

9 May 2008

Sarah Evans
Consumer Policy Manager
Ofcom
3rd Floor
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2A Southwark Bridge Road
London SE1 9HA

Dear Sarah,

O2 (UK) Limited Response: Ofcom review of additional charges, Consultation, 28 February 2008

INTRODUCTION

1. O2 (UK) Limited (O2) welcomes the opportunity to respond to Ofcom's Consultation: "Review of additional charges - including non-direct debit charges and early termination charges" (the Consultation).

EXECUTIVE SUMMARY

2. O2 supports Ofcom's view that Minimum Contract Periods (MCPs) are "core" terms under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR). However, we believe that Ofcom's approach in relation to Early Termination Charges (ETCs) is fundamentally flawed in several areas:
 - i. Ofcom has erred in law in respect of the treatment of terms requiring payment of any remaining monthly payments where the customer terminates the fixed term before the expiry of the MCP, and in the manner in which it deals with mitigation of ETCs;
 - ii. Ofcom's intervention is not a "light touch" intervention but rather a direct intervention in the retail market - which brings with it significant regulatory risk;
 - iii. Ofcom proposes to tie retail prices (for ETCs) to regulated wholesale prices - and tying between markets is something which Ofcom has generally recognised as having the clear potential to introduce market distortions;

- iv. The LRIC model - upon which Ofcom proposes to rely - presents a range of challenges which need to be addressed. Furthermore, Ofcom must consider if LRIC is the right proxy to use in any event;
 - v. Ofcom intends to proceed without conducting an impact assessment.
- 3. O2 is strongly of the view that these aspects must be satisfactorily addressed. To the extent that Ofcom's proposals require changes to billing and IT systems, the proposed 3 months for compliance post Statement is inadequate and unreasonable.

OFCOM's APPROACH TO "EARLY TERMINATION CHARGES" IS FLAWED

- 3. O2 supports Ofcom's view that Minimum Contract Periods (MCPs) are "core" terms under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).
- 4. However, O2 believes Ofcom has erred in law in its approach to "ETCs" in two areas:
 - i. In respect of the treatment of a requirement to pay any remaining monthly payments where the customer terminates before the end of the fixed minimum term, and
 - ii. In the manner in which it deals with any mitigation of "ETCs".

Remaining monthly payments

- 5. Ofcom has erred in law when it suggests that a requirement to pay any remaining monthly payments under an ETC where the customer terminates before the end of the fixed term is automatically a "non-core" term and that it automatically falls to be assessed for fairness.
- 6. Customers with relevant mobile contracts are committed to a minimum period and, on early termination, are obliged to pay the annual charges for the remaining months of the MCP. Ofcom agrees that an MCP is likely to be viewed as a core term. The requirement to settle any remaining monthly payments is (as Ofcom recognises) at the heart of the MCP and so it must also clearly follow that a requirement to pay remaining monthly payments under an ETC is a core term in accordance with:
 - i. Regulation 6 (2) of the Regulations:

"6 (2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate-

(a) to the definition of the main subject matter of the contract, or

(b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange."

- ii. Also, Recital 19 of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts¹ (the Directive):

"Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject matter of the contract and the price/quality ratio may nevertheless be taken into account in assessing the fairness of other terms; whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;"

- iii. And OFT's guidance²:

"Terms setting the price or defining the product or service

Terms in consumer contracts which set the price or define the product or service being supplied are 'core terms' of the contract and are exempt from the test of fairness as long as they meet the plain language requirement."

- 7. Accordingly, we believe Ofcom must revise its approach in respect of remaining monthly payments.

