TalkTalk
For Everyone

NON-CONFIDENTIAL VERSION

Prohibiting inflation-linked price rises

Ofcom proposals for new rules and guidance

Comments by TalkTalk

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Introduction

TalkTalk welcomes the opportunity to comment on Ofcom's proposals for new rules and guidance according to which contractual inflation-linked prices rises would be prohibited. As the UK's 4th largest CP, and the only national value player at scale, we are concerned about these proposals, their potential for counter-productive (and unintended) consumer impacts and the lack of coherence with current wholesale price regulation of Openreach.

By way of overview, Ofcom is proposing that wherever telecoms or Pay-TV providers apply in-contract price rises, they would be required to set these out clearly and up-front, in pounds and pence (£/p), when a customer signs up.

The £/p requirement would stop providers from including inflation-linked, or percentage-based, price rise terms in new contracts. Providers would be able to increase their prices during the contract period, but any price rises in contracts would need to be set out in pounds and pence, prominently and transparently, at the point-of-sale.

Ofcom proposes that the new requirement would come into force four months after the publication of Ofcom's final decision in 2024.

We are concerned about Ofcom's proposals for the following main reasons:

(i) Ofcom's proposals need to address the fact that its wholesale price regulation allows Openreach to increase its prices to TalkTalk and other CPs at the rate of CPI every year. TalkTalk is not currently able to pass through Openreach's price increases in full into a competitive retail market. Ofcom's proposals to ban CPI+ contracts put a further squeeze on TalkTalk's ability to recover its costs. This also puts TalkTalk at a commercial and competitive disadvantage compared to vertically integrated network and retail operators like BT and Virgin Media.

(ii) Ofcom has explicitly allowed inflation-linked price variation terms in consumer contracts for over a decade now. By doing so, Ofcom has set reasonable commercial expectations that providers would be able to use inflation-linked price variation terms in consumer contracts. It is therefore unreasonable and disproportionate for Ofcom completely ban these terms within only 4 months from its final decision. This is not a reasonable timeframe to deliver such a major change across the industry. If

Ofcom are to pursue this, a longer transition is required to ensure these changes are implemented smoothly without causing customer confusion.

(iii) Ofcom's analysis ignores the significant improvements in consumer satisfaction in the broadband market over the last decade and exaggerates the consumer frustration harm allegedly caused by inflation-linked price variation terms.

(iv) Ofcom's proposals may actually be counterproductive for consumers in that they may end up paying more than under the current regime. CPs will need to assess how to manage the risk of fixed mid-contract retail price rises in pounds and pence, against an unknown inflationary background and therefore unknown wholesale price increases from Openreach and Altnets. CP may end up pricing their retail services significantly above where inflation eventually lands to avoid the risk of margin squeeze. This would result in consumers paying more for services than they would with mid-contract price rises based on inflation.

We set our arguments in more detail in the following sections.

1. Ofcom's proposals put TalkTalk at a competitive disadvantage compared to other retail providers

Ofcom's proposals are in direct conflict with its overall economic regulatory policy whereby Ofcom allows Openreach to increase its key wholesale costs by CPI every year. [redacted]. It is unfair and unreasonable for Ofcom to dictate that TalkTalk should now bear the sole burden of any potential increases in the cost of inflation.

Openreach continues to have a dominant position in the network access market and, as such, faces a limited financial risk from competition. Although competition is expected to emerge from alternative network build, Openreach's position as a dominant provider is very unlikely to be challenged still for some time. In contrast, TalkTalk is exposed to significant competition in the consumer retail market for broadband and telephony.

Ofcom's proposals significantly constrain TalkTalk's ability to pass on inflationary price increases from Openreach into these retail markets. This regulatory change therefore risks putting TalkTalk at an increased competitive disadvantage compared to large, vertically-integrated providers like BT (and also to some extent Virgin Media). Inflationary price increases by Openreach effectively take the form of accounting transfers or 'wooden dollars' which pass from it to BT's retail operations whereas payments by TalkTalk to Openreach represent real costs.

It is well-established that the downstream business in a vertically integrated faces a different set of constraints and incentives from those of its third-party rivals which are likely to give it a significant advantage. Even with the current regulation of Openreach and its separation from BT Group, it is problematic from a competition point of view that Ofcom chooses to implement retail market measures without making the corresponding changes to wholesale regulation, i.e., removing the ability of Openreach to increase its prices in line with inflation.

