Virgin Media O2 response to Ofcom's consultation:

Prohibiting inflation-linked price rises

NON-CONFIDENTIAL VERSION

13 February 2024

EXECUTIVE SUMMARY

Virgin Media O2 ("VMO2") welcomes the opportunity to respond to Ofcom's consultation "Prohibiting inflation-linked price rises"[1]. Today, consumers are presented with a range of choices in contract structures when purchasing mobile and fixed telecoms services. There are flat rate contracts, pay as you go in mobile, 30-day SIM only contracts, contracts that rise by an amount expressed in £/p, or a fixed percentage and those which increase annually with reference to an independent measure of price increases in the economy (e.g. CPI or RPI) – inflation linked price variation (ILPV) terms.

Ofcom proposes to remove two options; ILPV terms and the use of percentages to describe an increase. Evidence in this consultation suggests prices may rise as a result, but Ofcom is convinced that increased engagement amongst consumers will see these transitory increases competed away.

Unfortunately, Ofcom expends its research efforts on trying to demonstrate disengagement with ILPV contract terms, rather than also making a positive case that £/p price rise terms are any better. This is a fundamental error. Ofcom relies on higher engagement from £/p terms (which it has not researched) being converted into more competition (it also does not research the mechanism, likelihood or scale of this conversion). An intervention to restrict pricing freedom in a competitive market imposes a high burden of proof onto a regulatory body. The data and analysis presented by Ofcom in this consultation falls far below a standard that would be sufficient to withstand profound and rigorous scrutiny. Ofcom's analysis is not forward-looking, notwithstanding that it is future contracts and competition that are affected by its proposals.

In competitive markets, restricting consumer choice is generally a bad thing and can lead to unintended consequences. Ofcom should be mindful of the experience in retail energy markets, where in 2016 the Competition and Markets Authority (CMA) found *"some of [Ofgem's regulatory] measures restrict the behaviour of suppliers and constrain the choices of customers in a way that may have distorted competition and reduced customer welfare."* This was because *"Those who were disengaged before the RMR rules appear to remain so."* And consequently, "*There are few, if any, signs that consumer engagement is improving materially, [..] in terms of direct consumer activity (eg switching, shopping around)".* In that case, Ofgem was forced to withdraw many of its interventions which restricted consumer choice, because they had led to higher prices, without also leading to more engagement and higher levels of competitive activity to offset that impact.

There is an opportunity to avoid a similar regulatory error. The facts have changed since Ofcom made its proposals. BT has recently announced that it will, unconditionally, be moving to £/p denominated in-contract price variation terms from "early Summer"[2]. It follows that there will be more choice in the market going forwards compared to when Ofcom made its proposals back in December.

VMO2 believes that Ofcom should let competition play out and see how consumers and competing providers respond to this change in circumstances. Regulatory failure can be avoided if customers are left to choose the contract they prefer, in the presence of more options.

[1] https://www.ofcom.org.uk/consultations-and-statements/category-1/review-of-inflation-linked-telecoms-price-rises

[2] https://newsroom.bt.com/our-new-pricing-structure-for-the-future/

OFCOM'S CASE FOR INTERVENTION AND PROPOSED REMEDY

The UK retail telecoms market is competitive and there are good deals available for those that shop around[3]. ILPV contracts have become increasingly prevalent, with over 40% of broadband customers and over half of mobile customers subject to these terms[4].

Ofcom's research shows that:

- 40-50% of consumers don't know that providers could increase their costs, so transparency provisions may be ineffective[5];
- 74-88% of consumers on these contracts cannot readily engage with the information in their contract to estimate the likely total price[6]; and
- Even those customers who do grasp the concept of inflation cannot readily predict the likely total price of their contract because of recent volatility in inflation[7].

Ofcom asserts that there will be a net benefit to consumers of them having absolute certainty as to the lifetime price of their contract – higher levels of engagement will increase competition, offsetting a risk that headline prices may rise in response to this change[8].

Ofcom is concerned that ILPV contracts make it hard for people to find the best deal, leading to lower engagement and so making competition less effective. Further, ILPV terms require customers to assume the risk and burden of the financial uncertainty from inflation, with tangible impacts on their ability to manage [their] costs[9].

Ofcom's proposed remedy is to ban ILPV contracts and the use of percentages to describe price increases within the minimum commitment period of a contract. Going forward, in-contract price rise terms must be set out in £/p in new contracts and be highlighted earlier in the customer sales journey.

[3] Consultation §1.7, §2.7.
[4] The figures quoted are somewhat misleading as they include both those customers in-contract, and therefore subject to the relevant term and those now out of contract, who as recognised by Ofcom can leave at any time in order to improve their certainty and/or reduce the impact of inflation.
[5] §3.14
[6] Ibid
[7] §2.6, §2.11,§3.30
[8] §4.81
[9] §1.12

STRUCTURE OF THIS RESPONSE

The remainder of this response is set out as follows:

- Legal basis : we look at the law pertaining to Ofcom's proposals.
- The importance of pricing freedom in a competitive market : we discuss why maintaining maximum pricing freedom is important in a competitive retail market and the risk of unintended consequences if market reaction to the change is not adequately considered in making any future decision.
- The role of Inflation-Linked Price Variation contracts : we look at why in-contract price rise terms exist and the role of inflation indexation in particular.
- Derivation of Ofcom's objectives - *certainty* : first we look at how Ofcom defines its objectives with regard to "certainty" for consumers by examining its previous decisions and the way Ofcom analyses choice in the market.
- Derivation of Ofcom's objectives – *inflation rates and volatility* : the second limb of Ofcom's "certainty" argument is addressed from the perspective of future inflation expectations.
- We examine Ofcom's three stated objectives and the analysis that underpins Ofcom's proposed intervention, informed by these objectives.
- Ofcom's impact assessment is reviewed.
- In Annex 1, is attached a report by Oxera, commissioned by VMO2, to which we refer throughout this response.
- In Annex 2, we provide a more comprehensive review of available contract types than that presented by Ofcom in the consultation, demonstrating greater choice on the market.
- In Annex 3, we provide examples of marketing materials which promote fixed price contracts as an alternative to ILPV contracts. This shows that contract differentiation is a factor that propels competition.

LEGAL BASIS FOR OFCOM'S PROPOSALS

At §§2.30-2.40 Ofcom sets out the regulatory duties it intends to have regard to when reaching a decision on this matter. In particular, it intends to have regard to one of its principal duties when carrying out this function:

> *"to further the interests of consumers in relevant markets, where appropriate by promoting competition"*[10].

At a high level, an intervention that reduces the choice of a competitive vector (price variation terms) seems to be at odds with "promoting competition". By definition, Ofcom is actually proposing to reduce the scope for competition on that vector by limiting choice. There would have to be particularly compelling and well evidenced reasons to act contrary to the interests of consumers in a (competitive) relevant market by effectively reducing the scope for competition.

Section 51(1)(a) of The Act provides that Ofcom may set *"conditions making such provision as OFCOM consider appropriate for protecting the interests of the end-users of public electronic communications services"*.

This does not mean that Ofcom has carte blanche to set General Conditions, it must identify clear consumer harm that, of itself, competition on the market will not remedy. Any intervention is limited by Section 47(2) which states that *"a condition can be modified where it is objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates, not such as to discriminate unduly against particular persons or against a particular description of persons, <u>proportionate to what the condition or modification is intended to achieve</u>, and transparent in relation to what it is intended to achieve."* [our emphasis]

The legal basis for intervention leads VMO2 to pose some questions:

- Is absolute certainty for consumers, as to the total cost of ownership of their contract, a legitimate and lawful objective for Ofcom to set? and
- Does banning inflation indexation make consumers unambiguously better off? ie. are end user interests unambiguously better served by a ban on indexation, taking into account potential market readjustments to this change and changes in consumer behaviour, versus the counterfactual of retaining choice?

In the next section we address the first question, the legitimacy of certainty and in particular absolute certainty of contract value as an objective. We look at the second question in more detail as we review Ofcom's analysis, through our appraisal of Ofcom's three stated regulatory objectives for this consultation.

[10] Section 3(1), Communications Act 2003. ("The Act")

THE IMPORTANCE OF MAINTAINING PRICING FREEDOM IN A COMPETITIVE MARKET

<u>The retail market is very competitive</u>

Retail mobile and fixed telecoms markets in the UK are very competitive. This is Ofcom's own appraisal in the consultation document[11] and in other publications[12]. At a recent Ofcom event, it was stated that[13]:

> *"we believe that we've still got a very competitive retail market in both broadband and mobile. And that's demonstrated by pricing and the impact that's had."*

Indeed, the retail markets are no longer subject to ex-ante economic regulation and have been removed from the list of relevant markets that are periodically subject to review. The legal and evidential burden to even bring one of these markets back for review is substantial. All CPs are investing in the UK market, on the legal basis in The Act.

Helpfully, Ofcom's senior leaders are keen to reassure investors that it does not regulate prices, nor does it seek to[14]:

> *"I think the point we were making was, however, that we don't regulate we don't want to regulate the price level. What want to ensure is that consumers can make a choice about the contract they want and the price they're going to get because there is good levels of retail competition. So we know that prices are good and they are affordable, for most people."*

Ofcom also recognises that inflation can go down as well as up and consequently when setting a wholesale price control, in order to maintain investor confidence, a sound regulator should act symmetrically[15]:

> *"so at the wholesale level, and as Lindsey says, you know, it was about incentivising that investment.*
>
> *So the, which is obviously there to give some inflation protection as well because that does flow through, in terms of the short-term it's probably right that because of the way inflation's gone, which I think is fair to say, we didn't necessarily fully predict, you know, a couple of years ago, that in the short-term that probably has led to higher sort of margins there.*
>
> *I guess I wouldn't necessarily jump on that too quickly, because as we keep saying, you know, we saw this as a ten year plan and, you know, inflation can hop up and down a bit and we could very quickly see in a year or two that it's gone the other way, and some of that we're back to sort of business as usual."*

---

[11] §1.7 *"The UK residential telecoms market is competitive and there are good deals available to consumers who shop around."*
[12] https://www.ofcom.org.uk/__data/assets/pdf_file/0024/273138/pricingtrendsreport2023.pdf p.4 *"average broadband and mobile prices have fallen in real terms in the last five years*."
[13] Ofcom Analyst briefing, 5th Oct. 2023, https://www.ofcom.org.uk/__data/assets/pdf_file/0022/269500/Ofcom-Analyst-Briefing-Transcript.pdf
[14] Ibid
[15] Ibid

Well-meaning regulatory interventions in competitive markets can lead to unintended consequences

In 2010, as part of Ofgem's Retail Market Reforms (RMR), that regulator proposed rules to deliver *"simpler tariff choices"*.[16] The reforms, implemented in 2013, were designed to make it easier for consumers to understand and compare energy tariffs, thereby promoting customer engagement and ultimately competition. Ofcom is going down a similar route if it were to go ahead with the proposals in this consultation. At §4.81, it appears that Ofcom is ambivalent as to whether the outcome of its intervention will be higher prices in the short run:

> *"Two providers have suggested to us that inflation-linked price variation terms enable them to lower headline prices for new customers and that these headline prices could increase in the absence of inflation-linked price variation terms. However, irrespective of whether this would be likely to materialise or not, we consider it is important that providers compete by being clear and certain about overall actual prices paid by customers, rather than headline prices alone."* [our emphasis]

Oxera, in its report at Annex 1, identifies three potential unintended consequences of Ofcom's proposal:

- £/p price increases set above the level that would have been paid if prices were linked to inflation : this is driven by the risk aversion of CPs which makes them seek a risk premium when setting £/p increases or flat rate pricing;

- Increases in non-headline prices (e.g. out of bundle charges) : moving some or all of the risk premium outside of the core subscription; or

- Reduction in contract lengths : shorter contracts tend to be more expensive than longer ones, so even if consumers were out of contract more often and could switch, the uncertainty in CP revenues (which drives higher prices in shorter contracts) would push up average prices overall.