Cost mitigation

- 3. A further area in which Ofcom's approach is flawed in law relates to Ofcom's proposal that ETCs should be reduced where costs can be mitigated. Mitigation of costs is dealt with in OFT's Guidance. However, Ofcom's guidance omits a key element of the OFT's approach within the OFT's Contract Terms Guidance (OFT311)³ at §§5.6-5.7, where the OFT states [our emphasis]:

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0013:EN:HTML>

² http://www.oft.gov.uk/advice_and_resources/resource_base/legal/unfair-terms/what-is-unfair

³ http://www.oft.gov.uk/shared_of/reports/unfair_contract_terms/oft311part2.pdf

“a penalty for wrongful cancellation that requires payment of the whole contract price, or a large part of it, is likely to be unfair if in some cases the supplier could reasonably reduce (‘mitigate’) his loss”; and

“There is unlikely to be any objection to terms which fairly reflect, in plain language, the ordinary legal position – that is:

- Requiring the consumer to pay a stated sum which represents a real and fair pre-estimate of the costs or loss of profit the supplier is likely to suffer.....”*

4. Ofcom has not reflected this in its approach. This must be corrected. O2's contractual approach is entirely consistent with §5.7b1 of the OFT Guidelines on UTCCR 1999, that is we make a reasonable pre-estimate of the profitability over the lifetime of the contract, including allowances for disconnections, and that consequently strict enforcement of the MCP (whether initial or subsequent) is justified. Such legitimate approaches must be recognised in any guidelines.

Consumer Choice

5. Furthermore, Ofcom gives no consideration to the fact that mobile competition has delivered a choice of innovative contractual options for customers (alongside lower prices) such that customers are not faced with a "take it or leave it" choice in relation to pay monthly contracts. The market provides many alternatives forms of contractual agreement:
 - Pay monthly contracts of various lengths (12, 18 and 24 months) – i.e. the customer can choose the level of commitment they wish to make and consequently they are positively choosing to bind themselves to an agreement of a given duration and economic cost.
 - Pay month "SIM only" contracts offering line rental, inclusive calls/ texts but without a subsidised handset on a simple 30 days notice contract.
 - Prepay contracts - which are generally recognised as doing more to bring affordable mobile telephony to segments of the market such as the unbanked and lower income groups than any USO intervention.
6. The mobile consumer is clearly not in a "take it or leave it" position and we are concerned that Ofcom does not appear to have taken this into consideration in its approach. Where there is clear consumer choice - and significant evidence that consumers are making those choices (witness the number of pre-pay and SIM only customers in the market as well as the level of churn and switching in the market) - then this must be considered in any

assessment of the fairness of terms. We believe this is entirely consistent with Recital 16 of the Directive:

"Whereas the assessment, according to the general criteria chosen, of the unfair character of terms, in particular in sale or supply activities of a public nature providing collective services which take account of solidarity among users, must be supplemented by a means of making an overall evaluation of the different interests involved; whereas this constitutes the requirement of good faith; whereas, in making an assessment of good faith, particular regard shall be had to the strength of the bargaining positions of the parties, whether the consumer had an inducement to agree to the term and whether the goods or services were sold or supplied to the special order of the consumer; whereas the requirement of good faith may be satisfied by the seller or supplier where he deals fairly and equitably with the other party whose legitimate interests he has to take into account;"

7. As the Consultation itself points out (Figure 2.2), there is very high awareness of the minimum contract term (70%). Furthermore, Ofcom also explains (see paragraph 5.32):

"The vast majority felt that once signed the contract should be honoured and ETCs were, by and large, accepted if the provider had kept up their side of the contracts."

8. We believe that Ofcom must take consumer choice - and hence the mitigation of any perceived abuse of power by the seller - into account in its approach.

OFCOM'S INTERVENTION IS NOT A "LIGHT TOUCH" INTERVENTION BUT RATHER A DIRECT INTERVENTION IN THE RETAIL MARKET - WHICH BRINGS WITH IT SIGNIFICANT REGULATORY RISK

9. We explain in the Annex 1, how a rationale firm sets its prices in the mobile market and the potential effect of interventions in relation to the MCP and ETC - what Ofcom refers to as the "water bed effect" in the Consultation:

"Ofcom accepts that any intervention to reduce the level of ETCs may give rise to suppliers reviewing other charges (such as upfront charges or monthly payments) or reviewing the length of MCPs. Ofcom accepts that this may happen and considers that transferring costs from charges which are relatively hidden, and incurred by relatively few consumers, to headline charges, which are constrained by competition, will lead to greater fairness for consumers, reducing the chance of an unpleasant surprise for those consumers" (paragraph 5.67).

