference how a provider has chosen to divide up the price between monthly subscription charges and other elements"* (5.9). As we have shown above there is indeed a very real, material difference between line rental, the contract core, and non-core services with other charges paid for separately and in addition. The former is a payment that must be made and is controlled by the Communications Provider; the latter is wholly avoidable and its cost of provision is not generally determined by the Communications Provider. There is a clear, logical split that Ofcom must recognise to ensure it does not create consumer outcomes that are worse than the harm it is trying to address.

3. Intervention must not create worse consumer outcomes

Ofcom's 'regulation max' option

It is vital that Ofcom fully understands the implications of what it appears to be proposing in 'Option 4', which can be characterised as the 'regulation max'[16] approach. Insofar as Ofcom has convinced itself that any change to core prices should trigger a right to cancel without penalty is a good consumer outcome, it should not think that extending this rule to all price changes is even more of a good consumer outcome. In fact the opposite is true.

Additional complexity

A significant concern for a Communications Provider making any in-contract price change would be adding more complexity into the market, by creating a range of different prices for the same services for different customers.

Vodafone has been working hard to increase the simplicity of its offers, of its website and of its pricing. For example we have cut the number of tariffs displayed for each device from (in some cases) a dozen or more to just the four best deals. Vodafone has also developed and deployed a customer portal, putting all the information a customer might need about our policies, terms and conditions and protections in one place www.vodafone.co.uk/customerinfo. We have also introduced a short, simple statement of our current pricing, supplemented by a price checker for certain higher-rate services. Ofcom's preferred option however would cut across these moves towards greater simplicity.

Under Ofcom's preferred option Communications Providers would be unable to retire old propositions, as customers on those propositions but still within their fixed term would be able to exit contracts without penalty taking their free or heavily subsidised devices with them. Providers would have to introduce new, different pricing for new customers. This would mean prices for the same service would vary depending on when the customer joined, which is a recipe for confusion and lack of transparency.

This situation is compounded by the number of prices that a mobile Communications Provider has to carry (there is little analogy with the energy industry, simply carrying units of gas or electricity with only a handful of variants – peak / off-peak / environmental or not). And it is a regulatory obligation that all of these many prices are

[16] 'Regulation max' refers to a literal interpretation of Ofcom's proposed preferred option, Option 4, which would seem to require Communications Providers to notify *every* customer of *every* change to the price of *any* service and that notification would confer contract termination rights without penalty.

conveyed in a clear and transparent manner[17]. Carrying this information an ever-increasing multiple of times is simply not practical or transparent for the consumer.

Control over wholesale costs

The wholesale charges that Originating Communications Providers have to pay to third parties for non-core services, such as directory enquiries, premium rate or international calls, are unconstrained. As wholesale prices can move at will, often with a matter of weeks' notice, it is essential that Originating Communications Providers can react by changing their own non-core charges.

Ofcom suggests that: *"Communications Providers are in a good position to forecast their costs when setting their prices"* (4.25). However, as we demonstrate in the section below, it is simply not the case that Providers are in a 'good position' to forecast the costs of non-core services. Communications Providers have no control over the wholesale price set by wholly independent third party providers. Ofcom also suggests that: *"It could therefore be argued that providers are able to use the current rules to pass on some if not all of the costs of any inaccurate forecasts on to their consumers"* (4.21). To categorise forecasts as 'inaccurate' is simply not a fair presentation of the Communications Provider's circumstances in the event it has to pass on wholesale costs over which it has no control and no ability to forecast with precision.

Changes in non-geographic wholesale call termination charges

The charging arrangements imposed unilaterally by BT, and subsequently a number of other terminating operators, for the termination of non-geographic calls over the past four years provide a revealing example of: (i) the limited ability of Communications Providers to control their wholesale costs; (ii) the scope for these wholesale costs to fluctuate; and (iii) the corresponding difficulty for Communications Providers to predict some of their prospective wholesale costs with a degree of certainty (contrary to Ofcom's proposition in its consultation document). The case of non-geographic calls is particularly relevant for the purposes of the consultation document given the volumes of calls generated to some of the non-geographic number ranges in question.

As noted earlier in this submission, the wholesale termination of calls to non-geographic numbers with the prefix 08 and 09 has not been and is not currently subject to any *ex ante* regulation. Terminating Communications Providers have therefore enjoyed the commercial freedom to vary their charges (subject to the ability of others to dispute changes under Section 185 of the Communications Act 2003. It is critical, for the purposes of Ofcom's analysis in this case, to understand that these are not charges agreed with an originating operator as result of commercial negotiation between the terminating operator and the originating operator; any wholesale termination charge has simply been notified, in accordance with contractual notification periods, via the BT

[17] See www.vodafone.co.uk/cs/groups/configfiles/documents/contentdocuments/vftst037635.pdf for Vodafone's pricing information table.

Carrier Price List. As we explain elsewhere in this submission, the lack of certainty and control over these wholesale costs has been a material factor in the decision of Communications Providers not to include calls to these number ranges as part of a basket of retail services that is subject to a fixed charge.

Historically, the level of these wholesale charges has been considerably higher than regulated termination charges (such as mobile or geographic fixed termination). Typically, these charges have been in the form of a flat-rate pence per minute or pence per call (or in some cases, a combination of the two). In July 2009, BT – without any prior warning or negotiation – imposed *unilaterally* a novel charging structure upon originating operators for the termination of calls to 080 number ranges.

Under previous charging arrangements for calls to 080 numbers, no wholesale charge had been payable to the terminating operator. Under the new charging arrangements, the amount of the wholesale charge payable was determined by the retail charge levied by the Originating Communications Providers. The applicable wholesale rate varied according to a band in which the retail charge fell. Thus, a higher retail origination charge would fall into a band on the wholesale charging structure or ladder that attracted a higher wholesale rate.

This charging structure was subsequently extended unilaterally by BT two months later to calls to 0845 and 0870 numbers. Termination rates for calls to these numbers had been previously charged by BT and other Terminating Communications Providers on a flat rate pence per minute and pence per call basis. The material step change in the charging arrangements for terminating calls to these number ranges can be seen in Figures 1-4 at Annex 3.

Following the imposition of these charges by BT in 2009, a number of other Terminating Communications Providers followed suit with the unilateral imposition of similar but not identical wholesale charging structures. These charging structures served to reinforce the complexity and uncertainty already created by BT's conduct. Over the course of the next two years, BT introduced ladder termination charges to 0843, 0844, 0871, 0872, 0873 and the entire 09 number range. All of these charging arrangements remain in force at the current time (although they are subject to the dispute resolution process).

The actual level of the wholesale charge payable to BT (and other Terminating Communications Providers) was characterised by considerable uncertainty resulting from the practical operation of these charging arrangements. Initially, it appeared that the level of the applicable wholesale rate would be determined according to one published retail tariff of the Communications Provider, although BT subsequently indicated to Ofcom that the wholesale rate could be determined according to an average retail rate.

There would of course be a very significant difference in the level of out-payments owed to BT under these different methodologies. When Vodafone first sought in 2009 to assess its additional liability to BT resulting from the imposition of 'ladder' termination charges for calls to 080, 0845 and 0870 numbers, it estimated that its new additional exposure to BT was in the region of [✂]

[✂]

However, as Vodafone noted at the time, the Terminating Communications Provider and the Originating Communications Provider were likely to have divergent incentives and therefore would be at odds over the calculation of an average retail rate and the consequential wholesale liability to BT.[18] This divergence would, as Vodafone predicted at the time, be likely to result in additional disputes and litigation that would serve to create additional uncertainty for an Originating Communications Provider.

[✂][19] [20]

[✂]

Moreover, even if some certainty might be secured about the use of an averaging methodology, the level of any wholesale liability could easily be affected by shifts in volumes of traffic generated by different customers on a monthly basis that might influence the average retail rate and the band on the BT charging structure into which the originating operator might fall.[21] Falling into a different band could have the effect of potentially increasing the amount of liability to BT by [✂] [✂]; this is, as Ofcom will recognise, a very significant level of uncertainty and risk for an Originating Communications Provider to assume.

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18 [✂]

[✂]

19 [✂]

[✂]

20 [✂]

[✂]

21 [✂]

[✂]

Whilst Vodafone initially lodged disputes with Ofcom about BT's charging arrangements, pursuant to the provisions of the Communications Act 2003, this did not provide any constraint on the commercial behaviour of BT; after Ofcom initially struck down BT's first 080 charging structure, BT simply introduced six weeks later a new charging structure with different wholesale bands or steps for the termination of calls to 080 numbers. This charging structure remains in place today, generating a potential ongoing liability to BT for an Originating Communications Provider. BT has subsequently sought to appeal Ofcom's determinations relating to the charging structures for 080, 0845 and 0870 numbers; the case is now before the Supreme Court and unlikely to be resolved before late 2014.

Accordingly, Vodafone still cannot conclude with any certainty the level of any potential exposure to BT on a historic or a prospective basis (not least because it is still far from clear when Ofcom's new regulatory regime governing non-geographic call services will come into force).

Evidence from changes in the wholesale charges of DQ services also helps to demonstrate the lack of predictability in changes to non-core services, with changes to the pence per call ("PPC") and pence per minute ("PPM") rates changing rapidly and radically[22]:

The Number
118 118

Effective	Until	PPC (day)	PPM (day)	Note
8.1.10	30.4.10	72	28	1
1.5.10	4.1.11	110	32	1
5.1.11	31.5.11	107	34	1
1.6.11	31.8.11	34	106	1
1.9.11	29.2.12	140	106	2
1.3.12	31.1.13	163	131	2
1.2.13		213	148	2

BT
118 500

Effective	Until	PPC (day)	PPM (day)	Note
1.4.10	31.3.11	78	106	1
1.4.11	30.11.12	88	119	1
1.12.11	17.6.12	97	133	1
18.6.12	30.11.12	114	140	1
1.12.12		100	173	1

1. PPM charge from application of Answer Signal.
2. PPM Charge from one minute after application of the Answer Signal.

[22] Data as of February 2013 – day rate used, rounded to nearest penny.

The evidence above demonstrates convincingly why Ofcom cannot safely conclude that Communications Providers can necessarily predict changes in wholesale charges or the frequency with which their financial exposure at wholesale level might be increased; once that principle is recognised, the corollary must be that Ofcom recognises that it would be unjustifiable to proceed on the basis that a Communications Provider should assume all the risk for wholesale arrangements in all circumstances. In the context of BT's charging arrangements, it should be highlighted that Ofcom itself has previously acknowledged that Originating Communications Providers were highly likely to respond to BT's conduct through mitigating actions of some kind at the retail level.[23] On the basis that this view remains unchanged, Ofcom must reconsider the scope of its proposed regulation.

Bearing risk and forecasting

The suggestion that Communications Providers can make an: *"unbiased forecast of these costs like any other costs and set prices for them periodically"* (5.13) is simply not the case. For example we could neither have forecast the increases in directory enquiry wholesale charges over the past two years, nor do we have control over them. And setting these non-core charges at the start of a two year contract would not be practical. Should a Communications Provider make a forecast that the trend in directory enquiry pricing will continue, so the cost in two years will be many times what it is now? Would setting the price at the start of the contract at many times current cost therefore be the logical approach?[24] Vodafone for one is not sure how this could be in the consumer's interest.

Ofcom also asserts that: *"Communications Providers are better able to assess and bear the risks of increases in their costs than consumers"* (5.12). We do not find this statement entirely convincing. As we have demonstrated above, Communications Providers can neither realistically predict nor control increasing wholesale costs. Consumers however do not have to use these non-core services and they are under no contractual obligation to bear any of these costs.

[23] Ofcom considered that an originating operator might seek to increase non-geographic retail charges (the "Direct Effect") or avoid BT's wholesale charges by reducing non-geographic charges and increasing charges for other services supplied to customers (the "Mobile Tariff Package Effect"). See Ofcom, *Determination to resolve a dispute between BT and each of T-Mobile, Vodafone, O2 and Orange*, 5 February 2010, paragraphs 4.8-4.17. At paragraph 5.188, Ofcom noted that BT's charging arrangements represented a new marginal cost for mobile operators that would potentially trigger an increase in retail charges.

[24] As a further very recent example, on 7 March 2013 we were informed that the price of BT directory enquiry range 118 606 is significantly increasing; the pence per call charges by 29% and the pence per minute by over 4,000% (four thousand percent). We have been given the minimum amount of notice permissible; 28 days. We would welcome an explanation as to how we were in a 'good position' to forecast this. See: https://www.btwholesale.com/pages/static/Library/Pricing_and_Contractual_Information/carrier_price_list/index.htm

Ofcom's approach that Communications Providers bear the entire risk of wholesale cost increases also creates a further detrimental consumer outcome as it appears to be expected that Providers spread the risk of increase throughout their customer bases (even Ofcom's 'regulation max' approach does not expect Providers to take no account of increases in wholesale rates). The implication seems to be therefore that those users who do not use non-core services should cross-subsidise those who do. We are not sure that this is a fair or logical approach.

The regulation max regime in practice

Given mobile Communication Providers will be deterred to the point of a *de facto* prohibition from changing their prices under Ofcom's proposed preferred option, the 'regulation max' option 4, it is instructive to consider properly what such a regime might mean in practice for Providers and ultimately for consumers.

A 'deterrent' to price changes

Ofcom observes that a formal, explicit prohibition on price rises in contract would be disproportionate and is not on offer for consideration in the consultation. Ofcom concludes that such a move would not be: *"a proportionate regulatory intervention"* (1.19). However Ofcom seems to appreciate that the reality of only allowing Communications Providers to change the prices of non-core services in the event that customers can leave without penalty will be a significant 'deterrent' to price changes:

> *We accept that the requirement to allow a customer to exit the contract without penalty may act as a deterrent to price rises in fixed term contracts in many circumstances* (6.43)

Vodafone contends that the literal interpretation of the 'regulation max' model provides a deterrent to the point of a *de facto* prohibition; mobile Communications Providers will have to impose on themselves a prohibition on moving prices entirely as it would make no commercial sense to do so under the current handset subsidy business model. Ofcom is in effect proposing a regulation, the practical implication of which Ofcom itself recognises is not proportionate.

