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TELEFONICA UK LIMITED RESPONSE TO:

“Helping consumers to get better deals in communications markets: mobile handsets”

23 September 2019

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Executive summary

1. Telefonica UK Ltd ("TUK") welcomes the opportunity to respond to Ofcom's consultation on its proposed amendment to General Condition 1.4, to limit the duration of "linked" split contracts ("LSCs") to no more than 24 months[1] ("the Consultation Paper").

2. As Ofcom is aware, TUK is one of four mobile network operators in the UK. It provides mobile wholesale services to a number of mobile virtual network operators, including Sky and Tesco Mobile. TUK also provides mobile retail services to over 25 million customers through its O2 and giffgaff brands. As Ofcom notes[2], TUK is the largest provider of split contracts. O2's Custom Plans is its principal tariff provided through direct channels and is an example of a LSC. Custom Plans affords customers the option to take an interest free loan for up to three years to purchase a mobile device from O2. Custom Plans customers also sign up to a 30 day rolling airtime agreement. Customers are free to end the airtime agreement but are required to pay off any outstanding loan if they choose to do so.

3. In TUK's view, the evidence and rationale presented by Ofcom in the Consultation Paper provide no basis at all for regulatory intervention. Providers in the competitive mobile market have developed LSCs of a duration exceeding 24 months because of consumer demand; consumers clearly value these propositions, which render accessible, expensive devices that some consumers might otherwise not be able to afford.

4. TUK believes that Ofcom's interpretation of Article 105 of the European Electronic Communication Code ("the EECC"), which is fundamental to its proposal, is wrong as a matter of law. Article 105 of the EECC simply consolidates previous provisions of the Universal Service Directive, which does not prohibit LSCs such as TUK's Custom Plans. The EECC contains no new prohibition on such contracts.

5. Indeed, the Custom Plans proposition is entirely consistent with the basic policy of Article 105(1) of the EECC and the provisions in the Universal Service Directive, which that Article consolidates. Unlike under a traditional mobile subscription contract, customers are not "locked in" to any minimum period for their airtime contract. Nor are they required to enter into a consumer credit agreement with TUK. Rather, they have the choice of taking advantage of TUK's interest-free credit, but only so long as they are TUK customers.

6. Further, Ofcom's concern, that LSCs over 24 months in duration disincentivise switching because of the need to pay off an outstanding loan, is not based on any empirical evidence. Ofcom simply asserts that this is the case (it is, in Ofcom's words, "self-evident"[3]). TUK believes that customers' freedom to switch provider is unlikely to be

[1] Helping consumers to get better deals in communications markets: mobile handsets. Ofcom, 22 July 2019: https://www.ofcom.org.uk/__data/assets/pdf_file/0037/157699/statement-and-consultation-mobile-handsets.pdf
[2] §3.16 refers
[3] See, for example §5.16

impeded in the way Ofcom describes, not least because there is a vibrant market in used handsets; customers are easily able to sell handsets (and do, in large numbers), acquired under LSCs, to pay off any outstanding loan, if they want to, in order to switch provider. TUK notes that Ofcom has failed even to mention, let alone take account of, the second hand mobile handset market, in arriving at its provisional view.

7. In any event, even in circumstances where paying off a lump sum might be seen to disincentivise switching (for which, there is no evidence), TUK believes that is not necessarily a problem that merits intervention. Certainly, there is no evidence that customers are complaining about this. Further, a narrow focus on switching, without considering the broader competitive landscape, has led Ofcom to draw incorrect provisional conclusions about consumers' interests, which are liable to result in intervention that reduces, not enhances, consumer welfare. Switching is just one aspect of the operation of the market. Ofcom appears to accept that there is strong competition when consumers subscribe to new contracts. Indeed, O2 developed its Custom Plans tariff offering in the context of this competitive market; the ability for customers to enter into an interest free loan agreement for up to three years addressed a need to spread the increasing cost of mobile devices over a longer period of time. TUK's customers are well aware of the nature of O2's Custom Plans offering. It is the customer, and not TUK, that determines the duration of the handset loan agreement under Custom Plans.

8. Ofcom's assumption, that, in response to the proposed prohibition, providers would simply "unlink" LSCs, with no changes to the substance of the arrangement, betrays a worrying commercial naivety. [✂]

9. Ofcom also fails to appreciate fully that it *already has* the power to intervene in circumstances where a provider's conditions and procedures for contract termination act as a disincentive to switching. Ofcom acknowledges that General Condition 1.3 can be used to address any concern that LSCs of duration less than or equal to 24 months disincentives switching[4]; on the same basis, that provision must be capable of being used to address concerns relating to LSCs of duration exceeding 24 months. Put simply, if Ofcom acquires evidence of end-users being unduly disincentivised from switching, it should consider enforcing the current rules, rather than seeking to impose new regulation that would have the (presumably unintended) consequence of prohibiting tariffs that consumers find attractive and, by extension, restricting and distorting competition in the competitive mobile retail market.