At the end of §4.81 Ofcom then relies on increased consumer engagement and competition to lead to more effective price competition than we see today (notwithstanding that Ofcom says in terms that the market today is already competitive).

> *"we expect consumer engagement and the effectiveness of price competition in the market to be strengthened, which will ensure consumers can benefit from more competitive prices overall."*

Ofcom presents no evidence or research to support this assertion. Its research focusses solely on disengagement with ILPV terms, rather than making an equivalent assessment of whether its proposed remedy would both:

- Lead to a greater proportion of consumers being engaged (noting that many consumers are engaged with ILPV contracts); and

---

[16] Referred to in Annex 1 report from Oxera (Section 3.4)

- That this net increased engagement would be converted into competitive activity in the market.[17]

As the experience of energy markets highlights, if Ofcom's remedy is to lead to a net consumer welfare benefit, any potential negative consequences from higher short run prices need to be offset by a positive increase in both engagement and competitive activity, in order to bring those prices down in the longer run. Ofcom has no evidence base to support this outcome and consequently its analysis is currently insufficient to withstand profound and rigorous scrutiny.

An alternative approach – retain the current level of pricing freedom in light of recent events

BT's recent unconditional announcement that it will be changing its standard contractual price variation terms from ILPV to £/p from the Summer of 2024, changes the factual basis behind Ofcom's proposal. Ofcom must now consider its decision in light of BT's unconditional move to £/p contracts and other changes in the market that have happened subsequent to its strong regulatory signal[18].

The threat of regulation has been sufficient to stimulate a change, maintaining that threat does not have the downside of the unintended consequences we have highlighted. There appears to be much to be gained from seeing how the market reacts before coming to any conclusion on this matter. It may be that consumers will value these new offers sufficiently to stimulate further competitive activity based on competition on the price variation term vector.

Any risks with such a "wait and see" approach are further mitigated because a relatively benign inflation environment is expected around the ILPV price rise round in 2025 (and following years), as we discuss later on.

Conclusion

VMO2 has substantial, principled and strongly held concerns about this consultation setting a precedent for the standard of proof required to reduce pricing freedom in a competitive market. This is why we repeatedly focus on whether the analysis used by Ofcom to demonstrate consumer harm is sufficiently robust to withstand profound and rigorous scrutiny.

If Ofcom cannot reach the requisite standard then it has no basis under which to convert its proposals into a decision. £/p contracts or fixed price contracts are both pricing options where the CP has to predict the effect of inflation and express it in a price that provides the consumer with absolute certainty. Just because Ofcom can mandate certainty, does not mean that all consumers will automatically be better off. Quite the contrary, if providers apply a single fixed £/p price rise, for example, this means, all else equal, that customers on low price contracts incur greater rises than those customers on higher price contracts. Whereas price rises based on percentages would apply increases proportionately to the current spend. This would disproportionately impact older mobile subscribers that are more likely to opt for airtime only and low data allowance tariffs, or financially vulnerable customers that select low price tariffs to mitigate affordability challenges.

---

[17] See Annex 1, Section 4.

[18] https://www.choose.co.uk/news/2024/talktalk-bring-back-no-mid-contract-price-rises/

Consumers who value certainty will only be better off if the prevailing premium for certainty demanded by the market is less than the willingness to pay of those consumers that value certainty[19]. Under Ofcom's proposals there is also a further negative distributional effect, in that those customers who are willing to bear risk today may prefer a transparent metric of price rises[20], but would now have to pay the premium for certainty, even if they would not value it.

There is very little margin for error here, as the evidence that Ofcom itself relies on, at footnote 100, suggests that there is a very small price premium placed on certainty[21]. If Ofcom's proposals do not lead to greater engagement, as it only *asserts*, then if this premium is small, there is a greater likelihood that consumer welfare overall will be lowered.

In the comparable intervention in energy markets the CMA found[22]:

> *"The available evidence on the impact of certain aspects of the simpler choices component of the RMR rules on customer engagement is not particularly encouraging. There are few, if any, signs that consumer engagement is improving materially, either in terms of direct consumer activity (eg switching, shopping around) or their experience and perception (eg views on tariff complexity). Those who were disengaged before the RMR rules appear to remain so. Further we have doubts that the four-tariff rule will have a benefit on engagement in the long term."*

ILPV contracts allow CPs to pass through increases in their costs with reference to a transparent metric that is conceptually understood by half of consumers. These customers may be worse off if, as seems plausible, CPs' risk-averse[23] estimates of future inflation used to determine £/p price increases, are higher than observed inflation in 2025 and 2026[24]. Maintaining the ability for CPs to use ILPV contracts could act as a competitive constraint on the setting of £/p price rise terms, something that Ofcom has not considered at all.

THE ROLE OF ILPV CONTRACTS

<u>Communication Provider costs will change during the term of a consumer contract</u>

Firstly, it is important to note the fact that Ofcom is not proposing to ban price rises within the minimum duration of a contract. There is good reason for this. Contracts with a multi-month duration are important contributors of revenue to firms in the sector. If these contracts were only allowed to be for a fixed price, firms would have to estimate both their likely costs and when these might increase,

---

[19] gm-4986874d-2dff-48d4-971f-0d6e0e574594-the-benefit-of-certainty-inflation-linked-mcprs-report.pdf (which.co.uk) p.41

[20] Ofcom's discussion forum - where some participants considered that it may be worth taking the risk of ILPV contracts if they expected inflation to fall. Ofcom (2023) 'Inflation-linked in-contract price rises: Qualitative research report,' December, p. 37

[21] *"consumers may not be willing to pay a substantial premium for certainty as only one in five preferred a fixed price contract with a much higher headline price than other options with inflation-linked price variation terms"*

[22] https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf Energy market investigation 2016, §9.508

[23] Annex 1, Section 3.5

[24] Annex 1, Section 3.6

across the terms of these contracts, in order to protect themselves against rises in their input costs, which may be uncertain.

In Annex 1, Oxera discusses the impact of inflation in certain important inputs for telecommunications services. It is of note that, as Oxera observes, some CPs are exposed to regulated prices which are indexed to CPI, through decisions made by Ofcom itself. VMO2's spectrum fees, for example, are indexed to CPI and rose by 8.7% in 2023 alone. Since the merger of Virgin Media and O2 in June 2021, the JV's spectrum fees have risen by 18.9%. A similar indexation applies to the prices of PIA products which are increasingly important in relation to our fixed network expansion. Moreover, CPs continue to face major cost challenges arising from scarcity in civil engineering and from complying with new legislative and regulatory requirements, e.g. TSA and EECC.

Inflation linked price variation (ILPV) contracts play a role in meeting customer needs

Inflation indices are independently produced by the Office of National Statistics. Research from other industries, as highlighted in Annex 1, shows that some consumers perceive price increases indexed to inflation to be fairer than alternatives because they are linked to costs.

Ofcom's own analysis shows that certain customer cohorts can engage with inflation. At §3.14, Ofcom's quoted figures suggest that 58% of mobile and 51% of fixed customers are aware that their contract is subject to inflation indexation[25].

These data suggest that perhaps half of customers understand that inflation plays a role in determination of their price. To do that, they must have some understanding of inflation as a concept[26].

CPs and competition benefit if customers can easily compare offers, in order to secure the best deal. In a market where ILPV contracts are widely used and are based on a similar mechanic[27], the dominant term in the equation that would tell you how much you will pay is the headline price. This is something that is transparent and readily understood. Whilst customers may need to both understand the mechanic and predict inflation to estimate the total cost of ownership, when choosing between providers of similar contracts, the decision process is not as complex as Ofcom suggests – the first month's price is an adequate proxy for comparing ILPV contracts, one from another.

Ofcom's research erroneously focusses on the indices in the ILPV term, rather than whether consumers understand the concept of inflation more generally. As Oxera sets out in Annex 1, asking a more open question about inflation can elicit very different answers from those achieved by Ofcom in its survey. For example, Ofcom uses evidence regarding whether consumers are familiar with CPI or RPI to demonstrate that consumers have a limited understanding of inflation.[28] However, empirical insights from other markets show that consumers do have a high understanding of inflation and prices

[25] Although we note that Ofcom cannot be sure of these values, as it assumes that if a respondent is with a provider that supplies ILPV contracts, that the respondent is definitely on such a contract (rather than SIMO for example) or that they purchased their subscription at a time when the provider was only offering ILPV contracts (e.g. Virgin Media).
[26] This aligns with the findings of Which? at p.15 https://media.product.which.co.uk/prod/files/file/gm-4986874d-2dff-48d4-971f-0d6e0e574594-the-benefit-of-certainty-inflation-linked-mcprs-report.pdf
[27] §2.27
[28] §3.17-3.18.

increasing in line with inflation, when it is framed using simple terminology (i.e. 'inflation' rather than 'CPI' or 'RPI'). Since operators typically make clear in their terms that CPI/RPI refer to inflation,[29] it should follow that consumers have a better understanding of ILPV terms than Ofcom's research reports.

Given the relatively small quantum of telecommunications price rises when compared to other variables in a household budget, e.g. energy and food, consumers do not need a precise understanding of inflation indices to estimate the impact on their finances. Furthermore, for mobile contracts, there are substantial proportions of mobile customer spend (notably the consumer credit agreement for a device) that are not covered by ILPV terms. The percentage increases stated by Ofcom at §2.11 are misleading as they do not take account of which parts of the customer's spend the increase applies. Based on our internal data about customer spend on airtime and device plans, we determined that the effective price rises experienced by O2 mobile customers on linked split contracts (our major proposition Custom Plans) were, on average, **[✂ REDACTED]** of the 17.3% price rise that Ofcom reported for O2 in Table 1. Moreover, average price rises for O2 customers on these contracts were lower than inflation during the past years of high inflation. This indicates that price rises experienced by these customers were considerably more limited than acknowledged by Ofcom.

Also, we note that Ofcom determines much greater price rises for customers on bundled mobile subscriptions. This is a consequence of providers of the latter contract applying ILPV terms to airtime and handset subscription whereas O2 only does this to the airtime plans for its linked split contracts.

THE PURPORTED NEED FOR MORE "CERTAINTY" IN CONSUMER CONTRACTS

<u>Clarity and burden of risk pursuant to consumer law principles</u>

The CMA (including its predecessor organisation, the OFT) has considered the issues of clarity and burden of risk extensively from a consumer law perspective. The case law regarding the fairness of the burden of risk is very case specific.

In 2013/14, Ofcom consulted on the issue of "clarity" within contract terms pursuant to the Unfair Terms in Consumer Contracts Regulations (UTCCR). Following its consultation, Ofcom concluded that inflation linked terms are explicitly not prohibited on the grounds of "clarity" under the UTCCR[30]:

> *"a degree of flexibility in pricing may be achieved fairly in a number of ways such as by specifying the level and timing of any price rise (within narrow limits if not precisely), by linking terms permitting price rises to a relevant published price index such as RPI or by allowing consumers to end the contract and not experience any financial loss as a result of cancellation."*

[29] For example, the text on Virgin Media's website informs customers that the 'monthly price of Virgin Media's main services and O2 Airtime Plan will increase each April from April 2025 by the Retail Price Index <u>rate of inflation</u> announced in February each year plus 3.9%.'