Frozen prices

One obvious consequence is price ossification; prices, once set, simply would not change. Yet inability to change prices in response to changes in supply and demand conditions strikes at the very heart of a well-functioning market. It is basic economics that prices convey information that allow markets to allocate scarce resources efficiently. Erecting major institutional barriers to price adjustments to reflect underlying supply and demand conditions is therefore a very major departure from all established regulatory practice.

Ofcom generally assumes that prices can and do adjust to externally imposed shocks. For example, in the context of determining mobile termination rates, Ofcom explicitly assumed and espoused the idea of the 'waterbed'; i.e. a recognition that disallowing recovery of fixed and common costs on inbound calls would force rebalancing of other prices to compensate. Nowhere in the extensive and detailed deliberations before the Competition Appeal Tribunal ("CAT") and the Competition Commission ("CC") did Ofcom suggest that waterbed effects were subject to the proviso that prices could only ever change in relation to new customers, which is what a literal interpretation of Ofcom's preferred option would imply.

This concern over institutional barriers to price adjustments is compounded by the likely action of third party wholesale providers. Once they become aware that Communications Providers cannot change their retail prices, there is very little to stop them from exploiting the situation by inflating their wholesale charges with relative impunity. In the worst cases, Communications Providers could find themselves faced with 'hit-and-run' arbitrage, where wholesale outpayments exceed retail revenues. At time of writing (February) we are facing considerable increases in traffic, which we believe to be based on arbitrage, from the UK to [✂] [✂]. Artificially holding down retail prices is only going to compound this issue and aid those wishing to exploit arbitrage opportunities.

Even short of the very real threat from arbitrage however, Originating Communications Providers have to be able to make a margin somewhere in order to cover fixed and common costs. If costs increase but prices cannot, the business model becomes unsustainable.

Withdrawal of service

Faced with such arbitrage risks, Originating Communications Providers would have to explore every opportunity to mitigate such risks. One obvious way of achieving this would be not to offer services subject to this sort of third-party margin squeeze risk. In fact, under Ofcom's proposals it might be that Originating Communications Providers could not respond incrementally by withdrawing services only as the wholesale costs trip a certain threshold. This is because Ofcom wishes to define price changes as also encompassing situations where the price itself remains unchanged but the underlying service quality is reduced – as it clearly would be if the service were suspended altogether.

It is a very real risk that the unintended effect of the maximalist approach would be that, over time, Communications Providers withdraw from providing services where lack of pricing flexibility renders the commercial risks simply too great to bear. Ofcom has to appreciate that, as well as being a poor experience for the customer, it would create by its new regulation a whole new set of regulatory problems emerging from disputes over Originating Communications Providers refusing to carry traffic subject to these risks.

Pay-as-you-go notifications

Ofcom's proposed new General Condition 9.6 reads that:

> *"The Communication Provider shall give adequate notice not shorter than one month:… (ii) to every Consumer and Small Business Customer of any Price Modification"*

Vodafone would remind Ofcom that this would cover any price change being notified to all our customers. For example, a change in the price of a call to St Kitts & Nevis would have to be notified to all our pay-as-you-go customers even if not one had ever called there. A literal interpretation would mean that we would have to notify our whole customer base – including children – of a price change to adult premium rate services. This cannot be the intended consequence of Ofcom's regulations. Vodafone would stress that the regulation as framed would be:

- a significant burden on operators, which has not even been noted in the consultation, let alone assessed or quantified;
- a significant annoyance to customers as they would be constantly hassled with information that is useless and unnecessary (and even possibly offensive); and
- wholly without evidence.

Vodafone would suggest that Ofcom must narrow and clarify the scope of its intervention.

'Evading' Ofcom's regulations

Ofcom has developed numerous hypotheses as to why its preferred option is both appropriate and necessary. Ofcom contends that:

> *Communications Providers could evade them [Ofcom's new regulations] by reducing monthly subscription prices and/or exploiting the ability instead to raise other aspects of the price. The adverse effect on consumers would be the same.* (5.10)

We do not recognise that this would be the case. The point about non-core charges is that they are avoidable costs for consumers, whereas the core line rental is not. As a customer does not have to use non-core services competitive pressure will be brought to bear and raising price to an excessive degree would simply drive non-use or substitution for current users. To respond in more detail:

a. First, the whole point about non-core services is that they do not form any part of any 'fixed' commitment by the customer to use them, either at all, or for the full term of the core contract. So, if prices increase, customers can decide for themselves if they are happy to consume those services at the new price or not. Their Communications Provider cannot compel customers to use services that they judge to be too expensive. The ability of customers to avoid price increases in this way is a proportionate consumer safeguard, whereas a right to cancel the core of the contracts without penalty is not.

b. Second, there are brand and reputation effects to consider. Responsible Communications Providers will not lightly increase prices unless they have to. Whatever the reason for them, price increases are never likely to be popular and customers who use and value the services in question will surely think twice before continuing to use services when prices increase. The whole point about the core / non-core distinction is that customers are not in any sense obliged to use non-core services as part of their 'fixed' contract. Their use is entirely discretionary. So Communications Providers will naturally be concerned about customer reaction, both in the short term in terms of the effect on demand, but also in the longer term through a spill-over effect on future subscription decisions and brand preference.

c. Third, there are substitution opportunities for many non-core services, so the consumer does not face a stark consume / don't consume decision. Taking international calls for example, a customer may need or want to make an international call, but he does not necessarily have to make that call from his mobile device. The customer could call from a fixed-line, perhaps in association with an international calling card. For directory enquiries, customers already extensively look to other options, such as getting information from their internet-enabled smartphones. For data-hungry services, consumers have the option of wifi off-load. These are real examples of consumers using substitution for out-of-bundle, non-core services.

Risks from under-investment

Ofcom's preferred option sets out further controls on how operators can charge for their services, in a market already heavy with regulatory obligations. There is no evidence in the consultation that Ofcom has considered the effects of its new regulation on investment, infrastructure, coverage and capacity.

Huge investment is needed to deliver the network speed, capacity and national coverage our customers demand, and we have to deliver this facing one of the most competitive mobile markets in world, whilst certain regulatory decisions continue to diminish the amount of revenue available for investment.

Vodafone needs to invest in its infrastructure to deliver the services that our customers expect. The move from voice and text to data consumption is revolutionising the way consumers are using mobile technology. Data usage has already increased tenfold over the last few years and it is critical that the UK has the infrastructure to meet the demand. Without an ability to continue to invest in both 3G and, further ahead, the next generation of higher speed 4G mobile services we will not deliver the services our customers expect.

As Ofcom will be aware, there is currently a misalignment between the revenues earned from internet services and the network costs associated with providing them. If this continues, it will damage longer term investment in networks and the delivery of superfast mobile broadband. If the UK is to build upon the advances to date, it is vital that operators are allowed to generate revenue from pricing to recover investment costs and to provide our customers – whether business, public sector or individuals – with the services that they need.

Ofcom will also be aware of the demands to roll-out coverage to areas which are less economically viable – largely rural areas or those with challenging topography. This desire for near-universal mobile coverage also requires massive network investment. It is vital that operators are allowed to generate revenue from pricing to recover investment costs.

At the same time as massive calls on our resources to deliver capacity, speed and geographic coverage, our margins are being squeezed by some regulatory decisions. Ofcom's decision to slash mobile termination rates is a case in point, where the cut will inevitably affect the lowest users of mobile technology the most, whilst leaving those higher spenders unaffected. For us this has meant that low users are increasingly uneconomic, forcing us to make tough decisions about our pricing and where to put price increases in an intensely competitive market. To continue to innovate and invest in our network we need to look for ways to maintain our revenue stream; a refresh of our prices is one way to achieve this.

We also remain paying some of the most expensive annual spectrum fees in Europe. As Ofcom will be aware, last month Vodafone's bid of £802m[25] for spectrum to operate 4G services was accepted in an auction costing the mobile industry £2.3bn. We have previously observed that, given that that there isn't an infinite amount of money available to mobile network operators to invest in networks, money taken by Government in spectrum fees will ultimately mean less money elsewhere – for example available to provide coverage in 'not spots'. Spectrum fees also lessen our ability to soak up inflation and rising wholesale rates from others in the value chain.

In conclusion

There are few if any signs in the present consultation that Ofcom has even considered these dynamic risks to competition, as a result of the proposed intervention, and the range of services available to consumers as a result. This is a grave omission if Ofcom really is serious about its preferred option. However, we sincerely hope that on reflection Ofcom will come to see that the risk of consumer detriment in this case far outweighs any hoped for – and illusory – consumer benefit in terms of price certainty for absolutely every price for the duration of a core contract, whether or not the

[25] Plus a further £60m to fund DMSL – the company that will mitigate the interference of 4G interference on Freeview.

services in question fall under the core contract. Vodafone believes that such re-consideration is warranted when considering the evidence, which we turn to below.

4. Proposed intervention should follow the evidence

Vodafone accepts that there is some public pressure for regulatory intervention in price changes to line rental, but we do suggest that, on closer analysis, the evidence for any intervention is actually both weak and partial. In particular it appears that Ofcom has construed more from the data than is reasonable, in relation to the extent and scope of any problem. We must question therefore the proportionality of Ofcom's proposed preferred option.

We must also stress that, whilst Ofcom's evidence for intervention in core price changes may be weak, it has not produced any meaningful evidence whatsoever in favour of intervening in non-core price changes and certainly there is none that suggest any need for the notification of every price change to every fixed contract and non-fixed contract customer.

There are two separate data sources that Ofcom refers to in the consultation, one provided by Ofcom and one by Which?

Ofcom complaints data

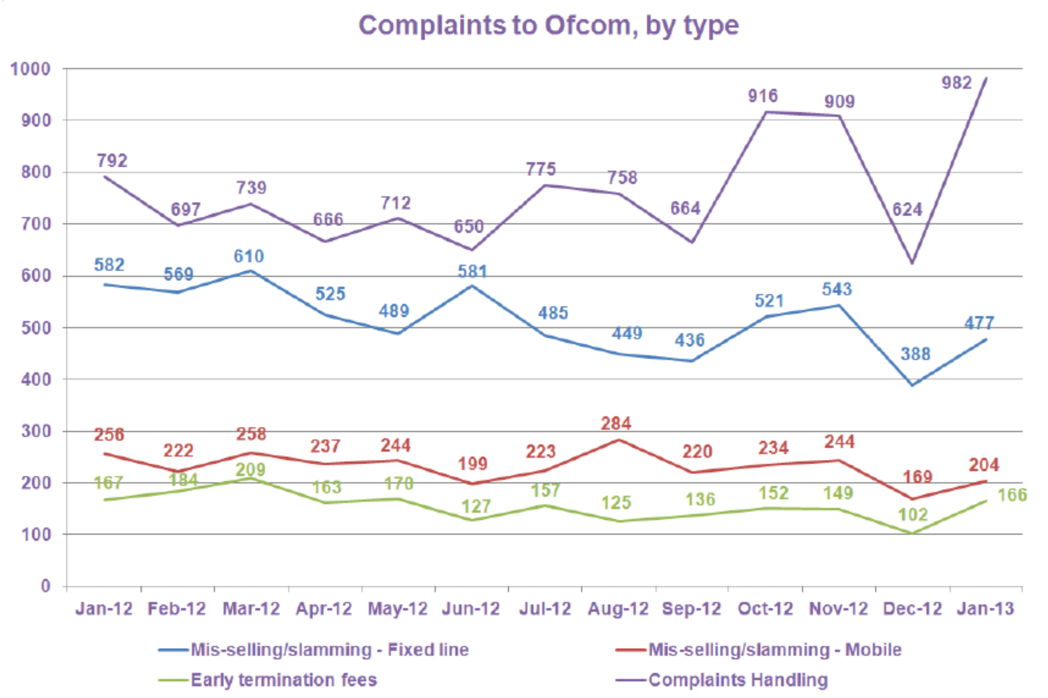
The Ofcom data source relates to an examination of complaints received by Ofcom that related to price rises. Ofcom reports that:

> *we noted a significant increase in complaints to our consumer contact team from consumers affected by price rises. Ofcom examined 1,644 consumer complaints about changes to terms and conditions in the period from September 2011 to May 2012* (2.8)

But reporting this total is not really on point – examination of the data suggests that the level of complaints actually related to issues arising from price increases inside contracted periods was significantly less than 1,644, and also was not by any means spread equally across the industry. The reported number of 1,644 complaints is merely the total number of complaints recorded over the period relating to changes in terms and conditions, or a running rate over the 9 months of 183 per month. But this includes complaints related to other matters than price increases inside contracted periods, so it is an overstatement of the relevant result.

Complaints on terms and conditions are not regularly externally reported by Ofcom – indeed the running rate of these complaints is considerably below that of other issues. In Ofcom's latest telecom complaints bulletin February 2013, figure 1 (below): "*shows* *monthly complaint trends for some of the key areas of consumer dissatisfaction over the past 13 months*"[26]

Figure 1. Consumer complaints summary, January 2012 – January 2013



It is clear that the mis-selling / slamming fixed line category has a running rate of complaints significantly greater than the apparent 183 per month on terms and conditions, yet the review of the fixed porting process, which is at the heart of this particular problem, is still on-going with little sign of immediate Ofcom intervention. Figure 2 of the bulletin details another common complaint – abandoned and silent calls. This shows a running rate since March 2012 of some 10 - 20 times that of the reported level of complaints about terms and conditions.

In fact, surprisingly, no mention at all is made in the February 2013 Telecoms Complaints Bulletin of any customer issue relating to changes in terms and conditions. It cannot therefore be considered to be a generally significant matter for Ofcom, which has not attempted to put in place contemporaneously any detailed analysis of complaint calls or to report the volume externally on a regular basis.

