Prohibiting inflation-linked price rises

Non-Confidential response of Gamma

13th February 2024

About Gamma and this Consultation Response

Gamma Telecom Holdings Limited ("**Gamma**") is a Public Electronic Communications Network ("**PECN**") that provides wholesale fixed and mobile telephony and data services, to some 1,200 channel partners. Two of these channel partners are wholly owned subsidiaries and represent themselves over 20% of our business. In all cases, our partners and subsidiaries sell almost exclusively to all sizes of businesses and not-for-profit entities throughout the UK and increasingly to various European Union member states.

This consultation response relates to Gamma and its subsidiaries. Any conflict between the implied position of Gamma in any UK Competitive Telecommunications Association (UKCTA), Comms Council UK (CCUK) or Federation of Communication Services (FCS) responses or that of any other association in which Gamma is involved, or implies Gamma is involved, is accidental and we consider that our views in this response should prevail.

Gamma trusts that this response addresses the questions posed by the Office of Communications ("**Ofcom**") and would welcome the opportunity to elaborate on any points in more detail if required.

General Comments

We do not disagree that consumer sentiment is against CPI+x% based in-term price increases at this time. However, we consider that such sentiment is a transient issue which will become considerably less acute when inflation returns to the target level. We note that on two occasions in recent history, Ofcom have concluded that too much intervention in the market with respect to price rises was not proportionate, and we would encourage the independent regulator to place more weight on consistency with its previous decisions and be less reactionary to consumer sentiment and other pressures during a period of outliers in historical inflation rates.

Knock-on effects of restricting CPs from offering a service over a term for the same price *in real terms* may have a detrimental effect on switching and the development and update of newer innovative devices and services. Additionally, a fixed-price increase regime potentially introducing a risk premium at a higher margin than the common 3.9% added to

CPI today. Furthermore, the restriction to a fixed pounds and pence increase does not apply to the supply chain, who will continue to apply increase based on CPI (in keeping with the basis upon which their input costs are charged).

There is a very real danger that a fixed price increase, applied equally across a product base, will disproportionately impact lower income consumers on relatively less expensive tariffs. We do not feel that this is the outcome that Ofcom are attempting to achieve with the Consultation, despite BT's recent announcement implying that it is proposing to take such an approach[1]. Equally, Ofcom's flagship policies to promote switching, may be less successful if 'loss leaders' are discouraged, preventing consumers from engaging in the market in response to attractive headline prices outweighing their search costs.

There is no basis whatsoever for Ofcom, as it has proposed, to restrict telecommunications in the United Kingdom for consumers and small businesses to be solely in the medium of exchange of Pounds Sterling and nothing else; not even allowing US Dollar for business transactions or a Bank of England cryptocurrency if issued. No evidence has been adduced of harm through different mediums of exchange being used, and therefore as drafted, the proposed GC cannot be said to be proportionate. We presume this is an omission, and that it will be remedied in the statement.

No evidence of harm in business transactions

Ofcom's evidence base from the two questionnaires is consumer specific. While we have never argued that a sole trader does not act as a consumer (and note it is possible the research captured this porous boundary), Ofcom have adduced no evidence that there is harm in the 10 employee or fewer market and therefore cannot pass the statutory proportionality test as a result given that, as far as we aware, there was no comparable questionnaire carried out for the small business community. The purchase of an Ethernet circuit, with thousands of pounds of excess construction charges amortised over a five-year term to a sub-ten employee business[2] is a very different retail proposition to a residential

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[1] https://newsroom.bt.com/our-new-pricing-structure-for-the-future/ [accessed 12th February 2024]

[2] This is not an improbable scenario – some boutique businesses are very bandwidth heavy.

consumer purchasing a mobile device and as such, a sweeping assumption that a ten-employee business requires precisely the same protections as required by the residential Consumer risks unintended consequences.

We would question how Ofcom can adduce that the remedy for residential consumers is equally applicable to small business subscribers.

The alternative is that small businesses will be forced to waive all benefits of the Contract Information ('CI') and Contract Summary ('CS') structure in the relevant GC, just to obtain the commercial position they want (or that is offered by a CP – there is no requirement upon a CP to write business to a small business with a CI/CS, they can simply refuse absent a waiver). In fact, the position is worse, as the new GC suggests that a waiver is required by a small business prior to a sales call which might, for instance, be to discuss the price for an Ethernet circuit, and a separate one to cover CI/CS. This appears to be a disproportionate interference in a sales process for businesses, for which no harm has been adduced. The correct place for such a remedy is at the point of sale, not during hypothetical exploratory conversations.

Incompatible with other Ofcom policy objectives

Users of business communications services in the UK often enjoy the high upfront cost of their CPE being amortised over the term of their contract. Such amortisation provides them with a working capital improvement for businesses (and an improvement in liquidity for consumers). CPs must fix their price for the term and to do so *in real terms,* which is what a CPI+0% increase does, is hardly an unreasonable position – not least because that is what Ofcom use to regulate their wholesale inputs.