[30] https://www.ofcom.org.uk/__data/assets/pdf_file/0017/38042/gc9_statement.pdf §3.15

Historically Ofcom has been concerned about "legal certainty" within a contract

It is important that the nature of "certainty" that Ofcom is concerned about in this current consultation is clearly understood, given that it does not appear to be fully in line with Ofcom's position in previous statements and guidance.

In Ofcom's guidance on GC C1 (Guidance)[31], Ofcom places two conditions on the use of price variation terms within the core subscription period without the General Conditions C1.14 and C1.15 being applicable, namely that, at the time the customer signed the contract:

> *"a) those terms were sufficiently prominent and transparent; and*
>
> *b) the provider ensured the customer was fully informed about the different amounts they would have to pay at different times, such that the customer can be said to have agreed to those terms."*[32] [our emphasis]

At §1.101 in Ofcom's Guidance, Ofcom expresses a concern about ensuring that the use of such clauses is limited:

> *"Price variation clauses should only be used where there is reasonable justification on practical grounds, and where the two criteria set out in the paragraph above are met."*

This reflects the statement Ofcom made in the first part of §8.21 in the 2020 EECC statement:

> *"…we would only expect such clauses to be used where there is reasonable justification on practical grounds, and where the two criteria set out at paragraph 8.20 are met."*

§8.21 continues:

> *"We would be concerned if the use of variation clauses became significantly more widespread than currently, in light of the risk that this could make contracts harder to understand and therefore customers would have less certainty about important terms of the contract at the point that they enter into it."*[33] [Our emphasis]

The use of the words *"the contract"* and *"enter into it"*, show this paragraph relates to the legal certainty of a given contract. Nothing more.

It is clear that the concerns about certainty expressed in the guidance on GC C1 and in the 2020 EECC Statement relate to "legal certainty", such that a customer must be able to understand the (impact of) terms and have agreed to them when entering into a contract.

[31] https://www.ofcom.org.uk/__data/assets/pdf_file/0028/229852/ofcom-guidance-general-condition-c1-contract-requirements.pdf
[32] GC C1 guidance §1.100, which reflects the position set out in Ofcom's 2020 EECC decision, §8.20
[33] Ibid §8.21

In this consultation Ofcom appears to be concerned about "certainty of contract value"

In the current consultation, at §2.19, Ofcom explicitly refers to §8.21 in the 2020 EECC statement[34] as a basis for its intervention.

> *"In the accompanying statement, we noted that we would be concerned if the use of variation clauses became significantly more widespread, that this could make contracts harder to understand and give customers less certainty about important terms of the contract at the point they enter into it."*

An individual contractual term does not become any more difficult to understand or more, or less certain, based on its prevalence in the market as a whole. Instead, a contract would have less "legal certainty" if it included multiple price variation clauses (i.e. widespread use within a singular contract), which we believe is the correct interpretation of §8.21 of the 2020 EECC Statement, as supported by the Guidance, *"such that the customer can be said to have agreed to those terms."*

Yet in its analysis at §§2.8-2.10 of the current consultation, Ofcom focusses on the widespread availability of ILPV contracts in the market as a whole when compared to other forms of contract with greater certainty of contract value. It appears that Ofcom is now moving away from its previous concern about "legal certainty" and focussing instead on "certainty of contract value" or "price certainty". Ofcom therefore has a duty to ensure that its argumentation is transparent and proportionate, such that it is sufficiently robust to withstand profound and rigorous scrutiny.

Ofcom's preliminary concern is about an absence of choice in the market

As we state above, the legal basis for this intervention is not consumer law, but rather Ofcom's general duties. In applying its general duties, Ofcom states its first objective as follows:

> *"Enable consumers to understand the price of a service readily, with sufficient clarity and certainty to make informed comparisons and choices and find the right deal for their needs."*

"Sufficient certainty" means enough certainty, not necessarily the provision of "absolute certainty of contract value" for each and every consumer. That is, it relates to the ability to choose between an ILPV contract and some other contract type in order to purchase a given product or service, not that there must be certainty within all individual contracts. As we show above, Ofcom has miss-appreciated its previous statements conflating "legal certainty" and "certainty of contract value".

That choice is really the issue here is supported by statements made by Ofcom's senior executives, when setting out the rationale for its review of ILPV contracts[35]:

> *"whether customers are really able to judge when they sign up to a contract what they are signing up to and what that price level is, which obviously enables them to make an objective choice between different providers and think about what the right choice for them could be.*

[34] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/204980/statement-eecc-revised-proposals.pdf
[35] Ofcom Analyst briefing, 5th Oct. 2023

Because if they're not able to do that, then that clearly does dampen and weaken competition potentially. So that's why we that's the frame that we're looking at this in."

Clearly this is framed as being about customers' choice of different types of contract, which is accurately described as the ability to make an objective choice between different providers, based on a judgement by the customer. It does not require absolute certainty of contract value for each and every consumer, within each and every contract.

At §2.21 Ofcom appears to suggest that in 2020 it did not have the legal (as opposed to evidential) basis to intervene to ban ILPV contracts.

"However, at the time we last considered this issue, our ability to make changes was constrained by the framework of European Union law. In particular, the changes to our rules that came into effect in June 2022 were made to implement provisions in the European Electronic Communications Code which were subject to 'full harmonisation'. This meant that, in the areas that those provisions covered, Ofcom could not maintain or introduce end-user provisions that diverged from those provisions, including more or less stringent provisions that would provide a different level of protection for end-users, except for where the provisions allow for such divergence."

This is a somewhat misleading statement. Whilst it is correct to say that Ofcom could not have used the EECC package as a basis for this particular intervention, it is not the UK's exit from the EU (and the removal of the requirement to harmonise) that suddenly allows Ofcom to make these proposals. The same laws still apply today as they did when the EECC was implemented. In 2020, as today, Ofcom could have relied on its general duties to intervene. So what has changed, such that Ofcom believes it should now intervene?

Ofcom's argument relies on two main limbs, first the issue of certainty, which is addressed in Section 2 of the consultation; then the issue of the ability of consumers to engage with ILPV terms, which is addressed in Section 3.

If there is lots of choice of contract structure in the market, then those consumers that cannot engage with ILPV or % terms have choices to contract with firms on a basis that they do understand. Sufficient choice in the market allows consumers to select contracts that suit their preferences and understanding - there is no harm caused by the ILPV term because it can be avoided by purchasing an alternative type of contract. In the same way that an inflation linked price rise can be avoided by customers who are out of contract – which is the rationale that Ofcom uses to narrow the scope of its intervention down to customers that are within the minimum commitment period[36].

"Customers who have seen out their contract period are not bound to accept price rises, as they are free to leave their contract, shop around and to switch to a new deal or to re-contract with their provider at any time."

In a market where there is adequate choice of contractual terms, the level of choice is the same for new and recently out of contract customers. Ofcom's task, therefore, is to demonstrate that going

[36] §2.25

forward, there is a significant reduction in choice for consumers, when compared to 2020, such that it needs to assess the merits of intervention versus the counterfactual of letting competition play out.

How is choice measured by Ofcom?

At §§2.2-2.10 in the consultation, Ofcom attempts to show that there is limited choice on the market, such that consumers have little option but to buy ILPV contracts. It does this by looking at *"the proportion of customers on contracts subject to inflation-linked price variation terms"*[37]. At footnote 7, Ofcom clarifies that its measure includes:

> *"in-contract customers and customers no longer within their Commitment Period who continue to be subject to inflation-linked price variation terms."*

Clearly this is very unsatisfactory. The consultation is about ILPV terms and the impact on customers subject to these terms. Out of contract customers are not bound by the terms that are at issue here. As Ofcom states in §2.25, they can shop around to avoid the impact of inflation on their price. These customers are not subject to the terms at issue in this consultation, yet they are used here and in the quantitative survey to create the evidence base relied on by Ofcom.

VMO2 wrote to Ofcom asking it to provide us with the same statistics as used in §2.10, but just for in-contract customers on ILPV terms, presented in the same aggregated format (i.e. without confidential information being disclosed). Ofcom declined to provide the information notwithstanding that CPs have provided it under Section 135 of The Act. It is fair to assume that the actual percentage and numbers of customers exposed to ILPV terms today is much lower than the headlines in the consultation and used by Ofcom to provisionally conclude that the scale of consumer harm absent intervention is substantial.

Putting the imprecision of this metric to one side, it is, in any event, the wrong measure to use to assess choice on a forward-looking basis. All Ofcom's data point tells us is how many customers have purchased ILPV contracts in the past. It tells us nothing about the available choice moving forward, which is the relevant consideration when evaluating the choices faced by customers entering the market for a new contract at the point Ofcom intends to intervene with its remedy. As the remedy affects only new contracts written from the implementation date[38], a forward-looking analysis of the benefits and costs, from the prospective date of implementation (i.e. after BT's price structure change) is required.

In order to assess the impact of its proposals in a way that is sufficiently robust to withstand profound and rigorous scrutiny, Ofcom needs to assess future choice for consumers. It's approach to measuring the benefits and costs of intervention must be done on a forward-looking basis. This appears to be entirely tractable, as there are a number of readily available metrics to use.

Conceptually, the availability of differing contract types matters, irrespective of what the plausible take-up of differing products and contract types will be. After all, it is the choice arising from

[37] §2.10

[38] §4.109 *"This would mean that providers are not able to include an inflation-linked price variation term that applies to the Core Subscription Price during the Commitment Period in any new contract offered from the date the new requirement takes effect."*

availability that allows consumers the opportunity to express their preferences for the contract terms they prefer or want to avoid. It is clear from our analysis in Annex 2 (and strengthened by BT's announced change) that consumers in mobile and fixed markets can choose between a wide range of contract types, tariffs and products. In addition, there are other metrics that would take into account other customer preferences, such as brand loyalty and look at the likely number of contracts sold in the market by contract type. For example:

- **Forward-looking shares by contract type of gross additions in the market :** this would be the most precise way of assessing which types of contracts will be purchased and from which providers. This will be particularly relevant when Ofcom has to take full account of BT's recent announcement about its unconditional move to £/p contracts. The prevailing share of the gross market arising from BT's brands (including BT, EE and Plusnet) will be highly relevant when assessing the availability of choice going-forward. Obviously, the change in BT's approach would have no impression on Ofcom's incorrect backward looking metric.
    - In fixed, ILPV contracts became the predominant offer only as recently as 2023 (with Virgin Media introducing ILPV contracts only in May 2023 and Sky continuing to apply prices may vary terms).[39] In light of BT's announcement, that situation will be more than reversed over the course of 2024, because BT has a higher market share than Virgin Media. Figure 1 below reports the distribution of gross additions across different contract types both in the current market and once BT has implemented its announced pricing approach (all else equal). Our analysis indicates that whilst ILPV contracts account for the large majority of broadband contracts written today, this will drop to below 50% when BT's new approach is applied. There is potential for ILPV % to drop even further as our analysis assumes that BT is the sole current ILPV provider that would change its main contract type. If, for instance, Vodafone or Virgin Media were to react to Ofcom's signal and consumer demand for non-ILPV contracts, ILPV contracts would be in the minority and most new contracts would be of the £/month type.[40]

      [✂ REDACTED]