10. Accordingly, Ofcom accepts that its interventions may affect retail prices elsewhere (and/ or the structuring of commercial terms and pricing plans). However, Ofcom does not consider the regulatory risk associated with such intervention.
11. This seems inconsistent with both the regulations and the directive. As the recent High Court ruling on unarranged overdraft charges⁴ points out, Regulation 6 (2) of the Regulations seeks to avoid intervening via a mechanism which introduces quality or price control:

"26. However the regime for consumer protection required by the Directive and established by the 1999 Regulations stops short of intruding upon parties' freedom of contract to the extent of introducing a mechanism of quality or price control: see Treitel, Law of Contract, (2007) 12th Ed. para 7-101, the 10th edition of which was cited with approval by Lord Bingham in the First National Bank case (cit sup) at para 12."

12. Yet Ofcom is proposing to regulate the level of ETCs charged by virtue of a formula based around LRIC. OFT's recently published research report: "Interactions between competition and consumer policy Economic discussion paper, April 2008"⁵ highlights the regulatory risk in intervention, identifying at least 5 drawbacks in relation to recent interventions regarding late payment charges on credit cards:

"Consider in more detail the case of late payment charges on credit cards. As an alternative (or in addition) to an informational remedy, such as making these charges more prominent when the consumer signs the contract, one could directly control the level of such a charge. Set against the beneficial impact on those consumers who end up paying the charge and did not realize it applied to them, there are at least five drawbacks to such a policy." para 5.12:

13. We believe that analogous drawbacks arise in relation to Ofcom's proposed approach.
 - i. The potential for asymmetric impact. Whilst Ofcom appears to have recognised the potential for customers to be affected by the "waterbed affect" of any package rebalancing, Ofcom does not appear to have considered the potential for its proposals to have an impact on the business plans of market players and as such the overall competitive landscape. For example, in mobile, where players have differing mixes of pre-pay (PAYG) and pay monthly bases, intervention (and indeed

⁴ http://www.ofcom.gov.uk/shared_ofcom/personal-current-accounts/Bank-charge-judgment.pdf

⁵ http://www.ofcom.gov.uk/shared_ofcom/economic_research/ofcom991.pdf

any subsequent rebalancing of contract packages) may have an asymmetric effect on an operator with a high proportion of pay monthly customers within its base.

- ii. Section B of the OFT paper refers to consumer policies which are “often heavily paternalistic” protecting the careless or vulnerable to the detriment of others.
 - iii. Paragraph 5.12 discusses credit card default charges. This is, of course, a very pertinent example in consumer law, whereby the OFT ensured a maximum charge of £12 by threat of legal action if the card issuers did not agree. Paragraph 5.14 says that “such a policy may be the thin end of the wedge.” That concession has been used to attack the banks on overdraft charges. It has resulted in higher interest rates to offset the loss of income.
 - iv. The friction between OFT consumer policy, in particular the 1999 Regulations, and competition can be illustrated as follows. If the credit card issuers agreed amongst themselves to all charge £12 on default, the OFT’s competition arm would no doubt quickly say that this contravenes the Enterprise Act 2002. However, the same result has been brought about, not by an agreement amongst businesses, but by the OFT itself; it is no answer to say issuers could charge less than £12 as, given that OFT has effectively set the market rate, there is little incentive to do so. The same result was achieved under the previous (1994) Regulations whereby, for some time, the maximum (and therefore standard) MCP was 12 months for mobile phones. This consumer policy of the OFT is creating standard terms across a particular industry which would never be tolerated on competition grounds if it was the product of industry agreement.
 - v. Similarly, in relation to ETCs, Ofcom's proposed intervention is to set a benchmarked regulated rate for mobile ETCs and, in respect of Ofcom's proposed transparency requirements, the effect is to create a standard form for presentation of various additional charges.
14. We believe Ofcom must consider these risks as part of a regulatory impact assessment (see below).

TYING BETWEEN MARKETS IS SOMETHING WHICH OFCOM HAS AVOIDED BECAUSE OF THE POTENTIAL TO INTRODUCE MARKET DISTORTION

15. Ofcom proposes that ETCs should be mitigated and proposes that a formula could be established to link ETCs to the regulated LRIC for mobile voice call termination. Linking between markets is something Ofcom has considered before. Ofcom's preliminary consultation on Mobile Call Termination, Market Review considered the appropriateness of linking changes in mobile call termination rates to (some definition) of retail prices as a mechanism to prevent excessive pricing of call termination.

