13 May 2008

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Ofcom

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Dear Sarah

Ofcom review of additional charges

Vodafone welcomes the opportunity to respond to Ofcom's consultation 'Ofcom review of additional charges – including non-direct debit charges and early termination charges' published on 28 February 2008.

Executive summary

1. We endorse Ofcom's belief that consumers need to be properly informed of charges that they may incur and that terms and conditions must be set fairly. Vodafone is committed to clear information on its charges and to its terms and conditions being as clear and user-friendly as possible.

2. Vodafone is concerned however by a lack of clarity in the consultation. Does the consultation just represent Ofcom's interpretation of a particular legal instrument (as asserted at paragraph 2.61) or is it an assertion of Ofcom policy? The latter belief would be evidenced by the term 'policy concern/s' being mentioned no fewer than 19 times throughout the document, page 12 having a section entitled 'Ofcom's policy concerns' and paragraph 2.22 asserting: "[w]e may also have additional policy concerns around competition effects and efficiency...".

   If the consultation is simply Ofcom's interpretation of a legal instrument it should not be used to forward Ofcom's policy agenda. If it is a policy document, then it should contain an impact assessment. Paragraph 2.24 asserts that: "[Ofcom] would expect much of these extra profits to be returned to consumers in the form of lower headline prices". Lower headline prices is just what has been happening and we would point to Ofcom's own evidence, from its last 'The Communications Market' report, that: "while consumers are getting more out of their communications services, the amount they are spending on them continues to fall"[1]. We would also highlight the observation that: "the largest like-for-like cost saving in 2006 was for mobile services, down 13%"[2]. In a policy document Ofcom would have to recognise – and account for – the potentially undesirable effect on the good functioning of the market of the 'waterbed effect' which Ofcom recognises as an issue in paragraph 2.24.

3. A further concern over the consultation as a policy document is that Ofcom seems to be selective in its evidence in places and its conclusions do not always reflect the evidence it provides. Ofcom does not seem to supply the 'high level of complaints' it mentions at 1.3. From paragraph 5.18, Ofcom

[1] Ofcom news release 'UK benefits from communications anytime, anywhere at lower cost' announcing 2007 report 'The Communications Market'
[2] Ofcom, 'The Communications Market', 2007, p.255

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seems to be receiving about 60 complaints a month in relation to early termination charges and minimum notice periods on mobile and highlights three main sources of complaints across platforms. And, although Ofcom does not give a break down, it is fair to deduce from these statements that the number of customers that leave a contract early (for reasons other than poor service) and who believe the absolute levels of ETCs are unfair, must be very small. This is certainly not evidence for such a radical shake-up of the contract side of the mobile communications market as proposed in the consultation.

We find further selective evidence at, for example, paragraph 3.14 which reports a high awareness of non-direct debit charges (74%) but Ofcom then feels it necessary to add: "we did not specifically restrict this question to suppliers of communication services, so this may also reflect awareness of, for example, energy companies". We would also point to figure 2.2, which shows a very high awareness of the minimum contract term (70%). And in paragraph 5.32 Ofcom states: "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."

Vodafone's concern about use of evidence is perhaps best exemplified by the 'vox pop comment boxes'. For a formal consultation document from an evidence-led regulator purporting (at least in parts) simply to interpret a legal instrument the comment boxes are quite extraordinary. They are selective, un-evidenced and tendentious – as well as being inappropriate for such a document.

4. Not recognising the very real differences between the mobile, fixed, broadband and Pay TV sectors compounds issues of clarity and does demonstrate a lack of rigour in the consultation framework. On the specific contention in the consultation that additional charges fall disproportionately on low-income consumers, or that they are excluded from communications services, Vodafone would note that this clearly is not a true reflection of the mobile communications area (and also that these are clearly issues of policy). Ofcom's own evidence is that mobile communications has a wholly suitable market-based solution to those who do not want a contract – and the costs associated with that – in the pre-pay mobile option. Regulating in the interests of low-income consumers where the market already addresses the issue is unhelpful and unnecessary.