[4] §5.40 refers

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10. The truth of the matter is that, in this Consultation Paper, Ofcom presents no evidence of consumer harm that arises from LSCs of duration greater than 24 months. Instead, Ofcom is proposing to regulate on a whim, in breach of both its statutory duties and one of its key regulatory principles, of a bias against intervention. In TUK's view, this would be a grave mistake.

11. In the remainder of this response, we answer the specific questions Ofcom raised in the Consultation Paper.

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Question 1: *Do you agree that our implementation proposal for bringing the requirements of the EECC into effect is sufficient to address our concern that linked split contracts (and other split contracts falling within the definition of a bundle) are liable to deter switching?*

12. TUK disagrees with the premise of this question.

13. Firstly, Ofcom's assertion, that the effect of the EECC is to require Member States to restrict the duration of LSCs to no more than 24 months, is an error of law. A proper reading of the EECC reveals that it requires nothing of the sort.

14. Secondly, TUK does not believe that Ofcom's concerns regarding LSCs are justified. Ofcom has not properly assessed its concerns relating to the impact of linked split contracts on switching. As we show later on in this response, such concerns are unlikely to be material. More fundamentally, Ofcom has failed to evaluate properly the impact of LSCs on competition in the mobile retail market. These arrangements have proved successful in the competitive mobile retail market and have increased consumer welfare. Any attempt to prohibit LCSs of duration greater than 24 months, would not, therefore, be objectively justifiable or proportionate. Further, to the extent that a prohibition would penalise, in particular, providers, like TUK, that innovate with respect to tariff offerings, it would be discriminatory.

Ofcom's Error of Law

15. In the Consultation Paper, Ofcom states that the EECC:[5]

> "*… requires Member States to limit the duration of certain contracts to 24-months. This includes split contracts for airtime and handsets where the terms require that, if the customer terminates the airtime contract, they must pay off any sums due for the handset.*"

16. Ofcom says that the proposed amendments to the General Conditions are intended to give effect to Article 105(1) of the EECC, which requires that contracts concluded between consumers and service providers should not "mandate a commitment period longer than 24 months".[6] Ofcom believes that contracts such as TUK's Custom Plans permitting repayment of up to 36 months will be impermissible under Article 105.

17. This interpretation of Article 105 of the EECC, which is fundamental to Ofcom's proposal, is wrong as a matter of law. Article 105 of the EECC simply consolidates previous provisions of the Universal Service Directive, which did not prohibit contracts such as TUK's 36-month Custom Plans. The EECC contains no new prohibition on such contracts.

[5] Consultation Paper at [5.3].
[6] Consultation Paper at [5.28].

18. Article 105(1) provides as follows:

    '*Member States shall ensure that conditions and procedures for contract termination do not act as a disincentive to changing service provider and that contracts concluded between consumers and providers of publicly available electronic communications services* [with certain inapplicable exceptions]*… do not mandate a commitment period longer than 24 months. Member States may adopt or maintain provisions which mandate shorter maximum contractual commitment periods.*

    This paragraph shall not apply to the duration of an instalment contract where the consumer has agreed in a separate contract to instalment payments exclusively for deployment of a physical connection, in particular to very high capacity networks. An instalment contract for the deployment of a physical connection shall not include terminal equipment, such as a router or modem, and shall not preclude consumers from exercising their rights under this Article'.

19. The first paragraph of Article 105(1) does no more than replicate and consolidate existing rules under Article 30(5) and (6) of the Universal Service Directive:

    'Member States shall ensure that contracts concluded between consumers and undertakings providing electronic communications services do not mandate an initial commitment period that exceeds 24 months. Member States shall also ensure that undertakings offer users the possibility to subscribe to a contract with a maximum duration of 12 months.

    Without prejudice to any minimum contractual period, Member States shall ensure that conditions and procedures for contract termination do not act as a disincentive against changing service provider.'

20. The second paragraph of Article 105(1) is a carve-out, exempting a class of instalment contract from the application of the first paragraph. The European Commission ("**EC**") explained in its proposal for the EECC Directive that this was 'as a means to facilitate reimbursement of contributions to the deployment of a physical connection and to support network roll-out through instalment-based contributions to network capital costs'. The proviso in the second paragraph, '*an instalment contract… shall not include*' was not included in the EC's original proposal but was adopted by the European Parliament. It appears to be intended not to broaden the scope of the existing rules, consolidated in paragraph 1 of Article 105(1), but to limit the scope of the new exception from the rules.