2. Ofcom's proposals conflict with its own explicit regulatory policy over the last 10 years

We do not believe that Ofcom is painting an accurate picture of the adoption by providers of inflation-linked price variation terms in the UK and how Ofcom has explicitly allowed such terms since 2013 (we believe some mobile providers had been including such terms in their contracts long before that without any Ofcom enforcement action).

When Ofcom last consulted substantially on the issue of mid-contract price increases in 2013, it originally proposed in its consultation that mid-term increases to the core subscription price would require the provider to give the customer the right to exit their contract. Originally, Ofcom's preferred option was then that:

> "*consumers [should be] able to withdraw from a contract without penalty for any increase in the price for services applicable at the time the contract is entered into by the consumer (including changes to the level of service provided which effectively constitute a (unit) price increase).*" [1]

Following consultation, however, Ofcom changed its mind to explicitly allow inflation-linked price increases in consumer contracts. Indeed, Ofcom acknowledged as relevant that:

> *"increases in costs outside CPs' control and the CPs' difficulties in forecasting and controlling those costs, together with the potential for price increases for relevant subscribers as a result of CPs adding on a "risk premium" to their charges were we to adopt our consultation option [set out above]."*[2]

Ofcom accepted that:

> *"in principle some benefits may accrue to consumers from rules allowing CPs to increase prices in fixed term contracts. First, such increases may allow a CP to preserve service quality and/or service availability in the face of unanticipated cost increases. Second, if CPs are able to pass on cost increases in higher prices this removes the need for CPs to incorporate a 'risk premium' to reflect the cost uncertainty.*
>
> *We accept that our guidance will constrain the ability of CPs to pass on increased costs through increases in the core subscription price. Accordingly, there is a risk in principle that this could impose costs on consumers in the form of a loss of the type of benefits discussed in the previous paragraph."*[3]

In its current consultation, Ofcom fails to acknowledge that it originally accepted in 2013 that inflation-linked price increase clauses in consumer contracts strike an important balance between providers' ability to control costs and consumers' ability to navigate prices and

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[1] "Price rises in fixed term contracts. Options to address consumer harm", Ofcom consultation document, 3 January 2013, https://www.ofcom.org.uk/__data/assets/pdf_file/0031/29299/condoc.pdf.

[2] Price rises in fixed term contracts, Ofcom Decision to issue Guidance on General Condition 9.6, https://www.ofcom.org.uk/__data/assets/pdf_file/0017/38042/gc9_statement.pdf, paragraph 6.121.

[3] Price rises in fixed term contracts, Ofcom Decision to issue Guidance on General Condition 9.6, https://www.ofcom.org.uk/__data/assets/pdf_file/0017/38042/gc9_statement.pdf, paragraphs 6.125 to 6.126.

associated terms in the mobile and fixed communications market. Over the last ten years, providers have adjusted their commercial practices to comply with the regulatory environment clearly set out by Ofcom.

Ofcom confirmed its acceptance of the use of inflation-linked price variation terms as late as in June 2022 when it introduced the requirements for providing contract summary and contract information documents at the point of sale. At that time, the CPI was also significantly higher at 9.4% but Ofcom continued to allow inflation-linked price variation terms. Ofcom even strengthened the information requirements at that point in time by requiring providers to provide an illustration in pounds of the likely annual price increase calculated in accordance with their inflation-linked price variation terms. In its contract guidance (which remains in force today), Ofcom says it expects *"providers to provide an example to the customer of how such a price term is likely to affect the price they will pay. If the increase is by reference to an inflation index, then providers should use the most recent value of that index."*[4] When TalkTalk implemented the necessary sales system and process changes to comply with these requirements, it made sure that the contract summary and information documents do indeed contain this additional information to provide the customer with the enhanced transparency of its inflation-linked price variation term.

[redacted] TalkTalk followed all the relevant Ofcom guidance (as formally introduced in January 2014) as well as observed industry best practice in terms of customer transparency at the point of sale. TalkTalk amended all marketing materials, TalkTalk's website, online sales journey, agent compliance scripts and welcome emails/packs to ensure that the relevant price terms are sufficiently prominent and transparent that the customer could indeed be said to have agreed on an informed basis, at the point of sale, to the tiered prices during the minimum term.

