NON-CONFIDENTIAL VERSION

Prohibiting Inflation-linked Price Rises

Virgin Media O2 supplementary response to Ofcom's consultation

17 April 2024

ILPVTs – Assessment of Implementation Requirements

Executive Summary

This submission complements, and should be read in conjunction with, Virgin Media O2's ("VMO2") substantive response to Ofcom's consultation on prohibiting inflation-linked price rises[1] ("the Consultation"). We wish to supplement our response by setting out our concerns about the system and process development work that will be necessary to implement Ofcom's proposals (including the time that this work will take), Ofcom's apparent disregard of these factors and, crucially, the consequential impact on consumers.

Specifically, we are concerned that Ofcom has failed to undertake a sufficient assessment of the practical impact of its proposals. As a consequence it has failed to identify the scale and complexity of the activity required to implement them. This has led to it underestimating the amount of time needed to make the necessary system and process changes, as well as the costs of doing so.

The amount of time allowed for implementation of Ofcom's proposals will determine the approach that providers take. A failure to allow sufficient time for implementation risks depriving consumers of additional choice in the market that would otherwise have been present. Put simply, the shorter the period of time, the greater the limit on the pricing structures that providers can develop as an alternative to inflation-linked price variation terms ("ILPVTs"). As things stand, there is a significant risk that providers will be forced to implement the most rudimentary version of Ofcom's proposals (with little or no differentiation) or to revert simply to 'prices may vary' terms. Again, Ofcom has overlooked this, presumably unintended, consequence.

This situation can, however, be avoided. As we set out in our response to the Consultation, we believe that Ofcom should forbear from implementing its proposals, in light of BT's decision to move, unconditionally, to £/p denominated in-contract price variation terms. This would allow competition to play out, with consumers and competing providers responding as they see fit to this change in circumstances, and consumers choosing <u>their</u> preferred type of pricing model, in the presence of more options. This would, we believe, result in the best outcomes for consumers.

Should Ofcom nonetheless decide to proceed as set out in the Consultation, having now completed our own assessment of the implementation requirements, we consider that providers should be afforded a minimum of nine months from the date of Ofcom's final statement to implement its proposals. Should that nine month period include the Christmas and New Year holiday, it should be extended accordingly, to account for providers' change freezes and reduced personnel resource.

Ofcom's duty to carry out an Impact Assessment

The Communications Act 2003 ("the Act"), requires Ofcom to undertake an assessment of the impact of any proposals that it makes where those proposals are likely to have, inter alia, "*a significant impact on persons carrying on businesses in the markets for any of the services, facilities, apparatus or directories in relation to which OFCOM have functions*".[2]

Ofcom clearly considers, as does VMO2, that its proposals to prohibit ILPVTs meet that requirement, since it has set out the results of an assessment of the impact of its proposals in the Consultation[3].

[1] Virgin Media O2's response to Ofcom's consultation "Prohibiting inflation-linked price rises: Proposals for new rules and guidance", as submitted 15 February 2024.
2 Communications Act 2003, Section 7(2)
3 Consultation, section 2 and paragraphs 4.9-4.86

Further, the Act requires explicitly that, "*Before implementing their proposal, OFCOM must… …carry out and publish an assessment of the likely impact of implementing the proposal*"[4]. For the reasons that we set out below, we believe that Ofcom's assessment in this case has failed to satisfy this requirement to the extent necessary. Specifically, Ofcom has failed to take sufficient account of the practical implications of the proposals and as such falls far short of the required standard and scope of assessment.

As Ofcom itself recognises in its impact assessment guidance, the decisions that it makes can "*impose significant costs on its stakeholders, and as such it is important for Ofcom to think carefully before deciding whether a particular policy intervention may be appropriate*"[5]. It follows that the costs, and the period of time required to implement any intervention, should form key components of Ofcom's assessments. There is no evidence in the Consultation to suggest that these factors have been afforded any substantive consideration by Ofcom.

