



Vodafone Response: The Review of the market for standalone landline telephone services

May 2017

Summary

1. With clear evidence of market failure, Vodafone understands the need for Ofcom to intervene in the Retail Narrowband market to protect consumers' interests. Interventions of this kind should be regarded as a last resort, avoided wherever possible through the availability of robust remedies within upstream wholesale markets that create the environment that generates competitive downstream retail markets.
2. We would urge Ofcom to be mindful of any current or future attempts to circumvent the spirit of this intervention by drafting specific remedies that ensure customers who should be protected by regulatory are sufficiently covered.
3. We believe another significant number of UK consumers served by WBA Market A also face poor retail choice and require specific attention. Faced with higher prices, poorer choice and the lowest broadband speeds in the UK, the needs of these consumers has not been addressed effectively. BT's regulatory financial statements show returns in this wholesale market of 70%. A detailed review of this market is necessary to minimise the risk of consumers paying high prices, but receiving relatively poorer service and choice.

The Case for Retail Intervention

4. Vodafone acknowledges the need for Ofcom to intervene in the Retail Narrowband Market to safeguard the consumer interest. Nine years after the market was deregulated it is clear that the significant minority of consumers who purchase voice services on a standalone basis are not being served effectively by the retail market and regulatory action is required, at least in the short term, to urgently improve consumer outcomes. While we would never endorse interventions in the retail markets as a first choice, in this particular case the consequences of market failure are focused upon a vulnerable set of customers who are less able to navigate the market for alternatives. Ofcom therefore has little choice but to intervene to protect these customers.
5. We firmly believe that the focus Ofcom has historically placed upon ensuring the availability of robust wholesale remedies is the right one. It facilitates healthy retail competition by allowing communication providers to access the appropriately priced wholesale inputs that they need to participate fully in the retail market. There is clear evidence of robust competition in other segments of the retail market (such as bundled voice and broadband) that back up the effectiveness of placing regulatory emphasis on the remedies around the supply of wholesale service to address access bottlenecks,



leaving it to the market to deliver for consumers. Where competition has delivered on the back of effective wholesale remedies it has generally provided price and service based competition that has greatly benefited UK consumers.

6. In the case of the retail residential standalone voice market it is clear that the market has failed to operate effectively, largely due to the lack of active participation by other communication providers in the stand alone voice space, as a result BT has retained an astonishing ~70% market share. This can be attributed to both the reluctance of customers in this segment to switch and of the failure of competition and regulated remedies. It appears that standalone voice consumers have proven to be less inclined to switch away from BT and unsurprisingly far less likely to purchase online, driving higher marketing acquisition and support costs that would mean that the cost of gaining market share would be considerable to alternative suppliers. This has allowed BT to make significant profit from these consumers with barriers for other suppliers to particulate in the market remaining stubbornly high.
7. In common with many other providers, Vodafone does not provide services into the consumer standalone voice market. In August 2016 Vodafone abolished separate line rental charges for home broadband customers, being the first in the market to do so. It was a move designed to make phone and broadband pricing more transparent and it has proved popular with consumers who welcome the end of separate line rental charges. The approach has resonated with many who felt frustrated by rising line rental charges, particularly those consumers who are primarily interested in the broadband aspect of their service.
8. It is clear from the evidence presented by Ofcom that consumers using BT's voice services on a standalone basis have not had their loyalty rewarded, with BT pushing through disproportionate increases in line rental charges in recent years. While other providers' line rental charges may have also tracked up, these price rises attributed to line rental need to been seen in the context of the overall voice and broadband package offered to the market, with line rental often sold alongside a heavily discounted broadband service, ensuring the package price is competitive, even if line rental as an itemised cost may have increased. Consumers of other providers also show willingness to switch supplier should they wish, having usually done so on at least one occasion before. This helps act as a constraint on supplier prices across the retail market.
9. When introducing a retail charge control on a targeted set of retail services, the specific regulation must be drafted in a way to minimise loopholes: to address any repackaging, or reconstructing to minimise the scope and volume of standalone voice customers, without truly providing additional competitive services. For example, bundling an unwanted broadband product for the existing landline price to ensure the customer no long qualifies for the forthcoming regulatory retail tariff even although they are unlikely to make active use of the broadband service. This would be especially troublesome if the consumer was not informed that the price of their existing service was potentially likely to fall substantially in the next twelve months at the time of signing up to any promotion. This would not be an acceptable outcome for these consumers and Ofcom



should ensure any activities of this kind are prohibited to ensure one source of consumer detriment is not simply replaced by another.

Understanding the consequence of deregulation

10. Ofcom's proposed intervention is a targeted one, seeking to directly address the symptoms of the problem, rather than tackle the root causes at source. While we support treating the symptoms, and doing so promptly as it is clear that some consumers have been over-paying for too long. This could have been addressed earlier, if retail market reviews had continued beyond the point at which retail regulation had previously been withdrawn. More widely, BT has a level of control over the entire communication market commercial operating system that is beyond the ability of individual market reviews to remedy. While market reviews may seek to address immediate issue of market power, they have failed to tackle this wider concern of cross-market control.