5. We would also highlight specific concerns over the additional regulation of early termination charges (ETC). For Vodafone, ETCs are clearly provided for in the contract and are never more than the contract term. There does not appear to be the expectation among customers or an economic justification for changing the arrangements existing in the market to deal with customers that voluntarily leave contracts early. There is a clear understanding among customers that the justification for minimum contract periods is to allow time for the pay back of initial investment in a free or heavily subsidised mobile communications device. Overall a customer leaving a contract early is a cost, not a benefit, to a mobile network and Ofcom's sole focus on the supposed benefits – and not the costs – is a serious failing in what we have the right to expect to be a balanced consultation. By Ofcom's analysis, Vodafone should be encouraging its contract customers to leave early because it receives a benefit. This, of course, is not the case, because it ignores the cost to Vodafone of customers leaving early: Vodafone does not recoup its investment in handset subsidy, it is left with over-capacity and eventually customers end up with lower subsidies via the waterbed effect.

We would conclude by noting that Ed Richard's comments in Parliamentary Committee on ETCs would seem to demonstrate clearly Ofcom's intention to make a significant change to its rules on ETCs; not just interpret a legal instrument. Mr Richards commented: "What we have said on early termination charges is that they should never be more than the rest of the contract... That again is a <u>significant change</u> which we think is very clearly in the consumer interest[3]" (emphasis added).

[3] House of Commons (HC 494), Minutes of Evidence taken before Business and Enterprise Committee and Culture, Media and Sport Committee on Ofcom Annual Plan 2008-09, 22 April 2008

Abstract

Before responding to Ofcom's set questions, we wish to address the following overall issues in our response; which we address in turn:

1. Relevance of consultation given existence of pre-pay mobile telephony
2. Potential undesirable effect on competition and the good functioning of the market
3. Concerns over legal definitions of concepts such as 'due prominence' and 'transparency'
4. Use of evidence
5. Non-payment by direct debit
6. Legal concerns over proposed rules on early termination charges / minimum notice periods
7. Flawed economic analysis of early termination charges
8. Non-itemised billing

We believe that this response structure addresses the core issues with which the consultation is concerned.

1. Pre-pay mobile

Ofcom acknowledges the existence of pre-pay mobile by observing that:

> for many low-income consumers pre-pay mobile (for which such charges are clearly not relevant) is likely to be more appropriate than mobile contract [3.40]

We agree with this assertion but would draw the seemingly obvious conclusion that low-income should not be identified as a reason for intervention in the contract market for mobile communications. The market's pre-pay offerings are extremely competitive and are not – as some other markets – punitively more expensive for the consumer. Ofcom's own research indicates that only 14% of low-income consumers have a contract phone – leaving 86% choosing pre-pay.

We believe that Ofcom's consultation should have been significantly more robust in drawing out the distinction between markets where pre-pay is, and is not, a viable option and that any regulation must recognise this distinction.

2. Undesirable effect on market

Vodafone is concerned about the effect of Ofcom's proposed rules on the healthy functioning of a competitive marketplace which benefits consumer choice.

The market impact of putting pressure on the way businesses can charge can have a 'waterbed effect' on other prices – i.e. the cost savings apparently going to the consumer are simply placed elsewhere in the market place – for example lower handset subsidies. Vodafone sets out how handset subsidies work at annexe 1.

Vodafone would remind Ofcom that the mobile market is different to the fixed market, with often very significant handset subsidies, and free upgrades, so that consumers are able to have the mobile device they want. Not being able to get a legitimate return on a significant investment in a customer should not be considered desirable and potentially could lead to customers ending up with lower subsidies via the waterbed effect.

Vodafone highlights the OFT's Economic Discussion Paper 'Interactions between competition and consumer policy' and stresses OFT's belief that intervention should not occur in circumstances where the vendor has subsidised hardware:

> For instance, the excitement of test-driving a new car may lead to an impulse purchase, whereas after a few days the desire may end. In such cases, a mandated 'cooling-off period', or a required waiting period before purchase is possible, may be a useful policy to counter-act

> this effect. Historically, the same reasoning applied to mandated notice periods for getting married. Likewise, excessively onerous notice periods or early contract termination payments seem a fairly clear cut area for intervention, unless the supplier has made specific durable investments which need to be recovered via a long-term contract (such as offering a free mobile handset in return for twelve months guaranteed service) [p.48]

Vodafone also noted with interest Ofcom's mocked-up advertisement. We suspect that having to create such an advertisement would lead advertisers away from competing, in advertising, on price given how undesirable any material would look. We would also add that having to advertise in this way, for the mobile sector, seems wholly unnecessary as consumers do not have to have a contract if they do not wish one; pre-pay is a perfectly reasonable alternative.