      In mobile, we estimate that ILPV contracts today make up the large majority of gross additions, but following BT's contracting change, that will fall sharply to just over half of gross additions, all else equal.[41] Figure 2 below reports our estimated distribution of gross additions across contract types in the current market and following implementation of BT's announced pricing approach. If, as Ofcom states, customers really value certainty, then this change in circumstances may be even more pronounced. The number of customers taking non-ILPV contracts (whether fixed prices or BT's £/month terms) will be three times the share it was before, even in the

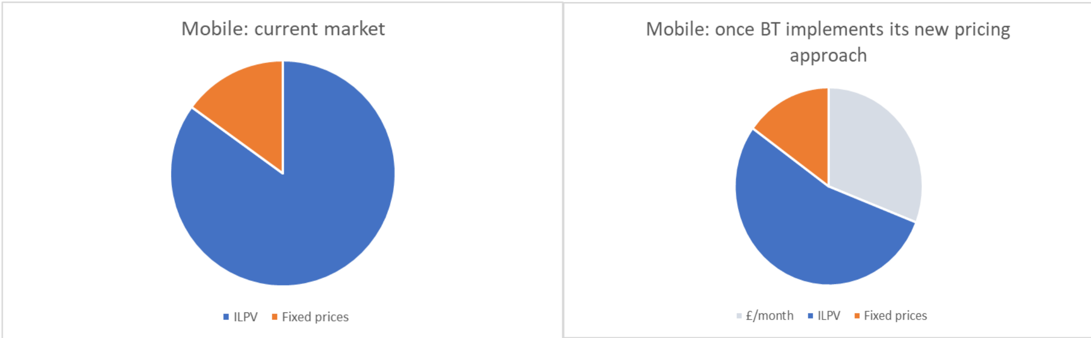
[39] The introduction of ILPV contracts by Virgin Media in May 2023 means that a minority of its fixed subscribers were on ILPV contracts in December 2023, when Ofcom published its Consultation. As an illustration, it was less than 9% at the end of June 2023.

[40] Furthermore, a considerable minority of fixed customers opt to remain out of contract. These customers are not exposed to the purported harm identified by Ofcom as they can switch provider when they learn about prices rises.

[41] **[✂ REDACTED]**

absence of intervention by Ofcom and without taking into account the reactions of consumers and competition for those consumers playing out. Our analysis is prone to understate the availability of non-ILPV contracts as it does not include mobile contracts that do not involve price variation terms (eg, PAYG and 30-day SIMO[42]).

Figure 2: Mobile – projected distribution of gross additions along contract types



Source: VMO2 analysis that uses public figures of subscriber numbers to project distribution of gross additions, and categorising providers based on their current - or in case of BT announced – pricing approaches.

Ofcom, in order to robustly evaluate the purported lack of choice, must review availability along similar lines as we presented for fixed and mobile. Ofcom will have access to better data through its previous s135 requests and it can ask providers, again using its statutory powers, to inform Ofcom on their plans and decisions regarding price variation terms. This would provide a more comprehensive look at offers on the market, rather than just focussing on "major providers", as at §2.9 in the consultation. In mobile, VMO2 itself offers both ILPV and fixed price contracts segmented across its brands. The O2 brand currently offers ILPV contracts, whilst giffgaff offers fixed price contracts. Moreover, O2 offers mobile products (PAYG, 30-day SIMO) that do not impose ILPV terms with a long minimum contract duration, thus giving choice to those consumers that want to be insulated from inflation risk. We reviewed the contractual status of our existing VMO2 mobile subscriber base (covering giffgaff, O2 and Virgin Mobile), **[✂ REDACTED]** The latter provides favourable conditions for competition on contract types and other vectors, going forwards. At Annex 2 we provide a more comprehensive assessment of contract types offered than provided in Ofcom's consultation.

- **An assessment of whether marketing messages are focussing on contract structure as a competitive differentiator.** If firms are investing in marketing the benefits of fixed price contracts in order to win customers, it adds weight to the case for letting competition play out, given that if customers truly value "certainty" then CPs are both offering and actively marketing this to consumers. The addition of BT's marketing budget to this movement will only add further impetus for a move away from ILPV contracts. Ofcom needs to choose a relevant metric that will account for this effect on a forward-looking basis. At Annex 3 we provide examples of marketing messages that show there is competition on the vector of

[42] Whilst these contracts may include ILPV terms, customers on such contracts are not exposed to the harm identified by Ofcom as they are able to quickly switch provider without incurring any cost when advised of a price rise.

contract price variation terms. These messages indicate that providers recognise that price variation terms allow them to differentiate their offer and to attract consumers that do not like ILPV terms and/or value certainty. Ofcom, with its information gathering powers, will be able to assess what proportion of marketing spend is going to highlighting non-ILPV contracts.

Put simply, Ofcom has chosen the wrong way to evidence an absence of choice for consumers on a forward-looking basis. Its measure is backward looking and does not reflect the choices facing consumers in the foreseeable future. It provides no basis under which to estimate the impact of Ofcom's proposals, because it cannot readily estimate the counterfactual for the analysis (i.e. the likely gross market of additions for different contract types, taking into account BT's recent announcement).

The burden of proof on Ofcom is high, if it is to interfere in a competitive market. On the issue of choice, the current analysis and evidence falls way below the required standard. To proceed on the basis of the evidence in the consultation would be flawed and insufficient to withstand profound and rigorous scrutiny.

WILL THE FUTURE INFLATION ENVIRONMENT CREATE EXCESSIVE UNCERTAINTY?

To bolster its position on certainty, Ofcom introduces an additional proposition[43]. Essentially it says inflation is now volatile and high, such that even those consumers that can engage with ILPV terms are exposed to excessive uncertainty, notwithstanding the presence of choice.

Under The Act, a forward-looking analysis is at the heart of any justification for *ex ante* regulatory intervention. So, this should really be a question about the future inflation expectations for Q1 2025 and Q1 2026 (when ILPV price rises would typically be imposed), not, as Ofcom discusses at §2.12, about observed historical inflation. Much like the analysis discussed above, looking at historical data tells Ofcom very little about the impact on consumers of ILPV terms moving forward, when its proposals would have effect.

When Ofcom comes to undertake a proper impact assessment, one sufficiently robust to withstand profound and rigorous scrutiny, it needs to assess whether there is likely to be continued volatility and high inflation in the foreseeable future, i.e. when its proposals would be in effect. Either there is an expectation in the immediate future that inflation will be high and volatile, or there isn't.

The foremost experts advising the Government forecast that inflation will be low and stabilising[44] in 2024 and 2025. Even taking account of recent events, there is still an expectation that by the time of the price rise round that would take place in 2025, inflation will be nearly 2%[45]. Indeed, the current Government is fully committed to this objective[46]. If Ofcom takes a different view, then it would be

[43] §§2.11-2.13

[44] https://www.bankofengland.co.uk/monetary-policy-report/2024/february-2024 *"We expect inflation to fall further by the end of this year to around 2¾%."*

[45] https://obr.uk/docs/dlm_uploads/E03004355_November-Economic-and-Fiscal-Outlook_Web-Accessible.pdf *"We therefore expect inflation to remain higher for longer, taking until the second quarter of 2025 to return to the 2 per cent target"*

[46] https://www.gov.uk/government/speeches/autumn-statement-2023-speech *"I will not take risks with inflation, and the OBR confirm that the measures I take today make inflation lower next year than it would*

instructive to understand on what basis Ofcom proposes to make a decision using assumptions at odds with Government policy.

Based on what Bank of England and Government have said, it seems more likely that inflation will be low by the time of the 2025 and 2026 price rise rounds. Consumers would face much lower uncertainty in these circumstances thus removing Ofcom's excessive uncertainty argument. Moreover, it would be prudent for Ofcom to account for these circumstances in considering what may happen in the market and which unintended consequences could arise if it were to implement the ban.

OBJECTIVE 1 – ENABLE CONSUMERS TO UNDERSTAND THE PRICE OF A SERVICE READILY, WITH SUFFICIENT CLARITY AND CERTAINTY TO MAKE INFORMED COMPARISONS AND CHOICES AND FIND THE RIGHT DEAL FOR THEIR NEEDS

Above we have addressed the issues of clarity, certainty and choice. In summary:

- Ofcom makes no claims about the clarity of ILPV contracts, they are explicitly not seen as unclear by the relevant guidance to general UK consumer law; and

- Sufficient certainty is really about the presence of choice on the market between ILPV contracts and other forms of contract.

We therefore address the remaining elements of Ofcom's first objective in the rest of this section.

otherwise have been. I thank the Independent Bank of England Monetary Policy Committee for their crucial role in bringing down inflation. We will continue to back them to do whatever it takes until the job is done."

Matching customer needs with the right type of contract (or no contract)

Ofcom's focus on "major providers" when assessing the presence of alternatives to ILPV contracts on the markets, misses important evidence of choice. VMO2, for example, uses its different brands to offer different contract types. In mobile, for example, O2 offers a range of contract types including ILPV contracts for handset plus airtime purchases. Whereas, our giffgaff brand offers handsets but with a fixed price contract. This enables both brands to have a clarity of message to the market which can aid consumers in their choices.

Even within the O2 brand we offer a range of different options, both to give customers a choice of products that better meet their needs and situations; but also through taking account of customers' ability to pay and credit worthiness. Ability to pay and risk of default are very relevant considerations when offering a consumer credit agreement for devices alongside an airtime plan. **[✂ REDACTED]** Through these methods, the company both controls its exposure to fraud and bad debt, but also ensures that consumers do not over stretch themselves with regard to their monthly outgoings. Combined with self-selection, it prompts consumers with poor credit or affordability challenges to select products that require both lower monthly and upfront payment, e.g. PAYG or SIMO combined with second-hand device.

Taking these two factors together means that **[✂ REDACTED]**. The much lower rates of sign-up in groups with low credit worthiness is because of the processes we have in place but also because of self-selection applied by applicants when they learn about the deposit they must pay to complete application.

It is in our interest to match customers to the types of contract that will suit them, as it provides both the firm and the customer certainty as to future revenues (costs). If we routinely steered customers to the wrong contract for them, we would be optimising customer contracts through the minimum term, which would induce substantial volatility into our revenues.

The credit checking process in fixed services is somewhat different because we will have our own credit history for the physical address being served. Consumers are not being provided with a high value and portable device, so here we are concerned more with ensuring a relationship with the customer in the long run, rather than creating a credit risk rated barrier to purchasing. But it remains the case that we want our customers to only sign up to services they can afford. We cover the measures in place to ensure affordability of fixed broadband services later.

Understanding the price of a service

While acknowledging recent regulatory interventions aimed at improving awareness and understanding of price rise terms, Ofcom is largely dismissive of them and has failed to take the effects of them into account. We consider this to be a significant oversight.

As Ofcom notes, in December 2023 the Committee of Advertising Practice (CAP) and Broadcast Committee of Advertising Practice (BCAP) introduced new guidance on the presentation of in-contract price rises in advertisements for telecoms services. The aim of this guidance is to assist advertisers in ensuring that advertisements for services that include in-contract price rises do not mislead consumers (for example, by omitting material information or by presenting qualifying information insufficiently clearly and prominently).

Underpinning the introduction of this guidance was the concern that:

> "*Price is an important consideration for consumers when choosing a telecoms product, and the presence or possibility of an increase to the monthly price they will be paying is material information in all circumstances. However, the recent wider context of increased cost of living expenditure due to rising inflation made it even more important that this information was presented clearly and prominently*"[47].