Vodafone queried this with Ofcom and received confirmation:

> *Our Consumer Contact Team logs complaints about price rises as "changes to terms and conditions". The project team looked through the complaint details for the cases logged under this category during this period to identify the complaints about price rises and to understand the main reasons for complaining.*[27]

[26] Ofcom Telecoms Complaints Bulletin, February 2013, p.2.
[27] Ofcom email to Vodafone Regulatory Manager, 16 January 2013.

So, Ofcom has retrospectively reviewed its complaints database specifically for the purposes of this consultation to elicit information on the volume and nature of complaints on contract terms and conditions received, but only over the limited historic period of September 2011 to May 2012. Given the absence of any data over a longer time series, it is impossible to know the level of complaints that were received in prior periods, when for example BT increased its prices in October 2010, and April 2010, and October 2009, and April 2009 (each time by 5% or more), and therefore how different the level of such complaints experienced in the examined period differs from the levels in prior periods.

Given that complaints about changes in terms and conditions are not on Ofcom's regular reporting radar, it is not surprising that the retrospective classification of the individually recorded complaints into a limited number of simple individual categories is somewhat ambiguous and compromised. It was not clear in fact from the consultation itself precisely what the data actually consisted of. A request by Vodafone for some clarification followed by a subsequent request by another Communications Provider has elicited a little more detail than that initially published. From the Vodafone request the following table was published:

CP	TOTAL	Main reason for complaint					
		Amount	Transparency	Unfair	ETC	All	Other
TOTAL	1644	266	399	407	166	42	364
% of total	100%	16%	24%	25%	10%	3%	22%

It would appear that 364 of the 1,644 complaints or 22% had little or nothing to do with price rises at all – their relevance is questionable. The volume of complaints relating to price changes was thus as a maximum 1,280, or 142 a month. But of the remainder, some 166 or 10% related to ETCs – however it is not clear how many of these were related to issues with ETCs in general rather than ETCs specifically in response to a price change.

Looking at the remaining categories, 25% complained about the amount of the price rise, and *"how it could result in material detriment and/or financial hardship for them[28]".* But such a complaint is hardly exceptional – complaints about energy cost increases, train fare increases etc. in the current economic climate are not unexpected. This category of concern does not relate to contract conditions per se, merely that the consumer was faced with a price rise that they were unhappy to have to pay, irrespective of the circumstances of that increase.

The complaint categories "transparency" and "unfair" are the ones that would most obviously appear to relate to the subject of the present consultation. They are explained by Ofcom as follows:

[28] Using Ofcom's explanation for the category.

1. *"Transparency: consumers complaining specifically about the lack of transparency of variation terms. These consumers complained about the price rise because they had assumed that the price was "fixed" for the duration of the contract term*

2. *Unfair: consumers complaining specifically about the principle of price rises in fixed term contracts and how they consider it "unfair" that providers can raise prices when they have already agreed to a fixed term contract."*

The total of complaints on these two categories was 806, or 90 per month. To this might be added some, but not all, of the ETC category of complaints, since it is not clear how many of these are ETC issues triggered by a particular price rise, or a more general ETC issue. Potentially therefore 806 plus some part of 166 or say approximately 900 complaints related to the issue of price rises inside the period of a term contract. This is equivalent to a running rate of 100 per month. As established, this level is significantly below the running rate of other complaints issues actually tracked by Ofcom.

A second clarification request by another Communications Provider led to the complaints data being disaggregated by Provider:

	TOTAL	**Main reason for complaint**					
		Amount	**Transparency**	**Unfair**	**ETC**	**All**	**Other**
Provider A	1322	214	293	336	149	39	291
Provider B	145	24	60	30	7	3	21
Provider C	67	15	19	18	10	0	5
Provider D	39	8	15	4	0	0	12
Provider E	33	2	7	7	0	0	17[2]
Provider F	26	0	2	10	0	0	14
Provider G	12	3	3	2	0	0	4
TOTAL	**1644**	**266**	**399**	**407**	**166**	**42**	**364**
% of total	**100%**	**16%**	**24%**	**25%**	**10%**	**3%**	**22%**

It was immediately obvious that the complaints were heavily biased towards Provider A, who represented 80% of the recorded complaints made to Ofcom. We were informed by Ofcom that Vodafone was Provider G, representing less than 1% of the complaints, despite the fact that as Ofcom reported in Annex 7, Vodafone increased its prices during the complaints period. Annex 7 in fact appears to show seven Providers changing prices (or announcing a change) over the period of data capture: BT, Orange, Virgin Media, T-Mobile, Talk Talk, Three and Vodafone. If we assume that these seven Providers can be matched in some order against the seven operators A - G (this is obviously not certain, since some complaints might be about other operators), then there are four mobile Providers and three fixed Providers being complained about.

Given this very skewed complaints distribution, it is obvious that the level of complaints per Communications Provider when measured against the number of customers per Provider must vary significantly. From this, one must conclude that there is not a simple relationship between a Provider's price rise and the resulting level of complaints. Yet this is how Ofcom has presented the data – that there is a direct correlation between price rises and the level of complaints. A cursory review of

Ofcom's data suggests that it must be more complex than that. It is likely that other factors such as the level of the price rise, coupled with the way that the change was managed and presented, together with any possible Provider targeting by consumer groups will be impacting the level of complaints.

To put it another way, if as reported above Vodafone's price increase gave rise to only three complaints about "transparency", two about "unfair" and three about "amount", together with another four complaints about other matters over nine months, this level is trivial in the context of Vodafone's [✂] [✂] contract consumer customers – it in no way constitutes sufficient evidence to suggest Ofcom should act. From a broader point of view, excluding Provider A from the complaints data, it gives a level of complaints on the topics "transparency" of 106, "unfair" of 71 and ETC of 17, a total of 194 or 22 per month across the rest of the fixed and mobile customer base, which must amount to several tens of millions of customers. This too is a very low level of complaints and not one that suggests any pressing need for action, particularly in the absence of any data on the level of such complaints in prior periods. Given that the customer base of all operators excluding Provider A is likely to represent the large majority of all customers[29], it is arguable that the average of Providers B-G is more representative of the industry average level of complaints than the outlier Provider A.

It is undeniable however that Provider A does have a measurable number of complaints (around 800 after discarding the "other" and "amount" categories), but we cannot know from the data whether this is a fixed or a mobile operator. It is apparent to Vodafone that, since the customer / complaints ratio for Provider A must be at considerable variance to that for the rest of the fixed and mobile industry, that there must be reasons for this particular disparity. Furthermore it is obvious that the reasons behind these differentiated results should have been examined by Ofcom as part of the present process and that the results from the complaints analysis should have been presented separately for Provider A and for the rest of the industry rather than as a simple across industry aggregation. Neither of these issues has been addressed. It is not a correct representation of the underlying data to include the skewed results from A to create an industry total without disclosing the fact of the outlier nature of Provider A. A proper reading of the complaints data might very well be: "in-contract price rises over the examined period gave rise to a very low level of consumer complaints except in the case of operator A". This is a very different conclusion.

The Ofcom complaints data therefore reveals three things:

- The total level of complaints about price increases in the contract period is rather less than 1,644 – it is at most 972 or 108 a month. We (and Ofcom) know nothing about the level of such complaints received by Ofcom in prior periods so cannot form a view as to the extent to which this volume represents an increase over previous levels.
- The level of complaints is very skewed to one Provider for which 778 of the complaints, or 86 per month have been recorded – for the rest of the industry a very low level of complaints of 194 or 22 per month is being recorded. This

[29] Unless Communications Provider A is BT.

latter level of complaints is very low and unlikely to be indicative of the need for general intervention.

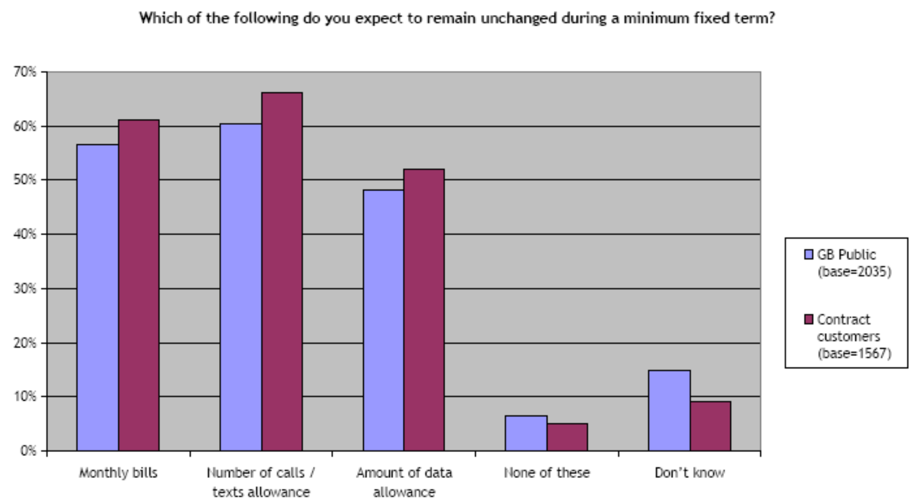
- The level of complaints on this topic even when including the Provider A outlier is insufficiently large for it to have been considered relevant for inclusion in Ofcom's regular complaint reporting.

Vodafone respectfully suggests therefore that the complaints data in itself does not provide meaningful evidence for intervention.

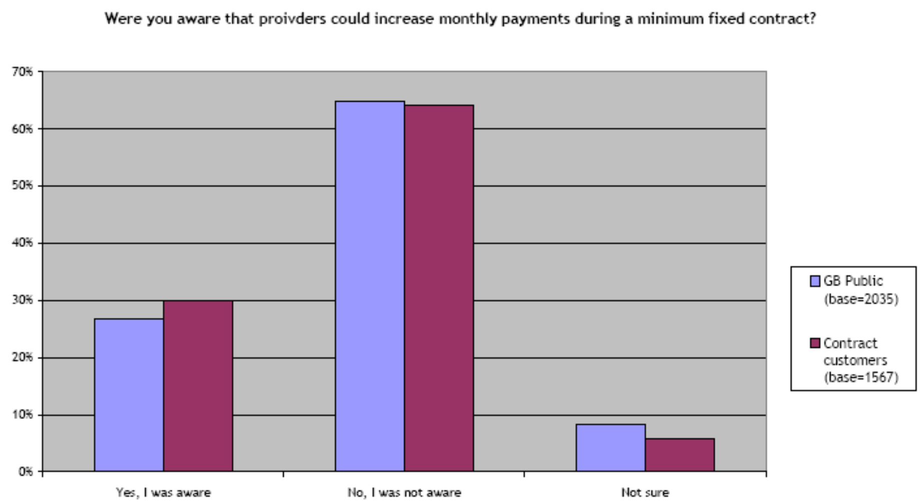
Which? complaints data

On 16 July 2012 Which? submitted a complaint to Ofcom on the subject of mobile phone fixed-term contracts (rather than the wider Ofcom complaints data which quite clearly includes both mobile and fixed operators). The primary piece of evidence of customer views is a survey commissioned by Which? and conducted by YouGov.

This apparently contained two questions only – and the results that are reproduced below:



Question: Which, if any, of the following would you expect to remain unchanged during a minimum term fixed contract with a mobile phone company? (Please tick all that apply)



Question: Were you aware that even if a mobile phone contract is fixed for a minimum term, some mobile providers could increase monthly payments during this fixed period?

The only information that is available about the survey is contained by way of footnote:

> *Total sample size was 2035 adults and 77% (1567) owned a mobile phone on a contract. Fieldwork was undertaken over 10th - 12th July 2012. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).*

Ofcom clearly states in that it has made use of the Which? data in forming its provisional conclusions:

> *We also received evidence from Which? as part of its "Fixed means Fixed" campaign which asks Ofcom to take action to stop mobile providers making in-contract price rises. Which?'s research found that over 60% of mobile contract customers said that they expected monthly bills and inclusive allowances to remain the same in fixed term contracts. The research also found a lack of awareness amongst consumers that providers can raise prices during fixed term contracts. (*2.9)

Given that Ofcom's latest data suggests that 47% of the UK population have a mobile phone on a contract[30], as opposed to a prepaid phone, rather than the 77% of consumers as in the population of the survey respondents from YouGov's online survey pool, and that the distribution varies with such factors as age[31], we were concerned as to how representative this YouGov online survey really was, and whether any unpublished additional questions were asked. Considerable care obviously needs to be exercised in conducting and using results from a survey that asks in effect "do you want to pay more?" since the automatic negative response is both obvious and in itself of little real value. Given the CAT's recent strictures on the use of survey data (particularly in relation to online surveys) discussed in some detail in Annex 2 of this document (paragraph 3.9) we asked Ofcom what investigation it had made of the survey to ensure that the results were in fact usable in its analysis.

Vodafone asked Ofcom:

> *While we note that Which? itself has published summary results for two questions, this provides limited insight into the wider results and underlying methodology. It is clearly important for stakeholders to have an opportunity to understand and comment upon any evidence on which Ofcom may be relying. As with Ofcom's own complaint data, in the interests of transparency we trust that Ofcom will make available the full evidence base to inform the consultation*[32]*.*

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[30] Figure 27 of the Ofcom Consumer Experience Report January 2013 reports that 92% of adults had a mobile phone and Figure 84 that 51% of mobile customers had a contract.

[31] Figure 85 of the same report shows the contract proportion of mobile ownership varying inversely with age.

[32] Email from Vodafone Regulatory Manager to Ofcom on 9 January 2013.

We received the following response from Ofcom:

> "*Which?'s research methodology is referred to in its complaint (footnote 21 on page 29). We do not hold any additional information in relation to the methodology or wider results and you will have to contact Which? if you require more specific information.*"[33]

Clearly therefore Ofcom has not seen the need to query Which? on the survey, yet has to an extent unquestioningly relied on the outputs. We find this omission surprising. There is no separate Ofcom consumer survey.