Based on Ofcom's longstanding practice of explicitly allowing inflation-linked price variation terms in consumer contracts (which was reaffirmed in June 2022 when the requirements around contract summary and information entered into force), it was fair and reasonable to expect that the regulatory framework would continue to support this practice.

TalkTalk introduced an inflation-linked price variation terms in its consumer contracts to protect itself from the inflation-linked (CPI) increases in the wholesale prices charged by Openreach as allowed by Ofcom in the Wholesale Fixed Telecommunications Market Review.[5]

Ofcom's proposals to ban inflation-linked price increases represent a U-turn in its decade-old policy and leaves TalkTalk in a position where it has little choice but to take on much more

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[4] Ofcom's guidance under General Condition C1 – contract requirements (December 2023), https://www.ofcom.org.uk/__data/assets/pdf_file/0028/229852/ofcom-guidance-general-condition-c1-contract-requirements.pdf, paragraph 1.23.

[5] Ofcom Statement: Promoting investment and competition in fibre networks – Wholesale Fixed Telecoms Market Review 2021-26, https://www.ofcom.org.uk/__data/assets/pdf_file/0022/216085/wftmr-statement-volume-1-overview.pdf.

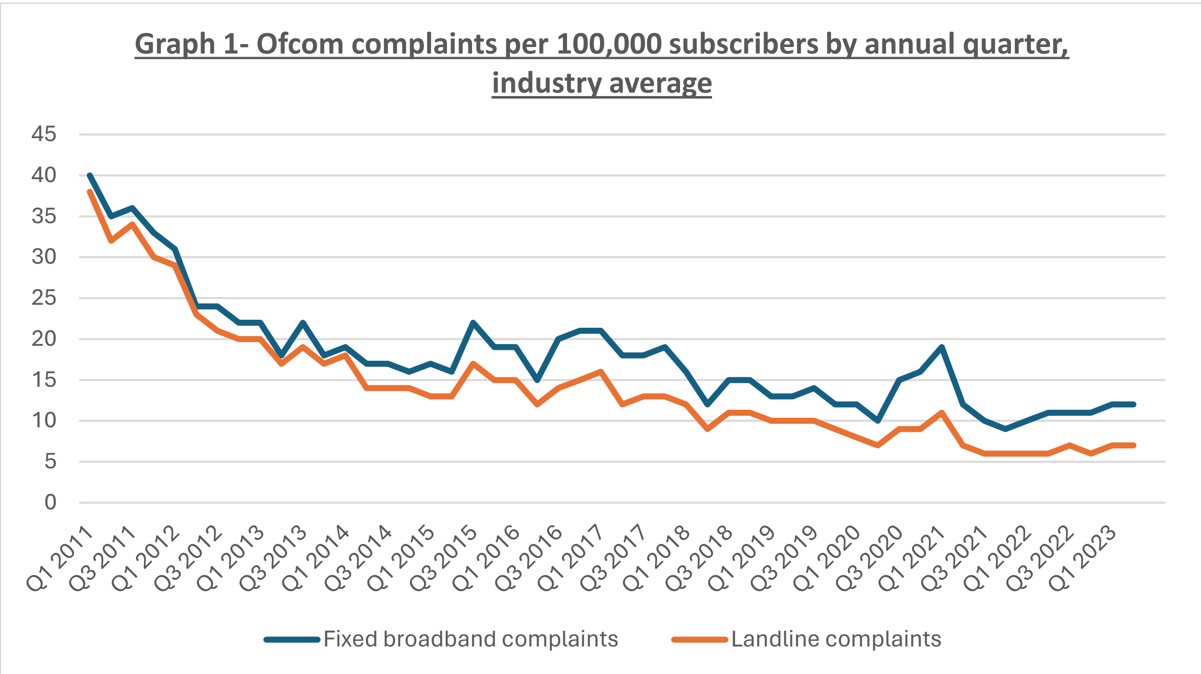
risk in its commercial decision-making and price-setting and, certainly to some extent, swallow the cost of future Openreach price increases.