In other words, the rationale for proposing, and implementing the guidance was very similar to the concerns that Ofcom has set out in relation to consumer awareness and understanding of ILPV terms. However, Ofcom is dismissive of the guidance, stating that notwithstanding its introduction:

> "*we still have concerns about consumers' ability to know with clarity and certainty the price they will pay where inflation-linked price variation terms are used and make an informed choice*"[48].

Clearly, the guidance does not seek to address certainty (in the context that Ofcom uses this term), however, it is highly relevant to Ofcom's concerns about awareness of ILPV terms and the lack of recognition by some customers that their prices will rise during the minimum contractual term. We think that it has the potential to, at the very least, improve awareness of ILPV terms, assist customers in identifying products containing such a mechanism and provide them with clarity about how pricing will apply during the life of their contract. It is therefore concerning that this intervention has been dismissed without any consideration of the extent to which it will address certain of the concerns that Ofcom has identified. It is also a further reason why, in our view, the data and analysis presented in the consultation fall below a standard that would be sufficient to withstand profound and rigorous scrutiny.

Moreover, we note that one of Ofcom's concerns is the fact that existing transparency and informational remedies relating to pricing terms apply late in the purchasing journey, when customers are likely to have made a purchasing decision.[49] The CAP/BCAP guidance, meanwhile, is targeted at customers at the very start of their purchasing journey.

The CAP/BCAP guidance was introduced after publication of the Ofcom consultation – thus Ofcom could not have assessed its effectiveness even if it had been minded to. This adds further weight to the notion that Ofcom should take a 'wait and see' approach in the light of developments in the market since the consultation was published.

We are also concerned about the lack of consideration afforded to the requirement introduced in June 2022 for providers to give an example to customers of how any planned price increase term is likely to affect the price they pay, using the most recent value of inflation (if the term uses an inflation index). Ofcom's research finds that worked examples are *"generally seen as containing useful*

[47] ASA: Regulatory statement - Mid-contract price rises in telecoms ads, 15 June 2023
[48] Consultation,§ 3.40
[49] Consultation, §3.37

information" and that respondents *"appreciated being given real world examples"*[50]. However, it is apparent that Ofcom considers them to be insufficient to *"ensure price clarity for consumers"*[51]. Ofcom notes that respondents' recollection of worked examples was poor, however, this is a separate issue. Moreover, Ofcom notes that some participants will have entered into contracts before the requirement to provide a contract summary (including a worked example) were introduced. There is a tangible risk, therefore, that Ofcom's research findings are not sufficiently representative of the latest consumer perspectives.

The dismissal of existing remedies and requirements is a common theme throughout the consultation. We think that Ofcom has failed to assess the effectiveness of certain of them to the required standard and we are concerned that it appears that many of them have been ruled out on the conceptual basis that they will not address its concerns about "certainty". This is too arbitrary, and also overlooks both the effects of the introduction of new consumer protections and the interaction of them with existing remedies (for example, the prospect of the new CAP/BCAP guidance increasing customers' propensity to pay more attention to ILPV information later in the purchasing journey).

[50] Qualitative Research Report, section 4.6
[51] Consultation, §3.38

Behavioural economics & Ofcom's consumer research

We now move onto Section 3 of Ofcom's consultation. VMO2 commissioned Oxera to review Ofcom's quantitative and qualitative consumer research, as well as the behavioural economics concepts explored in Ofcom's reasoning. We draw on that research here, when forming our own conclusions.

Ofcom's theory of harm is predicated on assumptions regarding the demand- and supply-side of the market and there are areas where these assumptions may be too strong in the context of the UK retail telecoms market:

- Lack of awareness of ILPV terms : Ofcom fails to take account of the impact of the most recent changes to the CAP/BCAP guidance, which has made information on ILPV terms prominent in advertising, ie at the very start of the sales journey – this may have had sufficient effect to make consumers more aware, Ofcom simply fails to test this; and even then

- The literature suggests that in markets where some consumers might lack awareness about certain price components, competition for consumers that are engaged and firms' reputational concerns can be sufficient to deliver good outcomes for all consumers.

The research looks at too narrow a set of behavioural biases and insights, Oxera explores a wider set which are relevant for (i) Ofcom's assessment of ILPV contracts, (ii) the justification for intervention, (iii) the effectiveness of the proposed intervention to trigger particular behaviour and (iv) the consequences of its proposed remedy specifically in telecoms markets. Oxera finds:

- Consumers engage with the telecoms market frequently, making repeated purchases for themselves and their family members. They can learn over time from their own experiences, those of their friends, through the media, marketing messages and even the press activity of the regulator. Such learning effects can overcome sequential bias. Further, sequential presentation of prices may actually be beneficial if inflation is low and there are comparable terms in the market, as it simplifies decision making – the right ILPV tariff is likely to be the one with the lowest headline price.

- Reputational concerns are much more relevant in telecoms markets because of repeat purchasing. As can be seen from Annex 3, many marketing messages are already focussed on alerting customers to the certainty benefits of fixed priced offers. Further, the more of these fixed price and £/p offers there are, the larger the marketing spend there will be on these messages. Reputational concerns of firms may be sufficient to tip the market in response to recent changes by major providers.

- There may be negative behavioural consequences of only allowing £/p increase terms which Ofcom has not considered. Presenting the price increase in absolute rather than percentage terms may potentially decrease consumers' sensitivity to price increases (price elasticity), which may soften competition as an unintended consequence. This is particularly relevant in the context of contracts where, whilst the quantum of a rise might appear small, its actual percentage might in reality be large.

Ofcom's market research is overly focussed on the precise terms within contracts, such as RPI and CPI, rather than engaging with customers more generally on the issue of inflation. Indeed, this appears odd given that the media and advocate narrative on this issue routinely cites "inflation"[52], in common with the title of this consultation. There are plenty of research results that show how many consumers can and do engage with ILPV terms. Finally, we note that Ofcom's quantitative survey uses a population of *"customers who were in-contract and were with providers that use inflation-linked price variation terms"*[53]. In fixed broadband in particular, at the time when the qualitative and quantitative research was conducted, a very small proportion of Virgin Media's base would have been on such contracts even though at that time Virgin Media itself was offering ILPV contracts. Therefore, in this case, "provider" is not a good proxy for "ILPV contract customer". This suggests to us that Ofcom's research results that focus on customers actual experience of the contract term, may not be reliable because of a lack of representativeness for VMO2's fixed customers.

<u>Conclusions on Objective 1</u>

We show in the analysis above that:

- Ofcom has previously determined that consumers have sufficient clarity and legal certainty in contracts with ILPV terms.

- Certainty of contract value is a novel departure and as we discuss earlier, Ofcom has not measured choice correctly in order to form any robust forward-looking assessment. When it does such an assessment it will need to take account of recent events, the likely reaction of consumers to that and consequently competitor reaction. We would note that if consumers do really value certainty, then the competitive effect of a major provider changing its approach would be large and may avoid the need for regulation at all.

- Informed comparisons and choices – recent changes to CAP/BCAP rules mean that customers are now much more aware of the ILPV term earlier in their purchase journey. Ofcom has not taken this into account at all in its analysis.

- Finding the right deal – the UK market is competitive, Ofcom says so in terms. There are a wide range of choices available and that choice is set to increase in light of recent announcements. Firms have an incentive to steer customers to the right choice for them, to ensure revenue stability and avoid bad debt. Behavioural biases other than those studied by Ofcom may actually work in the customer's favour, especially in the presence of more choice. We highlight reasons why, for example, a prohibition on ILPV contracts may be counterproductive, if behavioural biases untested by Ofcom dominate. For example, if consumers fail to appreciate that small £/p denominated increases, may actually be large increases in percentage terms and they would have been better off on an ILPV contract, come 2025.

[52] https://www.which.co.uk/news/article/how-to-avoid-inflation-on-a-mobile-contract-aurHQ5N6wAWb *"How to avoid inflation in a mobile contract"* – Which? 9 June 2023. We assume that Which?'s readership has, therefore, a grasp of what inflation is, in order for this headline to be sufficiently attractive to pull in readers.
[53] Ofcom quantitative research 2023, p.5 for example.

OBJECTIVE 2 – DRIVE PROVIDERS TO COMPETE BASED ON PRICE STRUCTURES THAT ARE CLEAR AND TRANSPARENT

ILPV terms are clear, as determined in the 2013 decision – nothing has changed there and Ofcom doesn't make a case regarding clarity in this consultation

The requirement to provide customers with a contract summary (including a worked example of any ILPVs) introduced in 2022 increased transparency, and assists customers in estimating the effect of inflation on the price that they will pay. We think that this will be a factor in stimulating providers to compete on price structures, as consumers become better informed and understanding of ILPVs increases. However, as we have set out above, Ofcom has instead dismissed this intervention as insufficient without undertaking a thorough assessments of its effects.

Similarly, the new transparency guidance introduced by CAP/BCAP in December 2023 increased transparency of ILPVs and in doing so, we believe, increased awareness of them. The fact that this increased transparency/awareness applies at the very start of customers' purchasing journeys suggests that it could be an important factor in driving providers to compete on pricing structures. Given that the publication of Ofcom's consultation pre-dated the coming into effect of the guidance, its impact could not have been taken into account in the consultation. However, this does not mean that Ofcom should not assess its effects. The arbitrary dismissal of it as an effective remedy to the concerns that Ofcom sets out is a glaring oversight, given the contribution that it could make to increasing competition on pricing structures.

<u>Conclusions on Objective 2</u>

At §4.25 Ofcom explains why it believes that additional transparency provisions alone might not be sufficient to deal with the problems it finds with ILPV contracts. Firstly, we would observe that Ofcom cannot draw any conclusions about transparency until it has evaluated the impact of the most recent changes to transparency and advertising rules, as we set out above.

The reasons Ofcom gives for not believing that transparency is sufficient are:

- Many consumers cannot understand inflation indices or percentages, so comparing estimates of future prices is too complex a task; and
- Uncertainty about future rates of inflation.

As we observe above, the fact that ILPV terms are broadly equivalent (inflation + 3.9%) is partly because CPs know that customers value the ability to compare prices easily. As the price increase term is roughly the same, the dominant figure to compare is the headline price. That allows different provider ILPV terms to be compared and consumers to choose the right deal from amongst ILPV contracts.

In the presence of greater choice, consumers that value certainty[54] have more options. If they place a premium on certainty, their comparison is less likely to be between ILPV contracts and £/p or fixed price contracts, but rather between contracts that give them certainty.

That leaves the cohort of customers who want to compare ILPV contracts and other types of contract. As we state above, with inflation likely to be low and stable for the foreseeable future, the second element of Ofcom's concern at §4.25 falls away, these comparisons are much more likely to be tractable, going forward.

OBJECTIVE 3 – PROTECT CONSUMERS FROM UNFAIR BURDENS AND RISKS (FOR EXAMPLE, FROM CONTRACT TERMS THAT IMPOSE UNFAIR FINANCIAL RISKS ON CONSUMERS)

<u>Ofcom misrepresents the scale of price increases</u>

At §2.10, Ofcom makes some bold claims about the scale of price increases arising from ILPV terms.

> *"In spring 2023, most customers on contracts subject to inflation-linked price rises saw their bills increase by between 14% and 17%. These increases could amount to hundreds of pounds a year for a family with a broadband connection and several mobile subscriptions."*

In Table 1, Ofcom reports that O2 customers faced a 2023 price rise of 17.3%. This is incorrect for the majority of O2 customers that are on Custom Plans and only experience a price rise in relation to their airtime plan. It is natural for customers to have regard to the effective price rise they experience in relation to their entire spend on telecoms. As O2 Custom Plan customers, on average ✂, the effective price rise they face was much smaller than that reported by Ofcom. Moreover, we note that the effective price rise experienced by these customers will have been below reported inflation during the past years of high inflation.