21. Ofcom is thus mistaken to suppose that Article 105(1) is novel in any relevant respect. The Article preserves the old rule that contracts must not "mandate" a "commitment period" longer than 24 months.

22. The concept of a "commitment period" "mandated" by a contract is perfectly clear. It describes a period during which the customer is legally committed to continue with the contract. As Ofcom itself explained in its 25 May 2011 Statement, *Changes to General*

Conditions and Universal Service Conditions: Implementing the revised EU Framework, with reference to its interpretation of "initial commitment period" in Article 30(5) of the Universal Service Directive, it is the period of the contract during which the consumer cannot leave the contract *'without being liable to pay compensation'* to the communications provider.

23. Contracts like TUK's 30 or 36 month Custom Plans do not "mandate" a "commitment period" longer than 24 months. They permit the customer to choose to make repayments of the credit they have received over a period longer than 24 months, but leave the customer to terminate the contract and bring the credit facility to an end at any time, without compensation or charge for early termination. Of course, the customer remains liable to repay any part of the loan principal that remains outstanding; but that liability to pay back the loan principal is incurred at the outset of the contract, as soon as the sum is advanced on credit, and involves no form of termination charge. (Some consumer credit agreements may mandate commitment periods longer than 24 months, e.g. fixed term interest-bearing loans with early repayment fees to compensate the lender for lost interest payments, but TUK's Custom Plans is not such a contract).

24. Indeed, the Custom Plans proposition is entirely consistent with the basic policy of Article 105(1) and the provisions in the Universal Service Directive which that Article consolidates. Unlike under a traditional mobile subscription contract, customers are not "locked in" to any minimum period for their airtime contract. Nor are they required to enter into a consumer credit agreement with TUK. Rather, they have the choice of taking advantage of TUK's interest-free credit, but only so long as they are TUK customers.

25. Thus, while Article 107 of the EECC Directive confirms that a bundled services agreement (such as the Custom Plans consumer credit agreement) is subject to the requirements of Article 105, there is no reason to suppose that those requirements are any stricter than they were under the Universal Service Directive 2002/22/EC. And since contracts like the 30 or 36 month Custom Plans are compliant with the Universal Service Directive, they will remain compliant with the EECC.

26. Ofcom's proposal to prohibit such contracts is thus undermined by a fundamental error of law.

27. Separately, TUK notes that, in any event, it is by no means certain that the UK will be obliged to implement the EECC, since it may not remain a member of the European Union. The Department for Digital, Culture, Media & Sport consultation on the implementation of the EECC[7] states that the EECC will be transposed by secondary legislation under the anticipated EU (Withdrawal Agreement) Act 2019[8]. Since then, of course, the UK has had a change of Prime Minister and the current Government's clear policy is that the UK should leave the EU, with or without an

[7] Implementing the European Electronic Communications Code, Department for Digital, Culture, Media & Sport, 16 July 2019. See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819964/EECC_Consultation_-_Publication_Version__4_Updated_.pdf

[8] On page 6

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agreement, on 31 October 2019. In a "no deal" scenario, it is far from clear that the UK Government would implement the EECC.

Development of O2's Custom Plans proposition

28. O2 was the first major provider to introduce split contracts, in 2013, through its "Refresh" proposition. Under Refresh, customers entered into two separate 24 month agreements: an interest free loan to pay for the handset; and an associated airtime agreement. Refresh provided customers with greater transparency and flexibility (to upgrade) and the benefit of monthly payments reducing automatically after the handset loan had been paid off.

29. Since then, the market has developed. Competitors have adjusted their propositions to remain competitive and the cost of devices has increased. O2 responded in August 2018 by introducing its Custom Plans proposition. This offers customers greater flexibility, compared to Refresh. Customers are able to select the duration of the zero interest loan agreement, up to 36 months. The associated airtime agreement is subject to 30 days' notice. However, the customer must settle the loan if the airtime agreement is ended. Customers also have the flexibility to adjust the airtime package (for example, by reducing or increasing the volume of inclusive data).

30. A fuller explanation of the development of O2's Custom Plans proposition and the benefits it offers customers is set out in the attached Alix Partners report[9].