A further effect of such rules around advertising could lead to the removal of offerings that are available by non-direct debit. Mobile networks are entitled to offer their products on the basis of consumers paying by direct debit only (indeed some do just that) and Ofcom should consider the effect in reality on consumers of overly restrictive rules on advertising.

Vodafone would conclude by noting the arbitrage risk to mobile communications companies of Ofcom's proposals. Subscribers would have the opportunity to set up numerous 'big bundle' contracts which would come with free of heavily subsidised high value devices and then subsequently cancel the contracts in short order, pay reduced ETCs – but keep the expensive, subsidised devices. This kind of arbitrage risk would quickly become unacceptable to mobile communications companies and the offering of high value devices for nothing – or near to nothing – may evaporate. So, if a consumer wants a high value device, he or she may have to pay the true cost of the device. This would be a fundamental shift in the economic model of one of the UK's largest sectors – one that Ofcom's own research demonstrates has served consumers well in terms of cost and choice.

3. Legal definitions

In section 2.41 Ofcom sets out Transparency as one of the key principles underpinning the Regulations and, at Annex A5.25, it sets out the key elements of the Regulations including Regulation 7(1), which requires all written terms of a contract to be expressed in plain intelligible language[4]. As part of the Transparency principle, Ofcom states that terms must in its view:

> … be set out with due prominence which reflects their importance to the parties. These requirements, which we link in the concept of "transparency", apply to both core and non-core terms

The requirement of "due prominence" does not appear in the Regulations and accordingly we do not see it as helpful for Ofcom to include in its statements of the key elements of the Regulations such a concept, when it is not part of the Regulations. In particular, Ofcom at section 2.43 records that there are areas where it has a policy concern that are not capable of being addressed directly by the Regulations. Given Ofcom's awareness of this, it is surprising that it then continues to develop its concept of due prominence without acknowledging that this is one such policy. This is not helpful and detracts from what it is trying to achieve.

The transparency requirements proposed by Ofcom go beyond the requirements of the Regulations as they seek to impose requirements on non-contractual marketing materials, as shown by the suggested marketing material samples released by Ofcom with this review. It is stretching the purpose of the Regulations somewhat to require regulations that cover unfair contract terms to cover marketing materials that do not form part of the customer's contract. This is shown in the next paragraph with evidence from the Unfair Terms in Consumer Contracts Directive (93/13/EEC) itself and the OFT Guidance. Transparency is an issue for contract terms but not marketing material.

[4] Regulation 7(1) is then set out in full in section A5.28

The OFT in the introduction to its guidance[5], whilst talking about the need for transparency, it is clearly in the context of the actual terms of the contract put in front of the customer when they sign.

> Thus terms may be considered unfair if the language used could mislead an ordinary person even though it might be clear to a lawyer, or if consumers are not given an adequate chance to read them before becoming bound by them

This focus on the terms of the contract and not non-contractual materials is supported by Recital 20 of the Directive which notes that: "… consumers should actually be given an opportunity to examine all the terms."

Naturally Vodafone does not object in principle to the concept of the due prominence as it fully supports clarity in marketing to consumers. But this concept is not embodied in the Regulations for the simple reason that there is already effective protection for consumers through existing consumer protection law such as the Control of Misleading Advertisements Regulations 1988 and the work of the Advertising Standards Authority (ASA) which works effectively across all industries, not just communications. Consumers are already adequately protected from misleading marketing.

Vodafone is also concerned about the implication of seemingly moving away from ASA regulation of non-broadcast advertising. Ofcom has consistently held up the ASA model as being a highly successful and respected regulatory model, worthy of emulation. We are confused as to why Ofcom sees it necessary to regulate in the ASA's stead and we are concerned that it could be seen as a criticism of the ASA which we do not believe would be a true reflection of its work.