The importance of Wholesale Remedies for retail effective retail competition

11. Looking ahead there are other retail markets where we believe consumers are at risk of being failed, that are worthy of closer Ofcom scrutiny. In particular, we would draw Ofcom's attention to the predicament of consumers who are served through the Wholesale Broadband Access (WBA) Market A. These customers suffer from a lack of choice and without effective regulation remain at risk of higher prices and poorer service. In Market A BT is often the only supplier with available infrastructure for Broadband deployment. A short review of any retail price comparison website demonstrates that in Market A there is less choice, retail prices are often more expensive, yet these areas record some of the lowest broadband speeds and investment in the UK. Simultaneously BT's Regulatory Accounts reveal it is making significant margin from these consumers, sweating old kit and able to comfortably meet a charge control that hasn't been effective at delivering consumer outcomes anywhere close to what can be expected in a competitive market setting.
12. The 2016/17 BT Regulatory Financial Statements¹ revealed that BT earned a return of 70% from the regulated wholesale broadband services used by around 1.8 million customers living in rural parts of the country who make up ~9.5% of UK homes and businesses. This provides BT with average profit in excess of regulatory predictions of nearly £94 per customer per year. This represents a sizable minority of UK Consumers and it is clear that the broadband market isn't working for them. We hope Ofcom will bring forward proposals for immediate starting charge adjustments in this wholesale market to allow alternative suppliers to price more competitively and better serve the rural economy in the UK, ending returns for BT that are unjustified both from the perspective of the services offered into the market and the low level of capital investment that has historically been delivered to support these consumers.

¹ <https://mediacentre.vodafone.co.uk/pressrelease/planned-reforms-openreach-required-new-report-highlights-bt-excess-profits-increased/>



13. In WBA market A, as in the narrowband market, it is absolutely vital that effective and appropriately priced wholesale remedies are available to alternative suppliers to bring price and service competition to consumers. In SMP services like these, if there is insufficient regulatory pricing pressure then consumer detriment is the only certain outcome. Weak regulatory pricing pressure has harmed consumers in Market A and we are now mindful that the same thing may well occur in the wholesale narrowband market through Ofcom's proposals to significantly relax pricing remedies on both WLR and CPS.
14. We believe that Ofcom's narrowband deregulatory agenda may well have adverse consequences for other retail consumers and we would take no pleasure in being proved right in the years ahead. Basic pricing safeguards are all that is required in Narrowband, with a CPI-CPI safeguard (or an WLR indexation to the eventual MPF charge control) being the proportionate backstop measure needed to protect the consumer interest
15. As a result, UK SME and business customers who don't tend to utilise MPF based suppliers are particularly vulnerable from the lack of narrowband pricing safeguards proposed. While we would never advocate an extension of any retail intervention to include them (given the number of suppliers active in the market and evidence on SME retail competition on both price and business grade service wraps), we do believe that these consumers would benefit greatly from the certainty that backstop pricing safeguards provide. Without these measures UK businesses remain at risk of excessive wholesale prices transferring through into higher retail charges as a result of a failure to implement suitable remedies to counter BT's SMP. This leads to both consumer detriment and contributes to BT's considerable excess returns in regulated markets. We would urge Ofcom to act with consistency by promoting robust wholesale remedies to prevent the need for long term retail intervention.

Issues that hinder competition in the voice market

16. In our response to the Narrowband Market Review we highlighted our concerns around the level of System Control that BT exerts across many different markets and the way that control manifests itself, often beyond the reach of tradition SMP remedies. This control is very real, formed by mechanisms, processes and contracts functioning together as a system of control to shape consumer outcomes across various regulated markets. Yet this concept is one that remains to be acknowledged by Ofcom in any shape or form, due to the market by market focused approach within which regulation works. In the UK we've seen other sector regulators joint the dots on the issue of system control, acknowledging it and taking steps to address it.
17. Make no mistake, whilst the further separation of Openreach from the rest of BT is welcome, the matter of system control, particularly in the narrowband market is not addressed in any way by the change in the legal status of Openreach. Indeed, for legal separation to be a success, issues of system control and incumbency advantage need to be dealt with appropriately. In particular, a significant amount of control lies in other



parts of BT, notably Wholesale & Ventures, who use this commercial freedom to maximum effect and consumer detriment.

18. The voice market is perhaps one place where evidence of system control is most apparent through the contractual, pricing, interconnection and service arrangements in place. Cumulatively these issues undermine the competitiveness of alternative suppliers, hampering the effectiveness of competition in the retail market. We set out some examples of the kind of issues that haven't been addressed, but impact the market both individually and collectively, reducing the ability of providers competing with BT to offer products in the voice market:
 - a. The SIA allows for unilateral price rises imposed by BT;
 - b. The Carrier Price List gives BT an advantage in the transit market, reducing competition and therefore competitors cost base;
 - c. BT controls the cost base for the entire industry through the Element Based Charging matrix, essentially and effectively, controlling third parties' costs;
 - d. BT provides monopoly services (text Relay, Access to emergency services etc.) that due to regulation and commercial necessity are required by other CPs, yet the pricing of these services is left for BT to determine.
19. In and of themselves it might be argued the individual impact of these issues maybe small, but the cumulative materiality of this level of market control and how it affects the competitiveness of downstream voice markets cannot be under-estimated.

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