16. In its subsequent consultation: Mobile Call Termination, Market Review in March 2006⁶, Ofcom concluded that "*retail tying yields significant challenges from both theoretical and practical perspectives.*" And Ofcom concluded:

Ofcom believes there are significant deficiencies in such a possible remedy, not least that the outcome may be materially different from an envisaged 'light touch' approach, such that its introduction, when considered in context, does not represent an appropriate remedy with regulation encroaching upon markets where it is not warranted and failing to target regulation in respect of mobile voice call termination.

17. We believe challenges exist in Ofcom's proposal to link retail ETCs to regulated LRIC, for example:

- i. Potential Distortions in Pricing Behaviour: Ofcom identified that a rational mobile operator will consider its commercial decision making in the round and hence will make pricing decisions taking into account the consequent effect on the linked market. Ofcom has been increasingly concerned about the level of litigation on its decisions regarding the mobile sector, in particular with regard to enduring regulation of voice call termination prices. To effectively up the stakes by tying retail returns to regulated prices does not appear to be aligned with the desire to rollback regulation of the mobile market, a desire that has been expressed at the highest level.⁷

⁶ <http://www.ofcom.org.uk/consult/condocs/mct/summary/mct.pdf>

⁷ Ofcom's Mobile Sector Assessment makes clear that a key element is to consider "*What is the scope for deregulation, competition and innovation in the mobile sector, and what does this mean for the future approach to regulation?*" See section 1.7 and elsewhere:
<http://www.ofcom.org.uk/research/telecoms/msa/msa.pdf>

- ii. Defining the starting point: there exist material differences between the mobile termination charges of the different operators. Such differences are the source of much debate and Ofcom recognised that it would be necessary to consider what the appropriate starting points would be for the different operators in order that the tying mechanisms would yield outcomes which would not favour one operator or one type of operator. Ofcom commented:

"It can be seen in this context, therefore, that the adoption of such an approach will not, if rigorously applied in practice, preclude the need for a detailed assessment of the appropriate starting point which, in turn, would require a degree of understanding of the cost structures of the existing operators and the relationships between prices for different services and their underlying costs. Furthermore, this challenge is exacerbated in the context of a requirement to recognise the deployment of 3G networks and the material differences in cost structures and business models that may exist across the operators."

- iii. Feedback loops: the LRIC model is based on traffic volumes. If "waterbed effect" changes in retail structures arise which affect usage volumes, then these volume changes are fed back into LRIC, creating a feedback loop.
- iv. Impact on investment incentives: The LRIC model takes one view of common and fixed cost recovery through one regulated product market (amongst many unregulated product markets). LRIC specifically does not ensure that common and fixed costs could be recovered in their entirety if all prices in the market, across all products, were set to LRIC. Furthermore, it is suggested that a forthcoming EC Recommendation will specifically preclude the recovery of fixed and common costs through call termination prices. In order to maintain investment incentives mobile operators will need to retain the flexibility to recover their fixed and common costs by setting prices flexibly across a range of products. Ofcom's March 2007 Decision on mobile call termination is currently before the Competition Commission, which will rule on, inter alia, the appropriate path of cost recovery for 3G spectrum within mobile call termination prices. O2 believes that for Ofcom to set retail prices with reference to (contested) mobile call termination prices may be severely prejudicial to the Competition Commission process due to complete by 31st October 2008.

18. Accordingly, O2 believes that Ofcom must reconsider its approach.

THE LRIC MODEL - UPON WHICH OFCOM PROPOSES TO RELY - PRESENTS A RANGE OF CHALLENGES WHICH NEED TO BE ADDRESSED. FURTHERMORE, OFCOM MUST CONSIDER IF LRIC IS THE RIGHT PROXY TO USE IN ANY EVENT