This state of affairs aligns with the observed increase in operator revenues over the period, as shown in Figures 4 and 5 below for mobile and fixed. Service revenues have not risen by *"between 14 and 17%"*, as stated above, but much more modest sums, if at all[55]. Noting that these increases will include both ILPV and out of contract price rises. The impacts on service revenue suggest that the average impact at customer level has been roughly half of the bill increases that Ofcom attributes to ILPVs.

[54] §3.62

[55] Enders Analysis "Inflation-linked price rises: Ofcom proposes shutting the stable door", 13 December 2023, showing pass through rates at around 50% for firms using ILPV contracts, ie only about half the headline price increase is subsequently realised in revenue growth.

Figure 4 **Increases in mobile headline prices and impact on mobile service revenue**

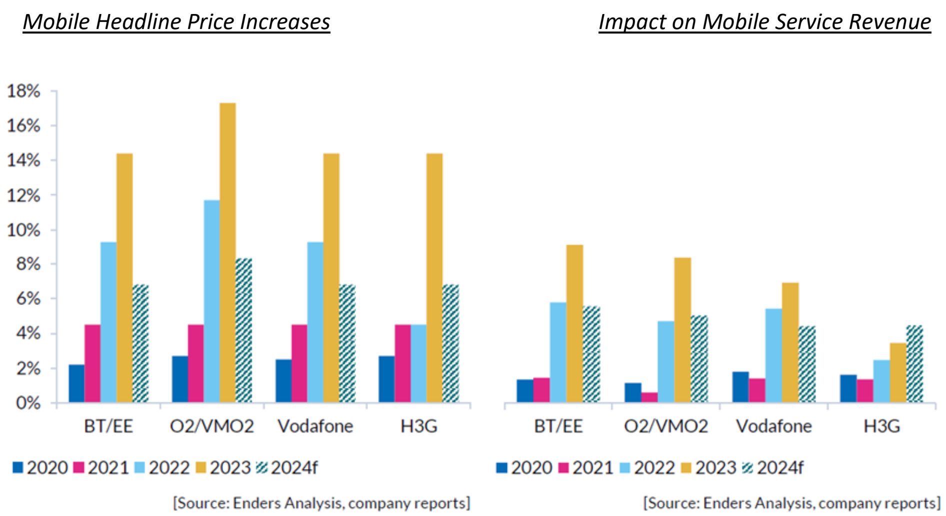
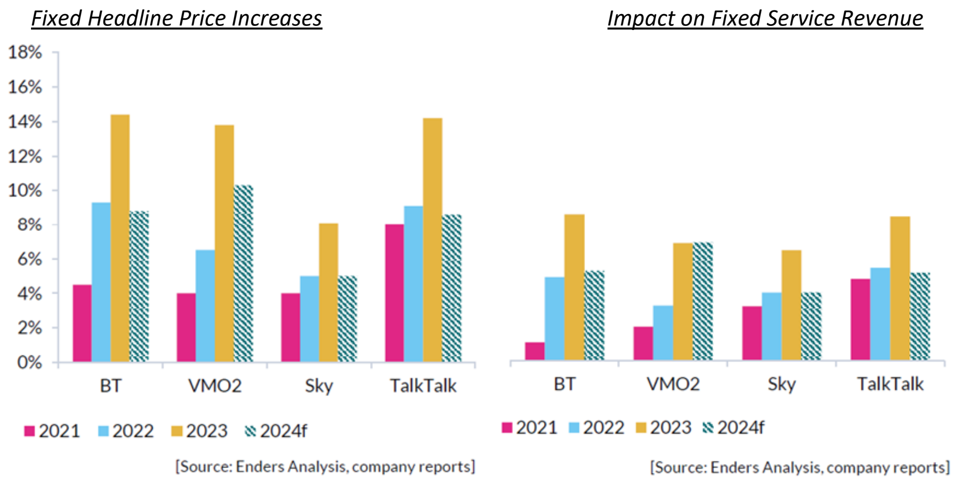


Figure 5 **Increases in fixed headline prices and impact on fixed service revenue**



Customers' ability to switch, spin down and optimise their spend, plus competition between firms for customers using ILPV contracts, has kept pricing competitive even in the face of an inflationary economy.

Fairness and harm caused to financially vulnerable and vulnerable customers more generally

In the consultation Ofcom expresses a number of concerns about the impact of ILPV contracts on financially vulnerable and vulnerable customers[56] more generally. We do not believe that Ofcom is proposing to intervene to ban ILPV contracts solely for the benefit of these cohorts, but rather that Ofcom believes that these cohorts would indirectly benefit from the removal of ILPV contracts as an option for them to buy. In summary, the concerns are:

- Price rises within the minimum commitment period leading to vulnerable customers being disconnected; and that

[56] §2.52, §§3.23-3.24, §3.52, §3.66, §3.69 and §4.69

- financially vulnerable customers and those with lower levels of numeracy find it hard to engage with terms such as CPI/RPI and percentages more generally.

There are two distinct issues here. The first point relates to the non-payment journey offered by a particular provider and the steps it takes to help customers stay connected whilst they repay their debts, it is not unique to ILPV contracts. The vast majority of providers, including VMO2, have measures in place to support customers who are struggling to pay their bills or miss payments. We place focus on preventing customers from getting into debt in the first place and encourage anyone who is struggling with affordability, or thinks that they may be unable to pay their bills, to contact us.

We offer a number of options to customers in such situations **[✂ REDACTED]**

We proactively contact customers who have missed a payment via multiple contact methods to maximise the chances of successful contact and prevent their financial exposure from worsening. In a limited number of cases (typically where customers do not respond to our contact attempts), we may apply service restrictions and, ultimately, disconnect customers. However, customers who are classified as vulnerable are managed via a separate, dedicated process, with more targeted contact measures and longer lead times before service restriction/disconnection is contemplated.

We consider, therefore, that Ofcom's concerns about ILPV contracts presenting a disproportionate risk to vulnerable customers is unfounded. Measures are in place to support customers who are experiencing affordability issues (be that as a consequence of ILPV terms or otherwise), with additional, targeted support for customers who are classified as vulnerable - and disconnection is used as a last resort, when other remedies have been exhausted.

The second point above relates to whether, in the presence of limited choice in the market, financially vulnerable and other vulnerable customer groups can get a deal that meets their needs. The more diversity there is in contract type, the more likely it is that these customer cohorts will get the right deal.

In order to estimate the extent to which ILPV contracts impact on financially vulnerable customers, it is important to understand that VMO2 does not view these customers as the addressable market for this type of proposition.

In relevant cases, we offer a social tariff for fixed customers, pre-pay and other options for mobile. Those financially vulnerable customers which find themselves moving onto Universal Credit have additional safeguards that they can draw on if they wish. Virgin Media's Essential Broadband social tariff has not changed in price since 2021 and does not contain a price rise term, insulating these financially vulnerable customers from the effects of inflation. We also offer a landline only service for elderly and vulnerable customers, with inclusive UK landline and mobile calls and a fixed monthly line rental charge – again insulating customers from the effects of inflation. For mobile there is currently pre-pay or 30 day SIM only contracts and later this year O2 will launch its mobile social tariff.

As explained above, those financially vulnerable customers that choose ILPV contracts, but then find themselves in payment difficulties, have many options to avoid increases in their price (e.g. by spinning down) but are also offered ways to mitigate impact.

We do not target ILPV contracts at financially vulnerable customers and we actively try to steer customers onto other products, by screening out financially vulnerable customers in the sales journey for ILPV contracts. Through a combination of self-selection plus credit and affordability checks, we mitigate the risk of applicants signing up to products they may not be able to afford. Evidence shows that these measures are effective: the average credit score of our fixed customers materially increases in the monthly spend they commit to.[57] **[✂ REDACTED]** Earlier we described how we screen out financially vulnerable customers during the mobile contracting journey. Despite the fact that vulnerable customers do not constitute the target market for ILPV contracts, it is not the case that they are manifestly 'bad' for such customers, as Ofcom appears to suggest. For example, during the last years of high inflation, the mid-contract increase for a contract containing an ILPV term may be lower than that applying under a contract containing a £/p price rise based on a provider's prior estimate of inflation (such as announced by BT). As noted above, application of a single £/p price rise likely means that customers on lower price contracts face greater percentage price rises than they would under ILPV contracts.

Finally, it is of note that some financially vulnerable customers have incomes that, to a larger extent than the general population, insulate them from the effects of inflation. State pensions have risen at higher than the rate of inflation between 2020 and 2024 thanks to the "triple lock", growing 31% across the period[58]. Similarly, the main social benefits have risen by CPI during this period. The National Minimum Wage has risen by CPI, the National Living Wage by 27% between 2020 and 2023.

We would observe that completely banning inflation indexation in telecoms contracts would break the link between incomes and outgoings for some of these customers, should CPs' estimates of future cost increases outstrip the out turn rate of inflation in 2025 and 2026. It follows that not all financially vulnerable customers may benefit from an outright ban on ILPV contracts.

[57] Average credit score is highest for customers that opt for a bundle including broadband, TV and mobile; lowest for customers selecting broadband only.

[58] Notably, in 2020 and 2024 increases were above CPI and pegged to average earnings increases. In 2021, the 2.5% floor was applied.

Complaints to Ofcom as a measure of fairness or harm

One further evidence point used by Ofcom is the level of complaints it has received from consumers. At §3.64, §4.75 and footnote 133 Ofcom puts forward these data:

- Between January and October 2023, Ofcom received over 800 complaints related to "price rises";
- In the same period in 2021 the figure was closer to 400 complaints; and
- Three verbatims are included, we assume, in an attempt to infer a qualitative understanding of these complaints data points and to link them to purported harm caused by ILPV contracts.

As we observe with other Ofcom data points, there is a certain amount of imprecision in its analysis, in particular an absence of context. Having looked more closely we would observe:

- The complaints volumes relate to price rises more generally, not ILPV contracts in particular. We asked Ofcom to provide us with more accurate statistics, splitting out general complaints about price rises from both ILPV price rises and end of contract, or out of contract inflation-linked price rises. Ofcom was unwilling to provide this information, although we infer from its response that it could do so if it wished to rely on more meaningful data;
- In light of the absence of specificity in these data, limited weight can be given to the three verbatim's quoted in §3.64, as we have no way of knowing how representative they are;
- We note from Figure 1 in the consultation that in January to October 2021 the number of customers on ILPV contracts would have been low and very few of those customers would have experienced a price rise at that time, but by 2023 these numbers would have been larger. Ofcom does not control its complaints metric for the number of customers with these contracts or who would have experienced a price rise. Even if Ofcom were to split out ILPV related complaints, it would need to control for the number of customers in-contract at a given time, in order to draw any inference that the level of inflation was causing an increase in complaint volumes (as opposed to increased customer numbers);
- Average industry complaint volumes have been broadly stable[59] between 2019 and 2023, so the volume of complaints about ILPV contracts do not appear to be observable against the background;
- Total telecoms complaints to Ofcom in the first two quarters of 2021 were around 11,500 with 2,300 of those being about "pricing, billing and charges".[60] In the equivalent period in 2023, these figures are 12,500 and 2,500 respectively. The contribution of "price rise" complaints to the latter measure (of which ILPV will be a subset) is about 3.5% in 2021 and 6.4% in 2023. However, as we note above, without controlling for the number of customers in-contract with

[59] We gathered data from the complaints figures that Ofcom publishes on a quarterly basis, eg, Most complained-about telecoms and pay-TV providers revealed - Ofcom. This allowed us to track complaints figures, both total and for individual categories, over the past four years.
[60] Same approach and sources as described in preceding footnote.