Ofcom's concerns are not supported by economic principles

31. Ofcom's theory of harm comprises several steps:

    1. Customer switching is important to competition;
    2. The requirement in LSCs to pay off the handset contract as a lump sum will tie customers to their current provider
    3. LSC customers will be harmed directly; and
    4. LSCs weaken competition

32. TUK does not consider that Ofcom's theory of harm is plausible. Generally, competitive markets can be expected to maximise consumer welfare, as firms are able to create new products and services that meet customers' needs. It is well established, and accepted by Ofcom, that competition is strong in the UK mobile market. For example, in Ofcom's consultation on the arrangements for the forthcoming spectrum auction, it noted that:

    "we consider that competition [in the market for the provision of mobile services in the UK] is generally working well, with prices decreasing over time, consumer

[9] §§80 - 99 refer

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satisfaction at a high level, and continued innovations and investment by operators”[10]

33. Without clear evidence of a market failure (which Ofcom has not set out in the Consultation Paper), a regulatory ban on certain products or services would be expected to limit customer choice and reduce welfare.

34. As regards the specific steps in Ofcom’s theory of harm:

    1. TUK considers that Ofcom places undue emphasis on switching and fails to recognise that it is the effectiveness of competition between mobile providers that ensures good outcomes for consumers, rather than switching per se. Ofcom appears concerned to ensure that LSC customers are able to switch during the period of the handset loan agreement, but this is not critical, given the competitive nature of the mobile market. What is key is that customers understand the nature of the arrangement before they sign up; they are then able to make informed purchasing decisions about mobile packages which best suit their needs.

    2. Ofcom has not collated any evidence to establish whether or not the requirement in LSCs to pay off the handset contract as a lump sum does, in fact, deter customers from switching. In fact, the available evidence suggests the opposite.

       Firstly, Ofcom does not refer at all to the established and large market for second-hand handsets. This is important, because the fact that customers are able to (and, in fact, do) sell handsets, including those acquired through LSCs, means that they can generate the cash necessary to repay, either in whole or substantially, the outstanding loan on handset agreements. TUK research indicates [✂]

       TUK would be happy to share its research on the issue with Ofcom.

       TUK has also examined customer complaints, to establish whether or not customers are complaining that they cannot switch provider because of the need to pay off handset loans. Our data reveal only a tiny number of such complaints[11] and we note that Ofcom has presented no evidence of any complaints, at all.

    3. TUK notes that Ofcom has presented no evidence that LSC customers are, in fact, harmed directly through taking out such agreements. TUK’s evidence shows that customers derive significant benefits from LSCs. O2 Custom Plans customers are

[10] §A6.2 of Consultation: Award of the 700 MHz and 3.6-3.8 GHz spectrum bands, Ofcom. 18 December 2018. See: https://www.ofcom.org.uk/__data/assets/pdf_file/0019/130726/Award-of-the-700-MHz-and-3.6-3.8-GHz-spectrum-bands.pdf

[11] See §116 of the attached Alix Partners report for further information

properly informed about the nature of the agreements they enter into before they sign up, including the requirement to pay off the handset loan agreement if they wish to end the airtime agreement. O2 Custom Plans customers have freedom to choose the length of time over which they wish to repay their handset loan (from 3 to 36 months) and a large proportion of customers choose a period of longer than 24 months. This is strong evidence that consumers see significant benefits in being able to spread handset cost over longer periods. Moreover, O2's Custom Plans prices are significantly more attractive to customers than equivalent standalone, independently priced, SIM only airtime tariffs and handsets.

4. The analysis supporting Ofcom's assertion that the impact of LSCs on customer switching will undermine competition and that the extent of harm will increase if more providers offer LSCs is, in TUK's submission, unduly narrow and static.

   It takes no account of the dynamic nature of competition; as more providers offer LSCs, they will need to compete to attract and retain customers, this is likely to drive innovation with benefits being likely to be passed to customers in the form of even lower prices.

Ofcom already has the power to address the concern it has identified

35. GC 1.3 requires Communication Providers to ensure that their conditions and procedures for contract termination do not act as disincentives for end-users against changing provider. Indeed, this is the mechanism that Ofcom proposes to use should LSCs of a duration of less than or equal to 24 months result in a disincentive to switch[12].

36. TUK believes that Ofcom, therefore, *already* has at its disposal an adequate regulatory means of addressing its stated concern, that LSCs of a duration exceeding 24 months might unduly disincentivise switching. Conditions and procedures for contract termination which disincentive switching are effectively prohibited under the existing regulatory regime, by virtue of GC 1.3. Consequently, if a CP's LSC, of any description or duration, has the effect of disincentivising end-users, unduly, from changing provider, that is likely to constitute a breach of GC 1.3 and Ofcom is able to take the appropriate enforcement action.

[12] §5.41 refers

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The proposed amendment to General Condition 1.4 would amount to a breach of various of Ofcom's statutory duties

37. In section 5 of the Consultation Paper, Ofcom explains how it considers its relevant statutory duties[13] would be served by amending General Condition 1.4 ("GC 1.4") in the way it proposes in Annex 7[14]. In TUK's submission, this analysis is perfunctory.