Irrespective of whether or not the Which? data is in fact sufficiently robust to be of evidentiary value and whether Ofcom should have conducted its own survey, we note that the questions asked clearly relate to the core, fixed component of the contract. One question states: "*were you aware that even if a mobile phone contract is fixed for a minimum term, some mobile Communications Providers could increase monthly payments during this fixed period?*" The other, partially complementary question is: "*which of the following would you expect to remain constant during a fixed-term contract with a mobile phone company, monthly bills, calls/text allowance, amount of data allowance?*" It is quite clear from the context that the scope of the questions relates to the core fixed term payment rather than non-core services which the customer is not obliged to use.

The Which? data, and the whole tenet of the 'fixed-means-fixed' campaign, relates to the regular fixed term in-contract monthly payment and whether this should change, either by means of an overall price change, or by a change in the volume of the included services. It does not relate to the wider interpretation apparently adopted by Ofcom in its proposed preferred option, that all prices irrespective of their significance should remain fixed and unchanged if an immediate ability to exit without penalty is not to be triggered.

At the most therefore, the Which? survey is saying that some consumers are not aware that mid-contract prices rises are possible and are not expecting mid-contract price rises to Communications Providers' core terms. Whether not expecting a price rise should be interpreted as a lack of awareness or an unwillingness to pay is a moot point, and one not apparently addressed by the survey. Given the similarity of the 60:30 split response to two questions suggests the prominence of the former, i.e. that the lack of awareness of the possibility leads to a lack of expectation of price change. We suggest in the section below that some of this lack of awareness in relation to mobile contract prices must arise from the fact that whilst fixed operators' prices have regularly risen, historically the trajectory of mobile prices has been downwards.

It is not clear therefore that the survey provides much in the way of useful or usable data. Ofcom has thus not paid sufficient attention to establishing the robustness of the survey, and in its apparent provisional conclusion that all services should be

[33] Response from Ofcom to Vodafone Regulatory Manager.

considered to be fixed in price has drawn an inference from the survey data that is unquestionably not there.

Test of proportionality

Ofcom's preferred option for regulatory intervention does raise significant concerns from the perspective of both objective justification and proportionality, which are at the heart of Ofcom's legal obligations. In simple terms, the courts have specified that these two principles require that:

i. Ofcom must be capable of demonstrating that its proposed course of action is soundly based on credible evidence and to a standard that *should "be sufficiently convincing to withstand industry, public and judicial scrutiny"*.[34]
ii. Ofcom must ensure, consistent with the jurisprudence of the Community courts and the CAT, that where there are a number of courses of action available to it, the least intrusive or burdensome option should be pursued that attains its policy objective.[35]

We apply these core principles or obligations to the salient facts in our legal annex (Annex 2) below and demonstrate there remain a number of potentially significant concerns about Ofcom's proposed approach; and that these concerns would call into question whether Ofcom's preferred approach to the regulation of fixed term communication services would be compatible with both of the above-mentioned objectives. Were these concerns not to be addressed in any final statement, there would be a material risk that they would be (whether individually or collectively) sufficient to vitiate that final statement.

In conclusion

Vodafone would suggest that the benefit of following the evidence is that it would lead to a more proportionate approach to any intervention in the regulation of in-contract price changes, which we address in the next section.

[34] *Vodafone v Ofcom* [2008] CAT 22, paragraph 47.
[35] *R v Minister of Agriculture, Fisheries and Food and Secretary of State for Health.*

5. A proportionate approach

As noted in the previous Sections, given the very substantial customer detriment which is likely to arise from an unfocussed and overly prescriptive regulation, Ofcom must ensure that its approach is proportionate and well-targeted. It must:

- limit its most intrusive intervention to that issue where consumers are principally concerned, namely unexpected price rises to core services during the fixed term of their contract;
- consider the chilling effect of overlapping regulatory intervention;
- take due account of other consumer law measures when determining the level of harm to be addressed by its intervention including whether inflation-linked price increases should be considered 'unfair';
- target 'back-stop' provisions to protect particular groups of consumers when such provisions would be unwarranted if applied to all; and
- limit any regulatory intervention to future contracts so that Communications Providers can properly take it into account when setting future prices or other terms.

In applying the first three principles, Vodafone believes Ofcom should properly limit increases to core service charges to the rate of inflation. Applying the fourth principle, Vodafone believes Ofcom should retain the 'material detriment' test for non-core services and non-price changes. All customers should be notified of a proposed price increase to core services and any customer who is likely to suffer material detriment as a result of a non-core or non-price change should be similarly notified. Vodafone supports Ofcom's recognition that any intervention can only be forward-looking to give operators an ability to react and re-balance their prices. Having discussed the first principle at length in previous Sections, we set out below further submissions on the remaining principles.

Chilling effect of overlapping regulation and legal complexity

Ofcom is aware that there are a host of regulations that govern contracts, setting out what can be considered 'fair' and 'unfair'. These apply across industry and are regulations all have to understand and comply with. Ofcom's preferred option introduces special, sector-specific regulation for the communications sector alone, on top of the regulatory burden faced by other industries. Whilst Ofcom has the power to introduce sector-specific regulation, it must take great care that the extra burdens it places on the sector it regulates are proportionate. There must be absolutely compelling reasons for intervention in a well-functioning competitive market, which is already regulated horizontally. Relevant regulations include:

- Sale of Goods Act and Supply of Goods and Services Act (and related regulations)
- Unfair Contract Terms Act ("UCTs")
- Unfair Terms in Consumer Contracts Regulations ("UTCCRs")
- Consumer Protection from Unfair Trading Regulations ("CPRs")
- Distance Selling Regulations (for sales to consumers made at a distance)
- UK Codes of broadcasting and non-broadcasting advertising (CAP and BCAP Code)
- Common law principles on contract law
- General Conditions of Entitlement

It is not in question that consumer law has evolved over many years into a complex combination of laws with many overlaps and areas of uncertainty. Layers of regulation can create confusion and an additional financial burden, not only for businesses trying to comply with the regulations but also for consumers. Complexity in the law does not protect consumer rights as it could result in increased costs in litigation (for both businesses and consumers) as both businesses and consumers strive to navigate the regulatory landscape in order to understand their obligations. It can also lead to consumers failing to have confidence of their rights and enforcement options.

Therefore, changes to law and regulation should not be undertaken lightly. The Department for Business Innovation and Skills ("BIS") stated in its recent consultation on the proposed Consumer Bill of Rights:

> *The government is determined to clarify, update and simplify the law. But we will not simplify at any price. Any change to the law can have unforeseen consequences, and may itself damage markets or promote undesirable business behaviours*.

'One-in, Two-out'

Recognising these concerns, since 2010, BIS has been running a system to cut the cost of red-tape for business. This January saw renewed impetus to the scheme. In November 2012, the Business Minister, Michael Fallon, announced that the: "costs of red tape on business will be slashed at double the present rate" as part of a Government blitz on bureaucracy. BIS' press release noted that:

> *From January 2013, every new regulation that imposes a new financial burden on firms must be offset by reductions in red tape that will save double those costs. The new 'One-in, Two-out' rule will be imposed across every Whitehall department from January 2013, and will apply to all domestic regulation affecting businesses and voluntary organisations.*[36]

[36] http://news.bis.gov.uk/Press-Releases/-One-in-two-out-Government-to-go-further-and-faster-to-reduce-burdens-on-business-and-help-Britain-compete-in-the-global-race-6838c.aspx

Vodafone realises that Ofcom is not caught formally by this 'One-in, Two-out' rule, as it is an independent regulator. We would suggest however that Ofcom should be mindful of the broader regulatory context and aware of the challenges facing business in the current financial climate.

Vodafone would suggest that Ofcom should observe the same regulatory rigour as applies to Government departments, by looking to where it can de-regulate and not simply add new regulations without the removal of any. In the words of the Minister:

> *[One-in, Two-out] will require radical thinking right across Whitehall. It will require policymakers to make tough choices, and to think hard about how to get government off the backs of hard-working and hard-pressed businesses.*

We would welcome a similar commitment from Ofcom[37].

Other consumer legislation already addresses the harm Ofcom purports to ameliorate

Ofcom must take account of other sources of consumer protection both when considering the size of the harm it is addressing and what would be a proportionate response. The principles outlined by Ofcom at paragraph 4.4 of the consultation are epitomised in the UCTs, UTCCRs and CPRs which protect consumers from unfairness and create explicit requirements on business to make material information transparent. The CPRs prohibit unfair commercial practices and misleading actions and omissions that cause customers to take different transactional decisions. The UTCCRs provide that a term in a standard contract between a business and consumer is unfair if it causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer. Terms in a standard contract between a business and consumer are not binding on the consumer if they are unfair.

OFT guidance

The Office of Fair Trading ("OFT") has provided clear and helpful guidance on increasing prices during contract periods. The guidance states that clauses that allow a business to increase its price without giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was formed may be unfair. However, paragraph 12.4 of the OFT's guidance states explicitly that: <u>"Terms which permit increases linked to a relevant published price index such as the RPI are likely to be acceptable</u>". The OFT provides in Annex A real-life contractual clauses to provide businesses with guidance on how it interprets the UTCCR. One of the amended (presumably 'fair') clauses reads:

> *We may need to increase our prices. The increases will not be more than the change in the Retail Price Index since the last increase*.

[37] Ofcom's duties under Section 3 (3) (b) of the Communications Act 2003 are relevant in this context.

Ofcom puts forward no case for why increases based on change in RPI are fair in other industries but somehow unfair in relation to telecommunications. Moreover, as consumers are already protected under the current regulatory regime, Ofcom's proposals are likely to create additional complexity without a corresponding consumer benefit. Ofcom's proposed changes should seek to reinforce the current regulations rather than create additional complexity.

Unfair Terms in Consumer Contracts

Notwithstanding the submission above, that the law already covers and protects consumers, during 2012 BIS consulted on a number of measures to clarify consumer law and improve enforcement measures. As part of this process, the Law Commission and Scottish Law Commission produced a paper on Unfair Terms in Consumer Contracts. The intention being to (i) clarify the law on unfair terms between businesses and consumers as it affects consumers and (ii) to formulate advice to BIS. The Law Commission advice and recommendations to BIS are due in the next couple of months. To avoid unnecessary regulatory burdens to Communication Providers (which may or may not contradict separate terms imposed by Ofcom) we recommend Ofcom wait and consider the advice to, and response from, BIS before creating sector-specific changes.

Consumer Rights Directive

BIS has recently issued consultations on the Consumer Rights Directive, the Consumer Bill of Rights and Enforcement of Civil Remedies. As referred to above, they will also receive advice and recommendations from the Law Commission regarding the UTCCRs. Any proposed changes required to legislation protecting consumers can be properly and appropriately captured in these regulations. BIS has sought to gather responses and concerns across the UK market. The changes proposed by BIS aim to reduce the regulatory burden to business. It is seeking to reduce complexity and uncertainty to provide one framework where consumer rights and obligations are captured and incidentally avoid both businesses and consumers having to understand and / or seek enforcement from sector specific regulations (for example, regulations related to consumer lease agreements, financial services, utility services and telecommunications). In recent discussions with BIS, it was clear they wanted to simplify the law to create fairness for customers, not create layered regulatory powers.

Ofcom has not provided an explanation as to why a consumer should have different contractual rights in a telecommunications contract compared to other industries where the issue of fairness in relation to consumer rights is no less relevant (for example, insurance, energy services, transport and television subscription services).

ASA ruling

The Advertising Standards Agency ("ASA") has already dealt with Ofcom's concerns that the lack of transparency regarding price increases creates surprise and harm to consumers. In December 2012, the ASA adjudicated on Hutchinson 3G and in

February 2013 adjudicated on Vodafone[38]. In its assessments the ASA considered that the monthly price of a contract was likely to be of importance to consumers and that the potential for it to increase, within the term of the contract, was a significant condition that needed to be stated clearly in adverts. The ASA told Vodafone and Hutchinson 3G to qualify their monthly prices in future adverts to make it clear that they could be increased during the contract.

Following the decisions on Vodafone and Hutchinson 3G, the ASA contacted companies confirming their ruling that the potential for monthly prices to increase within the term of a fixed-term contract must be made clear to consumers. They stated this means that the term (allowing prices to be increased) must be stated explicitly in the advertisement, in a footnote or equivalent. As Communications Providers will, as required by this ruling, include appropriate information in advertisements, any potential harm or surprise to consumers is significantly mitigated and Ofcom must take account of this factor before introducing burdensome new regulation.

The role of RPI

Ofcom's proposed intervention suggests that no increase, even if related to the level of inflation should be permitted with any contract cancellation exemption. However there is nothing inherently unfair about index linking to take account of inflation. Indeed, this is widely accepted in other sectors, and by Ofcom itself when designing regulatory charge controls.

Ofcom makes the suggestion at 6.47 that*: "any future loss of future revenues can be anticipated and built into initial prices"*. But is this a real or nominal loss that Ofcom is considering? At times of very low inflation, i.e. below 1%, there is only an insignificant difference between real and nominal price changes, but at levels of higher inflation, which Ofcom notes in 4.17 has occurred recently, holding prices constant in nominal terms will involve a significant real[39] loss of revenue.

Ofcom also notes in 4.17 that:

> *The Bank of England's inflation target of 2% is linked to the increase in the Consumer Price Index (CPI), which is typically below that for RPI. As a conservative estimate, then, we can assume future price increases might be around 2% per year. Where inflation exceeds its long run target (as it has done so recently) or where RPI is above CPI, increases could be more than this.*

Ofcom makes reference by footnote to the following ONS table, which clearly shows that the 2% target has been exceeded to a substantial and unpredictable extent:

[38] http://www.asa.org.uk/Rulings/Adjudications/2013/2/Vodafone-Ltd/SHP_ADJ_210326.aspx
[39] I.e. after adjusting for price change.

Figure A: CPI 12-month percentage change

United Kingdom

Source: Office for National Statistics

But in 4.25 Ofcom states that: *"given their expertise and experience, Communications Providers are in a good position to forecast their costs when setting their prices"*. Clearly one factor in this must be the level of inflation. However, if the Bank of England has been unable to accurately predict and or control inflation, how can mobile Communications Providers be reasonably expected by Ofcom to do be able to do so?