4. Use of evidence

Vodafone would like to use this dedicated section to cite four examples of Ofcom's deployment of evidence in support of its policy aims.

a. <u>Complaint levels</u>

At 1.3 Ofcom states that it is receiving a high level of complaints. From Ofcom's statistics however it seems to be receiving about 60 complaints a month in relation to MCPs and ETCs on mobile (paragraph 5.18). Ofcom highlights the main sources of complaints across all platforms as:

- consumers dispute the termination charge because, for example, they have received poor (or no) service from their provider
- consumers claim they were not informed they were signing up to a contract which had a minimum contract period
- consumers complaining about the unreasonableness of the length of the MCP

Although Ofcom does not give a break down, it is fair to deduce from these statements that the number of customers that leave a contract early (for reasons other than poor service) and who believe the absolute levels of ETCs are unfair, must be very small. They certainly do not provide adequate evidence for the radical shake-up of ETCs on mobile contracts being proposed in the Guidelines.

b. <u>Minimum contract term and early termination charges</u>

From the information presented to Ofcom, it would seem that the customer would expect to honour his or her contract and does not have an expectation of cancellation charges that are lower than are currently offered by the mobile operators. Figure 2.2 shows a very high awareness of the minimum contract term (70%). In paragraph 5.32 Ofcom states: "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". This evidence does

[5] See last paragraph of the Introduction to the Unfair Contracts Terms guidance (ref OFT311)

not provide support for Ofcom's proposed guidelines on mobile contracts being proposed in the Guidelines.

c. Non-direct debit charges

We have further concerns over the use of evidence at paragraph 3.14 which reports a high awareness of non-direct debit charges (74%); but Ofcom then feels it necessary to add: "we did not specifically restrict this question to suppliers of communication services, so this may also reflect awareness of, for example, energy companies".

d. 'Vox pop comment boxes'

Given the document is a formal consultation, from an evidence-led regulator, which purports (at least in parts) simply to interpret a legal instrument, the comment boxes would seem to be quite unprecedented. The comments in these boxes seem simply to have been selected to justify Ofcom's preferred policy approach. We are given no criteria for their selection, they are un-evidenced, they are tendentious and they would seem to be unrepresentative. Although we have not had sight of the questions, it would seem they were along the lines of: 'would you rather (a) pay for something or (b) not pay for something'. It seems wholly inappropriate for these sort of comments to appear in a formal consultation document.

5. Non-direct debit charges

Vodafone agrees that non-direct debit charges can be either core or non-core terms and that, whether or not they are core terms, they should be clearly set out in the contract to satisfy the requirement of Regulation 7 but this should only apply to the contract terms and not the marketing material for the reasons described earlier. Accordingly Vodafone disagrees with Ofcom's guidance in so far as it relates to marketing materials.

We would add that Vodafone does not charge interest for late payment, though such charging is not unusual in other markets. We observe that the statutory rate for late payment is 12-13%, which we presume to be fair as this amount is court set.

We would observe that non-direct debit customers do present more of a revenue risk than those who do pay by direct debit and it is normal business practice to be allowed to account for risk. As our response to Ofcom's S135 on additional charges in August 2007 observed, non-direct debit customers account for 6% of contract customers, but 38% of bad debt. Even without this evidence however, we do not see the relevance of Ofcom addressing this area for mobile operators as there is in place a perfectly satisfactory pre-pay solution for those who want to avoid contract-related charges.

We would draw attention to Ofcom's point that:

> These figures [awareness of non-direct debit charge] indicate a widespread lack of awareness of the charges imposed by a consumer's own supplier [3.17]

We do not find this conclusion helpful. Whilst your research shows that 83% of mobile customers do not know that mobile phone suppliers charge for non-direct debit payments, 79% do actually pay by direct debit. It is only important for those who do not pay by direct debit to know the cost of not paying by direct debit. To argue that those who do pay by direct debit should be aware that there is a cost for not paying by direct debit is specious.

6. Legal concerns over proposed regulation of initial minimum contract period (MCP) and early termination charges (ETC)

Vodafone agrees with Ofcom that terms relating to a MCP are likely to be core terms of the contract and need to be set out clearly in the contract. For mobile communications services, MCPs are well understood by consumers as being 'part of the deal' in return for which they receive a free or heavily-discounted handset, and marketing material always states that a minimum term contract applies. In this situation our view is that, even if Ofcom's reasoning in section A5.58 that the marketing material is part of the circumstances attending the conclusion of the contract is correct, which is by no means certain, the terms are clearly set out and as they are core terms are not open to review by Ofcom. Indeed Ofcom fails to provide supporting evidence (from itself, from the OFT or from the Courts) for this view.