38. Without prejudice to our response to question 2, below, TUK believes that the proposed amendment to GC1.4 would not satisfy the conditions in section 47 of the Communications Act and that, therefore, Ofcom cannot give effect to it.

39. Specifically, the proposed amendment could not be said to be proportionate[15], for two reasons:

    1. As set out, above, GC 1.3 already prohibits conditions and procedures for contract termination which act as a disincentive to switching. Ofcom has not explained why GC 1.3 does not address its concerns about LSCs disincentivising switching. Introducing another provision with the same objective would therefore not be proportionate; and

    2. In any event, Ofcom has not assessed the extent to which such agreements do, in fact, disincentivise switching and restrict the competitive process. For reasons set out in response to Question 4 of the Consultation Paper and in the Alix Partners report attached as an Annex to this response, TUK believes that any impact on competition is likely to be very limited. Conversely, prohibiting such arrangement would remove from the competitive mobile market, a class of tariff propositions that consumers value, considerably. Consequently, such a prohibition would be disproportionate[16].

40. In addition, the proposed amendment would discriminate against providers that have responded to market developments by introducing innovative tariff propositions, such as O2's Custom Plans tariff. Ofcom's proposed amendment to GC 1.4 would therefore seem to conflict with s 47(2)(b) of the Communications Act 2003.

41. Further, TUK believes that the proposed amendment to GC 1.4 would be inconsistent with Ofcom's principal statutory duty to further the interests of consumers in relevant markets, where appropriate by promoting competition[17]. The arrangements that the provision would prohibit have been introduced as commercial responses to competition

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[13] Set out in Annex 6, §§A6.23 – A6.31
[14] §§5.59 – 5.70 refer
[15] TUK believes that the proposed amendment to GC 1.4 would not be objectively justifiable, for the same reasons
[16] For the same reason, TUK believes that the proposed amendment to GC 1.4 would also breach the statutory duty set out in s3(4) of the Communications Act 2003, which requires Ofcom when performing its duties and where relevant, to have regard to the desirability of promoting competition and encouraging innovation in relevant markets
[17] Section 3(1) of the Communications Act 2003 refers

in the mobile retail market, and they are popular with consumers. TUK believes that, in principle, Ofcom should embrace innovative pricing structures, since they are an effective mode of competing. Instead, Ofcom's proposal would impede the competitive process, with a longer term detrimental effect on consumer welfare.

42. Section 3(3) of the Communications Act 2003 requires Ofcom, in performing its duties, to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and any other principles appearing to Ofcom to represent the best regulatory practice. For the reasons set out above, TUK believes that the proposed amendment to GC 1.4 would not be consistent with this statutory requirement.

43. Section 3(5) of the Communications Act 2003 requires Ofcom to have regard, in particular, to the interests of consumers in respect of choice, price, quality of service and value for money. In TUK's view, the proposed amendment to GC 1.4 would conflict with this statutory duty, because it would remove a class of tariff propositions that consumers clearly value.

44. In summary, TUK believes that the proposed amendment to GC 1.4 would constitute a breach of various of Ofcom's statutory duties.

Question 2: *Do you agree that the draft General Condition (in Annex 6) would achieve our aim of limiting the minimum contract periods of the contracts we are concerned about to 24-months?*

45. TUK believes that Ofcom's aim is flawed for the reasons we have explained. We do not, in any event, believe that Ofcom's draft General Condition in Annex 7 would achieve that aim.

46. The mechanism by which Ofcom proposes to introduce the 24-month cap is by an amendment to Condition C1.4A of the General Conditions to provide that Condition C1.4 '*shall also apply to contracts for the provision of Bundles in so far as the Subscriber concerned is: (a) a Consumer; or (b) a Microenterprise, Small Enterprise Customer or not for Profit Customer, unless such Microenterprise, Small Enterprise Customer or Not for Profit Customer has expressly agreed otherwise*'. 'Bundle' would be defined for these purposes as *'where Mobile Communications Services and Terminal Equipment are sold by the Regulated Provider under the same or closely related or linked contracts'*.

47. All Ofcom's amendment would do is thus to clarify the applicability of Condition C1.4 to linked split contracts. TUK would have no objection to such clarification, although we believe that prudent operators would in any event proceed on the basis that linked split contracts should comply with Condition C1.4.