19. Ofcom proposes that both mobile and vertically integrated fixed providers can mitigate their loss (from early termination) because the inclusive call minutes, or the broadband capacity, that a consumer no longer uses, in effect "frees up capacity on the core network which can be reused by another (existing or new) consumer." Ofcom argues that this means ETCs should be reduced to reflect the costs which the supplier can avoid elsewhere and that the cost mitigated could be estimated by the long run incremental cost (LRIC) pence per minute multiplied by the number of minutes the average consumer on that package uses, or the LRIC per unit of broadband capacity multiplied by the average capacity used.
20. Ofcom's proposals in this respect give rise to a number of issues, including:
- i. LRIC is just one method of determining costs and it is not necessarily the one that suppliers may use to set prices;
 - ii. Demand side drivers on capacity are already inherent in network costs - to credit 'freed up' network capacity as Ofcom proposes would be double counting. The model already includes allowances for disconnections;
 - iii. Ofcom's LRIC model used to determine call termination costs assumes the costs of an "average efficient operator" - not the costs of a specific operator;
 - iv. The appropriate cost recovery method for mobile is currently a live issue before the Competition Appeal Tribunal (CAT)/Competition Commission (CC);
 - v. Ofcom's LRIC model has been developed and calibrated to determine the costs of voice call termination. Ofcom recognise that its LRIC model cannot be used to determine other costs without further development. For example, see the decision on Donor Conveyance Charges. However, Ofcom now propose to use it as a proxy for the bundle of services to which ETCs relate, including: call origination, text, data etc. It is clear that Ofcom would need to manipulate the LRIC model to be able to use it for the additional proposed purpose - and it is by no means clear that it could be used in this way.
21. We have no reason to presume that a project to make use of LRIC (or an alternative) in relation to ETCs in the manner Ofcom proposes will not require significant work for Ofcom

and industry. As the recent OFT Economic discussion paper: Interactions between competition and consumer policy for OFT (OFT991)⁸ observes at paragraph 5.13:

"Unless it is completely arbitrary, in order to calculate the basis for a 'fair' small-print charge, the authority will have to investigate detailed costs incurred by many firms on an ongoing basis, which will be resource intensive for both the authority and the industry."

And at paragraph 5.16:

"It seems fair to say that current economic understanding of good policy towards small-print terms is limited, and one of the most fruitful avenues for future research at the law and economics interface would be to investigate these issues further. For instance, what should determine a 'small-print' term? How many consumers need to take into account the term before it can be considered a 'core term'? Could the high charges for making mobile phone calls beyond the monthly allowance be considered a small-print charge, and therefore needing explicit control? Can a supplier make a contract term 'small print' for some consumers but, by making appropriate adjustments, a 'core term' (and so not governed by small-print regulations) for other, perhaps more sophisticated, customers? And, what economic principles govern the appropriate level of charges in those terms deemed to be small print in standard-form contracts? For example, one would not wish to permit mobile phone companies to be able to set arbitrarily high charges for phone calls beyond the monthly allowance, since at least some consumers will mistakenly go over the allowance. On the other hand, there is no reason to think that the company should be forced to sell these extra calls at cost."

22. Accordingly, we believe Ofcom must give very careful consideration to proceeding with its proposal in respect of LRIC.

THE LACK OF AN IMPACT ASSESSMENT.

The lack of an impact assessment

23. Ofcom explains that it is simply presenting its view on the application of the Regulations and as such it is not proposing new policy. Hence an impact assessment is not required. However, we note that Ed Richards recently refers to Ofcom's proposals in respect of ETCs as "a significant change"⁹.

⁸ http://www.offt.gov.uk/shared_offt/economic_research/oft991.pdf

⁹ <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmcomeds/uc494/uc49402.htm>. Ed Richards in response to Q3.

24. We disagree that there is no need for an impact assessment. As we discuss above, Ofcom proposes to intervene by requiring the use of a regulated formula to assess the fairness of ETCs. Such intervention is likely to have consequences - not only in relation to those areas that Ofcom identifies in relation to the "waterbed effect" but also have the potential for a structural effect on the competitive dynamic. Such Impact Assessment must be married with a clear proof that intervention is justified. We discuss this further in the next section.