The proposed GC changes only apply to the contracting CP with the end customer. Ofcom have failed to take into account the supply chain and its contractual application of price increases. The supply chain will continue, where necessary, to apply increases on a CPI basis, regardless of the methodology applied to increase to the end user.

Some likely conclusions of Ofcom's approach will be (i) that contracting CPs introduce a risk premium for fixed price rises which may improve their margin at the expense of the consumer, in excess of the current CPI + x% approach or (ii) there will be a move away from the CPE- amortisation over a term approach which consumers and businesses enjoy, to a more commoditised no-lock in model. This in turn, perversely, may have an impact on switching if consumers are unable to afford the high upfront cost of new CPE, a reduction in the availability to consumers and businesses of the latest innovations as they defer purchasing decisions, a drive of consumers to less reputable credit sources to fund such purchases, or a reduction in working capital for businesses. To our knowledge, none of these potential impacts have been considered by Ofcom; the approach has simply been to cite the downside of the *status quo* and not consider the downsides of the proposed counterfactual.

Previous work by Ofcom in this field has focussed on fixing costs that CPs can control. CPI is a function of macroeconomic (and geopolitical) matters which is the purview of the central bank and Government. Also, given Ofcom regulates wholesale pricing by reference to CPI, then forbidding the use of CPI in retail models is incompatible with the previous precedent.

If Ofcom continues their stance on a pounds and pence only increase, then they must apply the same criteria to not only the upcoming market reviews but revise the current market reviews before applying the regulation. This is the only way that the contracting CP can forecast, with any amount of certainty, any supply chain increases and negate the need for an above inflation risk premium being applied, to the detriment of the subscriber.

Ofcom are correct that a large, well-resourced, vertically integrated CP is better able to forecast CPI than the average layperson. Ofcom, being an agent of the machinery of Government, which dwarfs even the largest private company in terms of budget and GDP, is even better places still to forecast CPI, suggesting that in future market reviews, Ofcom is best placed to fix, in pounds and pence, charge controls over future periods. Conversely, smaller CPs are less able to forecast CPI than their competitors. This leads to a potential where they include a higher risk premium in their forward pricing, to the detriment of their customers and competition, or, are caught out by high CPI being flowed down to them by wholesalers, putting financial pressure on the business supply market. There are at least 1,000 smaller retail CPs, who represent substantial innovation and choice for various vertical industries' telecoms needs, employing several thousand people. Any competitive distortion could have a catastrophic effect on the business market.

Incompatible with flagship Government policy

Ofcom has been very keen to ensure that there are low barriers to switching. The CPI+x% approach to pricing has afforded communications providers the ability to offer attractive rates for switching, which are subsidised by the year 2 increase. By creating a more attractive joining offer, end users are more likely to engage with the switching process, and it makes the search cost to potential benefit to be realised a wider margin, promoting switching. Removing this incentive may result in less engagement with the market for switching, which is directly contrary to Ofcom's stated aim in matters such as "One Touch Switch".

Matters in the welfare state such as the triple-lock on pensions suggest that CPI is understood by the population as whole. If CPI were not widely understood, contrary to Ofcom's research, then it would not be politically expedient for the Government to have so heavily emphasised the value of their flagship policy.

This further suggests the proposals are driven by the magnitude of CPI being the root of the problem, and not the mechanism itself.

Swapping one disliked mechanism with another at exactly the wrong time

The research performed by Ofcom fails to address a fundamental bias in consumer attitudes to price increases. Of course, consumers do not like them and will make such a sentiment clear in a survey.

We note that the script used for the survey identified Ofcom, who had previously been in the media about its investigation of inflation-linked price rises.

There is a risk that by announcing the survey is from Ofcom, and Ofcom's previous press releases in the area, that responses may have been matched to influence policy – how has Ofcom ensured this did not occur?

Suppose the question posed had been:

Would you rather know that your price was:

1. *(a) Fixed in real terms, so the price you pay over the life of the contract will stay the same, adjusted for inflation; or;*
2. *(b) Fixed in real terms but with an additional increase of 3.9% added, so the price increases by 3.9% year on year over and above inflation (or more if inflation is negative); or;*
3. (c) *Increases by £3 per month for broadband contracts, and £1.50 per month for mobile contracts, each April, regardless of the rate of inflation at the time.*

One presumes that most respondents would have preferred (a). For the avoidance of doubt, the figures used in (c) are those BT has proposed to use for its annual monetary increases. In April 2024, with January CPI at 4%, this results in a 7.9% increase with the 3.9% added in accordance with their current terms, and those used by many providers of consumer services. BT's ARPU on connectivity services sold to consumers is £36.20 per user per month[3]. Therefore, assuming a post-April-2024 ARPU of £39.06, a £3 monthly increase is an effective 7.7% rise, against a backdrop where the consensus is one of inflation continuing to fall back to lower levels. Thus, it would appear, based on the evidence available, that BT is taking a commercially reasonable position of applying an additional risk-premium which, ironically, is not in the interests of consumers.