Ofcom's impact assessment

Ofcom appears to have expended considerable effort on the assessment of the commercial impact and market effects of its proposals and alternative options. It also dedicates many pages of the Consultation to attempting to demonstrate disengagement with ILPVTs but, as we set out in our response, it fails to make a positive case for the impact that £/p price rise terms will have on this perceived lack of engagement. Conspicuously absent from the assessment is, however, any substantive consideration of the practical impact on CPs of implementing the proposals.

For example, when considering the implementation costs (to providers), Ofcom states its belief that these will be low relative to the benefits[6]. However, the basis for reaching this conclusion is anecdotal at best, and Ofcom makes no attempt to quantify them.

Similarly, to the extent that Ofcom affords the necessary lead time for implementation any consideration from a practical perspective, this is confined to two paragraphs, with Ofcom concluding that four months will give providers "*sufficient time to make the necessary changes to their processes and business plans*"[7]. This appears entirely arbitrary, with Ofcom instead basing its decision to allow providers four months to make the necessary changes to their systems and processes on its concern about the scale of consumer harm that may result from providers continuing to sign customers up to ILPVTs[8].

Ofcom's failure to consider either of these factors is, in our view, a significant and concerning oversight, particularly as the amount of time allowed for implementation will have a material influence on the approach that providers take to complying with the new rules and, therefore, the impact on consumers. Moreover, we believe that it raises serious questions about Ofcom's compliance with the requirements of section 7 of the Act.

[4] Communications Act 2003, Section 7(3)
5 Ofcom's Impact Assessment Guidance, 19 July 2023, paragraph 1.4
[6] Consultation, section 4
[7] Ibid, "*What we are proposing – in brief*", page 4.
[8] Ibid.

VMO2's assessment of costs and the time required for implementation

Since submitting our response to the Consultation, we have completed a high-level impact assessment of the costs of implementation of Ofcom's proposals and the time that would be required to effect the necessary changes to our systems and processes. Our assessment is based on the simplest form of Ofcom's proposals – i.e. a consistent £/p price rise across our portfolio, with minimal differentiation or tailoring[9]. We set out a summary of our findings below.

<u>Costs</u>

Ofcom states that "*We do not expect that providers would need to build new systems to implement the changes. As a result, we expect any changes to their existing systems that are needed to move from one form of price increase to another, and associated costs, to be small*"[10]. While it may be the case that new systems are not required, this does not mean that the costs and effort required to incorporate Ofcom's proposals into existing systems and processes will be small. Nor will it be confined to "*some changes to billing systems to operationalise the new pricing structures,… training customer-facing sales agents to explain new contract terms and… changes to advertising and marketing and amendments to providers' contractual terms*"[11].

In the case of VMO2, there are many systems and process that support our underlying pricing model, including our sales engine, and all of these would require some form of amendment. **[✂ REDACTED]**

We note that a significant amount of the required development work would need to be completed prior to the date of effect of Ofcom's proposals, since much of the impact is on the *selling* of products (and the requirements that sit alongside that), rather than the later stage *billing*.

The below chart shows the key areas requiring development and the relative complexity of those.

[9] Ibid, footnote 130.
[10] Ibid, paragraph 4.72
[11] Ibid, paragraph 4.71

[✂ REDACTED] Our assessment indicates that the median costs of implementation would be approximately **[✂ REDACTED]** This covers the work required to prepare the customer discovery and purchasing journeys (i.e. the costs to be compliant on the date of effect). It does not include the full costs of updating billing systems to be able to execute price rises in the proposed format at the relevant point provided for in customers' contracts. A summary of key cost components is set out in the table below.

[✂ REDACTED] This is clearly not a "small" cost, as Ofcom suggests[12] – and in any event, we note that Ofcom has not set out what level of cost it considers to be small, let alone explored what the costs to providers of implementation would be.

<u>Lead time for implementation</u>

Ofcom's intention to allow providers four months to implement its proposals do not reflect the scale and complexity of the system and process development, and other changes that would be necessary to comply with the prohibition on ILPVTs. The Consultation contains, at best, cursory consideration of what period of time would be realistic and reasonable, with Ofcom stating simply that four months should be "sufficient", since it does not expect that providers will need to build new systems and believes that some providers' systems may already have the capability to implement pounds and pence increases[13].