48. Condition C1.4, however, does not prohibit contracts such as TUK's 30 or 36-month Custom Plans. It prohibits any contract *'that stipulates a Fixed Commitment Period of more than 24 months in duration'*. A consumer credit agreement permitting (but not mandating) repayment over a term of more than 24 months does not involve a Fixed Commitment Period of more than 24 months as that expression is defined by the General Conditions (*'a period beginning on the date that contract terms agreed by a Communications Provider and a Subscriber take effect and ending on a date specified in that contract, and during which the Subscriber is required to pay for services and facilities provided under the contract and the Communications Provider is bound to provide them and in respect of which the Subscriber may be required to pay a charge to terminate the contract'*). The credit agreement is in the nature of a facility which the customer is not obliged to use but may choose to bring to an end at any time; and the customer's liability to repay the principal sum advanced at the outset of the agreement is not a *'charge to terminate'* but a liability consequential upon termination.

49. Ofcom's proposed drafting is thus inadequate to achieve Ofcom's flawed objective of outlawing contracts such as TUK's 30 and 36 month Custom Plans: such contracts would remain compliant with the General Conditions as amended.

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Question 3: *Do you agree with our implementation proposal that providers should have three months to make the necessary changes to their contracts and other relevant materials?*

50. Without prejudice to TUK's position, that regulatory intervention in the way Ofcom proposes is not justified and that, in any event, the draft provisions in Annex 7 of the Consultation Paper do not give effect to Ofcom's proposal, we do not agree with Ofcom's implementation proposal.

51. In the Consultation Paper, Ofcom states that there "will be minimal implementation costs for providers to comply [with the new GC 1.4] (they will need to remove the relevant linking clauses from their contracts)"[18]. Ofcom does not set out the basis for this assertion. [✂]

52. [✂]

53. Under O2's Custom Plans, the customer must retain an airtime contract with O2, in order to benefit from the interest free handset loan facility. [✂]

54. [✂]

55. [✂]

56. [✂]

[18] §5.46 b) refers

57. TUK would be happy to provide Ofcom with more information about this issue if Ofcom would find that useful.

58. In conclusion, without prejudice to TUK's firm position against Ofcom's proposed intervention, TUK disagrees strongly with the implementation proposal. [✂]

***Question 4:** Do you have any comments on our impact assessment of our proposal to prohibit linked split contracts (and other split contracts falling within the definition of a bundle) of over 24 months?*

59. Ofcom purports to assess the impact of its proposal in paragraphs 5.45 – 5.58 of the Consultation Paper. In TUK's view, this is a perfunctory assessment, which is flawed and not fit for purpose. It provides no basis for the proposed intervention.

60. In the response to this question, we set out the appropriate standard for regulatory impact assessments, why Ofcom's work falls far short of this standard and how, as a consequence, Ofcom has arrived at the wrong conclusion.

61. However, we first explain why Ofcom has no need to introduce more regulation in the first place, since it already has the power to address the problem it is concerned about.

Ofcom already has the ability to act against LSCs of any duration, which have the effect of disincentivising switching

62. As we set out in our response to Question 1, GC 1.3 requires Communication Providers to ensure that their conditions and procedures for contract termination do not act as disincentives for end-users against changing provider. Indeed, this is the mechanism that Ofcom proposes to use should LSCs of a duration of less than or equal to 24 months result in a disincentive to switch[19].

63. TUK believes that Ofcom, therefore, *already* has at its disposal an adequate regulatory means of addressing its stated concern, that LSCs of a duration exceeding 24 months might unduly disincentivise switching. Conditions and procedures for contract termination which disincentive switching are prohibited under the existing regulatory regime, by virtue of GC 1.3. Consequently, if a CP's LSC, of any description or duration, has the effect of disincentivising end-users from changing provider, unduly, Ofcom is able to take the appropriate enforcement action.

64. As regards Ofcom's impact assessment, the effect of this existing regulatory obligation is simply not considered. TUK believes that GC 1.3 can be relied upon to address Ofcom's concern entirely; if that is wrong, Ofcom needs to set out in its impact assessment where the regulatory lacuna lies, how the proposed amended General Condition 1.4 fixes the problem and any other costs and benefits associated with it.

65. In TUK's view, the deficiencies in Ofcom's impact assessment are not restricted to its failure to assess the extent to which the current regulatory regime already provides a means for Ofcom to address its concerns. As we set out later in this response, a proper, robust analysis demonstrates that Ofcom's proposed intervention would harm consumers, not protect them.