In section 5 Ofcom considers that there may be exceptions to the principle of the right to cancel in the event of a price increase:

> *5.28 We note that in most terms and conditions, providers include a clause which provides for variations (to price and other terms) for reasons that are "outside of their control". Where a change is made under these circumstances, consumers are not allowed to exit the contract without penalty regardless.*
>
> *5.29 Such clauses typically include the following examples as reasons for price changes that would be outside of the provider's control:*
>
> - *an increase in the rate of VAT,*
> - *the imposition of a new tax, or*
> - *the extension of an existing tax that has not previously applied.*

> *5.30 Ofcom's initial view is that any cost increases imposed by Government for the reasons above would be outside of the control of providers. As such, we consider that providers should be able to rely on a term which specified that consumers are not allowed to exit the contract without penalty where such increases are passed through to consumers in the form of price variations. Any amendments we make to GC9.6 would be subject to this caveat.*

Whilst we would not disagree with any of these factors with respect to their potential to change prices, we would suggest that inflation is a similar factor, which Ofcom has however failed to consider. It is entirely because inflation is also out of Communications Providers' control that customer contracts generally also contain an exit exclusion with respect to an RPI-related (or RPI ceiling) price change.

With respect to inflation, there are two related issues – the general level of RPI and the unpredictability of the actual RPI outcome. If future inflation were a known low level over the next two year period e.g. 1% with a low risk of variability such as +-0.5%, then it would be a realistic option to build anticipation of such a price change into the monthly fixed contract level to ensure that over the contract period, the real terms decrease could be controlled for without any mid-contract price increase. But where the level of future inflation is both unknown and at potentially significant levels, e.g. 2% to 6% with no obvious central case, then this becomes much more difficult.

A prudent Communications Provider in the face of high and unpredicted inflation would need to factor a very considerable initial uplift into the fixed monthly payment in order to avoid an inflationary deficit. But to do so in circumstances of uncertainty could very well be more to the detriment of the consumer than a situation where the Provider implements a mid-term price rise based on known historic inflation: this would appear to be a better balance of risks between the consumer and the supplier.

The suggested regulatory intervention might be workable at very low and totally predictable levels of inflation but will obviously be a much poorer fit when inflation is high and unpredictable, and thus inherently not in any way controllable or manageable for the mobile Communications Providers. There is no evidence that Ofcom has considered this point. Furthermore there is no evidence as to why, uniquely, mobile contract terms should not be permitted to allow RPI related increases to offset real terms decreases in revenue.

The whole basis of Ofcom's general regulatory approach to charge controls has been of the RPI+-X format, i.e. that there is an overall trend or glidepath of X% per year, that is adjusted upwards by RPI. So for example the existing charge control for fixed termination and origination is RPI+3.25%, which has meant that BT has been allowed to increase its regulated wholesale voice charges by 6% or so. Similarly the Post Office has on 1 March 2013 announced an increase in the retail price of stamps and postal charges by around RPI, with some increases above RPI and some below.

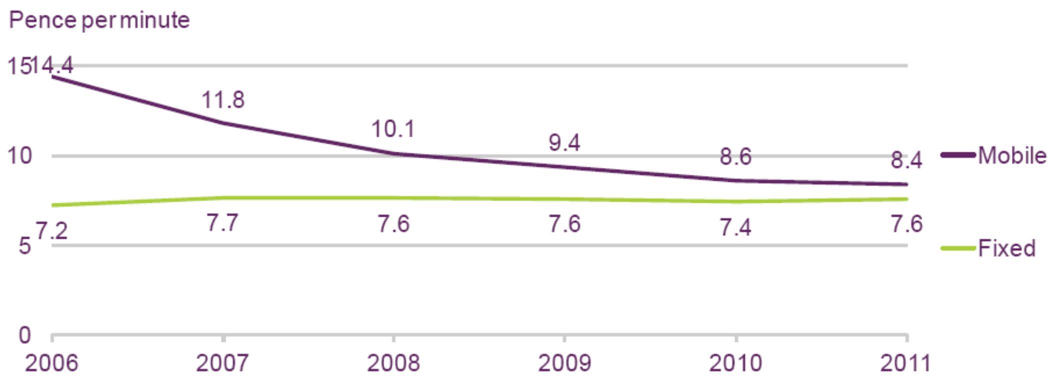
In the case of the rail network, the regulator has consistently allowed customer prices to rise on an annual RPI+X basis (on an overall basket principle rather than a per tariff basis, so some prices, particularly peak commuter rates, have risen faster than this). The principal reason is to allow the rail operators to invest in improvements to infrastructure. Yet this is exactly what the mobile operators are proposing and expected to do in terms of deploying another mobile technology (4G) to provide high-speed mobile broadband widely across the country, as well as having to make increased payments for their primary transport medium, i.e. spectrum.

Ofcom would therefore have to make a reasoned case for why a different treatment of a zero price increase, or as the Post Office reported it in the context of those elements of its increases that were below the level of RPI, “a real terms decrease”, should apply to certain types of consumer contract in the telecoms sector. This is a case that Ofcom has not yet made, however.

We struggle with why Ofcom in the present consultation is surprised that mobile prices are rising, even if they are rising only at RPI or sub-RPI levels (clearly the Post Office’s point on sub-RPI increases being real terms decreases is correct). An expectation by Ofcom that retail prices would rise if termination rates were restricted by regulation to pure LRIC was a key component of Ofcom’s statement on mobile termination rates in March 2011, and continued to be argued by Ofcom to the CC in the mobile operators’ appeal against that decision. Ofcom was quite content with the principle of retail price rises.

It should have been little surprise to Ofcom therefore that mobile retail prices have risen since March 2011. It may have been somewhat unexpected to some consumers however. Unlike fixed phone charges, mobile prices have been as a long-term trend falling over time. Ofcom has regularly charted this in its annual Communications Market and Consumer Experience Reports. For example Figure 92 of the latest Consumer Experience Report, January 2013, shows both a continued fall in mobile prices and a rise in fixed prices, leading to a virtual convergence:

Figure 92 Comparison of average residential fixed and mobile voice call charges



Source: Ofcom / operators
Note: Includes estimates where Ofcom does not receive data from operators; fixed calculation excludes non-geographic voice calls; mobile calculation includes business calls; adjusted for RPI.

Note that in this chart Ofcom *has* adjusted for RPI.

Unfortunately, for mobile Providers, this long-running trend of real price reductions to the benefit of consumers has more or less bottomed out, and retail mobile prices have needed to start rising. For consumers of fixed telecoms services, and most other services, price rises are the norm, and whilst unwelcome are not unexpected. But this is different for mobile consumers where there has historically been little expectation of the likelihood of price increases. But by early 2013 all mobile operators have increased their in-contract prices at least once. It is perhaps therefore the unexpected nature of mobile price rises that has caused some recent difficulty (despite the fact that the ability to increase prices without contract cancellation has been inside consumer contracts for some years).

The Which? survey showed that by July 2012 30% of the surveyed contract customers were aware that a contract price could increase mid-term – one suspects that a similar question if asked in March 2013, now that all mobile operators have increased their prices would show a rather higher awareness percentage.

Retrospective regulation

We note Ofcom's proposal at paragraph 6.59 that any modification to General Condition 9.6 should only apply on a prospective basis to new contractual arrangements entered into by customers. Vodafone would endorse such an approach on the basis that it is consistent with the enshrined presumption that laws should not operate retrospectively unless there is a compelling justification for departing from that proposition.[40] In a regulatory context, enforcing regulation retrospectively would be offensive and inimical to the principle of legal certainty upon which operators so heavily depend when making strategic commercial decisions, in particular those relating to investment.

We discuss this issue in more detail in our legal annex (Annex 2), as well as the legal tests Ofcom has to meet more generally.

New General Condition text

For the reasons explained in our main submission and Annex 2, the proposed scope of Ofcom's preferred regulatory option and the consequential revisions to the existing General Conditions are disproportionate.

This is because the proposed approach and amendments to the General Condition would enable customers to be able to terminate their contract with their Communications Provider without incurring any financial liability or penalty for any increase in charges for those services that are not subject to fixed term contractual commitment. Ofcom's clear focus in the consultation document has been on fixed term contractual charges (consistent with the limited evidence it has gathered); there is

[40] *R v Home Secretary ex parte Asif Mahmood Khan* [1984] 1 WLR 1337; *R v North and East Devon Health Authority ex parte Coughlan* [2000] 2 WLR 622.

accordingly no case for a right of automatic termination to be extended to *every* increase in a non-fixed term charge.

We therefore propose below an alternative amended General Condition 9.6 that gives effect to the proportionate regulatory approach that we have articulated in our submission (with further explanation in Annex 2). To bring the revised General Condition into line with that proportionate approach, we propose the amendments below which:

- Provide for a definition of what constitutes a fixed term contractual charge. The consequence of this approach is that where there is an increase in a fixed term charge, the Communications Provider must enable the customer to terminate their fixed term contract without incurring any penalty or facing any further ongoing financial liability.

- Ensure that the fixed charge is expressly tied to the provision of services to be specified and agreed by the Communications Provider with its customer. This approach, of course leaves the range of services subject to the fixed term charge to be proposed by the Communications Provider. This is what is meant by the term “specified services” that we use in the proposed text. Accordingly, each Communications Provider in the market may propose a different range of services subject to a fixed term charge. That should be the result of a competitive process in which each Communications Provider independently forms its own view of the preferences, requirements and expectations of consumers.

- Provide for the exclusion from the scope of revised General Condition 9.6 of increases in fixed term contractual charges in certain circumstances. For the reasons that we have outlined in the main body of our submission, we consider it appropriate to enable Communications Providers to be able to adjust to inflationary pressures without being required to allow customers to terminate a contract. We have also retained Ofcom’s proposal that where increases in fixed term charges are levied pursuant to legal and regulatory obligations imposed upon the Communications Provider, the customer should not be able to terminate a contract without penalty.

- Ensure that increases in non-fixed term charges or other non-price modifications may be within scope of General Condition 9.6(b) and (c) by retaining the existing material detriment threshold. As we have emphasised in our submission, it would be disproportionate for a customer to enjoy a right of *automatic* termination for increases in non-fixed term charges where the customer makes negligible or no use of the service that is the subject of an increase in the charge. However, the retention of the existing material detriment threshold would mean that where a specific customer *may be* affected by a non-fixed fixed term charge increase (according to the specific circumstances), there would still be scope for that customer to be able to terminate without penalty. Equally, non-price modifications, such as the withdrawal of a service would also be subject to a material detriment threshold; in effect, the customer would continue to benefit from the protection which they already have today.

- Provide for an implementation period of six months rather than the three proposed by Ofcom. As we explain in our response to Question 27, distributors of mobile airtime will also need to give effect to any new General Condition 9.6 and in so doing will require time to accommodate and adapt existing systems. This process in the indirect channel would occur *only after* Communications Providers had revised their current contractual terms and conditions and contracting systems following the publication by Ofcom of a new General Condition 9.6. These in-house contractual revisions and adaptations are likely to be a time-consuming process. In those circumstances, a six month implementation period would plainly be more reasonable.

Vodafone would suggest the following text for General Condition 9.6 (amendments or additions to the original text are underlined):

1. General Condition 9.6 will be modified with effect from the date <u>six</u> months after the date on which Ofcom publishes a statement setting out our decision to make the modifications.

2. The modified condition will read as follows:

"9.6 The Communications Provider shall:

(a) give adequate notice not shorter than one month:

(i) to every Subscriber in relation to whom any modification of a contract is likely to be of material detriment; and

(ii) to every Consumer and Small Business Customer of any Price Modification;

(b) allow its Subscribers, Consumers and Small Business Customers, as the case may be, to withdraw from the contract to which the modification, or Price Modification, as the case may be, in Condition 9.6 (a) above relates without penalty upon such notice; and

(c) at the same time as giving the notice in Condition 9.6 (a) above:

(i) in the case of a modification falling only within Condition 9.6 (a) (i) above, inform the Subscriber of his/her ability to terminate the contract without penalty if the modification is not acceptable to the Subscriber; or

(ii) in the case of a Price Modification, inform the Consumer or Small Business Customer of their ability to terminate the contract without penalty.

(d) For the purposes of Condition 9.6:

(i) "Price Modification" means an increase to <u>a Fixed Term Charge</u>;

(ii) *"Fixed Term Charge" means a minimum subscription charge payable on a specified monthly or other periodic basis in exchange for specified Electronic Communications Services which the Communications Provider has agreed to provide to the Subscriber under a contract for a duration of more than one month, including any modification which has the effect of increasing the unit price of a specified service subject to a Fixed Term Charge from the price agreed at the time the contract was entered into, but excluding:*

(a) *any increase in the Fixed Term Charge comprising only an amount equal to any charge imposed directly and specifically by changes in legal or regulatory requirements compliance with which by the Communications Provider is compulsory; or*

(b) *an increase in the Fixed Term Charge up or equal to the percentage increase in RPI since the Fixed Term Charge was first introduced or last changed by the Communications Provider;*

(iii) *"Small Business Customer" has the same meaning as in Condition 9.3(a); and*

(iv) *"RPI" means the prevailing Retail Prices Index as published by the Office for National Statistics"*

A proportionate approach to GC9

Vodafone believes that the approach set out in its re-drafting of Ofcom's revision of General Condition 9 is consistent with Ofcom's regulatory principles as it targets regulation where it is needed. It would also have a number of benefits over Ofcom's 'regulation max' model described in Section 3 above as it:

- avoids irrelevant and annoying notifications going to customers who are unaffected by a non-core price change;
- removes the risk of significant harm to the handset subsidy model, as a customer right to exit a contract without penalty in response to any price change would be unsustainable for Communications Providers given the level of stranded investment they would face in devices costing many hundreds of pounds compared with a price-rise measured in pence;
- avoids the risk of Communications Providers being forced to withdraw access to certain services, as retail prices move underwater or they face arbitrage;
- enables prices to move in line with underlying costs, as they should in a competitive market, and as is explicitly recognised in Ofcom's proposed future regulation of non-geographic numbers.