It is not clear if Ofcom's apparent decision to forego this assessment is based on a belief that the "urgency" provisions in the Act[14] apply, or if it is genuinely under a misapprehension about the scale and complexity of the task. Either way, its absence is a significant oversight.

Our own assessment shows that changes of the type required by Ofcom's proposals would typically necessitate **[✂ REDACTED]**, implementation and testing work. Such activity would also need to be coordinated with dependencies, such as software updates, hardware replacement etc. **[✂ REDACTED]**

Figure 1 above shows **[✂ REDACTED]** However, the most challenging aspect remains the changes to the sales channels - particularly the need to set out, at the point of sale and in the Contract Information and Contract Summary documents, the customer/tariff specific charging amounts applicable at the various relevant points during the contractual term. In order to reflect that aspect of the proposed updated General Condition, this must be in place on day one, given that Ofcom's proposals require the simultaneous implementation of a restriction on price variation terms and changes to informational aspects of the sales journey.

It would, in theory, be possible to reduce the overall timeframe set out above. We could, for example, re-schedule other programmes, reallocate resources and budgets and, where possible, prioritise dependencies. We acknowledge that our development schedule is a plan over which we, rather than Ofcom, have discretion. However, changes to it inevitably cause us to incur significant additional cost and disruption, potentially affecting our ability to compete in the retail market through the introduction of new propositions during that period.

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[12] Ibid, paragraph 4.72

[13] Ibid, paragraphs 4.108-4.109

[14] Communications Act 2003, section 7(1). We do not believe that the perceived issued identified by Ofcom obviate the need for Ofcom to undertake an impact assessment, as provided for by section 7(1) of the Act. In any event, this point is somewhat moot, since Ofcom *has* completed an assessment of the impact of its proposals, albeit that this assessment, in our view, falls far short of what is required. Furthermore, any potential claim that intervention is in anyway "urgent" is undermined by the fact that that Ofcom has waited more than three years to make its proposals and now does so when the impact of inflation on price rises is small.

Even without the challenge of scheduling the implementation and coordination with in-flight/planned projects, we estimate that we would require a minimum of nine months from the date of Ofcom's final statement to complete all of the changes required under the current proposal. We do not consider that it would be possible to implement the required changes in a shorter period of time. Moreover, if that nine month timeframe included the Christmas and New Year period, it should be extended accordingly, to account for our change freeze and reduced resourcing levels and our practice of minimising the risks of disruption to customers caused by system changes during this period.

Whilst this timeframe is longer than originally proposed in the consultation, we note that consumers will now not be deprived of the choice of £/p contracts, should the regulatory implementation period be significantly longer. BT has now introduced such tariffs and, to the extent that consumers value this option, they have the opportunity to purchase these contracts from BT. There is therefore little or no incremental purported consumer harm from extending the implementation period, to avoid a situation in which the period itself does not artificially limit the choice of contractual structures for consumers going forward.

Exacerbating the timing challenge is the fact that precisely what changes (if any) are required will not be known until Ofcom's final statement is published. It would clearly be inappropriate for us or Ofcom to pre-suppose the outcome of the consultation process – and even if that was not the case, it is not rational for a commercial organisation to commit funding and resource to preparatory activity for something that has not been confirmed.

Depriving consumers of choice

The failure to afford providers sufficient time to prepare for the prohibition on ILPVTs will, we believe, lead to significant consequences for consumers. Specifically, consumers are likely to have fewer tariff choices than would otherwise have been the case.

Notwithstanding our concerns about Ofcom's proposed implementation lead time, we believe that the optimal approach, as we have previously stated, would be for Ofcom to acknowledge that the material change in circumstances since its statement was published obviate the need for a prohibition on ILPVTs and to allow competitive market dynamics to prevail. This would leave providers free to determine the best way to respond to these changed circumstances, with the backstop of the constraint afforded by what Ofcom itself acknowledges are very strong competitive forces in the market[15].