ILPV terms, it is impossible to determine whether increased inflation has had a bearing on the complaints about these contracts;

- Assuming about 40-50 million telecoms customers (over the age of 18) in the UK, about 2 in 100,000 have complained to Ofcom about "price rises", of which ILPV contracts will be a subset; and finally

- In 2021, Ofcom received 55,000 complaints about Piers Morgan, over 130x the complaints volume for "price rises" in telecoms generally.[61] In 2023 the comparable benchmark would be complaints about GB News, which were running at about 10x the complaints about telecoms price rises (noting that the multiple will be reduced due to the relatively lower viewership of GB News vs Good Morning Britain).

We do not believe that Ofcom can draw any firm conclusions from its complaints evidence in its current form.

Some customers do value inflation indexation

Ofcom's own data shows that about half of consumers can readily engage with the uncertainty caused by inflation indexation and may benefit from sharing risk with CPs through ILPV contracts[62]. Some consumers routinely elect to share risk in this way:

- In retail energy markets – choosing whether to benefit from potentially lower future wholesale energy prices by staying on variable tariffs, or hedging against higher future wholesale energy prices by fixing their price for a period; or

- In mortgage markets – by either fixing the interest rate, or choosing a floating rate, depending on the customer's future estimates of interest rates or desire to fix their outgoings; or

- In purchasing annuities – where pensioners can choose between drawdown (variable income), flat rate annuities, those that grow by x% per year or inflation indexed annuities, depending on their desire to hedge against inflation. Noting that the choice of an annuity is irreversible.

We accept that some of these choices should rightly be on an advised basis. That is a reflection of the scale of the risk. Some of these examples take place on transactions which are many orders of magnitude larger than a mobile airtime agreement or fixed broadband contract. In the case at hand, the quantum of the risk is low and so, in the presence of sufficient choice, consumers can be sure of getting a good deal, as Ofcom repeatedly observes. We note that energy contract purchases are not done on an advised basis and contract durations are not constrained to 24 months, as they are in telecoms, yet that market makes use of both variable and fixed price contracts to the benefit of consumers.

[61] "I don't believe it!" - 2021 marks a record year for TV and radio complaints - Ofcom

[62] As Oxera observe in Annex 1, Section 4.5, Ofcom's discussion fora demonstrated that some consumers have an appetite for bearing inflation risk - i.e. they were willing to take the chance that inflation would fall and they would be better off as a result than those on contracts with higher inflation forecasts baked in.

Customers contracting on an inflation linked basis have as much chance of being better off, worse off or indifferent compared to median inflation expectations[63], depending on the time of contracting. It is ironic that Ofcom's proposal to ban ILPV contracts is removing the option for customers to rely on an independent measure of price inflation to index their price, at the very point in the inflationary cycle where this cohort might be expected to benefit from out turn inflation in 2025 and 2026 that is predicted to be much lower than the inflation we observe today.

Conclusions on Objective 3

We have shown that some consumers routinely share risk with providers of services to them. Some consumers have the ability to engage with inflation linked terms and may actually prefer them to estimates of cost increases generated by CPs themselves.

ILPV contracts are not targeted at financially vulnerable customers and to the extent that these customers still do purchase services in this way, there are protections in place should the increase in costs caused by inflation become burdensome to them or their circumstances change. And finally, some financially vulnerable customers have inflation indexed incomes that may go some way to shielding them from negative impacts on their budgets.

OFCOM'S IMPACT ASSESSMENT

At Section 4 of its consultation, Ofcom sets out its assessment of different regulatory options to protect the interests of consumers:

- At §§4.9-4.20 it assesses the implications of doing nothing and relying on existing rules and guidance;
- At §§4.45-4.65 it sets out why it considers that its proposed remedy would be an effective way to meet the objectives set out in the consultation; and
- §§4.21-4.34 assesses a range of alternative remedies.

In alighting on a remedy, Ofcom needs to find the least intrusive remedy to address the identified harm being caused to consumers, in order to protect their interests. Intervening more than is necessary heightens the risk of regulatory failure through unforeseen market reactions to its intervention. This is particularly true in a competitive market, such as the markets at issue here. Ofcom addresses the proportionality of its remedy at §§4.66-4.82 of the consultation.

Do nothing – the counterfactual to intervention

At §4.20, Ofcom states that notwithstanding it has not assessed the impact of recent changes, it does not believe that they will be sufficient to address the *"lack of clarity and certainty about the prices they will pay when contracts include inflation-linked price variation terms".* Firstly, ILPV terms are

[63] See Annex 1 (Section 2.4)

clear, when previously assessed (by Ofcom) against Consumer Law. We note that the consultation assesses only certainty, as now defined.

At no point in Ofcom's assessment of "do nothing", does it address the possibility that we now observe on the market, ie that one of the "major providers" has unilaterally and unconditionally decided to offer £/p price variation contracts prior to Ofcom's decision and any implementation.

In light of this new information and to adequately discharge its duties, Ofcom will need to assess whether the impact of the availability of more choice (rather than less choice as it proposes) might lead to an unambiguously better outcome for consumers. Consumers that value certainty now have more options from a major provider, competitors may well react to that in order to retain or attract these customers – leading to Ofcom's objectives being met for the cohort of customers that value certainty, without recourse to regulation.

We note that in the consultation Ofcom relies on the recent changes to Virgin Media's terms and conditions as a basis to demonstrate that choice has reduced in the market[64]. In order to discharge its duties to consult fairly, Ofcom must treat changes in circumstances equally. As BT will change its terms and conditions, choice will be increased, arguably to a greater degree than the dilution of choice on which Ofcom relies.

Importantly, allowing the market to play out and respond to the change in circumstances would also avoid having to remove the option of ILPV contracts from customers who wish to have their contracts indexed to an independently derived measurement of inflation. A measure that might actually make those customers better off *ex-post*, once we see the inflation figures in the first quarter of 2025[65].

<u>Ofcom's proposed remedy of banning inflation indexation and % price increase terms</u>

Ofcom's approach to assessing its proposed remedy is structured as follows:

- At §4.52 Ofcom is concerned that a lack of engagement for ILPV contracts leads to consumer detriment due to less effective competition.
- At §4.53, it is stated that £/p contracts will give customers clarity and certainty over the price they will pay. We note that Ofcom fails to mention that ILPV terms are also clear (on its own analysis) when judged against prevailing Consumer Law.
- Ofcom **asserts** that £/p variation terms must drive higher engagement (on the basis that it isn't an ILPV contract). What Ofcom research does tell it, casts a lot of doubt on this assertion, or isn't actually or systematically tested:

[64] See §1.2, §2.10, Footnote 9, §3.9, §3.77 and §4.68.

[65] CMA, Energy Market Investigation §173, "*The introduction of the four-tariff rule has led to a number of the Six Large Energy Firms withdrawing a number of tariffs and discounts and changing tariff structures, which may have made some customers worse off.*"

- Only 39%[66] of broadband customers surveyed and 35%[67] of mobile customers could tell that a range of £/p denominated price rise terms, expressed in different ways, all gave the same total cost of ownership;

- Contracts expressed as £/p increases were the least easy to understand £/p price rise term[68];

- Whether consumers would be able to engage with the price rise part of the £/p term or just look at the first month's price when making their choice is not assessed. Without this, customers may be choosing the wrong £/p contract[69]; and

- There is a total absence of any analysis of whether these changes will lead to *"direct customer activity (eg switching or shopping around)"*[70].

This latter point is a major failing in Ofcom's analysis. Especially as it reflects the criticism by the CMA in the equivalent example of regulatory failure from the RMR intervention in retail energy markets. In that case, even if there was higher engagement (which was not clear), it did not lead to more switching and competition, which might have competed away any short run price increases. Ofcom must make a positive and well evidenced case that £/p price rise terms <u>increase</u> engagement AND greater activity in the market as a result. It cannot just assert that £/p contracts are better because they are not ILPV terms. On that basis, any contractual term is better, even a punitive one.

Ofcom's assessment that £/p contracts will present a lower financial burden and unfair risk rather assumes that the out-turn prices of ILPV contracts in 2025 will be higher than the £/p equivalent, where CP's set the price[71]. Notwithstanding evidence in the consultation that some CP's expect these prices to be higher[72] and Which?'s evidence that consumers may have to pay higher prices[73]. Ofcom already has evidence from BT's announcement about the scale of its proposed price increases for 2025. It can compare these to reputable forecasts of inflation that are aligned with Government policy.

We note that even Which? recognises[74] that Ofcom's proposals would need to generate greater competition if these price increases are to be mitigated. Yet Ofcom lacks any concrete evidence that these changes will lead to greater competitive intensity in order to off-set these price effects. Perhaps

---

[66] Broadband research report, p.22
[67] Mobile research report, p.21
[68] Broadband research report p.21 and Mobile research report p.20
[69] Ofcom's qualitative research does not assess whether customers engage with £/p price rise terms in any better way than they do ILPV terms, at the point of sale. And even if that experiment were to be run, it would have to clearly differentiate between Ofcom's proposed GC changes on the sales journey (transparency) and £/p terms (certainty), when assessing engagement.
[70] CMA, Energy Market Investigation §172
[71] §§4.54-4.55. The risk on consumers is asymmetric, when comparing £/p contracts vs ILPV contracts. Consumers are only exposed to risks of higher prices in ILPV contracts compared to the counterfactual of a £/p contract where a risk-averse provider sets the price rise term, if inflation is high and volatile during their contract period, contrary to their expectations. The Government believes that inflation will be low and stable.
[72] §4.81
[73] Footnote 140 refers.
[74] Ibid

it would be best to run that experiment in the market, by seeing if recent changes and competition between ILPV contracts and £/p contracts moderate price effects?

<u>Improving transparency alone</u>

Ofcom dismisses the option of improving transparency (on its own), on the grounds that, even if transparency and awareness of ILPV terms was increased, it would not address consumers' lack of understanding of inflation indices (and ILPV terms in general). We think this reasoning is arbitrary.

First, Ofcom has not taken sufficient account of the effects of a number of existing regulatory interventions (particularly the requirement to provide a worked example of price rise terms and the new CAP/BCAP guidance). As well as failing to assess the effects of these interventions on awareness, there is no consideration of the extent to which they may help to improve consumers' understanding of ILPV terms and inflation indices. In our view it is not unreasonable to assume that increased awareness and transparency could have such an impact (i.e. as the terms become more widely known and recognised and customers become more familiar with, and curious about them).

Second, we think that Ofcom has underestimated consumers' ability to understand ILPV terms, inflation indices and percentages. As we have set out above, these mechanics are a common element of prices in many markets and are a staple fixture of mortgage products, pensions and consumer benefit payments. Consumers will be familiar with inflation, percentages and indices when it comes to discounts, VAT, tips and wage bargaining. As the Oxera report in Annex 1 observes, eliciting views about inflation depends on how you ask the question.

As we have set out above, transparency interventions have the potential to be an important component in addressing the concerns that Ofcom has set out – and may in fact be sufficient on their own. Ofcom has not met the assessment or evidential standard to dismiss them out of hand.