The consumer remains protected however, as:

- significant users of non-core services will still be alerted when prices change, allowing them to avoid the effects of price increases as they can stop, lower or substitute their use;
- non-core services and non-price changes will remain subject to the test of 'material detriment' so customers cannot be made significantly worse off; and
- the core line rental could only rise in line with inflation as measured by the Retail Price Index without triggering a right to cancel without penalty.

Vodafone does not believe that Ofcom has made its case for disallowing inflation-linked increases to core services unless customers are given a penalty-free right to cancel. Its evidence base is weak and partial and its purported concerns are already addressed by heavy control and oversight from existing consumer regulation. It is contrary to Ofcom's own practice in setting charge controls and while Ofcom may consider it a modest additional burden on Communications Providers in today's low interest rate environment it cannot blithely assume that this will be the case in the future.

The focus of Vodafone's concern however is around its proposed regulation of price changes to non-core services. Ofcom has not provided any credible evidence of the need for intervention and it would create significantly worse consumer outcomes in a market that is currently delivering consumers some of the lowest prices, widest range of handsets and most innovative services in the world.

Vodafone Limited
13 March 2013

Annex 1

Ofcom questions

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?*

No. We recognise that price increases are never likely to be popular and that they can provoke a negative customer reaction. However, on inspection the evidence of consumer dissatisfaction is both less pronounced and more nuanced than Ofcom's summary presentation suggests. In any event, there is no simple equation between expressions of irritation or dissatisfaction and consumer harm. As discussed in the body of this response, Ofcom also needs to consider the risk of consumer harm in the counterfactual where *any* price rise, however small, triggers an automatic right to terminate without penalty.

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?*

This is not an either / or choice. Currently, Communications Providers do bear the risk of costs increasing to a very significant extent. It is simply not the case that Communications Providers can change prices at will – existing consumer protection law (including the current material detriment provisions) clearly circumscribes the scope for price variation without triggering termination rights. Communications Providers have every incentive to assess and manage cost risks to the extent they can. But there are some classes of cost risk that are beyond their ability to predict or control. Forcing Communications Providers to bear all of this risk, without any safety valve to pass through underlying cost increases to customers where they cannot be absorbed completely, may well create worse consumer outcomes as we have demonstrated above.

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?*

No. The underlying legal principles are clear. Their application in particular cases will necessarily take account of the particular context in which they are applied. It is not appropriate to attempt to codify prescriptive rules for every eventuality and it is not proportionate to abandon the concept of a materiality threshold altogether in the name of uniformity. In practice, RPI measures of price inflation – which Ofcom itself uses widely in other regulatory contexts – already provide a *de facto* upper limit for line rental increases. It is perfectly possible to confirm this within a revised General Condition without undermining the concept of materiality inherent in any proportionate response.

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

See Q3 above.

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?*

See Q3 above.

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

Not entirely – see Q1 above.

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?*

In principle, transparency should go a long way to providing necessary consumer protection. However, transparency is not really 'alone' – it operates in conjunction with the overall framework of existing consumer protection law governing contract terms. Vodafone's proposed amendment to Ofcom's suggested change to GC9.6 would contribute to greater transparency and consistency, without the risk of worse overall consumer outcomes that Ofcom's current proposal could introduce (albeit unintentionally).

8. *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?*

We agree that regulation should protect consumers, but we do not agree that this should mean any increase automatically triggers a regulatory notification requirement conferring the right to cancel without penalty.

9. *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?*

It is necessary to distinguish between price changes in core charges, which a consumer is committed to pay, and increases in non-core charges, where customers can avoid the effect of an increase without exiting the entire contract. Under Ofcom's proposed transparency model for non-geographic numbers, the 'service charge' is entirely the responsibility of the third party service provider, not the Originating Communications Provider. Thus there should be no question of Originating Communications Providers being required to notify their customers of changes in service charge (up or down), let alone of increases in third party service charges conferring a right for consumers to terminate their contract with the Originating Communications Provider.

10. *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?*

We agree that the scope of regulation should include small business customers on standard term contracts, but should not apply in cases where contract terms have been individually negotiated.

11. *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?*

See Q10 above.

12. *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?*

We agree with this approach in relation to the current proposal. However, the scope of 'any subsequent regulatory intervention' is something that would have to be considered in relation to a specific proposal so we reserve our position.

13. *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?*

It would be unprecedented for a company to be unable to react to a change in VAT or the imposition of a new tax.

14. *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?*

The cost of third party non-core services, such as directory enquiries and international calls, are in reality outside of the control of the Communications Provider, which has no control over the wholesale rate it is charged and no ability to predict with reasonable certainty how, when and to what extent rates may move over a period of years. Critically, consumers are not generally committed to use such non-core services so they can avoid price changes without cancelling their core contract. An automatic right to cancel without penalty upon *any* change is disproportionate in these circumstances. We therefore propose that the existing materiality threshold should be maintained for such services.

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

Yes.

16. *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?*

Vodafone is happy for Ofcom to liaise informally with providers where appropriate.

17. *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?*

Vodafone views Ofcom's guidance on notification as reasonable best practice.

18. *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?*

Vodafone supports the concept of 'not less than one month' for those customers whose price changes to the extent that they are entitled to exit contracts without penalty.

19. *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?*

The important point is that customers should have the ability to exit their contracts before any materially detrimental price change takes effect and they face additional charges.

Section 6

Option 1

20. *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?*

As noted, we do not entirely share Ofcom's view of current 'consumer harm'. Accordingly, we are not persuaded that the case for change is quite as pressing as Ofcom suggests. However, we can see a case for some refinement of current regulation on a prospective basis, providing always that the new regime is proportionate and the lead-time to implement is realistic.

Option 2

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

Not entirely. The benefits of greater transparency, rather than burdensome regulation, should be considered further. However, as Ofcom's present focus in on its preferred Option 4 we focus our comments on that option.

Option 3

22. *Do you agree with Ofcom's analysis of option 3? If not, please explain your reasons.*

Not entirely. Vodafone does not believe that consumers should have to 'expressly opt in to any variable price contract' as it would skew a competitive market, making a regulatory presumption that one kind of contract should be chosen over another. However, as Ofcom's present focus in on its preferred Option 4 we focus our comments on that option.

Option 4

23. *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?*

Vodafone does not support Ofcom's proposed 'preferred option' of allowing customers to withdraw from their contracts without penalty in the event of any price change to any service. Our reasons are set above in the main body of the response.

Other

24. *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?*

No. As discussed in the body of this response, we believe that Option 4 is disproportionate as currently framed. We therefore propose a more proportionate and targeted alternative.

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

Vodafone suggests that its re-working of GC9 would be more consistent with good regulatory principles as it is targeted only where intervention is necessary.

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

Our proposal maintains the current material detriment test remaining for non-price variations.

27. *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?*

Ofcom should not underestimate the logistical complexity of rolling out new form contracts. After considering the implications of Ofcom's Statement, we would have our own drafting and internal sign-off processes. We would have to factor in the time taken to secure a Plain English Campaign Crystal Mark for these documents. We would have to ensure the training of staff on the new contracts, across our estate, and printing them and distributing them (and shipping away and pulping the current contracts). We would also have to consider our indirect channel partners and the lead time and additional support they may need. We therefore suggest a minimum six month implementation period would be more realistic and appropriate.

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

We strongly agree that any new regulatory requirement should only apply on a prospective basis to new contractual arrangements entered into by customers.

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Annex 2

Legal analysis

1. Introduction and summary

1.1 Vodafone welcomes the opportunity to be able to comment on the legal basis for Ofcom's proposed form of regulatory intervention in relation to price rises in fixed term contracts. We recognise that Ofcom should keep under review the effectiveness of the existing regulatory framework and determine whether adaptations are appropriate, taking into account all relevant facts and circumstances. However, it is nevertheless critical that any proposed regulatory intervention is based on credible evidence and proportionate to the policy objective being pursued. This is to ensure that regulatory intervention is effectively targeted at the identified harm and does not generate unintended consequences and adversely affect the welfare of the consumers of Communications Providers.

1.2 In this instance, whilst Vodafone recognises and understands the importance attached by Ofcom to the issue of price rises in fixed-term contracts, we have material concerns about: (i) the evidence base that Ofcom has gathered in support of its preferred course of action; and (ii) the scope of the form of regulatory intervention proposed in the consultation document.

1.3 The regulation of contractual terms (including charges) for the provision of communications services is primarily governed in the ex ante sector-specific regulatory regime by existing General Condition 9.6. As Ofcom rightly notes, its proposed course of action would require a modification to that General Condition 9.6 that cannot proceed without certain statutory safeguards or criteria stipulated by the Communications Act being satisfied. For the reasons stated above and described further below, we consider it doubtful at the current time that Ofcom's currently contemplated course of action would be compatible with the safeguards provided by the Communications Act governing modifications of General Conditions.

1.4 We explain in further detail below and elsewhere in our consultation response why there are a number of questions surrounding the nature of the evidence that Ofcom cites to justify the need for regulatory intervention. Suffice it to say that the 'complaints data' upon which Ofcom relies in support of its proposed actions has a number of notable deficiencies and limitations; Ofcom could and should have elected to gather its own credible survey evidence based on a robust methodology that revealed the nature and extent of consumer concern about increases in prices in fixed term contracts. Yet it has not done so and, by its own admission, has failed to interrogate the only survey evidence of consumer reaction at its disposal provided by Which?.

1.5 However, were we to assume that Ofcom were able to make good its case that the level of customer harm from increases in prices to fixed term communications services justified some modification to the existing General Condition 9.6, there remain significant questions about the proportionality of the apparent scope of regulation that Ofcom proposes. These questions arise in large part because of an ambiguity and inconsistency in the analytical framework or approach that Ofcom itself in relation to the range of services that would not be considered 'fixed-term'. If it is Ofcom's suggestion that all price increases, including those relating to non-fixed term services, should fall within the scope of the proposed new General Condition 9.6 (and enable customers to terminate a contract without penalty), there can be little doubt that such intervention goes far beyond what is necessary to remedy the harm identified in the consultation. Claimed future-proofing of regulation against unknown and unforeseen events cannot be a credible justification; such an approach would simply enable any regulator to evade the need to satisfy the principle of proportionality when imposing regulatory obligations upon industry stakeholders.

1.6 A critical part of the assessment of the scope and the proportionality of any revised General Condition 9.6 is the basis on which it is to be applied and enforced. In this regard, we welcome Ofcom's intention to apply any revised General Condition 9.6 on a prospective basis only. Such an approach is consistent with the long-established presumption that laws and regulation should not operate retrospectively. From both a legal and policy perspective, that presumption reflects the need for industry stakeholders to be able to take commercial decisions in a stable legal and regulatory environment. In a situation where tariffs and handset funding arrangements were determined on the basis of a very different regulatory framework, a decision on the part of Ofcom to apply any new regulation retrospectively would be plainly inequitable and damaging on a prospective basis to the legal and regulatory certainty that Ofcom must, as a matter of law, seek to promote.

2. Ofcom's legal obligations when imposing regulatory burdens

2.1 It is a well-established and enshrined principle of public and administrative law that public bodies should be expected to explain their decisions and provide sufficient reasoning for those decisions. This is because, as has been recognised on numerous occasions by the courts, such an obligation acts as an effective form of discipline upon a public authority, ensuring that decisions are soundly based and, consequently, clearly comprehensible to those stakeholders affected by these decisions.[41]

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[41] See for example, *Cullen v Chief Constable of the Royal Ulster Constabulary* [2003] UKHL 39 per Lord Steyn: *"First, they* [reasons] *impose a discipline…which may contribute to such* [decisions] being *considered with care. Secondly, reasons encourage transparency…thirdly, they assist the courts in performing their supervisory function if judicial review proceedings are launched.*"; *R (Macrae) v Herefordshire District Council* [2012] EWCA Civ 457 at 41 per Pill LJ *"a requirement to give reasons concentrates the mind. If it is fulfilled the resulting decision is much more likely to be soundly based on the evidence than if it is not."*

2.2 In the case of the sector-specific regulator for the communications industry, Parliament has effectively chosen to codify these long-established duties through specific provisions of the Communications Act 2003. These provisions stipulate the criteria that must be satisfied before Ofcom is able to introduce new regulatory measures or adopt changes to an existing regulatory regime.

2.3 In this case, the regulation of charges in fixed term contracts is currently governed by General Condition 9.6. As Ofcom itself notes in its consultation document, the correct starting point for understanding Ofcom's ability to modify an existing General Condition is section 47(2) of the Communications Act which provides that Ofcom cannot take a decision to modify or amend a General Condition unless it is satisfied that the decision to modify is:

a) ***objectively justifiable*** *in relation to the networks, services, facilities, apparatus or directories to which it relates.*
b) ***not such as to discriminate*** *unduly against particular persons or against a particular description of persons;*
c) ***proportionate*** *to what the condition or modification is intended to achieve; and*
d) *in relation to what it is intended to achieve,* ***transparent****.*

2.4 Closely intertwined with the attainment of the above-mentioned obligations that Ofcom must discharge when modifying a General Condition is the duty, pursuant to Section 7 of the Communications Act, to conduct an impact assessment in relation to a regulatory proposal would have a significant impact upon stakeholders. That impact assessment must explain how Ofcom's wider statutory duties would be realised through its intended course of action.[42] Amongst the most significant of those duties in this instance would be those relating to the promotion of competition and the interests of consumers.[43]

2.5 Parliament has also sought to reinforce further these specific duties with broader over-arching obligations that govern how Ofcom should undertake its role more generally. Accordingly, Ofcom is subject to a general duty under s.3(3)(a) of the Communications Act 2003, to have regard in all cases to "the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed."

2.6 Ofcom's preferred option for regulatory intervention (Option 4 in the consultation document) raises significant concerns from the perspective of both objective justification and proportionality, which are at the heart of Ofcom's legal obligations. In simple terms, the courts at both national and supranational level have specified that these two principles require that:

[42] Section 7(4) Communications Act 2003.
[43] Section 3(1)(a) and (b) Communications Act 2003.