Moreover, there is no reason to believe that the change in circumstances will be anything other than enduring, even without a regulatory mandate. We note that BT has recently enacted its stated intention to move, voluntarily, to a £/p in-contract pricing model[16]. We further consider it unlikely that BT will deviate from this model in the foreseeable future, given the public statements that it has made in support of the model[17] and the fact that reverting to inflation linked increases, or transitioning to some other model, would have a (likely considerable) cost and resource overhead.

[15] Consultation, para 1.7

[16] See BT's announcement of 10 April 2024 and, for example, the latest EE price guide at https://ee.co.uk/content/dam/help/terms-and-conditions/price-plans/home/ee-monthly-home-price-guide-update-10-april-2024.pdf.

[17] See for example https://newsroom.bt.com/our-new-pricing-structure-for-the-future/ and https://newsroom.bt.com/calling-out-a-new-pricing-structure-in-pounds-and-pence/

A 'free market' approach would also enable providers to consider strategically how to tailor their offerings, reflective of what their customers actually want[18], unencumbered by either a deadline or restriction on pricing models.

Conversely, in the face of a mandated prohibition on certain types of pricing model, and a challenging deadline by which that prohibition must be complied with, there will be a limit to the pricing structures that providers can offer as an alternative to ILPVTs, given that some options take longer to implement than others. Moreover, if the lead time for the prohibition is too short, it is likely that some providers will be forced to implement the most rudimentary version of Ofcom's proposals (e.g. a common price rise amount, with no differentiation by tariff) or even to withdraw in-contract price variation terms completely and revert simply to 'prices may vary' terms. We do not believe that this is Ofcom's desired outcome. It would also, in our view, be a very poor outcome for consumers.

This curtailment of choice does not, however, appear to be an outcome that Ofcom has considered. This is concerning, given that a perceived lack of choice (as ILPVTs proliferated) was a key concern set out by Ofcom in the Consultation. Through its information gathering powers, Ofcom will be able to determine an implementation timeframe that will have a lower impact on the choices available to providers in the market and avoid an outcome whereby CPs are driven to respond with the easiest contractual terms to implement, rather than those that result in greater choice for consumers or those that are easiest to engage with (in accordance with the justification for the intervention).

Conclusion

We maintain our view that Ofcom's proposed prohibition on ILPVTs is unwarranted, particularly in the light of the material change in circumstances since it published the Consultation. Not only are the proposals unwarranted, but they present a significant risk of leading to worse outcomes for consumers, by depriving them of choice that they would likely otherwise have as market competition plays out.

In and of themselves, the proposals are not tailored to optimal consumer outcomes. Ofcom has erred in failing to afford sufficient consideration to the practical impact of them, leading to it underestimating significantly the costs and length of time needed to put them into effect. This has led to a failure to identify and consider the risk that consumers' options will be restricted, as providers will have insufficient time to develop alternatives to ILPVTs and/or will be forced to implement the most rudimentary form of £/p pricing terms.

Accordingly, should Ofcom proceed with its proposals, we urge it to undertake a proper assessment of the practical requirements of implementing a prohibition on ILPVTs. This should include the changes that providers would need to make to their systems and processes, the costs incurred and the time periods that would reasonably be required to effect those changes without unduly limiting their choice of options.

Extending the implementation period to nine months would not impose any incremental purported negative impact on consumers, because BT's price change means they now have access to the option of £/p tariffs, should they value them.

[18] We note, for example, that Ofcom's own research shows that some customers *favour* ILPVTs over other pricing models

This is necessary to ensure that Ofcom's decision does not impose a disproportionate and unreasonable burden on providers, it does not restrict consumer choice and, importantly, that it satisfies its duties under the Act.

Furthermore, as we highlighted in our initial response, Ofcom has not considered at all whether the changes to the ASA/BCAP regime have been effective in informing customers about the price rise terms in their contracts. Therefore, there is even less of a case to make changes within the proposed four month timeframe, without first evaluating whether these changes need to be made at all.