

The review of the market for standalone landline telephone services

TalkTalk response to Ofcom's February 2017 consultation

8 May 2017

NON-CONFIDENTIAL VERSION

This is TalkTalk's response to Ofcom's consultation on its review of the market for standalone landline telephone services ("the consultation") published on 28 February 2017.

1 Summary

- 1.0 We support Ofcom's preliminary conclusion that it must introduce retail price regulation on BT to protect customers who buy standalone landline services. We propose a hybrid remedy option to address consumer detriment in this market, while incentivising BT to implement measures to promote competition.
- 1.1 We have addressed Ofcom's specific consultation questions as follows:
- Questions 3.1, 3.2, 4.1, 5.1 on Ofcom's provisional conclusions on market definition and SMP: see §§2.3-2.6.
 - Questions 7.1-7.3 on customer engagement remedies: see §§2.9-2.11.
 - Questions 8.1 on price control options: see §§2.7-2.12.
 - Questions 8.2-8.6 on price control design considerations: see §2.15.
 - Questions 9.1-9.3 on remedy proposals: see §§2.7-2.14.

Where we have not commented on an issue, no inference should be drawn as to whether we agree or disagree with Ofcom's proposals.

2 Our position

We support Ofcom's proposal to protect customers by imposing a price control on BT's standalone landline services

- 2.0 We support Ofcom's proposal to cut prices for customers who buy standalone landline services by imposing a retail price control on BT. Customers buying bundles of services including a landline and broadband have benefitted from competitive pricing resulting from lower wholesale costs, while customers buying landline separately have not benefitted from falling prices.
- 2.1 The evidence that Ofcom presents in the consultation demonstrates that standalone landline customers are facing progressively higher prices for these services. Line rental prices have increased by 25% to 49% in real terms from December 2009 to December 2016, with particularly sharp inflation in prices from 2013 onwards (figure 1.2).
- 2.2 Standalone landline customers are predominantly older – more than half are over 70 – and not engaged in the market. The average tenure for this group of customers is 22 years.¹ The consumer harm identified is specific to the standalone landline market where there is strong correlation between vulnerability and demand for the service. This means that retail price regulation is appropriate in this instance because it will not reduce competitive

¹ [Pricing trends for Communications Services in the UK](#), Ofcom, 15 March 2017, p4.

incentives in other markets. Ofcom is right to act to protect these customers and ensure they are provided with better value for money.

BT has SMP and retail regulation is needed to address consumer detriment

- 2.3 We agree with Ofcom's provisional conclusion that BT has SMP in the standalone fixed voice (SFV) access and calls markets. Ofcom demonstrates in its analysis that there are two separate relevant economic markets: residential SFV access and fixed voice calls sold to SFV access customers. We also agree that the relevant geographic area for this review is the UK excluding Hull.
- 2.4 BT has a dominant position in the relevant markets which has allowed it to increase prices without facing competition from alternative providers. BT accounts for the vast majority of this market with over 70% market share, and customers have suffered as choice has declined and BT's market position has strengthened. The consultation shows that BT acts as a price leader and its profitability per line is increasing.
- 2.5 The structure of the market and regulatory framework has not supported competition in standalone fixed voice services. There is no prospect for increased competition from other CPs in this market in the absence of SMP remedies. In fact, in the absence of regulation we consider that competition will weaken further as the market continues to decline in size and customers age and become increasingly inactive in the market. Even CPs such as the Post Office, with strategies aligned with serving standalone fixed voice customers, find it difficult to compete due to high customer inertia. Ofcom notes that even when the Post Office offered lower prices than BT it did not manage to gain a significant number of customers (§7.5). This demonstrates the inability for entrants, even those with a strong brand, to be able to win market share by undercutting the dominant incumbent.