ETCs are clearly set out in the contract and therefore form a core term. In addition, such ETCs are expressed as a right for the customer to terminate their fixed term early and pay to the end of the minimum term. They are not charges for default, there is no additional element merely the charge that would have been levied if the customer had not terminated their contract within the minimum period (they also receive a discount for paying early).

This is similar to the right that a consumer would have if they were purchasing a car, for example, using credit provided under the Consumer Credit Act and were to pay back any credit balance on their car loan in advance of the agreed payment term; then the law would not classify this early repayment as a default payment. Ofcom action in an area where consumer regulation already exists would not be helpful for competition or the consumer and could affect the current competitive nature of the UK mobile communications market.

On subsequent minimum contract periods, Vodafone agrees with the principles of Ofcom's analysis in A5.79 but not with the guidance on how this may apply. There is no need for the contract that the customer initially signs to cover upgrades – the essence of the upgrade is that the customer agrees positively to set a new MCP in return for the benefit of a new handset or other incentive. As it is the choice of the customer whether or not to upgrade, there is no need under the Regulations to refer to this in the original contract provided at the time the new MCP is made clear to the customer.

7. Flawed economic analysis of early termination charges (ETC)

The Consultation states that operators receive a benefit from consumers breaching their contract, because operators 'avoid' investment in capacity for future consumers. Consequently, the financial impact of breaching usage contracts must take this 'benefit' into account (5.77-5.78).

While Vodafone can see how Ofcom views avoiding future capacity investment as a 'benefit' to MNOs, Ofcom fails to recognise that investment decisions have opportunity and option costs arising due to operators foregoing the ability to delay capacity investment. These costs arise because operators invest in capacity based on a legitimate expectation of traffic growth – influenced in part by contractual commitments – which when not met results in stranded investments. These stranded investments impose very real costs on operators. Unless foregone traffic is replaced instantaneously operators will incur a cost. In addition to the temporal aspect of opportunity and option costs, if the location, type and technology of replacement traffic does replicate the foregone traffic, operators will incur costs. These issues are discussed in more detail below.

Even if Ofcom holds onto its view that excess capacity imposes no opportunity or option costs on operators, Ofcom's economic analysis in the consultation is more akin to by Frédéric Bastiat's famous 'broken window fallacy' than to a regulatory impact assessment. The analysis is incomplete and fails to acknowledge the non-network costs that arise from subscribers breaching their contracts, such as foregone revenue and costs incurred in attracting and acquiring the replacement subscriber.

Irrespective of the methodological correctness of Ofcom's approach to the benefits and costs of contractual breaches, the overall impact on mobile networks in reality, is likely to small and insignificant. Ofcom's assertion that mobile networks build capacity in advance on the basis of traffic projections is of course sound. However the assumptions that flow from the contention that these projections are calculated net of leavers (pre-pay and contract within and outside of contract) are not sound, as the number who leave within contract is so small that it is not relevant to network capacity planning and is far outweighed by the margin of error involved in forecasting traffic demand. As Vodafone's response in August 2007 to Ofcom's S135 on additional charges observed, we have around [CONFIDENTIAL] early leavers a year, out of a customer base of over 18 million.

Opportunity cost of premature investment in capacity

The opportunity cost of premature investment is the cost of investing in assets before it otherwise would, thus stopping firms from using those funds to invest in other ventures / assets. The opportunity cost arises because:

1. the level of network investment is determined on expected future traffic for a certain period
2. the traffic level estimated for this period depends significantly on committed contractual traffic
3. once network investment has been committed, it is not reasonable to alter the investment due to the costs incurred and the planning period required to make investment decisions
4. once investments are made, they cannot be reversed (i.e. excess capacity is not removed from network)