Burden of proof for regulatory intervention

25. Ofcom explains that there is a "risk ... *that some of these additional charges are not constrained by competition, leaving it open to suppliers to set these charges in a way that does not reflect underlying costs and causes consumer harm*".
26. Ofcom's solution to this "risk" is to determine a "regulated rate" for ETCs by reference to benchmark formulas based on LRIC (or, in respect of broadband, LRIC and BT wholesale prices) rather than to rely on its ex post powers to enforce the Regulations. Furthermore, Ofcom further constrains competition by effectively determining that even if ETCs were provided transparently, consumers "may *still not always take them into account in choosing their supplier and service.*"
27. We believe that given Ofcom's bias against intervention, there is a high standard of proof that must be satisfied and that this must entail an impact assessment. Ofcom in its "*Better Policy Making – Ofcom's approach to Impact Assessments*" (February 2005), explains:

*"It should be borne in mind, however, that Ofcom's bias against intervention means that **a high standard of proof must be satisfied**. In other words, there must be a clear case for regulation, and the prospective benefits [of regulation] must exceed the costs. If a case for regulation can be made, we will choose the least intrusive means of achieving our objective."*⁴⁰ (emphasis added) ...

Regulatory clarity and certainty

28. O2 is a firm supporter of regulatory clarity and certainty wherever possible. Hence we welcome Ofcom's desire to consult in advance on its new guidance for communications "... *[spelling] out Ofcom's view of the law and what communications providers have to do to meet their obligations under the Unfair Terms in Consumer Contract Regulations.*"¹⁰

¹⁰ http://www.ofcom.org.uk/media/news/2008/02/nr_20080228

29. As Ofcom recognises "*ultimately a decision as to whether a term is unfair is a matter for the courts*" (paragraph 2.51). We do not consider that the guidance should be too dogmatic as the Courts will necessarily determine the question in the light of the wording of any particular term and in the context of the overall consumer contract.
30. Accordingly, we are concerned that in some areas, in particular, Ofcom's interpretation of the law in relation to "Early Termination Charges", is incorrect and inconsistent with OFT's own guidelines and the interpretation of the courts. This is unlikely to make it easier for providers to comply with the regulations (paragraph 2.51). This must be addressed.

The nature of complaints

31. In terms of the nature of complaints, we note that Ofcom remarks that some of the complaints appear to be more related to individual circumstances rather than the general principle. This would appear to be consistent with Ofcom's research showing the high awareness of MCPs and attitude to ETCs (paragraph 5.32):

"The vast majority felt that once signed the contract should be honoured and ETCs were, by and large, accepted if the provider had kept up their side of the contracts. However, if the provider did not provide the service as originally agreed, then consumers felt they should have a right to leave the contract without penalty."

32. The way that O2 deals with enforcement of MCPs fully reflects consumers' individual circumstances, rather than being entirely mechanistic as proposed by Ofcom.
33. Given the level - and nature - of complaints Ofcom cites at 5.18 to 5.20. For example, Figure 5.4 in the Consultation suggests that complaints in respect of mobile are running at around 25 - 50 per month. O2 believes this level of complaints must be considered in the context of the mobile market activity (connections etc). We would be interested to see complaints figures for January - April 2008 and if they continue to follow the downward trend started in December 2007.

The cumulative effect of transparency

34. We note that Ofcom does not provide an illustrative example of what an advertisement for mobile services might look like covering: headline prices, direct debit¹¹ and itemised billing prices¹².

¹¹ Ofcom maintains that if charges for direct debit are to be considered "core" and hence not subject to a "fairness" test, they must be given "equal prominence" on all marketing information - otherwise Ofcom will

- 35.** The Better Regulation Executive and the National Consumer Council's interim report "Warning too much information"¹³ recommends that policy makers ensure that before intervening to mandate the provision of information to consumers in specific forms, such intervention must be subjected to five tests:
- i. Have you defined the behavioural outcomes that you wish to achieve? (What do you want to achieve?)
 - ii. Will information provide a sufficient incentive for consumers to change their behaviour? (Is the information likely to be of value to consumers?)
 - iii. To what extent does the information fit with the wider system and simplify choices for consumers? (Will the information help consumers make choices?)
 - iv. Is the information aligned with business incentives, where this is possible? (Will businesses support or oppose what you are trying to achieve?)
 - v. Have you considered the fit with existing regulated information requirements? (What information is already there?)
- 36.** We believe that these tests are a useful tool and we would urge Ofcom to consider the transparency proposals in light of these principles.

consider compliance on a case by case basis. Ofcom provides an illustrative example of what a broadband advert might look like <http://www.ofcom.org.uk/consult/condocs/addcharges/mockup/>

Ofcom requires that customers must be made fully aware of any charges for itemised billing/ paper billing such that they (customer would regard them) as part of the essential bargain under the contract. Ofcom specifies that contract and marketing material must make information clear in a "prominent manner". We understand Ofcom thus intends there to be a difference between "prominence" and "equal prominence".