[19] §5.41 refers

66. We first discuss the appropriate standard for regulatory impact assessments that Ofcom is required to carry out.

Standard for regulatory impact assessments

67. Ofcom acknowledges its statutory duty to carry out an impact assessment in respect of the change to the General Conditions it is proposing[20]. Ofcom's policy in relation to the carrying out of impact assessments[21] is also instructive. In it, Ofcom explains that:

    1.1 The decisions which Ofcom makes can impose significant costs on our stakeholders and it is important for us to think very carefully before adding to the burden of regulation. *One of our key regulatory principles is that we have a bias against intervention. This means that a high hurdle must be overcome before we regulate. If intervention is justified, we aim to choose the least intrusive means of achieving our objectives, recognising the potential for regulation to reduce competition.* These guidelines explain how Impact Assessments will be used to help us apply these principles in a transparent and justifiable way. (emphasis added)

68. TUK agrees that the decisions that Ofcom makes are capable of imposing significant costs on Communication Providers. In this case, the effect of Ofcom's proposal would be to prohibit O2's flagship tariff offering which, as Ofcom notes, has proved very popular with consumers. TUK also notes Ofcom's "key regulatory principle" that it has a "bias against intervention" which means that a "high hurdle must be overcome before we regulate". Further, Ofcom aims to "choose the least intrusive means" of achieving its objectives. Further:

    1.4 In identifying options, *we will aim to consider a wide range of options, including not regulating*. Where appropriate, we will explore more risk-based, targeted approaches to regulation and will consider whether there are alternatives to formal regulation, such as co-regulation.

    1.5 In developing policy proposals, *our aim will be to think widely about the possible impacts*, taking account of the whole value chain and knock-on effects across the communications sector. By doing so, *we will seek to minimise any unintended consequences*. (emphasis added)

69. TUK's interpretation of this is that Ofcom will consider a range of possible policy responses to any problem, including not regulating at all. In this case, of course, GC 1.3 already requires Communication Providers to ensure that their conditions and procedures for contract termination do not act as disincentives for end-users against

[20] §2.37 refers

[21] Better Policy Making, Ofcom's approach to Impact Assessment, 21 July 2005. See: https://www.ofcom.org.uk/__data/assets/pdf_file/0026/57194/better_policy_making.pdf

changing provider, so, in TUK's submission, the option of not introducing *further* regulation merits particular examination. TUK also notes the desirability of minimising unintended consequences of regulatory intervention. TUK's submission is that Ofcom's proposal would have the effect of restricting competition in the mobile retail market [✂].

All of these unintended consequences would harm the interests of consumers.

70. Ofcom's guidance also sets out the way in which the costs and benefits of regulatory options are to be assessed:

> **Quantifying costs and benefits**
>
> • *Costs and benefits should be quantified where possible,* although benefits in particular may be hard to quantify as they tend to be more uncertain and are often spread across many citizens or consumers.
> • Precise quantification will often not be possible and we should avoid spurious accuracy. Where quantification is possible, it will often be partial i.e. it is not possible to quantify all the relevant costs and benefits.
> • *Where costs and benefits cannot be quantified precisely, we should aim to give broad estimates* e.g. in the order of £x million, or ranges of costs and benefits e.g. between £x million and £y million. It is also helpful to form an idea of the relative size of the respective costs and benefits. As a minimum, costs and benefits should be described qualitatively.[22] (emphasis added)

71. The need to seek, wherever possible, to quantify the various costs and benefits of a proposed regulatory intervention is well understood and uncontroversial. For example, in the 2007 Judgment in mobile number portability the Competition Appeals Tribunal[23] found:

> "124. In written submissions and at the hearing, the Tribunal was referred to the decision of the Competition Commission ("CC") in E.ON UK plc and GEMA and British Gas Trading Limited CC02/07, where the CC considered an appeal brought by E.ON UK plc ("E.ON") under section 173 of the Energy Act 2004 against a decision of the Gas and Electricity Markets Authority ("GEMA") in relation to proposed changes to arrangements for the off take of gas from the National Transmission System as set out in the Uniform Network Code. Included as part of GEMA's decision was a cost benefit analysis, which was challenged by E.ON. The CC held that:
>
> > "6.156 [We] accept GEMA's submission that a code modification appeal should not be regarded as an opportunity for rival parties to debate exactly what value should be ascribed to particular items within a quantitative assessment of the costs and benefits of a proposal. Cost benefit analysis involves a degree of judgement and discretion. Unless the regulator has

[22] §5.30 refers
[23] Neutral citation [2008] CAT 22 Case Number: 1094/3/3/08. See: https://www.catribunal.org.uk/sites/default/files/Judgment_1094_180908.pdf

erred in logic or principle in quantifying a benefit, the CC will be slow to overturn the regulator's quantification of that cost or benefit.

6.157 [We] accept GEMA's submission that benefits need not be quantified in order for them to be reflected in a CBA, and that non-quantified benefits may be as important, or more important, than quantified benefits. *However if a CBA is to be transparent, benefits should be quantified where possible. For the same reason, qualitative benefits should be explained clearly and in detail, so that it can fairly be seen whether there is any potential overlap between the qualitative and quantitative benefits*."