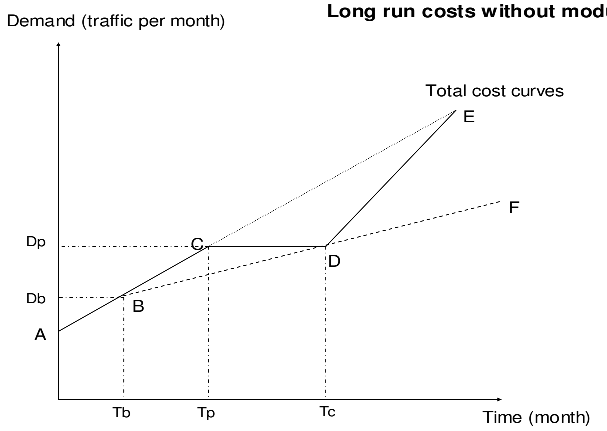
As an example, let us take the assumptions that a subscriber signs a 24 month contract and that the planning period for network investment is 24 months (i.e. operators commit to investments for 24 month periods and cannot change commitments in that timeframe). As such, the operator invests in capacity, based on the expected traffic growth as measured by the subscriber's contractual commitment. In the absence of the contracted subscriber's traffic, the network would incur a lower investment cost, reflecting the need to invest in less capacity due to less traffic. If after four months the subscriber breaches his contract, network traffic would justify a lower level of network investment. However, due to the planning period and the cost of stopping committed investments, the operator is locked into investment for the full 24 months. In addition, the irreversibility of investment means that the operator cannot remove excess capacity from the network.

For a given contractual length and investment level, the opportunity cost of breaching the contract depends on the timing of the breach relative to the planning period. That is, the further away the breach occurs from the time when an operator can adjust its investment decisions the greater the cost – typically breaches early in a contract. Similarly, the closer the breach occurs to the time of investment adjustment, the lower the cost – typically applying to breaches occurring late in subscribers' contracts.

Calculating opportunity cost using existing long run cost estimates

The opportunity cost of premature investment can be calculated by looking at the long run cost curve (Graph 2) of a firm and using the long run incremental cost (LRIC) estimates from existing regulatory models. At point A in Graph 2, consumers sign contracts to subscribe to an operator. If all subscribers fulfil their contractual obligations, the total cost curve corresponding to the growth in traffic is given by the curve AE. Assume that at point B, some subscribers breach their contracts and leave the operator. However, due to the planning and commitment period, the operator has committed to investment up to point C. This results in the cost curve moving from points B to C, even though traffic after the breach only justifies investment equivalent to the dotted curve BD. At the end of the planning and commitment period (point C), the operator can readjust its investment decision, but since it cannot remove committed assets, it can only hold investment constant until traffic reaches the capacity of the committed assets (point D). At that point the operator can invest as per traffic growth given the level of contractual breaches. The operator follows this cost curve until the traffic converges back to the long run traffic level at point E. If traffic does not converge, the cost curve will become ACDF. As can be seen, however, the issue of convergence after point D is not relevant to determining the opportunity cost incurred through premature investment.

Graph 2
Long run costs without modularity



The opportunity cost of the operator is given by the area between the solid curve ACD and the dashed curve ABD – triangle BCD. The value of this triangle is calculated by: LRIC[(Dp–Db)(Tc–Tp)/2].

So if the LRIC of traffic (originating and terminating cost) is 10 pence per minute, the difference between the traffic level at breach (Db) and the traffic level at end of planning period (Dp) is 287 million minutes of traffic per month[6], and the time between the end of the planning period (Tp) and the time when excess capacity is used up (Tc) is 12 months, the opportunity cost of subscribers breaching their contracts is £172.2 million. That is, the operator has foregone £172.2 million of other investments it could have undertaken because of subscribers breaching their contractual obligations.

Additional costs of premature investment

In addition to the opportunity cost, premature investment caused by contractual breaches removes operators' option to delay investment, invest in different locations or technologies, and the option to avoid investment in extra capacity. The removal of these options imposes real costs on the firm.

The costs imposed are particularly high in mobile industry where there are many factors to assess when deciding on capacity investment – not only on the timing of investment, but the location, service and generation in which to invest. For example, subscribers who have breached their contracts may have been subscribers to 2G phones in Scotland. As such, MNOs would have invested in additional TRXs in BTSs located in Scotland, more backhaul between Scottish BTSs and their relevant BSC as well as backhaul from the BSC to the MTX located elsewhere in the UK. However, due to the breach of contracts, this traffic is removed resulting in capacity in those assets in those areas. But there is no reason why that capacity would be replaced with 2G voice traffic based in Scotland. Rather, the growth in traffic could be in 3G HSDPA data coming from London. As such, while the aggregate level of traffic seen on the network may appear to grow and replace the foregone contractual traffic, the replacement traffic may be completely different from the foregone traffic. As a result, there would still remain excess capacity in particular areas of the network.
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8. Non-itemised billing