¹² We understand that other cited additional charges such as Cease charges/ late payment charges must be transparent within contract at point of sale - so they are not required to be included in adverts.

¹³ <http://www.berr.gov.uk/files/file44588.pdf>

Minimum Notice Period

37. Ofcom accepts that minimum notice periods (MNPs) are likely to be considered fair where they reflect the necessary administration of terminating service. However, Ofcom then goes on to say that Ofcom will consider action where MNPs are in effect longer than any formal regulatory migration process. Ofcom is confusing two aspects here, the administration of terminating service/ the customer's account and a regulatory requirement to effect migrations. It is quite possible that each process may have a different timescale. Furthermore, where there is a regulatory migration timescale, we are concerned as to why Ofcom considers that an MNP may be a barrier to switching - since the provider will be under a duty to effect switching within the set timescale.

Timescales

38. Ofcom proposes that it should allow the market 3 months following its Statement to implement any necessary changes. 3 months is unlikely to be reasonable in relation to a number of Ofcom's proposals. For example, in relation to ETCs, Ofcom proposes a benchmark formula using LRIC. As explained earlier, we would anticipate that taking this work forward will result in a considerable amount of debate and dialogue between Ofcom and industry such that it is unrealistic to expect completion and execution within 3 months. Furthermore, to the extent that Ofcom's proposals require changes to billing and IT systems, a timescale of 3 months will be unreasonable and impractical.

CONCLUDING COMMENTS

39. O2 supports Ofcom's view that Minimum Contract Periods (MCPs) are "core" terms under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR). However, we believe that Ofcom's approach in relation to Early Termination Charges (ETCs) is fundamentally flawed in several areas:
- i. Ofcom has erred in law in respect of the treatment of terms requiring payment of any remaining monthly payments under ETCs where the customer terminate the fixed term before the expiry of the MCP, and in the manner in which it deals with mitigation of ETCs;
 - ii. Ofcom's intervention is not a "light touch" intervention but rather a direct intervention in the retail market - which brings with it significant regulatory risk;

- iii. Ofcom proposes to tie retail prices (for ETCs) to regulated wholesale prices - and tying between markets is something which Ofcom has generally recognised as having the clear potential to introduce market distortions;
- iv. The LRIC model - upon which Ofcom proposes to rely - presents a range of challenges which need to be addressed. Furthermore, Ofcom must consider if LRIC is the right proxy to use in any event;
- v. Ofcom intends to proceed without conducting an impact assessment;
- vi. To the extent that Ofcom's proposals require changes to billing and IT systems, the proposed 3 months for compliance post Statement is inadequate and unreasonable.

40. These aspects must be satisfactorily addressed. O2 is strongly of the view that retail competition in the sector will be significantly destabilised if mobile operators cannot set their retail prices with reference to their own cost recovery criteria, rather than with reference to LRIC. Going forwards, tying the retail and call termination markets via this intervention is likely to lead to more, rather than less, focus on the quality of Ofcom's analysis on the cost of call termination services.

41. Finally, in the absence of an impact assessment, O2 struggles to see how Ofcom can act in this way without *"unbalancing what is possibly the most competitive mobile market in Europe."*¹⁴ One major operator has a predominantly post-pay base and may be affected asymmetrically by Ofcom's proposals when compared to other operators with more balanced customer acquisition strategies. On other matters, Ofcom has made much of the welfare benefits accrued by having five players in the UK market. It would be ironic if Ofcom's proposals with regard to MCP and ETCs were to materially impact overall consumer welfare by undermining the position of one of the market players.

Ian Roy
Regulatory Manager
O2 (UK) Limited

¹⁴ <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmcomeds/uc494/uc49402.htm> . Lord Currie of Marylebone in response to Q32