(i) Ofcom must be capable of demonstrating that its proposed course of action is soundly based on credible evidence and to a standard that should, as the CAT has previously emphasised, *"be sufficiently convincing to withstand industry, public and judicial scrutiny"*.[44] In practice, this means that factual analysis undertaken by Ofcom should be rigorous; the CAT has previously expressed concerns where findings are based on *"…little more than speculation"* or *"…inconsistent with the evidence."* [45];

(ii) Ofcom must ensure, consistent with the jurisprudence of the Community courts and the CAT, that where there are a number of courses of action available to it, the least intrusive or burdensome option should be pursued that attains its policy objective.[46]

2.7 We apply these core principles or obligations to the salient facts in this case and demonstrate there remain a number of potentially significant concerns about Ofcom's proposed approach; these concerns would call into question whether Ofcom's preferred approach to the regulation of fixed term communication services would be compatible with both of the above-mentioned objectives. Were these concerns not to be addressed in any final statement, there would be a material risk that they would be (whether individually or collectively) sufficient to vitiate that final statement.

3 Ofcom's evidence base

3.1 The consumer harm that Ofcom appears to have identified through its analysis relates specifically to the issue of changes in price for the fixed element of communications services contracts, namely that element that imposes a contractual obligation upon a customer to pay a fixed sum to its communication provider on a regular basis for a fixed period of time. For ease of reference, we use the term 'fixed-term charge' or 'fixed term services' in the remainder of this annex. Ofcom's concern appears to be two-fold:

(i) there appears to be a lack of awareness on the part of customers about the ability of their Communications Provider to increase prices over the course of the contract; and

(ii) customers consider it to be unreasonable that fixed-term prices should be increased mid-contract.

[44] *Vodafone v Ofcom* [2008] CAT 22, paragraph 47.

[45] *British Telecommunications Plc v Office of Communications* [2012] CAT 20 ("Pay TV"), paragraph 806.

[46] Case C-331/88, *R v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others* [1990] paragraph 13; *Vodafone v Ofcom* [2008] CAT 22, paragraph 51: *"The principle of proportionality requires that any action by OFCOM shall not go beyond what is appropriate and reasonably necessary to achieve their stated objectives. Also, where a choice exists between equally effective measures that might be adopted to address a problem, recourse should be had to the least onerous measure that will achieve the stated aims."*

In light of the above, Ofcom proposes additional guidance to improve transparency for customers, coupled with a revision for General Condition 9.6 enabling the customer to terminate a contract without penalty where prices are increased mid-contract. The precise scope of this new provision is characterised by an element of uncertainty; as we explain further in Section 4, the widest possible application of this new regulatory obligation would not be compatible with the principle of proportionality.

3.2 However, before examining the issue of proportionality, it is necessary to establish that Ofcom has established the existence of credible evidence demonstrating the need for a modification to the existing regulatory regime. The key evidence that Ofcom relies on to demonstrate the extent and scale of the consumer detriment in relation to mid-contract price rises comprises:

(i) logs of complaints that Ofcom received from consumers between September 2011 and May 2012; and

(ii) evidence set out in a complaint submitted to Ofcom by Which?

As we reveal below, both of these sources of evidence have a number of notable limitations that make it difficult for Ofcom to rely upon them safely when deciding upon the appropriate form of intervention.

3.3 Vodafone's reservations about the utility of the customer complaints data regarding changes to prices mid-contract and the extent to which reliable inferences can be drawn from such data are described at length elsewhere in this submission. Suffice it to say that detailed interrogation of the actual data reveals that the extent and level of customer dissatisfaction, when placed in a wider commercial and regulatory context, is unlikely to be as significant as Ofcom has claimed or sought to portray in its consultation document. On any objective analysis, it is difficult to examine a mere eight customer complaints over nine months out of a total Vodafone consumer post-pay customer base of [✂] [✂] about Vodafone's approach to price changes and extrapolate substantive conclusions about the extent of customer dissatisfaction and resulting harm about increases in fixed term contractual charges.

3.4 Even considering the complaints gathered in their totality, a total of 806 complaints spread across a total mobile fixed and customer base of 105 million customers (the figure cited by Ofcom) is not indicative of deep-seated levels of customer dissatisfaction or a significant level of risk faced by consumers under the current regulatory framework. More generally, it is of course important to highlight that Ofcom has not disclosed to industry stakeholders the actual complaints in their original raw form so it is not possible to verify the complaints or the way in which Ofcom has sought to classify these complaints.

3.5 Given the limitations inherent in the use of the customer complaint data described above and in other sections of this submission, it would have been incumbent upon Ofcom to conduct a survey across a robust weighted sample of the UK population to test the preliminary conclusions that it may have formed from a review of the customer complaints data. This would have been entirely consistent with the previously expressed expectation of the CC in cases involving the response of customers that "a robust survey [would] be important evidence that a regulator would seek to rely on."[47] Yet, Ofcom has chosen not to pursue this course of action, instead relying upon survey evidence provided to it by Which? about customer reactions to recent fixed-term price increases. As is considered further below, this survey evidence appears to have a number of deficiencies that do not appear to have been investigated or taken into account by Ofcom.

3.6 A useful starting point for assessing the robustness and the consequential reliability of survey evidence is the joint guidance issued by the CC and OFT about the methodology and approach to be adopted in the construction and conduct of surveys (the "Survey Guidelines")[48.] Although the Survey Guidelines were produced in the context of mergers, the key principles plainly have much wider applicability. In order for survey evidence to be robust and hold sufficient evidential weight, the Survey Guidelines state that it should:

- test a clearly-stated hypothesis;
- be representative of the relevant consumer population;
- deploy sound social research methods; and
- be reported in full, with supporting data available to allow key results to be replicated and tested.

3.7 In attempt to ascertain if Ofcom has acted in accordance with these principles, Vodafone therefore enquired as to the extent to which Ofcom had interrogated the Which? survey evidence, including the methodology employed and identification of the sample. The answers to these questions would enable Vodafone and other stakeholders to verify the weight being attached by Ofcom to this evidence. Given the centrality of this evidence to Ofcom's justification for regulatory intervention, this was plainly a legitimate subject for investigation. Ofcom's response to Vodafone indicated that: (i) it had not undertaken such an analysis or asked any questions of Which? to determine whether the survey evidence was reliable; and (ii) proposed that Vodafone should make its own enquiries of Which?.[49]

3.8 Had Ofcom posed such questions of the Which? methodology even at a high level, it would have discovered that the Which? survey was based on a population sample in which 77% of consumers were on a post-pay contract, a statistic that differs markedly from Ofcom's own data about the proportion of customers subscribing to post-pay contracts. This in itself raises questions

[47] CC Final Determination, 9 February 2012, paragraph 2.700.
[48] OFT and CC Guidance, *Good practice in the design and presentation of consumer survey evidence in merger inquiries.*
[49] Email from Ofcom to Vodafone 16 January 2013

about the extent to which the survey was carried out amongst a representative sample. Nor does Ofcom itself have appeared to considered the reliability of outputs generated from online research or the way in which questions were put to respondents (a number of which would be considered as leading the respondent); indeed, Ofcom itself has previously expressed material reservations about the use of online surveys on the grounds that they do not generate survey samples representative of the UK population. Ofcom has also previously noted that such online surveys raise concerns because there is no interviewer to clarify the questions or provide additional context to ensure that responses are reliable. These criticisms were made specifically in the context of an online survey conducted by Vodafone seeking to assess the likely impact of a particular form of regulatory intervention upon mobile consumers.[50]

3.9 In this context, it is also instructive to refer to more recent guidance provided by the CAT in the *Pay TV*[51] case about the importance of the way in which surveys are constructed and conducted:

- in *Pay TV*, the CAT noted that polling respondents exclusively online meant that they would be above averagely amenable to technology and not representative of the general public. This is akin to Which? surveying (i) the 139 members who subscribed to Orange and who were potentially more pre-disposed to a particular perspective over a sample from the wider general public who do not subscribe to Which?); and (ii) a YouGov panel of consumers (who volunteer in exchange for remuneration[52] to take part in surveys that are of interest to them, therefore tending to skew results away from reflecting the views of general consumers); and

- in *Pay TV*, a survey assessing different media platforms was criticised for being unclear on whether it had taken a sufficient spread of customers between the platforms. This is akin to weaknesses in the Which? evidence such as not providing details of the specific store brands visited during Which?'s mystery shopping exercise.

3.10 Ofcom's approach to the analysis and interrogation of survey evidence, with respect, falls some way below the standard described earlier that would be expected of a regulator seeking to ensure that its proposed course of action was consistent with its regulatory obligations and duties. We would accordingly query whether Ofcom is, in fact, in a position to assert that it has discharged its primary obligation to ensure that its proposed action is objectively justifiable.

[50] Ofcom, *Wholesale Mobile Call Termination: Statement*, 15 March 2011, Annex 5, paragraphs A5.16-A.5.17.
[51] *Pay TV*, paragraph 613
[52] http://yougov.co.uk/panel/join-yougov-panel/?sourceid=105442&gclid=CIa6ioiA9bUCFaHHtAodnSsAVw

4. Proportionality concerns about Ofcom's proposed approach

4.1 Setting aside the very real concerns described above about the credibility of Ofcom's evidence base, we assume for the purposes of a proportionality assessment that Ofcom is in possession of evidence that demonstrates the need for a modification to the existing regulatory framework. If this is the case, the central issue for consideration is whether the proposed modification is compatible with the principle of proportionality.

4.2 As general point, we note that Ofcom rightly identifies that it should conduct an impact assessment, pursuant to Section 7 of the Communications Act, to determine the appropriate form of regulatory intervention that it should adopt. An impact assessment is highly germane to the issue of proportionality since it should reveal – typically through a cost-benefit analysis – the least intrusive or burdensome regulatory option that would still deliver the most efficient outcome. In this regard, it is surprising that Ofcom has made no attempt to decide whether or not it would be appropriate to quantify the costs or benefits to industry stakeholders and consumers flowing from the four different regulatory options under consideration. Such an approach would be consistent with Ofcom's own stated preferred approach to the conduct of impact assessments, which has also been endorsed by the CAT.[53]

4.3 We note, for instance, that Ofcom has made no attempt to undertake an analysis of the potential consequences of its preferred option for consumer welfare as it is required to do by law when undertaking an impact assessment; Ofcom itself recognises that its preferred course of action may result in changes in the ways that Communications Providers currently subsidise handsets, but simply discounts the prospect of potential disbenefit to consumers. A meaningful impact assessment would, given the significance of the well-established handset subsidy model to competition and the interests of consumers, seek to assess the market-wide levels of handset subsidy invested by Communications Providers in the current market conditions and the corresponding impact on consumer welfare were consumers no longer to benefit from these current levels of handset subsidy. It is simply not credible for the purposes of an impact assessment Ofcom to rely upon an assertion that device pricing should remain attractive following the introduction of its preferred regulatory option.

4.4 In the main body of our submission, we highlighted how inappropriate and ill-considered regulation can adversely affect the ability and incentives of industry stakeholders to continue to invest in networks and services or to innovate in terms of products or services. Such an analysis of the dynamic effects of

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[53] Ofcom, *Impact Assessment Guidelines*, paragraph 2.1. In *Vodafone v Ofcom* [2008] CAT 22, the Tribunal referred to and endorsed the approach previously pursued by the CC in *E.ON UK plc and GEMA and British Gas Trading Limited* CC02/07 that "*if a CBA is to be transparent, benefits should be quantified where possible. For the same reason, qualitative benefits should be explained clearly and in detail, so that it can fairly be seen whether there is any potential overlap between the qualitative and quantitative benefits*."

Ofcom's preferred regulatory option would be considered a sine qua non in any credible assessment undertaken by a regulator of the impact of proposed regulation in economic efficiency terms[54;] it would seem particularly necessary when proposing a very significant form of regulatory intervention at a time of economic contraction with industry stakeholders in the highly competitive mobile sector face ever increasing challenges to current profit levels. This consultation document is, with respect, conspicuous for the absence of any attempt to undertake an analysis of the kind described above. Absent such an assessment, Ofcom is simply not in a position to safely conclude upon the scope of its proposed intervention.

4.5 Putting these concerns aside, in this case, Ofcom's primary concern, reflected in the title of its consultation document, relates to changes to fixed term contract charges. This is because, on Ofcom's own reasoning, fixed term contract charges create an obligation on the part of a customer to pay, over a specified period at regular intervals, certain charges for designated services; in the event of an increase in the level of the fixed term charge, that increase cannot, on a pure contractual analysis, be avoided by that customer without incurring an ongoing financial liability.

4.6 Ofcom notes that its analysis of the evidence relating to fixed term contract price increases points to two obvious areas for further consideration:

(i) a lack of awareness on the part of some customers of the ability of a Communications Provider to vary fixed term charges, suggesting that those customers may not be making informed decisions prior to entering into transactions; and

(ii) increases in fixed term charges are *per se* unjustifiable and customers should be given the ability to avoid their effects.

4,7 The lack of understanding on the part of some customers about the ability of a Communications Provider to increase the level of the fixed term charge points to a need for enhanced and more effective transparency measures, requiring Communications Providers to make clear at the point of sale the obligations to be assumed by the customer in relation to fixed term charges. The logical corollary of the introduction of such transparency measures would be customers being better informed about likely transaction costs before electing to make a particular subscription decision. Such an approach is entirely consistent with the principle of proportionality since it is targeted at the harm identified in the review of the evidence.

4.8 However, Vodafone's understanding of Ofcom's wider policy position is that the increases in fixed term charges are 'unfair' or 'unreasonable' (whether in a legal or a more general policy sense) because such increases result in unexpected

[54] Indeed Ofcom has previously acknowledged the need to consider the effects of regulation in dynamic efficiency terms; see Ofcom, *Wholesale mobile call termination*, Final Statement, 15 March 2011, paragraphs 8.45 and following.

additional costs that must be borne by customers. On the basis of that understanding, the principle of proportionality would require that any regulatory intervention would be limited and structured in such a way so as to enable customers to acquire the automatic right to avoid the effects of an increase in the fixed term charge. In practice, this would mean that a customer would be able automatically to terminate and exit a contract without penalty where the Communications Provider had elected to increase the fixed term service charge.