We would agree with Ofcom's analysis, at 8.17, that low-income groups are not seriously affected by itemised billing charges and that this issue is "relatively unimportant for low-income consumers" (8.39). We accept that customers should be aware of the additional charge in the contract they sign, but believe the evidence is against further intervention given Ofcom's assessment. We would add that our order form has a box that a customer has to tick for itemised billing and our order form has itemised billing as a separate line item in the summary of monthly costs also on the front page of the order form.

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[6] Assume that the time difference between Tb and Tp is one year. Therefore, difference between Db and Dp can be the difference between monthly traffic levels in 2006 and 2007. VFUK total monthly minutes (incoming plus outgoing) grew 638 million minutes in that period. Vodafone UK had in 2007 approximately 45% contract subscribers. Monthly contract growth can be approximated as 287 million minutes. Source: Analysys Market Matrix, April 2008.

Ofcom’s questions

Question 1: Do you agree that it is helpful and appropriate for Ofcom to issue guidance on the application of the Regulations to consumer contracts for communications services?

Potentially, but the current guidance is not helpful in many respects, and does not adequately recognise the market-based solution of pre-pay available to those who do not wish / cannot afford a contract.

Question 2: Do you agree with Ofcom’s proposed guidance regarding core terms and transparency?

No

Question 3: Do you agree with Ofcom’s proposed guidance (including any administrative thresholds we have set) on non-core terms to which we apply the test of fairness?

No

Question 4: Are there any other issues that are covered by the Regulations which Ofcom should give guidance on?

N/a

Question 5: Do you agree that three months is an appropriate period during which suppliers can adjust their terms and marketing practices to ensure they are in line with Ofcom guidance?

No, an implementation period of three months is not realistic. It would take significantly more than three months to get the order form and T&Cs changed (if required) and out to the stores (and all our dealers) for use.

If you have any questions about this response, please do not hesitate to contact me.

Yours sincerely

Richard Sullivan

Richard Sullivan
Regulatory Affairs Manager

ANNEXE 1

Categories of charges through which such costs are recovered

At its simplest, Vodafone's charges may be categorised as falling into three classes:

(i) up front and periodic charges: these comprise any upfront payment which the subscriber pays in order to subscribe (typically for handsets, SIM cards and connection fees) and, in the case of contract customers, any further monthly payments which the subscriber commits, at the outset, to pay later, or continues to pay after any initial contract term has expired. In the majority of cases the monthly payment carries an entitlement to a number of 'free' outgoing call minutes.

(ii) specific outgoing call charges: these comprise charges which subscribers pay for outgoing calls (not including any periodic payment); and

(iii) specific call termination charges: these comprise charges which interconnecting operators pay for terminating calls to a particular Vodafone subscriber.

Handset subsidies

Competition has driven operators to subsidise the up-front costs of subscription. Vodafone uses the term 'subsidy' to refer to a subsidy <u>per subscription</u>, not <u>per handset,</u> since the subsidy abates not merely handset costs, but other costs that the subscriber would otherwise be expected to pay at the point of subscription (i.e. the full incremental costs of subscription). For a particular section of customers the extent of the subsidy reflects their expected life-time value. Although the subscriber does not commit, at the time of first subscribing, that he or she will continue the contract beyond the expiry of the initial 12 month contract term, Vodafone's experience tells it that, in many cases, subscribers will do so, and Vodafone therefore factors into its pricing the likelihood that a proportion of subscribers will continue their contracts and thereby continue to make periodic payments. Vodafone expects the subscriber to continue to subscribe represents a means of sharing between Vodafone and the subscriber the risk that the subscriber will not wish to maintain the subscription for long enough to cover its costs: Vodafone is better able to assess and manage that risk (by pooling the risks associated with different subscribers) and, in effect, Vodafone bears the risk that the subscriber will not wish to maintain his or her subscription after the first 12 months. Put simply, customers who depart early receive an up-front subsidy on the expectation that, on average, customers stay longer on the Vodafone network than the initial contract period and typically make calls that are not covered by their bundle entitlement.