125. The CC concluded that the decision of GEMA "contained insufficient material to support the conclusion that [the decision challenged] will, or is sufficiently likely to, deliver benefits to consumers, and insufficient explanation of the nature and extent of the benefits to be expected." While adopted under the specific statutory framework laid down in the Energy Act 2004, *we agree with the CC's general approach to analysing a regulator's assessment of the costs and benefits of a proposed modification* to existing processes." (emphasis added)

72. In TUK's submission, the impact assessment that Ofcom sets out, as reflected in sections 3 and 5 of the Consultation Paper and summarised at paragraph 5.46 of the Consultation Paper suffers from a number of significant deficiencies:

- Ofcom's key regulatory principle, that it has a bias against intervention, is not considered at all. In TUK's view, given that customers are able to make properly informed purchasing decisions, and that the mobile market is competitive, the starting assumption is that competition, and not regulation, best serves customers' interests. Further, the fact that there is a vibrant market in used handsets means that customers are easily able to sell their handsets to repay handset loan agreements, if they choose to do so;
- There is no evidence that Ofcom has considered a range of possible approaches to address the issue it has identified. This is a particularly stark ommission, given that GC 1.3 already requires Communication Providers to ensure that their conditions and procedures for contract termination do not act as disincentives for end-users against changing provider and would seem to address entirely Ofcom's concerns;
- The unintended consequences of the proposed amendment to GC 1.4 are not given serious consideration by Ofcom. [✂];
- The full set of the various costs and benefits associated with the proposed intervention have not been properly identified; and
- Ofcom has not quantified sufficiently those costs and benefits which have been identified

73. We set out in more detail the final two issues, below.

The full set of the various costs and benefits associated with the proposed intervention have not been properly identified

74. Ofcom has summarised its assessment of the impact of its proposals at paragraph 5.46 of the Consultation Paper. In TUK's view, Ofcom has failed to identify fully the range of costs and benefits of its proposals. In broad terms, these appear to TUK to be (in addition to those already identified by Ofcom):

    1. Implementation costs. Ofcom's assumption that such costs are limited to removing relevant provisions in customer agreements[24] [✂].
    2. Impact on consumer welfare. By prohibiting a class of tariff propositions that the competitive market has generated, which customers clearly value, Ofcom's proposed prohibition would reduce consumer welfare.
    3. Impact on competition. Ofcom's prohibition of LSCs of more than 24 months duration is likely to blunt the dynamic competitive process, leading to a reduction in consumer welfare.
    4. Removal of better terms for customers that LSCs generate. Please see the attached Alix Partners report at paragraphs 117 to 129 for an explanation of this. Ofcom is able to use its information gathering powers to assess the quantum of better terms that might be offered to customers across the industry that would be lost were it to implement its proposal
    5. Elimination of cost savings related to linking. Please see the attached Alix Partners report at paragraphs 130 to 138 for an explanation of this. Ofcom is able to use its information gathering powers to assess the quantum of cost savings across the industry that would be lost were it to implement its proposal

75. These issues are discussed in more detail in the Alix Partners report attached to this response.

Ofcom has not quantified sufficiently those costs and benefits which have been identified

76. In TUK's view, Ofcom's statutory duty requires it to seek to quantify, wherever possible, those costs and benefits that it has already identified at paragraph 5.46 of the Consultation Paper:

    1. Removal of a barrier to switching. Ofcom has not attempted to quantify the extent to which LSCs of duration greater than 24 months actually do act as a barrier to switching. Further, it seems to TUK that a quantitative assessment could be carried out. Ofcom could model the number of customers that might be expected to choose such agreements, the subset that might wish to end those agreements prior to the duration of the handset credit agreement, and those that might be unable to do so. TUK's expectation is that the subset of customers that wish to switch provider before the end of the handset loan agreement, but who are unable to do so, is likely to be a very small number because:
        a. The mobile market is competitive

[24] §5.46 b) refers

b. Customers make well informed purchasing decisions
c. Customers are able to sell used handsets to pay off their outstanding loan agreement
d. The evidence is that, in practice, very few customers complain about this issue

2. Implementation costs. We have commented on this above and in our response to question 3. Ofcom is able to arrive at a better assessment of implementation costs across the industry using its formal information gathering powers.
3. Price rebalancing. TUK believes that the linking of split contracts result in cost savings and better terms being offered to customers, as described above and in more detail, in the attached Alix Partners report.

77. In conclusion, in TUK's submission, the impact assessment presented by Ofcom cannot be relied upon to justify the regulatory intervention that Ofcom proposes.

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