Additionally, the application of a £3 monthly increase, regardless of broadband variant, is a disproportionate penalty on those only able to afford a lower bandwidth product. Do Ofcom consider it fair and proportionate that a low-income household paying for example £26 per month is subject to the same pound and pence increase as that of a subscriber buying a 500Mbps full fibre broadband circuit?

Notwithstanding the disparity between service variants, 7.7% year-on-year price rise across a multi-year contract against a backdrop of inflation at 2% could, quite legitimately, be

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[3] Statista article [accessed 12th February 2024]: https://www.statista.com/statistics/290306/british-telecommunications-bt-consumer-arpu/#:~:text=ARPU%20of%20British%20Telecommunications%20(BT,FY%202015%2D2023%2C%20by%20quarter&text=The%20customer%20average%20revenue%20per,34.4%20British%20pounds%20per%2

argued to be harming consumers who purchased a long-term service. It is akin to the regrets a consumer may have if they had ‘fixed’ their mortgage rate at a time of high interest rates, only to see them fall. The main differences are a) in the mortgage industry, ‘tracker’ variants are allowed, and, b) one would expect the consumer to take a higher degree of care in selecting a mortgage when compared to a telephony package that, on average, represents just 3.5% of their monthly spending[4]. Might Ofcom consider allowing an indexed linked ‘tracker’ tariff in addition to a fixed monetary increase? This may serve to provide better value to consumers and ensure providers are transparent with the risk premiums applied to the fixed monetary increases.

We know, from many years’ experience (notably in the introduction of the unbundled tariff in NGCS) that consumers attention (in mobile) is on the headline price, the number of gigabytes and the new phone, with an equivalently holistic view taken in other PECS purchases. Their attention is not taken to access charges, to ancillary charges, to international call rates, to roaming rates etc. Which means, it is unlikely to be taken to the fixed price increase proposed. That would result in there being very little net benefit to society for the changes proposed – consumers will still be annoyed and allege harm when 12 months have lapsed, and a price rise comes in, even if the new regime means the required mathematics calculation has been performed for them.

That would suggest the solution is an outright ban of any price change; but Ofcom have previously examined that twice before and concluded it would not be proportionate, for very good reasons.

A failure of fiscal policy is not a failure by the industry.

The inferred harm only became acute enough to be a significant part of Ofcom’s policy work when CPI was running at record levels. Twice before Ofcom have concluded the regime

[4] https://www.assemblyresearch.co.uk/press-comments/value-of-telecoms-in-the-uk-2023

which allowed CPI-based price changes were proportionate and acceptable, both times when the Bank of England was broadly meeting its targets.

We do not believe that an interventionist policy (including affecting the traditionally *caveat emptor* business market) is the correct solution to a failure by the Bank of England to maintain its 2% inflation target.

Restricting the medium of exchange to Sterling

The language of the proposed modification to the GCs limits any interaction with a consumer, or a small business which has not waived its right to a CI/CS (or more generally), to being just in pounds and pence if that interaction involves a price increase during the term.

That is an overly restrictive approach, for which Ofcom has not adduced any evidence as to whether it is suitable to restrict the market in such a fashion. As such, Ofcom cannot be found to have met the proportionality test required of it in the Act.

For example, it is not uncommon for business software to be denoted in US Dollars. The market for eSIMs for roaming is widely denoted in US Dollars, even for UK purchasers, and Ofcom will effectively outlaw this, meaning consumers and businesses will be forced to pay a risk premium for the foreign exchanges costs now thrust upon them as a result of this policy (itself a cost that Ofcom have not considered in the impact assessment or proportionality). It is also contrary to Ofcom seeking a simple and obvious answer for someone weighing up a purchase. For a contract to be in US Dollar, with an increase expressed in pounds and pence. The mathematics and forecasting to perform that calculation is more difficult than that to perform a CPI+3.9% adjustment.

It also precludes trade in cryptocurrencies (the Bank of England is considering issuing its own coin[5]), and raises questions about paying, or part paying for a PECS with Nectar points,

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[5] https://www.bankofengland.co.uk/news/2023/february/hm-treasury-and-boe-consider-plans-for-a-digital-pound [accessed 30th January 2024]

or Avios etc. To our knowledge, the only law that comes close to such a restriction is the very narrow definition of legal tender and that only relates to what can and cannot be refused in the settlement of a debt – otherwise the UK's common law legal system has a very wide concept of consideration.

If we were to accept that a fixed-price increase was required in the GCs as opposed to allowing CPI+x% (which we do not), the correct approach would be to limit increases to be a fixed amount in the medium of exchange in which the contract is governed. This would mean that for a US Dollar contract, the fixed increase would have to be specified in dollars and cents. For a bitcoin denominated contract, in an amount of bitcoin and so on and so forth.