TalkTalk has not sold voice-only services to new customers since 2014. Our strategy has focussed on selling bundled landline and broadband services underpinned by investment in local-loop unbundling to serve customers using MPF. Inefficient engineering resulting in excess jumpering in the exchange leads to additional MPF costs and limits providers' ability to compete. As Ofcom acknowledged in the Narrowband Market Review 2017, it is not economically viable to use MPF to serve standalone fixed voice customers.² In addition, there is no available MPF variant that would enable a CP to use it to sell a voice-only product to customers without removing the possibility of the customer taking broadband from another provider in the future. [3<].

² [Narrowband Market Review consultation 2017](#), Ofcom, 1 December 2016, §4.93.

The retail price control remedy – a hybrid option to protect customers while promoting competition

- 2.6 We agree with Ofcom that the existing wholesale regulation is not sufficient to address the consumer detriment as it occurs at a retail level. Retail price regulation must be introduced in a market where competition has become too weak to protect consumers such as the retail voice market.
- 2.7 Taking account of the negligible prospects for increasing competition in the market and lack of engagement within the customer base, we consider there could be an argument for addressing the consumer detriment by immediately imposing the maximum price reduction of £10 on BT line rental for SFV (“option 3”). Nevertheless, we appreciate why Ofcom may be reluctant to introduce a remedy that removes the scope for other CPs to compete from the outset without at least trying to introduce greater competition. We remain sceptical, however, that it will prove possible to create a reasonably competitive market situation in retail voice.
- 2.8 We see Ofcom’s rationale for seeking to promote competition through a £5-7 price reduction on BT line rental for SFV accompanied by measures to promote competition (“option 4”). However, we consider that there is a risk that this option results in extending consumer detriment over the market review period if the measures to promote competition are not effective. This risk is particularly acute given the challenges of implementing effective customer engagement approaches. As Ofcom recognises, there are inherent difficulties associated with designing effective ways to increase customer engagement. We also anticipate that it will be particularly difficult to successfully apply these approaches in this market given the low levels of customer engagement, brand loyalty to BT, and limited number of competitor CPs.
- 2.9 We therefore recommend that Ofcom considers a hybrid option that would balance the need to protect customers while retaining some possibility of promoting competition. We propose that Ofcom introduces an immediate price reduction of £7 on BT line rental for SFV accompanied by a target for BT to achieve switching rates of at least 25% of its current standalone fixed voice customers away from BT within two years. If BT does not meet this target, Ofcom should impose a £10 price reduction on BT line rental for SFV in the third year of the charge control. BT would therefore be incentivised to implement customer engagement remedies in order to promote switching from its SFV base.
- 2.10 We consider that placing the onus on BT to actively engage with these customers will be more likely to be effective than Ofcom specifying a range of measures for BT to develop and test. BT may choose to trial engagement approaches before implementing them if it considers that this will increase the prospects for success. Overall, BT would be incentivised to implement its

chosen engagement approaches more effectively and within a shorter timeframe than would be likely under option 4.

2.11 If Ofcom does not consider that the hybrid remedy proposal is practicable or legally possible, we consider that, given the low chance that measures to promote further competition will be successful, Ofcom should simply immediately adopt option 3.

2.12 [REDACTED]

2.13 [REDACTED]

2.14 We have the following further comments on the design of the price control:

- We support the introduction of an immediate reduction in BT's retail price for standalone fixed voice services and only allowing it to increase prices in line with inflation to hold them constant in real terms.
- Introducing a retail price reduction on a glide path from the current level to the target level would not be appropriate as it would extend the consumer harm during the charge control period.
- We agree with the proposed basket structure and the need for a separate sub-cap on the line rental within the basket.
- We agree with the proposal to exclude the Home Phone Saver and Line Rental Plus from the price control.
- We favour the hybrid option we set out above.

Conclusion

2.15 In general, we share Ofcom's reluctance to abandon the prospects for competition as we consider it is the best way of driving better services and cheaper prices. We would urge Ofcom to consider how it might ward against similar deterioration of competition in other markets so that the customer detriment experienced by standalone fixed voice customers is not repeated as other markets mature and decline.

2.16 We consider our hybrid remedy proposal to be a pragmatic approach to addressing Ofcom's objectives to protect standalone landline customers from higher prices while seeking to promote competition.