4.9 Such an approach would be plainly targeted at the harm revealed by the evidence obtained by Ofcom. Both the complaints data and the Which? survey evidence demonstrate overwhelmingly that the objection of the customers concerned related to increases in the fixed term charge, namely the regular (typically monthly) payment that a customer would make for the provision of a specified 'basket' of services over a fixed period of time. In such circumstances, there is no case for regulatory intervention to go any further than to enable customers to avoid the effects of an increase in the level of a fixed term charge.

4.10 In simple terms, if Ofcom's objective is ensure that customers are able, by virtue of the revised regulatory regime, to adjust their behaviour and respond to price changes in ways that were previously not possible, then every increase in those non-fixed term services for which regular payment is not obligatory should not automatically result in the customer having the right to terminate their fixed term contract without penalty. This is precisely because customers are currently not inhibited from adopting the appropriate response to increases in the level of charges for such non-fixed term services. The most obvious response on the part of a customer would take the form of a decision to significantly reduce usage of a particular type of service or even to cease to use the given service completely (and switch to alternative channel). The critical feature in either of these scenarios is that the customer has no existing contractual obligation to pay for such services on a regular basis over a specified period and is able to adopt a decision of their choice without financial consequence. As we explain subsequently in this annex, there remains a more proportionate way of ensuring that customers facing an increase in a non-fixed term charge remain protected under the regulatory framework.

4.11 Unfortunately, there appears a degree of ambiguity and inconsistency in Ofcom's approach to the scope of any proposed new regulatory regime that indicates that it has not fully applied the reasoning underpinning its justification for intervention to its logical conclusion. Ofcom recognises that where a customer has opted to pay for services in addition to those that would be provided as part of a fixed-term contractual arrangement – for example, a separate monthly 'bolt-on' for international calls – that customer should not have the right to terminate the wider fixed-term contract if the cost of the monthly bolt-on were subject to an increase. Such an approach is entirely consistent with Ofcom's proposed regulatory intervention in this case because the customer is not inhibited, in the context of a monthly bolt-on, to make an adjustment to their purchasing behaviour, most obviously through a decision to opt out of the bolt-on without incurring additional financial liability.

4.12 Yet Ofcom simultaneously considers that an intermediate category of services that are not subject to a fixed-term charge or part of a bolt-on should be subject to the scope of the proposed new regulatory regime. This would mean that the customer would have acquired the automatic right to exit from the fixed term contract even in circumstances where the fixed term contract charges had not increased. This reveals an evident incoherence in Ofcom's reasoning since there is no difference between these charges and those levied under a bolt-on; in both cases, the customer is able to adapt their existing behaviour in response to price increases without incurring any financial liability. The precise way in which the charges are levied (whether or not in the form of a bolt-on) is immaterial to the substantive analysis. Ofcom's current approach thus erroneously elevates form over substance and in so doing risks an inconsistent and incoherent approach to regulatory intervention.

4.13 The issue to be considered then is why Ofcom considers that the way in which non-fixed term services are sold merits differential regulatory approaches as described above. From the consultation document, Ofcom's central reason for including the intermediate non-fixed term services and charges in the scope of the proposed regulation appears to be an (unsubstantiated) assertion that that wholesale costs of providing these services can be forecast by Communications Providers easily and with uncertainty. Unfortunately, close examination of this argument reveals that it is not capable of being borne out by evidence; accordingly, were Ofcom to proceed on the current basis, it would do so in breach of its duty to gather and take into account all relevant facts and evidence.

4.14 It is indeed true to state that Communications Providers are able to form an assessment of the wholesale cost of some services that they provide at retail level. Unfortunately, these have not been the non-fixed term services claimed by Ofcom. Instead, in the retail mobile market it is the services that would typically form part of a fixed term contract – calls to mobile (on and off-net) and to fixed geographic lines – where costs are actually capable of being predicted with any degree of certainty. This is because the wholesale costs of these services have been subject to ex ante regulatory intervention for more than a decade, pursuant to the provisions of the provisions of the common pan-European Regulatory Framework.

4.15 This regulatory intervention at wholesale level has taken the form of a price control limiting the level of the wholesale charge for terminating a call on a mobile or fixed geographic network. Whilst the level of the price control may vary over time, the likely direction in the level of the charge controls can be forecast given that such controls can only be imposed following exhaustive market reviews and the construction of price control methodologies, both of which will be the subject of detailed and lengthy consultation. It is precisely because there exists a measure of certainty over the level of these wholesale charges (through the imposition of charge controls) that Communications Providers have been able to provide certainty for their consumers through the development over the past decade a basket of designated services that are subject to a fixed regular charge for a specified period of time.

4.16 By contrast, the intermediate services considered by Ofcom, such as non-geographic or international calls, are not (and have not been) subject to any ex ante regulatory intervention. As such, the wholesale costs associated with the provision of such services can be and are subject to significant and regular fluctuation. Elsewhere in this submission, Vodafone has provided credible and compelling evidence – specifically in the context of international call termination, directory enquiry services and non-geographic calls – demonstrating how these charges may be varied by the wholesale provider at a stroke. As a result of these significant (and frequent) variations at a wholesale level, Communications Providers are left with little option but to pass on such increases to their end user customers.

4.17 In the case of non-geographic calls, Ofcom's own detailed examination of the wholesale 'ladder' termination charges imposed by BT left it in no doubt that mobile Communications Providers would have little option but to respond to BT's wholesale charging arrangements by passing through the additional wholesale costs to customers or to mitigate foregone retail revenues from the origination of non-geographic calls by 'rebalancing' tariffs.[55] This evidence, including Vodafone's specific submissions, is already in Ofcom's possession and we would strongly urge Ofcom to take this evidence into account before reaching any decision about the scope of its regulatory intervention.

4.18 In this regard, it is important to emphasise that the charges for the level of wholesale input are not subject to negotiation between the wholesale provider and its customer (which might enable a Communications Provider to secure an element of certainty over cost); rather the evidence that we have provided relates to circumstances in which the wholesale charges have simply been imposed by the wholesaler upon the Communications Provider seeking to offer the service at retail level. This has been a critical reason behind the decision of Communications Providers not to incorporate the provision of such services as part of the fixed term contract. Once the nature of the commercial dealings relating to the terms on which wholesale inputs are supplied to Communications Providers is fully appreciated, it is difficult to sustain an argument that the Communications Provider is able to forecast reliably the level of wholesale costs that may be incurred.

[55] See Ofcom, *Determination to resolve a dispute between BT and each of Vodafone, T-Mobile, H3G, O2, Orange and Everything Everywhere about BT's termination charges for 0845 and 0870 calls, Final Determination*, 10 August 2010, paragraphs 9.19-9.26.

4.19 Ofcom may still wish to ensure that customers are not unduly affected by increases in the level of charges for non-fixed term services and enjoy a measure of protection under the regulatory framework. The simple and proportionate solution way of realising this objective would be, as Vodafone proposes, through the retention of the existing 'material detriment' threshold for non-fixed term charges. Under Vodafone's proposed General Condition 9.6, the customer who had suffered material detriment from a non-fixed term price increase would still be able to terminate a contract without penalty.

4.20 This approach would ensure that not every single increase in a non-fixed term charge would result in the customer having an automatic right of termination. Where the customer's use of the non-fixed term services is minimal or non-existent, proportionality would mean that such a right of automatic termination without penalty would be unjustifiable. However, if the increase is likely to be material to a specific customer, that customer would continue to benefit from the same level of protection that exists today under the current regulatory framework.

4.21 It would be a matter of concern if Ofcom were to maintain the current scope of its proposed regulation on the basis that any new regulation should be 'future-proofed' against some as yet unidentified consumer harm arising at some point in time. Were that justification be deemed to be a credible basis for regulatory action, it would enable Ofcom to operate in a potentially arbitrary way and render the specific provisions of Section 47(2) of the Communications Act for all practical purposes otiose. These provisions exist specifically because Parliament has expressly elected to limit the margin of discretion afforded to the regulator when performing its role in specific circumstances. In simple terms, in this case, Ofcom has no meaningful evidence at its disposal indicating the existence of or the potential for further harm relating to the provision of non-fixed term services (or charges relating to such services); to broaden the scope of regulatory intervention in such circumstances would plainly be in breach of Ofcom's requirement to act in an objectively justifiable and proportionate way.

5. Regulation should not be retrospective

5.1 We note Ofcom's proposal at paragraph 6.59 that any modification to General Condition 9.6 should only apply on a prospective basis to new contractual arrangements entered into by customers. Vodafone would endorse such an approach on the basis that it is consistent with the enshrined presumption that laws should not operate retrospectively unless there is a compelling justification for departing from that proposition.[56]

5.2 In a regulatory context, enforcing regulation retrospectively would be offensive and inimical to the principle of legal certainty upon which operators so heavily depend when making strategic commercial decisions, in particular those relating

[56] *R v Home Secretary ex parte Asif Mahmood Khan* [1984] 1 WLR 1337; *R v North and East Devon Health Authority ex parte Coughlan* [2000] 2 WLR 622.

to investment. As such, it would undermine the legal and regulatory consistency that Ofcom is obliged to attain as a matter of law. This line of thinking has been endorsed emphatically by the CAT:

> *The Tribunal agrees that it is good practice for the regulator to be consistent in its approach to issues in the sector. This is recognised in section 3(4)(a) of the 2003 Act which provides that OFCOM must have regard to "the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed". Consistency is important because companies need to be able to plan their business on the basis of how they reasonably anticipate the regulator is going to act."*[57] (Emphasis added)

5.3 The need for certainty and consistency is particularly compelling in this specific situation where Communications Providers have already made decisions about tariff structures and levels of device subsidy on the basis of an existing regulatory regime that does not provide customers with an automatic right to exit a contract without any financial liability in the event of subsequent variations in fixed term charges. We therefore endorse Ofcom's view that that there should be no compelling reason to pursue a course of action that would operate so as to undermine legal and regulatory certainty.

6. Conclusion

6.1 If Ofcom is minded to conclude that it intends to rely upon the evidence that it has gathered to date in support of a change to the existing regulatory framework, the analysis of that evidence in this legal analysis and the wider submission provided by Vodafone points to the need for the adoption of proportionate measures that are targeted solely at the concerns and potential harm identified by Ofcom.

6.2 In this case, proportionality would mean that any regulation must be focused on what Ofcom describes as fixed term charges, namely those regular fixed charges that the customer is currently contractually obliged to pay over a specified period of time. Amending the existing regulatory regime so as to enable the customer to terminate that contractual obligation without incurring any further financial commitment plainly achieves Ofcom's dual objectives of ensuring that customers are not surprised by any variations in future and, equally importantly, would enable customers to evade the effects of such charges.

6.3 By contrast, there is no case for an automatic and immediate right of termination to be extended beyond fixed term charges; as Ofcom itself recognises, its own limited evidence demonstrates that there is currently no concern being expressed by consumers about variations in non-fixed term

[57] *T-Mobile and others v Ofcom* [2008] CAT 12, paragraph 108.

charges; the absence of such concern is in large part likely to reflect the fact customers are already able to adapt their behaviour in response to such variations without incurring any financial liability. Moreover, the retention of the provisions of the existing regulatory framework for non-fixed term charges ensures that those customers adversely affected by increases in such charges will still be effectively protected. In these circumstances, a decision by Ofcom to adopt its preferred regulatory option unchanged would be in clear contravention of Ofcom's duties and obligations when imposing regulatory burdens on affected industry stakeholders.

Annex 3

Ladder pricing tables

Figure 1: BT charges for termination of calls to 080 numbers post 1 July 2009*

ONO Retail Charge (pence per min)	BT Charge (all times of day)
between 0.00ppm & 8.49ppm inc VAT	0 ppm
between 8.50ppm & 12.49ppm inc VAT	2.0000 ppm
between 12.50ppm & 17.49 inc VAT	4.5000 ppm
between 17.50ppm & 22.49ppm inc VAT	7.0000 ppm
between 22.50ppm & 27.49ppm inc VAT	10.0000 ppm
greater than 27.50ppm inc VAT	13.0000 ppm

***NB. No wholesale charges applied to the termination of calls to 080 numbers prior to 1 July 2009.**

Figure 2: BT Charges for termination of calls to 0845 and 0870 numbers pre-1 November 2009

No. Range	Day (ppm)	Evening (ppm)	Weekend (ppm)	Set Up Fee
0845	2.6654	0.8430	0.6422	2.0171*
0870	0.5600	0.2600	0.2000	N/A

* Although this was presented in BT's briefing document as being a set-up charge of 2.0171 pence per call, [✂]

[✂]

Figure 3: BT charges for termination of 0845 calls from 1 November 2009

0845				
OCP Retail Charge	Day (ppm)	Evening (ppm)	Weekend (ppm)	Set Up Fee
12.50 - 17.49	4.6654	2.8430	2.6422	2.0171*
17.50 - 22.49	7.1654	5.3430	5.1422	2.0171
22.50 – 27.49	9.6654	7.8430	7.6422	2.0171
27.50 – 32.49	12.6654	10.8430	10.6422	2.0171
> 32.50	15.6654	13.8430	13.6422	2.0171

* Although the set-up charge was advertised by BT at the rate of 2.0171 pence per call, subsequent BT documentation (including the first invoice issued pursuant to the new charging structure) has revealed that BT appears to be levying a set-up charge of 2.55 pence per call.

Figure 4: BT charges for termination of 0870 calls from 1 November 2009

0870			
OCP Retail Charge	Day (ppm)	Evening (ppm)	Weekend (ppm)
12.50-17.49	2.5600	2.2600	2.2000
17.50-22.49	5.1600	4.7600	4.7000
22.50-27.49	7.5600	7.2600	7.2000
27.50-32.49	10.5600	10.2600	10.2000
32.50 and above	13.5600*	13.2600*	13.2000*

* [✄]

[✄]