In addition, the failure to consider the significant link between inflation-linked wholesale price rises and consumer price rises ignores the main plank of Ofcom's telecoms regulation and is wholly contradictory as well as having severe commercial impacts. For a value provider such as TalkTalk, significant rises in wholesale prices since 2021 have had a major impact on our profitability given our reliance on Openreach, and inability to pass through price rises to 100% of consumers, of which Ofcom is fully aware.

3. Ofcom is exaggerating the extent of consumer harm

We are concerned that Ofcom is painting an unduly narrow and bleak picture of the UK mobile and fixed markets and that this leads Ofcom to exaggerate the extent of consumer harm caused by inflation-linked price variation terms. As we state above, these proposals may actually cause consumer harm by paying more than they would under the current framework.

Taking a more representative, holistic look at the development of the UK communications markets one can see that providers have made huge improvements in customer service and satisfaction over the last ten years or so coinciding with the presence in the market of inflation-linked price variation terms. In total, complaints to Ofcom's consumer contact centre about mobile and fixed markets have fallen dramatically by over 75% in the last ten years as is shown in Graph 1 below. There is no visible evidence of a specifically negative impact on customer satisfaction of inflation-linked price variation terms.



Source: www.ofcom.org.uk

More generally, Ofcom's own data show that overall customer satisfaction with their broadband service is showing a slight upward trend over the last 6 years as depicted in Graph 2 below.

Source: www.ofcom.org.uk

We accept of course that some customers may not like inflation-linked price variation terms and the fact that their broadband price increases annually. Clearly the price increase has been greater in the last 2 years because of higher inflation although though CPI has now fallen back to 4% in December 2024 in line with overall expectations. Again, however, we believe that Ofcom is exaggerating the impact on consumers in the UK. According to Ofcom, as of April 2023, at least 11 million broadband customers and 36 million mobile customers, equivalent to around four in ten broadband customers and over half of mobile customers in the UK, were on contracts subject to inflation-linked price variation terms.[6] Ofcom also says that it received over 800 consumer complaints related to price rises in January to October 2023. Even if all those complaints related to price rises based on inflation-linked price variation terms (Ofcom appears to admit that they are using a wider pool of price rise complaints), this means that only 0.0017% of all customers on inflation-linked price variations terms complained to Ofcom. We believe this figure is very low and certainly not an indicator of wider consumer harm.

Ofcom's analysis also does not appear to consider consumer dissatisfaction generally with price increases, including those introduced by providers who mainly or solely rely on right to vary clauses in their contracts. More specifically, Ofcom does not appear to have considered possible consumer harm caused by right to vary clauses and how such harm could relate to the alleged harm caused by inflation-linked price variation terms. There is an argument that right to vary clauses give customers less certainty about future price increases because, unlike inflation-linked price variation terms, they effectively give customers only 30 days' forewarning. Although customers do have the right to cancel their contract under a right to

[6] Ofcom consultation document, paragraph 3.77.

vary clause, we believe Ofcom should carry our market research to determine how many customers in practice do switch provider when faced with such an unexpected price increase. If customer inertia is large enough and only a very small proportion of customers switch in response, the consumer harm caused by price increases under a right to vary clause might be just as harmful as price increases under an inflation-linked price variation term. Ofcom has, however, removed right to vary clauses from its review at the outset which means that its overall analysis might be flawed as a result.

4. Concluding remarks

We have outlined above our concerns with Ofcom's proposals which we believe are unpredictable, discriminatory and unreasonable.

Ofcom's proposals are discriminatory as they favour vertically integrated providers like BT and Virgin Media who do not have to face the cost of real payments to network operators who, in the case of Openreach, will continue to be able to rely on inflation-based price increases.

For over a decade, Ofcom has explicitly allowed inflation-linked price variation clauses and acknowledged their legitimacy as late as June 2022. Ofcom has thereby given providers a reasonable commercial expectation that these clauses can be used in consumer contracts and it is unreasonable to expect providers to carry out a complete U-turn at this stage and within a very challenging timeframe of only 4 months.

We believe that Ofcom's consumer research is flawed in that ignores the wider signs of a very healthy broadband market with little or no cause for concern when it comes to consumer harm. Ofcom's analysis also flawed because it does not contain a detailed assessment of any consumer harm caused by price increases introduced based on right to vary clauses. We are concerned therefore that Ofcom is choosing to concentrate on a distortive selection of indicators as evidence to justify its proposals.