<u>Proportionality</u>

At §§4.56-4.82, Ofcom addresses the proportionality of its remedy. Ofcom replays its benefits arguments with regard to engagement and certainty. Its costs analysis is limited to the costs incurred by CPs in making changes to their systems and processes, or through variances versus their current business plans.

The issue of the impact on investment is addressed a §§4.76-4.79. Adverse consequences (ie costs on consumers) are addressed in just three paragraphs §§4.80-4.82. The three main competitive responses to the proposal considered are:

- An increased use of unspecified price rises (e.g. prices may vary terms), which Ofcom believes could be moderated by the "right to exit";

- Higher prices than the counterfactual, as risk-averse CPs increase prices by more than the out-turn inflation we later observe. Ofcom confidently predicts at §4,81 that *"we expect consumer engagement and the effectiveness of price competition in the market to be strengthened, which will ensure consumers can benefit from more competitive prices overall."*

It presents no evidence, nor has it conducted any research on this point. Notwithstanding the time and resources expended in trying to make its benefits case. This is very disturbing given the risk that Ofcom makes the same regulatory error as its sister regulator Ofgem; and

- A shortening of contract periods, leaving more consumers out of contract and on inflation linked out of contract price rise terms. Again, Ofcom relies on customers shopping around with higher levels of engagement caused by its proposals. It presents no evidence that improved engagement with contractual terms will lead to greater switching than we see today (which would be required for competition to offset the negative effect). And in any case, the likely effect of shorter contracts is to raise average prices in the market due to increased revenue risks for CPs. We note Ofcom presents no empirical evidence to support its assertions.

Put simply, Ofcom invests in evidence and research to make its case. It relies on assertion and conjecture to deal with the likely adverse consequences of what it proposes. Such an approach is contrary to its own consultation principles and insufficient to withstand profound and rigorous scrutiny.

CONCLUSION

ILPV contracts have been around since 2020 and Ofcom has had the opportunity to assess their impact on the market for some time. Today ILPV contracts form the predominant option for customers purchasing long-term mobile contracts and, since 2023 only, purchasing fixed broadband contracts.

However, circumstances will soon change and Ofcom needs to take full account of this in a better evidenced forward-looking assessment. BT's unconditional move to £/p price rise contracts from Summer 2024 will mean that in fixed broadband, ILPV contracts will form less of the gross additions market than they did back in 2020, when Ofcom did not intervene. In mobile, it would only take one more major provider to introduce non-ILPV options, for ILPV contracts to form the minority of new contracts written. Ofcom needs to take account of this change when considering what it should do next.

Risk averse CPs may well over-estimate their likely input cost inflation going forward, leading to higher prices than the counterfactual, with ILPV contracts. Contract lengths may shorten, leading to higher average prices, or out of bundle charges may rise (or their scope increase). Ofcom appears unconcerned, because it is convinced its intervention will increase competitive intensity and these transitory increases will be competed away.

Ofgem, the retail energy market regulator, undertook a similar intervention which restricted tariff choices for consumers. That intervention was eventually referred to the CMA for investigation after prices rose in the market, rather than falling as predicted by Ofgem. The CMA found that the intervention did not lead to more engagement or if it did, that was not converted into more competitive activity. The net result was higher prices for consumers because valuable tariff options were removed from the market. Ofgem was forced to remove many of its tariff restrictions and allow the market to resolve the problem it had created, by offering consumers greater choice.

Ofcom's research evidence focusses on showing that ILPV contracts disengage customers. It does not present a positive case to show that its preferred remedy would improve that engagement AND convert that into more competitive activity. In fact, consumers that struggle with understanding inflation indexation still struggle to identify the best deal when presented with a range of £/p pricing options. In the meantime, the cohort of consumers (about half of them) who can engage with inflation indexation, would be made worse off, if, as appears likely, inflation turns out to be in line with the Government's expectations and just 2% in the Spring of 2025.

Given the change in circumstances, the welfare maximising approach would be to let competition play-out in the presence of this strong signal from the regulator and a change in the competitive landscape. In that way, the greater choice can be converted into better outcomes for those consumers that value "certainty of contract value", whilst also allowing ILPV contracts to potentially act as a competitive constraint on the scale of £/p increases.

Annex 1 : Oxera report on Ofcom's proposals to prohibit inflation-linked price increases

Annex 2 : Availability of product and contract types across a wide range of providers

Mobile providers that include ILPV terms in their contracts

Provider	Price variation term	Product type	Contract period for airtime
EE / BT Mobile (until summer 2024)	CPI + 3.9% (full PAYM bundles)	SIMO, PAYG, PAYM bundles previously, split PAYM now	1 month rolling, 12 / 24 months
Three	CPI + 3.9% (full PAYM bundles, airtime only for split PAYM)	SIMO, PAYG, PAYM bundles previously, split PAYM now	1 month rolling, 12 / 24 months
Vodafone	CPI + 3.9% (full PAYM bundles, airtime only for split PAYM)	SIMO, PAYG, PAYM bundles previously, split PAYM now	1 month rolling, 12 / 24 months
O2	RPI + 3.9% (airtime only for split PAYM)	SIMO, split PAYM	1 month rolling, 12 / 24 months
Virgin Mobile (does not offer new contracts)	RPI + 3.9% (airtime only for split PAYM)	SIMO, split PAYM	24 months
Tesco Mobile (non-clubcard members)	CPI + 3.9%	PAYG, SIMO, split PAYM	1 month rolling, 12 / 24 months
ID Mobile (by Currys)	CPI + 3.9%	SIMO, split PAYM	1 month rolling, 12 / 24 months
Plusnet Mobile (does not offer new contracts)	CPI + 3.9%	PAYM bundles, SIMO	12/ 24 months
Talkmobile	CPI + 3.9%	SIMO, PAYM bundles	1 month rolling, 12 months

Source: compiled by VMO2 having accessed provider websites in January 2024.

Mobile providers that offer fixed prices or price variation terms other than ILPV

Provider	Price variation term	Product type	Contract period for airtime
EE (from summer 2024)	£/month increase	SIMO, split PAYM, PAYG	1 month rolling, 12 / 24 months
BT Mobile (from summer 2024)	£/month increase	SIMO, split PAYM	12 / 24 months
Sky Mobile	No price rises during contract period	SIMO (with separate device plans)	Minimum of 12 months
Giffgaff (by VMO2)	Commitment to fixed prices	PAYG, SIMO	1 month rolling, 18 months
VOXI (by Vodafone)	Fixed price	SIMO	1 month rolling
Lebara	No price rise on 12-month contracts in 2022 and 20323	SIMO, PAYG	1 month rolling, 12 months
Lyca Mobile	Fixed until 2026	SIMO, PAYG	1 month rolling, 12 months
Honest Mobile	Loyalty discount	SIMO	1 month rolling, 12 months
SMARTY (by Three)	Fixed prices	SIMO	1 month rolling
Asda Mobile	No price rise terms	SIMO	1 month rolling (with auto-renew option)
Utility Warehouse	No price rise terms	SIMO	1 month rolling
Tesco Mobile – clubcard members	Fixed prices	SIMO, split PAYM, PAYG	1 month rolling, 12/ 24 months
Talk Home Mobile	Fixed prices for 2023 and 2024	SIMO, PAYG	1 month rolling, 12 months
1p Mobile	Fixed prices for 2023	SIMO	1 month rolling

Source: compiled by VMO2 having accessed provider websites in January 2024.

Broadband providers that offer 'fixed prices' contracts (or price rises not linked to inflation)

Provider	Price variation term	Contract period
Youfibre	Fixed prices	24 months
Hyperoptic	Fixed prices	24 months
Trooli	Fixed prices	24 months
Zen Internet (powered by Cityfibre)	Fixed prices	12 months, 18 months, monthly rolling
Zoomm	Fixed prices	12 months
Utility Warehouse	Fixed prices	18 months
Hull Fibre	Fixed prices	12, 24 months
Connect Fibre	Fixed price	18 months
Voneus		24 months
Link Broadbands	Fixed price	3, 6, 12 months
Octaplus	3.9% increase per annum	12, 24 months
Open Fibre	Fixed price	24 months
Squirrel Internet (powered by Gigaclear)	Fixed price	18 months
Infinics	Fixed price	24 months
Yayzi (powered by Cityfibre)	Fixed price: three-year price guarantee	Monthly or 18 months
Cuckoo	No price rise after contract ends?	12 months

Source: compiled by VMO2 having accessed provider websites in January 2024.

Broadband providers that offer 'prices may vary terms' contracts

Provider	Price variation term	Contract period
Sky	Prices may vary	18 months
Now Broadband (by Sky)	Prices may change during contract	Monthly rolling, 12 months
Gigaclear	Prices may change during the contract	18 months
Direct Save Telecom	Prices may vary	12, 18 months
Zone Broadband	Prices may vary (according to third party source)	12, 24 months

Source: compiled by VMO2 having accessed provider websites in January 2024.

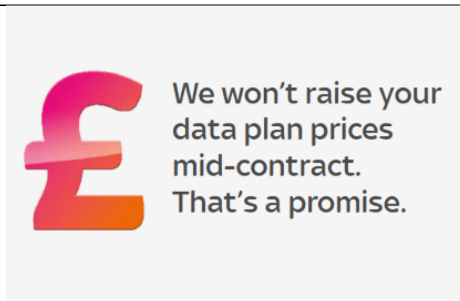
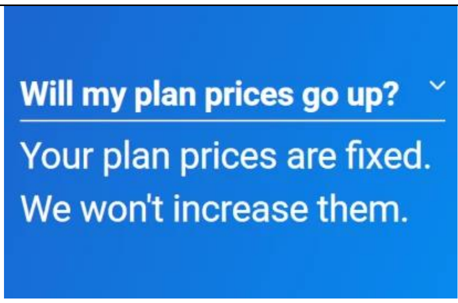
Broadband providers that offer contracts including ILPV terms

Provider	Price variation term	Contract period
BT, Plusnet, EE	CPI + 3.9%	12, 24 months
Vodafone	CPI + 3.9%	24 months
Shell Energy	CPI + 3.0%	18 months
Three 5G Home broadband	CPI + 3.9%	1 month and 24 months
TalkTalk	CPI + 3.7%	24 months
KCOM	CPI + 3.9%	24 months
Community Fibre	Fixed in 2024; thereafter CPI + 2.9%	24 months
Virgin Media	RPI + 3.9%	18, 24 months
Onestream	RPI + 3.9%	24 months

Source: compiled by VMO2 having accessed provider websites in January 2024.

Annex 3 – Marketing messages focussed on an absence of in-contract price variation terms

Mobile providers

sky mobile		
Lebara		
SMARTY Simple, honest mobile		
giffgaff the mobile network run by you		
TESCO mobile		

Sources: marketing materials gathered from the websites of each company, during January 2024.

Broadband providers

	Say goodbye to broadband price hikes - Hyperoptic TV Advert 2023 (youtube.com)	Instant regret – shock mid-contract price hikes make two thirds of recent broadband buyers wish they'd chosen a different provider | Hyperoptic
	WE SAY 'NO' TO PRICE INCREASES - Trooli	
	Zen's Contract Price Promise | Zen Internet	
	Broadband without the hike (uw.co.uk)	
	Flexible Payment Options | Broadband Payment Plans | TalkTalk	TalkTalk offer no mid-contract price rises in new deal (choose.co.uk)
		

Sources: marketing materials and links gathered from the websites of each company and other websites, during January 2024.